Q1 2019 Earnings Call

Company Participants

- Brad D. Smith, Chairman & Chief Executive Officer
- Jerry Natoli, VP Corporate Finance & Treasurer
- Michelle Clatterbuck, Executive Vice President & Chief Financial Officer

Other Participants

- Brad Alan Zelnick, Analyst
- Brad Robert Reback, Analyst
- Brent Thill, Analyst
- James Macdonald, Analyst
- Jennifer Swanson Lowe, Analyst
- Ken Wong, Analyst
- Kirk Materne, Analyst
- Matthew Charles Pfau, Analyst
- Michael Millman, Analyst
- Michael Turrin, Analyst
- Ross MacMillan, Analyst
- Scott Schneeberger, Analyst
- Shankar Subramanian, Analyst
- Sterling Auty, Analyst
- Walter H. Pritchard, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, my name is Gigi, and I'll be your conference facilitator. At this time, I would like to welcome everyone to Intuit's First Quarter Fiscal Year 2019 Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer period.

With that, I'll now turn the call over to Jerry Natoli, Intuit's Vice President of Finance and Treasurer. Mr. Natoli?

Jerry Natoli {BIO 4692239 <GO>}

Thanks, Gigi. Good afternoon, and welcome to Intuit's first quarter fiscal 2019 conference call. I'm here with Brad Smith, our Chairman and CEO; Michelle Clatterbuck, our CFO;

and Sasan Goodarzi, our incoming CEO.

Before we start, I'd like to remind everyone that our remarks will include forward-looking statements. There are number of factors that could cause Intuit's results to differ materially from our expectations. You can learn more about these risks in the press release we issued earlier this afternoon, our Form 10-K for fiscal 2018, and our other SEC filings. All of those documents are available on the Investor Relations page of Intuit's website at intuit.com. We assume no obligation to update any forward-looking statements.

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. Unless otherwise noted, all growth rates refer to the current period versus the comparable prior-year period, and the business metrics and associated growth rates refer to worldwide business metrics. A copy of our prepared remarks and supplemental financial information will be available on our website after this call ends.

With that, I'll turn the call over to Brad.

Brad D. Smith {BIO 6294100 <GO>}

Thanks, Jerry, and thanks to all of you for joining us. As we kicked-off fiscal year 2019, we entered the second year of implementing or One Intuit Ecosystem strategy, and we're off to a strong start through the first quarter.

We delivered 12% revenue growth and exceeded our overall financial targets. Small Business and Self-Employed Group revenue increased 11% with Online Ecosystem revenue growing 42% in the quarter. Revenue for both the Consumer Group and Strategic Partner Group was also in-line with our expectations.

While this is a great start to the year, there's plenty of game to be played with our two largest quarters ahead as we move towards tax season. With that backdrop, let me share some observations on our business overall, starting with our Small Business and Self-Employed Group.

As we foreshadowed last quarter, we are placing an increased emphasis on our online services to deliver greater value for our Small Business customers. Sasan shared many of these advances at our QuickBooks Connect conference earlier this month.

First, with QuickBooks Capital, which leverages QuickBooks Online customer data to provide loans to Small Businesses, nearly 60% of whom may not qualify for loans elsewhere. QuickBooks Capital has funded $200 million in cumulative loans over the first 12 months since launching publicly.

Customer receptivity has exceeded our expectations with 84% of QuickBooks Capital customers stating an intent to apply for a second loan in the future. We've also introduced an innovative same-day payroll capability within QuickBooks Online, enabling Small

Businesses to pay their employees on the same-day if they process their payroll by 10:00 a.m. Eastern Standard Time. This allows customers to hold on to their money longer and better manage their cash flow. Traditionally, Small Businesses have been required to fund payroll two to five days in advance, so same-day payroll is quite meaningful for these customers.

In addition, we'll soon be launching next-day funding within QuickBooks Payments, allowing Small Business and Self-Employed customers to receive their funds the next business day, twice as fast as the two to three-day waiting period they currently experience. QuickBooks Payments has also been redesigned, making critical payments functionality more easily discoverable for customers within the offering.

We're also serving a broader range of customers with the recent introduction of QuickBooks Online Advanced. This offering is designed for the 1.5 million mid-market customers with 10 to 100 employees. Approximately, 180,000 of our existing QBO customers fit this target profile, providing us with a significant opportunity to grow with them over time.

While it's still early, customer feedback on QBO Advanced is quite positive, and we're optimistic about the opportunity as we introduce additional functionality in the months ahead. Turning to the Consumer Group, the team is actively developing the next wave of innovation to better serve our customers in the upcoming tax season.

Our strategy remains focused on expanding our lead in the do-it-yourself tax category, while transforming the assisted tax segment with TurboTax Live. TurboTax Live eliminates the traditional trade-off between a do-it-yourself solution or a one-on-one advice from a pro. This innovative service significantly increased the confidence of our tax filing customers last season, and it's only getting better.

During the upcoming tax season, we're launching several new features, many of which were tested during the tax extension season in October. These include mobile access to an expert on-demand, given that half of online tax filers use a mobile device at some point when filing their return. We're introducing a wider range of price points, providing access to an expert from the simplest to the most complex of tax returns.

Finally, we're providing additional ways for TurboTax users to access the TurboTax Live expert through their tax prep experience, including the ability to submit a question and receive a response from an expert in 24 hours.

Beyond these customer-facing innovations, we've made several enhancements to the experience for the tax pros on the TurboTax Live platform as well. These enhancements include a new built-in help panel, and expanded case management functionality all-in-one place. We expect these new tools to improve the overall experience and productivity for the tax pros operating on our platform.

As we shared last quarter with regards to the external environment, we've long advocated for tax simplification and believe anything that made taxes easier to understand is good for consumers. While the new legislation increases the number of people who will qualify for the standard deduction, which introduces some trade-down risk from our paid to our free offering, in aggregate, we believe tax simplification will be an overall catalyst both for the do-it-yourself category and for TurboTax growth as more assisted tax customers choose to adopt digital solutions.

This expectation is grounded in historical evidence. Over the past decade, many hypothesized that major legislative changes such as the Affordable Care Act would create confusion and cause a shift towards more assisted tax prep methods; that simply didn't happen. In fact, TurboTax filings growth over this period of time has outpaced tax pros' growth by 600 basis points, tax stores by over 900 basis points, and the IRS returns grew at a compounded annual rate of less than 1%. These trends reflect the secular tailwind of customers adopting digital solutions even with major changes to legislation.

Moving beyond our Consumer business, to the Strategic Partner Group, our professional tax revenue grew 6% year-over-year. We continue to focus on multi-service accounting firms that do both books and taxes, enabling us to drive our accountant success, while growing our Small Business ecosystem. To sum it up, the momentum we exited fiscal year 2018 with continues, and our testing during the extension filing season gives us increased confidence that we should have another successful tax season.

With that overview, let me hand it over to Michelle, who'll walk you through the financial details.

Michelle Clatterbuck {BIO 20314804 <GO>}

Thanks, Brad, and good afternoon, everyone. For the first quarter of fiscal 2019, we delivered revenue of $1 billion, up 12% year-over-year, a GAAP operating loss of $10 million versus a $35 million loss a year ago, non-GAAP operating income of $102 million versus $65 million last year, GAAP diluted earnings per share of $0.13 versus a loss per share of $0.01 a year ago, and non-GAAP diluted earnings per share of $0.29, up 71% versus $0.17 last year. Our GAAP earnings per share for the first quarter includes a $41 million excess tax benefit on share-based compensation.

Turning to the business segments, total Small Business and Self-Employed revenue grew 11% during the quarter. Online Ecosystem revenue remains strong with growth of 42%. As we shared last quarter, we believe the best measure of the health and success of our strategy going forward is Online Ecosystem revenue growth, which we continue to expect to grow better than 30%. We're pleased with the continued growth of both Online Accounting and Online Services revenue.

QuickBooks Online subscribers grew 41%, ending the quarter with nearly 3.6 million subscribers. Growth remains strong across multiple geographies, with U.S. subscribers growing 35% to approximately 2.7 million, and international subscribers growing 61% to over 880,000.

Within QuickBooks Online, Self-Employed subscribers grew to approximately 745,000, up from roughly 425,000 one year ago. As we told you last quarter, we expect total subscriber growth to begin to moderate some as we shift our emphasis in the next chapter of the business model evolution.

Desktop Ecosystem revenue was down 4% in the first quarter, consistent with the mid-single-digit decline we indicated last quarter. Within the Desktop Ecosystem, our QuickBooks Enterprise customers continued to grow at a double-digit pace in the first quarter. During fiscal 2019, we continue to expect QuickBooks Desktop units to decline single-digits and Desktop Ecosystem revenue to be roughly flat. Total Consumer revenue was up 22% in one of our smallest quarters of the year.

Looking ahead to the upcoming tax season, we have an opportunity to address the needs of even more tax filers with TurboTax Live. Last year, the product contributed to a 2-point increase in retention, brought customers into the franchise at a faster pace than our TurboTax Online offering, and attracted first time filers at a higher rate. As Brad mentioned, we continue to expect tax reform to be a catalyst for the DIY category this season.

As a reminder, we expect to provide a tax unit update in late February concurrent with our second quarter earnings release. We'll also provide a final update in late April after the tax season ends. Professional tax revenue within the Strategic Partner Group grew 6% in the first quarter, in line with our expectations.

Turning to our financial principles, we remain committed to growing organic revenue double-digits and growing operating income dollars faster than revenue. 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%. Our first priority for the cash we generate continues to be investing in the business to drive customer and revenue growth.

Next, we consider acquisitions to accelerate our growth and fill out our product road map. We return excess cash that we can't invest profitably in the business to shareholders via both share repurchases and dividends. We finished the quarter with $1.3 billion in cash and investments on our balance sheet.

We repurchased over $101 million of stock in the first quarter. Approximately $3.1 billion remains on our authorization, and we expect to be in the market each quarter this year. The board approved a quarterly dividend of $0.47 per share payable January 18, 2019. This represents a 21% increase versus last year.

Second quarter guidance for fiscal 2019 includes revenue growth of 10% to 11%, GAAP diluted earnings per share of $0.55 to $0.58, and non-GAAP diluted earnings per share of $0.85 to $0.88. We're also reiterating our fiscal 2019 guidance provided last quarter. You can find our Q2 and fiscal 2019 guidance details in our press release and on our fact sheet.

With that, I'll turn it back to Brad to close.

Brad D. Smith {BIO 6294100 <GO>}

Thank you, Michelle. Putting a bow around our performance this quarter, we are pleased with the strong start to fiscal year 2019, and we look forward to accelerating our momentum as we head into peak season. Our One Intuit Ecosystem strategy continues to take shape, and I could not be more proud of the innovation and the results that our employees are delivering.

As you know, this is my last earnings call as Intuit's CEO. Effective January 1, I will transition to the role of Executive Chairman as Sasan Goodarzi takes the reigns. It has been a privilege to serve as Intuit's CEO for the past 11 years. I could not be more confident in Sasan and the next generation of Intuit's leadership team. As I look ahead, I have never felt better about Intuit's future. I want to thank you for your support over these many years, and I look forward to the continued progress the company will achieve in this next chapter.

And with that, let's open it up to hear what's on your mind. Gigi, we'll turn it back to you.

Q&A

Operator

Thank you. And our first question is from Brad Zelnick from Credit Suisse. Your line is now open.

Q - Brad Alan Zelnick {BIO 16211883 <GO>}

Excellent. Thanks so much and congrats on a great start to the year. I just wanted to follow up on the comments around tax and the trade-down risks of tax reform. And, Brad, I appreciate you reminding us of past examples and why you feel that this should be something you're able to navigate through and will benefit the overall category in TurboTax, but can you perhaps give us a little bit more insight into how you're thinking about the trade-off of units versus ASP and the tolerance that you've built into the model and guidance you've given us?

A - Brad D. Smith {BIO 6294100 <GO>}

Great. Thanks, Brad. Thanks for the comments on the quarter and, yeah, I'd be happy to talk about that. When we put together our guidance for the year, we factored in any of the potential trade-down risk as well as the upside, which is quite frankly, much larger when we think about the number of people using an assisted tax prep method that are also going to qualify for the standard deduction, and will now have the opportunity to move into a do-it-yourself solution, because the taxes (16:14) are simpler or they'll have an innovative solution that TurboTax Live where they can get assistance if they lose confidence at any point in the process.

So as you saw, that fundamentally led to a higher guidance for this year's tax season than what we provided last year as well as a more robust long-term outlook. Now, in terms of our principles, we continue to strive across the company to grow our customer bases as fast as we can, because we know ultimately that will create a pipeline of growth over the long-term as they continue to (16:42) grow and have increased problems that we can solve.

With that being said, we're in a unique situation right now as we launch TurboTax Live, which is creating an opportunity to serve a $20 billion total addressable market that up to this point we weren't able to effectively serve; and that comes with a higher average revenue per return. So when you introduce that to the mix, even as we grow customers, we believe that you're going to get an uplift from that revenue per return which is going to drive the overall performance of the segment.

So we would not be surprised this year if revenue grows faster than customers in the tax business is going to be primarily because of mix. But I want to be really clear, our primary goal is to grow the do-it-yourself category, and to grow our share in that category, and if we aren't growing share, we don't consider that to be a successful season.

Q - Brad Alan Zelnick {BIO 16211883 <GO>}

Thanks so much. And if I could just ask a quick follow-up on QuickBooks; I know you've said it before, and you reminded us again that total sub growth is expected to moderate some from here. Just for our modeling purposes, and to wrap our heads around what that trajectory might look like, any kind of parameters we should be thinking about? Thank you.

A - Brad D. Smith {BIO 6294100 <GO>}

Yeah, Brad, we're really trying to step away from that. The reason being is, first, we think the overall health of the category and of that business is really going to be driven by the Online Ecosystem revenue being greater than 30%. The other reason is, we're moving into a chapter of apples and oranges on what qualifies as a subscriber.

We have the Self-Employed SKU, we have QuickBooks Online, we're launching QuickBooks Online Advanced; they come with very different average revenue per returns. And now we're introducing the new front doors, the ability to have a standalone payments offering or a standalone payroll offering, and the question will be, well, what counts as a sub?

And so our view is, look, all of those are solving important problems. That's why it's most important to focus on Online Ecosystem revenue. What we did provide is a little bit of a gating factor for people to think about is, we will not be proud of our performance if we don't add at least as many net subs as we did last year. So if you think about that as the qualifier, and you think about the number of subs that we added, that's the kind of goal we've put out there for ourselves.

Q - Brad Alan Zelnick {BIO 16211883 <GO>}

Excellent. Thank you so much.

A - Brad D. Smith {BIO 6294100 <GO>}

You're welcome.

Operator

Thank you. Our next question is from Brent Thill from Jefferies. Your line is now open.

Q - Brent Thill {BIO 1556691 <GO>}

Good afternoon. Brad, the economy is on everyone's mind, and I'm just curious, I think, we all know how defensive the tax business can be, but can you give us a sense on the Small Business side, what's giving you confidence as you look forward? And it's obviously way too early to call, but where are the components that are put in that you feel good about as you look in your next year, that's even if we go into a softer economy that you can sustain those headwinds?

A - Brad D. Smith {BIO 6294100 <GO>}

Yeah, Brent, thanks for the question. And as you pointed out, our portfolio over 35 years has proven to be resilient, and with the points that you called out, taxes are going to need to be filed regardless of the economy.

On the Small Business side, we've learned to look past some of the more public-facing indices, things like Small Business Optimism, because if that's going up, that's not a surprise for us, because one out of two small businesses fail in the first five years, they're always sure it's going to be the other person. So they're just natural optimists and that's why we love an entrepreneur and a small business owner.

So we look for more of the leading indicators of the real health of their business, and we look at things like charge volume. Are they hiring employees? Are they hiring contract workers? Are those workers working longer hours? Are they actually increasing the wages for those workers? At this point in time, we have not seen any of those indicators weaken, and so we still believe that there is a lot of noise in the market, certainly in terms of the investment community and equity market, but we haven't seen that show up on Main Street, yet.

But as you might imagine, and we shared this at Investor Day, we've already got game plans in place, that should there be a softening in the market, we know what actions we need to take to both help customers grow, but also ensure we deliver on our commitments.

Q - Brent Thill {BIO 1556691 <GO>}

And real quick, just Payroll attached and the impact going forward, it seems like a big opportunity. What do you need to do to see that through from here?

A - Brad D. Smith {BIO 6294100 <GO>}

Brent, we've been focused on as we talked about in the opening comments, our Online Services. We're still very excited about the opportunity to get more people into QBO, but we've also decided and found that it was an opportunity for us to go down a parallel path and get more of these attach services or Online Services.

This past quarter, Online Payroll attached to QBO revenue grew 36%. Payments grew 34%, and we're really getting down to the blocking and tackling. Simple design that makes it easier to discover it inside the offering, trying to be able to pre-populate data where possible so you can get to a benefit very quickly, and those are the execution pieces, and then there's the new innovations, things like same-day payroll, the ability to actually, if you file before that 10:00 a.m. time on the East Coast, you can get your payroll done on the same day, and that is a big acceleration from what you're able to do with most other offerings in the competitive market.

So that basically allows you to hold on to your money longer, and that's a compelling value prop for a small business owner. So what we're doing right now is improving our execution, simpler design, easier to discover, pre-populate data, and also introducing breakthrough innovation that alternatives don't have in the market that we think makes our value proposition even that much more compelling.

Q - Brent Thill {BIO 1556691 <GO>}

Thank you, Brad.

A - Brad D. Smith {BIO 6294100 <GO>}

You're welcome.

Operator

Thank you. Our next question is from Walter Pritchard from Citi. Your line is now open.

Q - Walter H. Pritchard {BIO 4672133 <GO>}

Thanks. One, main question, and a follow-up. Just on the Online Services side, that business is growing quite a bit faster than the core QBO U.S. subs. I'm wondering if you could help us understand what sort of prior drivers like Payroll and Payments are continuing to fuel that Online Services piece versus some of the new drivers, TSheets and QuickBooks Capital and other drivers like that, how much might you attribute to some of these newer drivers that we haven't been used to seeing in the past?

A - Brad D. Smith {BIO 6294100 <GO>}

Yeah, Walter, you actually hit the key drivers. You did a nice job of summarizing it. The bulk of it is really being driven by our core Payroll and Payments, but we do have a nice upside with TSheets, which came in. But that is not the bulk of that improvement; the bulk of that improvement is coming from improved execution, simpler design, easier discoverability, faster time to benefit, and then the new innovations like same-day payroll or next-day funding and payments.

And it's those latter two things, it's the new innovation we're bringing to market that we think is really shifting the playing field more in our direction, and you're going to see more of that coming from us in the future. TSheets is nice spin on top of that.

Q - Walter H. Pritchard {BIO 4672133 <GO>}

Great. And then maybe, Michelle, you could help us understand, tax seasonality seems like it's always a tough thing to gauge. Maybe you could help us understand what factors you see this year that would impact seasonality as we move beyond the – or move through the tax season in January and into the year.

A - Michelle Clatterbuck {BIO 20314804 <GO>}

Hi, Walter. Thanks for the question. Yes, every single year, we have to look and see exactly how the season is going to play out. One of the biggest drivers – well, first of all, you have ASC 606 this year, which I think we've given some information last quarter, and on the Investor Relations website to help you understand that a little bit more.

The other thing that just comes into play every single year is the IRS opening date. And so the IRS has not released when they are opening yet, and so we've had to make some assumptions on that, and so we'll just have to see how that plays out.

Q - Walter H. Pritchard {BIO 4672133 <GO>}

Great. Thanks.

Operator

Thank you. Our next question is from Shankar Subramanian from Bank of America Merrill Lynch. Your line is now open.

Q - Shankar Subramanian {BIO 18818908 <GO>}

Hi. Thanks for taking the question. This is Shankar behalf of Kash. I've a question on the QBO revenue profile. It seems like the overall QBO revenue is growing faster than the unit growth rate for the past five quarters. But based on what you're seeing right now, do you see that kind of trajectory continue on in the future? And maybe just talk about the drivers; not just U.S., but international in terms of say how the UK market will play out for the year?

A - Brad D. Smith {BIO 6294100 <GO>}

Yeah, thanks, Shankar. This is Brad. So yes, we have continued to see an acceleration of QBO revenue, and as we suggested, that's the best indicator of the health of this business going forward. What's really driving that is a combination of things. First and foremost, we continue to be able to execute both new subscribers, but also getting Online Services up and running; things like Payroll and Payments or TSheets, as we were just talking about.

The second is, as we bring customers in, we sometimes have a promotional discount or an introductory trial period, and then once they anniversary off of that trial period, then their average revenue per customer goes up in that 13th month in a nice healthy bump. And so we've got a larger base that continues to anniversary off of that, so you get a lift in ARPU and revenue as a result of that.

The third is, we've been delivering more compelling value propositions and new feature functionality to customers, so our retention rate is going up. And if you go back to Investor Day, you'll see we improved the retention rate of QBO as well, and so that continues to drive the revenue.

And then last, but not least, we have opportunities as we look ahead to get smarter about our promotions. And so, we have been adjusting things like the kinds of promotions we offer to accountants. We've found the sweet spot of what's able to get the unit lift we're looking for without leaving too much on the table. And when you put those combinations together, it's attach services, it's the ability for us to have that anniversary group come off of their promotional trial period, we have the opportunity to do things like get wiser on our promotions, and then we have improved retention from just stronger value props with new feature functionality, and that's driving the revenue.

I would continue to go back to our talking point, that we want to keep that Online Ecosystem revenue greater than 30%. We are delighted to see it at 42% now, and we're going to continue to keep our foot on the pedal and see just how high we can drive that.

Q - Shankar Subramanian {BIO 18818908 <GO>}

Got it. As a follow-up on the tax side of the equation, how do you gauge the competitive front going into the tax season? Anything that you see as an early indicator of how the season will turn out to be or is yet to be seen?

A - Brad D. Smith {BIO 6294100 <GO>}

Well, each year, we always anticipate the best from our competitors. We have really good competitors in the market. We often talk about the respect we have for them. They keep us on our toes and they actually improve the game for the end consumer. So we expect a very competitive tax season as we do each year.

At the same time, I feel like we've got a really strong lineup in place. We've got a compelling offering that's going to be hard to match with TurboTax Live. Our teams got several things that they're going to be introducing in our core TurboTax product that we'll talk a little bit closer to tax season about. So I feel like we've got our best foot forward and we expect to have a really competitive, but in our case, we believe we have the chances to have another very successful tax season.

Q - Shankar Subramanian {BIO 18818908 <GO>}

Perfect. Thank you, guys.

Operator

Thank you. Our next question is from Jennifer Lowe from UBS. Your line is now open.

Q - Jennifer Swanson Lowe {BIO 6926228 <GO>}

Great. Thank you. I wanted to dig in a little bit on the QBO Advanced product, and I think you sort of talked about the subset of your customer base where it has the best fit currently. But I'm curious if we dig into that, I think you said 180,000 users, how much of that is people who are outgrowing QBO versus QuickBooks Desktop customers that maybe wanted to move to the cloud and didn't have the right functionality versus opportunities to go out and get new customers? How should we think about in that context?

A - Brad D. Smith {BIO 6294100 <GO>}

Yeah, Jennifer, thank you for the question. First of all, we can look at evidence we already have in the market on the Desktop with QuickBooks Enterprise on Desktop. We have 140,000 customers there, a business that's north of $440 million, both units and revenue growing double-digits on that platform.

And over the years, we've come to appreciate that that mix ends up being somewhere in the neighborhood of about 70% or stretchers. They're existing QuickBooks customers who need to continue to grow and add functionality as they add employees. And then about 30% of what we call switchers, where the product is disruptive in the market, we're priced at a level that we're able to get customers off of competitive platforms and onto QuickBooks Enterprise.

So our going-in assumption is we have 180,000 in the QBO customer base that look a lot like that 140,000 in Desktop, so those are our target profiles and those would be the ones that we want to keep in the family and simply have them be stretchers. And, of course, as we introduce this product and we continue to add functionality, we think it's going to be just as disruptive in the cloud as it is for the Desktop players, and we think we'll get some switchers from other alternatives as well. But right now, the best proxy we have is the evidence we've already proven in Desktop, and that tends to break down to about a 70/30 split.

Q - Jennifer Swanson Lowe {BIO 6926228 <GO>}

Great. Thank you.

A - Brad D. Smith {BIO 6294100 <GO>}

You're welcome.

Operator

Thank you. Our next question is from Kirk Materne from Evercore ISI. Your line is now open.

Q - Kirk Materne {BIO 5771115 <GO>}

Thanks very much. Brad, I was wondering if you could just touch upon some of the QBO growth internationally, anything to call out just in terms of any particular regions? Obviously, a lot of opportunity in international, so just wondering if anything sort of popped up on your radar screen this quarter that you might not have been expecting mostly, I guess, for the good. Thanks.

A - Brad D. Smith {BIO 6294100 <GO>}

Yeah, thank you, Kirk. Obviously, we're proud of the results right now, 61% growth year-over-year in the international markets. We've hit escape velocity in our three core markets, Canada, the UK and Australia. UK continues to be the darling of the bunch. They're adding customers at a rate much faster than the competitive alternatives in the market, and we continue to see our Net Promoter Scores or product recommendation scores advance in each of those markets.

As we think about the next group of countries, we continue to have France, Brazil and India, and we're monitoring things like active use, product recommendation scores, and we're seeing positive trends in those countries as well. They haven't hit escape velocity yet, but they're getting closer. So net-net, I would say it's the three core markets we talk often about with UK being the belle of the ball in that group.

Q - Kirk Materne {BIO 5771115 <GO>}

Great. Thanks a lot.

Operator

Thank you. Our next question is from Matt Pfau from William Blair. Your line is now open.

Q - Matthew Charles Pfau {BIO 19136163 <GO>}

Hey, thanks for taking my questions, guys. Wanted to dig in a little bit, Brad, on your comments about TurboTax Live and having a wider range of price points this year, and maybe you can just sort of dig into what the purpose behind that is. And is any of that a competitive response to some of the tax doors potentially lowering prices for their bricks and mortar return filings for this upcoming tax season? Thanks.

A - Brad D. Smith {BIO 6294100 <GO>}

Great. Thank you, Matt. So first of all, I'd go back to coming out of last tax season, we had two big insights with TurboTax Live where our hypotheses actually were off last year, but we discovered some upside opportunity.

The first was, we had anticipated TurboTax Live would be a service that would be something that people with more complex returns would be interested in, but then we quickly understood that people who have more simple returns also have areas where they don't have confidence and they would benefit from an on-demand expert. So that led us to – we need to have TurboTax Live not just as a bundle, but actually as an add-on service for the simplest returns all the way up to the more complex returns.

The second thing that we discovered is we had held back on our go-to-market and advertising to the second-half of season, because our assumption had been, more complicated returns come in the second-half, so let's put the marketing there. We've come to appreciate as I just said that, having an access to an expert applies to people early in the season as it does later, so that we have a more robust go-to-market plan that we've got set up for the full season as well.

Now, it just happens to be the competition has come out recently and talked about some of the things they plan to do, and that gets me excited, because we already had our plans in place and I think this better positions us to be able to address what they're doing while also take advantage of the opportunities we learned last year in tax season.

Q - Matthew Charles Pfau {BIO 19136163 <GO>}

Great. That's it from me guys. Thanks.

A - Brad D. Smith {BIO 6294100 <GO>}

Great. Thank you, Matt.

Operator

Thank you. Our next question is from Ross MacMillan from RBC Capital Markets. Your line is now open.

Q - Ross MacMillan {BIO 1994797 <GO>}

Hey, Brad and team; thank you. Just on tax, one of the things that's obviously happening this season is, we're going to see a higher percentage of people move from itemized to standard deductions, and I think our math suggest it could be anywhere between 8 million and 20 million filers could sort of come into that part of the funnel. What are you doing to, I guess, make sure that those folks that may be moving to standard deductions for the first time are sort of educated around DIY, and see the value of making that potential shift if they're using an alternative way to file today. What's the plan to capture as many of those as possible?

A - Brad D. Smith {BIO 6294100 <GO>}

Yeah, thanks, Ross. As you just pointed out, you know those 8 million to 20 million are spread across multiple tax prep methods; they don't all sit in do-it-yourself. Many are going to be coming into the category for the first time, some are in a tax store, some are with pros, because that's the way their parents may have filed or that just maybe the way they've historically been more comfortable, because they wanted to have advice on a certain area of their tax return and then some are in DIY.

So the first thing we're doing is, we're going to continue to make sure they understand that there is a better alternative in the market which happens to be TurboTax, and that's going to be our go-to-market campaign where we'll have our message out there in all forms of media.

The second is our word of mouth will work in our favor. We have higher Net Promoter Scores than the alternatives in the market, that means people talk about these are the kind of solutions I used to get my taxes done, and they'll tell their friends and family. And then third is, with the introduction of TurboTax Live, anyone who historically would say, it may be a standardized deduction, but I'm still nervous for this reason, they'll have the ability to come into our solution and be able to get that question answered so that they don't have any nagging question unanswered when they file.

So think about it as a robust integrated marketing campaign, word of mouth continuing to work in our favor, and then a network of experts available just in case you decide that you still have a nagging question, you don't have to make the arbitrary choice to get into your car and drive somewhere, you can login right from the solution an get your question answered on demand. And we thought through this and we feel pretty good about our assumptions and we think we've got a strong plan in place to be able to capture as many of those as we can.

Q - Ross MacMillan {BIO 1994797 <GO>}

That's great. And maybe one just for Michelle; this quarter, we saw very high incremental margin across the business for Q1, but for the full year, you haven't really, I guess, aggressively taken up the stance on margins. What are the puts and takes that we should think about as we go through this year, and what's the potential if you will for surprises on margins as we go through tax season, given how strong the first quarter has been?

A - Michelle Clatterbuck {BIO 20314804 <GO>}

Hey, Ross. Thanks for the question, appreciate it. Yes, we did see some strong margin in Q1. A couple of things I'd just tell you to think about. We do sometimes have operating expenses that can shift from quarter-to-quarter and we are seeing a little bit of that happen from Q1 this year into Q2. We did gave the guidance, reiterated it, so we do feel that that's a good place to focus for the total year, so that's really what I would focus on is, I would focus more on this total year, and I wouldn't get overly concerned with some of the movements that we may see between quarter-to-quarter.

Q - Ross MacMillan {BIO 1994797 <GO>}

Thanks so much.

Operator

Thank you. Our next question is from Michael Turrin from Deutsche Bank. Your line is now open.

Q - Michael Turrin {BIO 20079094 <GO>}

Thanks, and good afternoon. Going back to the macro for a minute, Michelle, at the Analyst Day you mentioned managing a balance sheet that can sustain all economic cycles, and potentially allows you to lean in during any downturn. I wanted to take a moment to revisit that comment. I was hoping you could walk through your thought process in evaluating those trade-offs and potentially leading into a tougher macro?

A - Michelle Clatterbuck {BIO 20314804 <GO>}

Yeah, thanks for the question, Michael. There has been quite a number of questions around it, that's why we thought it was important to address a potential downturn, and what that might look like for us. For us we really do go back to focusing on our fundamentals, which for us are our financial principles.

We see those as enduring, and that goes when you think about growing organic revenue and then growing operating income dollars faster than revenue, we really are no matter what we think about the economic environment looking to deploy our cash to the highest opportunities we have. We do have a 15% ROI target over five years, and that's where we continue to focus.

Q - Michael Turrin {BIO 20079094 <GO>}

Great. Thank you.

Operator

Thank you. Our next question is from Scott Schneeberger from Oppenheimer. Your line is now open.

Q - Scott Schneeberger {BIO 5302695 <GO>}

Thanks. Good afternoon; and great looking quarter. I have a question, it's probably three questions tied into one. And in regards to some of the seasonality that Michelle, you've addressed. But I'm curious, there's a recent press release about tax reform consultation, and about how you're going to be offering consultations for free to all. I'm curious on what type of expense impact that would have and the timing of it, Michelle.

And then also, I think, Brad said earlier, something about marketing last year on TurboTax Live in the late season, but learning that it's relevant to early season as well. So kind of tying all those together, how might that influence some of the quarterly pattern we've seen? And I realize you just answered on, I think, it was Ross' question that there will be these variations, but just kind of the overall theme of what is – where the marketing shift might be and where the human labor expense might shift this year. Thanks.

A - Michelle Clatterbuck {BIO 20314804 <GO>}

Hey, thanks for the question. Couple of different things I would say is, first of all, when we look at the TurboTax business, one of the things that we look at specifically when we're looking at the marketing spend is, we really look at a payback within the current year, and so that's what we focus on. We don't get overly focused on when that's going to occur, whether it's Q2 or Q3. It is around making the best decision for the tax season and making sure that we do have that payback within the current season.

Brad did reference that last year we spent more in the late season, this year, we have the opportunity to look at the entire season, we made some different decisions there. The only other thing I'd say you called out specifically at the tax reform consultation that we're providing this year. That is, right now, it's for a two-week time period in November. I believe, it's 13 through the 27th of this month, and it does give people a chance to call in and see exactly how tax reform might impact them going forward. So obviously the impact of that would be in this current quarter.

Q - Scott Schneeberger {BIO 5302695 <GO>}

Okay. Thanks. I appreciate that.

Operator

Thank you. Our next question is from Sterling Auty from JPMorgan. Your line is now open.

Q - Sterling Auty {BIO 2070271 <GO>}

Yeah, thanks. Hi, guys. First of all, Brad, congratulations on a wonderful tenure, and sad that you won't be part of these calls moving forward.

A - Brad D. Smith {BIO 6294100 <GO>}

Thank you so much. I appreciate it. And I'm going to miss you as well.

Q - Sterling Auty {BIO 2070271 <GO>}

And then onto business, I'm kind of curious as you think about the strategy from a very high-level, if we look back over the last several years, there were definite years that you targeted low-end returns as a way to capture market to your point to allow that to grow as they get to more complex returns and kind of grow in terms of the mix versus other years kind of using price to drive revenue. Any sense in terms of what the strategy going into this tax season from that simplistic framework looks like?

A - Brad D. Smith {BIO 6294100 <GO>}

Yeah, Sterling, I think you just did a nice job of summarizing, and we went through this at the Investor Day. We have a strategy slide or a plan on the page that has five sort of solar system rings to it, but the first (41:59) is to extend our leadership position in the do-it-yourself category, which includes being competitive on free, as well as introducing additional innovation to the paid offering so we continue to grow faster than category and take share in do-it-yourself, and that's going to be a core part of our strategy this year.

The next part of that strategy is to transform the assisted tax prep market with TurboTax Live, and we're very excited with the offering, and we're really excited by the leading indicators we saw in October in the extension filing season. And so, the things that we introduced including access to an expert on a mobile device, the ability to send questions in and get a response in 24 hours, or the ability for you to have different price points so you could use an expert with the simplest return to the most complex returns are just three examples.

And so, those are the fundamental two prongs of this year's strategy. If you look at the rest of the strategy, it goes beyond tax, and to being a financial identity and expanding into things like Turbo and Mint, and then eventually exploring global.

But this year, I would tell you, it's a two-pronged approach. Our go-to-market model will be with both do-it-yourself and the TurboTax Live offering, and we feel like when we introduced our new product lineup, it's going to be easier for customers to know which one is right for them, and we think that our marketing campaign will make that even clearer. So we're very excited, and I think what you're end up seeing is the do-it-yourself category continue to grow faster than the other categories. We plan to take share in that category, and we think our revenue per return will probably pop a little bit, because we're going to get a favorable mix shift with TT Live.

Q - Sterling Auty {BIO 2070271 <GO>}

Excellent. Thank you.

A - Brad D. Smith {BIO 6294100 <GO>}

You're welcome. And thanks again for the comment, and I really appreciate it.

Q - Sterling Auty {BIO 2070271 <GO>}

You got it.

Operator

Thank you. Our next question is from Jim Macdonald from First Analysis. Your line is now open.

Q - James Macdonald {BIO 1542627 <GO>}

Yeah, Brad, congratulations on going out on a high note here. I just want to ask about TSheets, and specifically and you've owned that for several quarters now, and just wanted to know maybe more specifically, how happy you are with that acquisition, what you can say about that? And my follow-up is, does that make you want to do more of these types of Small Business acquisitions?

A - Brad D. Smith {BIO 6294100 <GO>}

Yeah, Jim, thank you. It's been great, and you and I've talked about this. We go back a lot of years, and I appreciate your kind words as well. And to answer your question specifically about TSheets, it may be our single most successful acquisition we've done in recent memory. We just had a board meeting three weeks ago.

As we do every other year, I think you all are aware of this. We do a retrospective on all of our acquisitions. This time we went back 35 years. We look at every acquisition in the company's history, then we broke it down to the last 10 years, and then we broke it down to the last two years. And we measured the performance of all those acquisitions against the original business case we have presented to the board and how they have performed both strategically as well as financially.

And I can tell you that our capability in learning from our scar tissue as well as our successes, which ones work and which ones don't, have increased our ability to bring these acquisitions in and help them be successful faster, and TSheets is benefiting from that. They've really helped us inside the company think differently about how to move with speed, and we've helped them with the channels and the innovation they were looking for to be able to reach the broader audience that they were hoping to get to.

And so, in terms of our go-forward approach, our strategy remains unchanged. We know what problems we need to solve for customers. The question becomes, do we build, do we partner or do we buy? And if the ultimate answer is buy, then it gets held up against a 15% rate of return over a five-year period like any other decision we make, and that's what ends up helping us make the decision of what we're going to buy.

But I hope you hear that our playbook has gotten more refined, our execution capability has improved, and our board and we were very intellectually honest about our performance, and we are getting better each year in terms of our ability to bring acquisitions in and turn them into a success.

Q - James Macdonald {BIO 1542627 <GO>}

Great. Thanks.

A - Brad D. Smith {BIO 6294100 <GO>}

Thank you.

Operator

Thank you. Our next question is from Michael Millman from Millman Research. Your line is now open.

Q - Michael Millman {BIO 1494618 <GO>}

Thank you. Following up on some of the comments, I was wondering, when you look at Block talking about cutting its price, they also talk about cutting its price to $59 for in-store, and in the hopes of at least causing people to think before shifting to do-it-yourself. So one question is, do you think this is going to have much effect?

Secondly, related to – looking at the industry, do you see Block as more of a competitor or are you more concerned with Credit Karma?

And then I wanted to thank you for what you've done over the 10, 12 years. The company has made terrific strides. And kind of my question following is that as you think about what's going to happen over the next five years as you look at the company from 30,000 feet, what do you see is going to be the major disruptive device that the company shoots into the stratosphere?

A - Brad D. Smith {BIO 6294100 <GO>}

Great. Thank you, Michael. And I'll start with where you left off in terms of the kind words. This team has performed incredibly well over 35 years, and I certainly benefited from their expertise and their execution for the last 11 in the seat. And so it's been a pleasure to work with them and with you.

Let me start with the first, which was H&R Block and their decisions recently be more transparent on price and to roll out some of their approaches. I think first and foremost, I would go back to the 10-year trend, because we've seen a lot of promotional discounts and early refunds and refund anticipation loans in the tax stores, but if you look at a 10-year period, the IRS returns have grown 0.6%, pros have grown 0.3%, tax stores have declined 2.9%, and TurboTax during that period of time has grown 6.3%. So what ends up happening when they get into promotional battles is it's often between the tax prep methods. It doesn't necessarily change anyone's decision if they're going to leave the category and go to a do-it-yourself solution.

I think, the second challenge to that is, $59 is incredibly competitive when you're thinking tax store to tax store, but it pales in comparison to free when you think about do-it-yourself. And so, I think, that's the first headline.

The second is quite frankly, I mean this sincerely; I have a ton of respect for H&R Block as does our company. We have a ton of respect for Credit Karma, for Tax Act and all the other players out there. Each one of them brings something unique and different to the category so it would be hard for me to tell you which one we spend more time thinking about, because we look at all of them. It used to be called plagiarism, now it's called benchmarking we look to learn from our competitors, and we want to make sure we have a better game so we can get out there and compete in the market and earn the customers' trust and earn the customers' business.

As I think to the future, this is really for Sasan and the leadership team, but I will tell you that we're fundamentally going to continue down the path we're on, which is a platform company that unlocks this ecosystem. And if you get underneath that, what is the major thing that is powering that, and that quite frankly is data that has been in a trusted and secure manner, stewarded by the company, and then we match that with artificial intelligence and machine learning to do amazing things for customers they could have never thought possible.

And so if I had to boil it down to anything, it is the power of data with the customer's consent that we can match up with our science, our algorithms and our data scientists to make magical things happen. That I think will be the single biggest breakthrough that

Sasan and the team are all over, and they'll continue to drive forward over the next five years.

Q - Michael Millman {BIO 1494618 <GO>}

Thank you.

A - Brad D. Smith {BIO 6294100 <GO>}

Thank you, Michael. Take care.

Operator

Thank you. Our next question is from Ken Wong from Guggenheim Securities. Your line is now open.

Q - Ken Wong {BIO 20723645 <GO>}

Hi, thanks for taking my question. The first one, Michelle, a fairly strong start to Q1 and looking at Q2 guide, that suggest, first half is going to be much better than expected. Would you say that, that was purely due to just strength across your various pockets of your business or did you notice anything that suggests maybe moderate shift in seasonality through the front half of the year? Thank you.

A - Michelle Clatterbuck {BIO 20314804 <GO>}

Thanks for your question, Ken. And you actually, yes, you answered it in your own question. It is really, as we look at the strength that we've seen, coming off of FY 2018, it was a really strong year for us across each of the pieces of our business, and we've continued to see that strength come into Q1. And so, I would say it is more of the strength that we're seeing in the business versus any other shift outside of just the normal shift you'd see with the ASC 606 change, so thank you.

Q - Ken Wong {BIO 20723645 <GO>}

Got it. Thank you very much.

Operator

Thank you. Our next question is from Brad Reback from Stifel. Your line is now open.

Q - Brad Robert Reback {BIO 3441314 <GO>}

Great. Thanks very much. Maybe could we get a quick update on where you guys stand on the transition to AWS? And beyond that, I know you're also using GCP on the data, AI, and machine learning side. Maybe how early we are in that process, and are we getting to the steep part of the gains from that or should we expect more in the future?

A - Brad D. Smith {BIO 6294100 <GO>}

Hey, Brad, it's Brad. We'll keep that simple. So on the transition to AWS, by the end of this fiscal year, all of our consumer-facing apps will be in Amazon Web Services. Today, we have TurboTax Online there. It ran both its primary and secondary instance in the last of tax season in the cloud so that's completely there.

QuickBooks Online is now in AWS, as is Mint, but we have some other services we'll make sure are in there by the end of this fiscal year. There will be a long tail of infrastructure and internal apps that we'll continue to move to the cloud that will take another 18 to 24 months, but all of our customer-facing apps will be there by the end of July 31; that's our target.

The second part of the question, I have to admit wasn't able to follow. I heard the data, and I wasn't quite sure what the question was. Do you mind repeating that for me?

Q - Brad Robert Reback {BIO 3441314 <GO>}

Yeah, I apologize. So I believe you're using GCP for a lot of your, we'll say big data type of work. I'm assuming we're still very early on in that process, and significant gains to be made in the future?

A - Brad D. Smith {BIO 6294100 <GO>}

Yes, Brad that's correct. So you're referring to the Google Cloud services and some of our capabilities that we have working with Google on the data leg as well as what we're doing with Amazon Web Services. Yes, we are early days. We are primarily right now working with Amazon Web Services on most of our offerings. We are running some experiments in a sort of a parallel path with the Google Cloud, but at the end of the day we are very early days in that regard, and we'll continue to share more as we learn more.

Q - Brad Robert Reback {BIO 3441314 <GO>}

Great. Thanks very much.

A - Brad D. Smith {BIO 6294100 <GO>}

You're welcome.

Operator

Thank you. I am showing no further questions.

A - Brad D. Smith {BIO 6294100 <GO>}

Great. Thank you, Gigi. And let me just wrap up by reiterating that we feel very good with our Q1 performance. We're out of the gate strong as we head into our peak season. We're building momentum with some positive leading indicators as we came through these first three months, but as you all know, the real gain starts now and it comes down to execution.

It's our team's favorite time of the year. We feel like we're ready, we've got a strong product line up, a strong go-to-market game plan, and I want to thank you for your questions. I definitely want to thank you for your kind wishes, and I hope everyone has a wonderful holiday season. And we'll speak with you soon. Take care.

Operator

Ladies and gentlemen, thank you for your participation. This concludes today's conference call.