Company Name: Intuit
Company Ticker: INTU US
Date: 2017-11-20
Event Description: Q1 2018 Earnings Call

Market Cap: 53,239.50
Current PX: 207.49
YTD Change($): +49.71
YTD Change(%): +31.506

Bloomberg Estimates - EPS
Current Quarter: 0.231
Current Year: 5.527
Bloomberg Estimates - Sales
Current Quarter: 953.154
Current Year: 5928.733

Q1 2018 Earnings Call

Company Participants

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

Other Participants

- Brent Thill
- Kash Rangan
- Matthew Charles Pfau
- Sanjit K. Singh
- Adam Holt
- Michael Nemeroff
- Jesse Hulsing
- Kirk Materne
- Michael Millman
- Ross MacMillan
- Scott Schneeberger
- Jennifer Swanson Lowe
- Matthew Wells
- James MacDonald
- Jackson E. Ader
- Nandan G. Amladi

MANAGEMENT DISCUSSION SECTION

Jerry Natoli

GAAP and Non-GAAP Financial Measures

Some of the numbers and 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

Business Highlights

Revenue Growth

- We're off to a strong start in FY2018
- In Q1, we grew revenue 14% and exceeded our overall financial target

- Small Business & Self-Employed Group revenue grew 17%, with QuickBooks Online subscribers growing 56% and the online ecosystem revenue growing 35%
- Both the Consumer Group and the Strategic Partner Group revenues were also in line with our expectations
- With that backdrop, let me share some observations on our business overall, starting with the Small Business & Self-Employed Group

QuickBooks Online Subscriber Growth

- QuickBooks Online subscriber growth continues at a rapid pace, with online ecosystem revenue accelerating
- We exited the quarter with over 2.5mm QuickBooks Online subscribers, surpassing the 2mm subscriber milestone during the quarter in the United States, while our non-U.S. base grew 70% y-over-y to approximately 550,000 subscribers

Customers and Online Ecosystem Revenue

- Within QuickBooks Online, Self-Employed subscribers grew to roughly 425,000, up from 390,000 last quarter and 110,000 just one year ago
- The strong growth in QBO customers and online ecosystem revenue reflects our focus on improving the customer experience and delivering what matters most in their lives when choosing our products
  - That is more money, no work, and complete confidence

Net Promoter Score

- Our teams are laser-focused on delivering these customer benefits, and they’ve produced a steady flow of new features and capabilities, many of which were showcased at our QuickBooks Connect conference last week
- Our QBO innovations are resonating with customers, with our most recent Net Promoter Scores once again improving, this time by more than 6 points on top of the 22-point improvement we drove last year
- These improvements are reflected in each geography around the globe, positioning us well vs. local alternatives and giving us confidence in continuing our expected QBO subscriber growth north of 40%, with online ecosystem revenue growth of more than 30%

Consumer Group

- Turning to the Consumer Group
- First quarter revenue finished in line with our expectations, up 7% y-over-y
- We’re gearing up for the upcoming tax season and remain laser-focused on delivering an outstanding end-to-end customer experience from do-it-yourself taxpayers
  - We’re also launching our new TurboTax Live offering, leveraging technology for those seeking access to a tax expert on demand
- Our experience with October tax extension filers gave us an opportunity to run some water through the pipes, and we are encouraged by the results as we head into the season

New Turbo Platform

- As we discussed last quarter, our Consumer Group now includes Mint and personal financial management
- We unveiled our new Turbo platform at the Money 2020 conference in mid-October
- Turbo is the first step towards expanding beyond a tax offering to a consumer platform
  - This platform will improve the overall financial health of the end user
- Turbo goes beyond a credit score and unleashes the power of verified IRS-filed income, the credit score, and a debt-to-income ratio to show customers who give consent where they truly stand
- We announced an exciting slate of initial partners who will use the platform to provide offerings for participating customers starting early in calendar 2018

Strategic Partners Group

- Moving on to the Strategic Partners Group
- Our professional tax revenue was also in line with our expectations for the quarter
- We continue to focus on multiservice accounting firms that do both books and taxes
  - This is in service to driving our accountants' success, while growing our small business ecosystem
- Putting a bow around the quarter, we're off to a strong start to FY2018 and we are excited about our prospects for the year

R. Neil Williams

Financial Highlights

Revenue, Operating Loss and EPS

- For Q1 FY2018, we delivered revenue of $886mm, up 14% y-over-y
  - A GAAP operating loss of $57mm vs. $61mm a year ago
  - Non-GAAP operating income of $43mm vs. $32mm last year
  - GAAP loss per share of $0.07 vs. $0.12 last year
  - And non-GAAP diluted EPS of $0.11, up from $0.06 last year

Small Business & Self-Employed

- Turning to the business segments
- Total Small Business & Self-Employed revenue grew 17% in the quarter, up from 14% in FY2017
- QuickBooks Online subscriber growth remained strong at 56%, ending the quarter with 2.552mm subscribers

Revenue Growth

- Small Business online ecosystem revenue accelerated to 35% in Q1 from 30% in FY2017
- Online accounting continues to drive this revenue growth

- We expect y-over-y QBO subscriber growth to slow in H2 due to the introduction of the Self-Employed bundle last tax season
- We remain confident in our outlook for growth in QBO subs, as reflected in our FY2018 guidance of 3.275mm to 3.375mm subscribers
    - We also continue to expect online ecosystem revenue to grow better than 30%

Desktop Ecosystem

- Desktop ecosystem revenue grew 8% in the quarter, driven by QuickBooks Enterprise strength
- QuickBooks Desktop units fell 35%
- Remember that operating system changes in the year ago period led customers to upgrade to the newest desktop version, which drove strong unit growth last year
- For FY2018, we expect QuickBooks Desktop units to decline mid-teens and desktop ecosystem revenue to be up mid-single digits

TurboTax Live

- Total Consumer revenue was up 7% for the quarter, while professional tax revenue within the Strategic Partner Group grew 2%
- Looking ahead, I'm excited about the opportunity TurboTax Live provides to address the needs of more tax filers
    - We typically see 3mm prior year TurboTax customers go to a pro each year
- TurboTax Live provides us the opportunity to keep more of those customers in our franchise

Capital Management

- Turning to our financial principles
- We continue to take a disciplined approach to capital management
- We finished the quarter with approximately $780mm in cash and investments on our balance sheet
- Our first priority for cash remains investing in the business to drive customer and revenue growth

Acquisitions

- Next, we use acquisitions to accelerate our growth and fill out our product road map
- We return cash that we can't invest profitably in the business to shareholders via both share repurchases and dividends
    - We repurchased $170mm of shares in Q1
- Approximately $1.4B remains on our authorization
- We expect to be in the market each quarter this year

Dividend

- The board approved a quarterly dividend of $0.39 per share payable January 18, 2018, an increase of 15% over last year
- Our Q2 FY2018 guidance provides revenue growth of 14% to 16%, GAAP diluted EPS of $0.08 to $0.11, and non-GAAP diluted EPS of $0.31 to $0.34
- You can find our Q2 and FY2018 guidance details in our press release and on our fact sheet

Summary

Finally, I'd just like to say that I am thankful for the opportunity to work with you, Brad, for the last 10 years

It has been the high point of my career to learn from you and to laugh with you during our time together

Brad D. Smith

Closing Remarks

There are no words, although I'll share some at the end of the call, but I do say that this last 10 years has flown by like it was just a blink of an eye

It's been an awesome ride

So shifting back to the business, we are pleased with the strong start to the FY and we look forward to accelerating our momentum as we head into peak season

- We couldn't be more proud of the work that our employees are doing

QUESTION AND ANSWER SECTION

<Q - Brent Thill>: Brad, on QuickBooks Capital, I was curious if you could just talk a little bit about your aspirations. And as I understand it, in the past you had a group of connected lenders that would loan to small businesses. I think now you're putting your own capital out to these small businesses. Can you just walk through the dynamics and how those changes in this initiative? And I had a quick follow-up.

<A - Brad D. Smith>: Sure, Brent. Let me start by saying that our goal remains unchanged. If you look at the number of small businesses and self-employed who are seeking access to credit, 70% of them still get turned down. And yet we have visibility into things that most lenders don't have. Most only have a look backwards at history. We also have a look forwards. We have over 26B transactions in the QuickBooks ecosystem that we're able to look at. That includes forward-looking things, like inventory on-hand, invoices outstanding, cash flow, projects in process. And it's a combination of the past and the future and a proprietary algorithm that we think has led to a credit score or a credit rating system that is much more predictive of good businesses in which you can invest. And case in point is, so far to-date, 60% of the loans that we've been able to issue or facilitate have been to people that would have been considered un-lendable by other institutions. So we're really excited to get access to capital into the hands of these small businesses and self-employed.

To your second question, we think this could be a very promising opportunity over the long-term, but our use of capital was really to fuel or prime the pump. What we needed to do is get a rapid feedback loop on whether our algorithms were predicting the things that we needed so it would make it a better tool for other lenders. And so we, at this point in time, don't have plans to become a bank and we don't have plans to lean into that aggressively as opposed to using it as a way for us to tune our algorithms and make it a really good platform for other lenders to be able to provide access to capital. So that's sort of the summary of QuickBooks Capital and hopefully answers your question.

<Q - Brent Thill>: Great. And just a quick follow-up on the QuickBooks business and the growth rate in the back half of the year. I know you cited a couple of factors, but I think one of the questions we've had from investors is, given how big the market is and how early it is, why the growth rate should be fading at this point? Any perspective? It doesn't sound like there's anything fundamental -- fundamentally off, but I'm just curious to kind of what the rationale is, given how early this is and why you would see that type of fade.

<A - Brad D. Smith>: Yeah. There is no fundamental weakness in the business itself. As you've heard, the Net Promoter Scores are improving in every geography. We're seeing strong funnel management. We just released a whole new set of innovations at QuickBooks Connect last week that we think will only accelerate the conversion of the funnel. It's just a reality of last year we opened up one of the biggest channels any company could hope for, which is 100mm people visiting TurboTax.com in a 100-day period, and we got a nice pop of customers that were exposed to that for the first time.

And so we're going to have that grow over. We don't view that as a foundational or a systemic weakening. We simply view that as a seasonality thing, and we'll see how strong we can go through tax season. But right now, we just want to manage expectations that we did get a big tranche of customers in that period of time, and we want to make sure that we know H2 compares are a little more difficult than H1.

<Q - Kash Rangan>: Neil, we will definitely miss you, and congratulations on your 10 years at Intuit. Brad, a question for you. Can you talk a little bit more about TurboTax Live, the specific segment of the market that you're trying to go after? Is there any, on the flip side, potential of a cannibalization, albeit you may experience higher ASP even if that were to happen? But what is it that you're looking to uncover here? And how solid is the market research that you've conducted to validate the true potential for TurboTax Live? Thank you so much.

<A - Brad D. Smith>: Great. Thank you, Kash. Well, step back and look at the market, and we'll size the U.S. at a little over 150mm returns that go to the IRS and somewhere approaching 90mm of those turn to an expert, whether it's a tax store or a tax professional to answer questions or to complete their taxes for them. And when we get underneath that, the series of questions sometimes will just go as far as, if I only had the answer to one nagging question, I would have been happy to do my taxes myself. And that's really where TurboTax Live leans in.

Now we have two flavors of TurboTax Live. We have the do-it-with-me, where we offer advice, and then there's do-it-for-me, where we can take over the return and complete the return for you and sign it. And those are both going to be in the marketplace, but we think the big opportunity is going to be that advice-giving.

A lot of people out there have simpler taxes, and they simply have a nagging question based upon a life event change. They had a child, they moved between states, they sold stock. And being able to actually get a tax expert on-demand to answer that question and then go on and finish your taxes, we think, is a big opportunity. I don't see this as cannibalization. We actually see this as an opportunity to extend our value further into the market that historically has not moved to the do-it-yourself category or may actually switch from DIY to a tax pro, because they lost confidence. We think it's a great retention tool, as well as an opportunity to go into a part of the market that we have underserved.

<Q - Kash Rangan>: That's fantastic. Do you have enough capacity to handle the demand if it surges? Because that sounds like a terrific value proposition. Thanks. That's it for me.

<A - Brad D. Smith>: Yes. Kash, I would tell you, as we went through the tax filing extension season in October, we not only were able to validate there's real demand in the market on the consumer side. There's real interest on the professionals side, and they like the experience of the platform we've created. We were also able to run water through the pipes on our ability to scale.

Now, obviously, as we get into season, we're going to continue to learn, because there will be more and more volume as we get closer to April 15. But right now we have confidence to say, we feel like we've got a strong operational model that has both consumer and tax professional benefit, and we're really excited for the season to come.

<Q - Matthew Charles Pfau>: Just wanted to follow-up a bit on TurboTax Live. So, first of all, I think you mentioned that there's typically around 3mm TurboTax customers that go to a pro every year. Just wondering, in terms of those customers that switch over, is it the case that they start the return and then run into a roadblock and switch to a pro, or does something happen prior to them even starting their tax return that motivates them to switch over to a pro.

And then I guess, parlaying on that, how do you go about communicating to these customers or getting the message out there to sort of stop them from moving over to a pro? And then also in terms of the Live offering, just kind of wondering the initial feedback you've heard from accountants and how confident you are that you'll be able to build up that network big enough to handle any demand that you have on that offering to provide a good experience? Thanks.

<A - Brad D. Smith>: Great. Thanks, Matt. So, you're right. We did reference 3mm TurboTax customers, who y-over-y end up losing confidence themselves simply because of a life event change and they opt to go to a professional sometimes for that next year, sometimes it could be for a couple of years, and we have to win them back. Sometimes that decision is made before even logging into the product. Many times it's once they get into the product and they realize that they've now had a child that's crossed the magic age and they can no longer claim them as a deduction or they sold stock and they start to lose confidence.

So how we're reaching them? Two ways. You're going to see our go-to-market campaigns and our advertising talking about the ability now to have a tax expert on demand. So if you don't log into the product, you'll now know you can, because you have a tax expert that will be included with the software. For those that are in the product, we have in-product discovery. So if we see you hovering too long in a particular area, and throughout the product there's a perpetual link that says if you want to get access to an expert, simply press here. So we have both outside the product advertising and inside the product advertising.

In terms of the experience, two things have happened. We are way ahead of our expectations in our ability to recruit the number of professionals we think we'll need for season. We have milestones for every month leading up to season, and we are ahead of those milestones in terms of people signing up for the service. So we think we'll have very strong professional supply.

And the second is the Net Promoter Scores of those tax professionals during the October extension season was above our targeted goal. So we're excited both in the volume of professionals we're able to recruit, but also the experience they're enjoying so far. Now, we'll have to see if we can sustain those levels as we get into the peak tax season.

<Q - Sanjit K. Singh>: I have two questions for you guys. One in terms of this year in terms of international expansion plan, any new countries that are coming on board this year that's important to flag?

<A - Brad D. Smith>: At this point, we haven't announced any additional countries. As we often say, we have so much opportunity in the countries we're in, we have real acceleration happening in Canada, the UK, and Australia. We're still working to get that last mile with compliance and product market fit in France, India, and in Brazil. We do have tests going on in other countries we've referenced in prior calls, but those tests have not yet validated that we're ready to go big into those markets. And so at this point in time, I would say the countries we've announced are the ones we would stay focused on, and that is still $224mm prospect opportunity. And as we just celebrated 2.55mm subscribers, we got a lot of headroom just in those countries.

<Q - Sanjit K. Singh>: That's super helpful. And then maybe if I can toggle back to the commentary on the TurboTax bundle. Any early indications on what retention rates might be for those cohorts of customers that signed on last year? Any sort of early readings on whether they're staying on board or whether they are attriting higher than normal?

<A - R. Neil Williams>: [ph] David, (22:09) I think the proof is going to be in the tax preparation season. The customers that have that bundle now look good in terms of their retention and their active use. But we all know that as the tax preparation process itself, that is the big value proposition for these customers. And so I think we want to get through an entire filing season and have a full annual cycle with these customers before we get too definitive about what their retention characteristics are.

<Q - Adam Holt>: So another good first quarter, and I had two questions on the QuickBooks business. First, it looked like outstanding year-on-year margin expansion in QuickBooks, looked like 3 full points on a year-on-year basis despite the strong unit growth. You've talked a lot about different factors that drive that. But maybe as relates specifically to this quarter, what did you see that enabled you to expand margin so much?

<A - R. Neil Williams>: Adam, the seasonality, I think, is something that can play some tricks on you in terms of trying to do the margins analysis there. We don't really look at it on too much on a quarter-by-quarter basis. As I mentioned on the call, the accounting revenue is really what's driving the top line. The revenue growth, our retention rates for QuickBooks is doing nicely, and so that's held up the revenue side really well. But our expenses and our investments are really not evenly distributed throughout the year. So we're excited about where it is, but it's going to move around a bit through the year. So we're excited about the customer growth and the top line growth for sure.

<Q - Adam Holt>: Well, apologize, I'm going to ask another quarter-oriented question. But you beat numbers this quarter. And as we've learned in the past, sometimes you roll that into the year, and in this case you did as well. So the annual numbers don't change, which means we've got to take down our numbers a little bit in one of the forward quarters. Given what you said about the tough comps in QuickBooks, which seem to be tougher in Q3, should we, A, assume that the delta is in QuickBooks, and B, assume that that principally falls in Q3? That's it for me. Thanks so much.

<A - R. Neil Williams>: Adam, I think that definitely the Small Business Group was the one driving the revenue growth in Q1. We do think that we've got a tough grow over in Q3, particularly in Small Business. And so that's why the overall guidance we've given for the year for revenue and for subs takes that into account. That's why we've been cautioning people that we're going to have a tough compare when we get to those Self-Employed bundle units in Q3. So I would look to the full year guidance both in terms of online ecosystem revenue and in terms of subs, and think about how Q2 and Q3 play out for those, but I would stick – I wouldn't get far away from the full year guidance on either revenue or subs for the Small Business segment.

<Q - Michael Nemeroff>: And Neil, been nice working with you. Good luck going forward. Brad, I wanted to ask about TurboTax Live. I know there's been a bunch of questions on it, but can you give us a sense of what pricing has looked like during this trial period and how you expect that to be priced going into this tax season? And then for – that's it for the second.

<A - Brad D. Smith>: All right, Michael. So many of you have been going through the product, and we've spoken to you offline and you've been a part of our test sells. We've been testing a lot of price points out there. We have not yet announced our pricing. It's still a little too far out for us to give competition or others that nod. But I would say that, what you're going to see is it's going to be a premium to the current price points we have in the TurboTax lineup, but we have not landed yet on what that price point will be or announced it. So if you don't mind, I'd like to just hold that back and we'll get a little closer to season, and then you'll see the price points out there.

<Q - Jesse Hulsing>: Yeah. Thank you. Brad, I wanted to ask about Turbo, which it sounds like you're launching next year. If you were to compare Turbo to some of the other consumer finance platforms out there, I guess, like Mint and Credit Karma and others, what's the value proposition to consumers to get them to use the app? And, I guess, if you're a partner institution looking at Turbo vs. the others, what's the value proposition for those partner institutions and lenders?

<A - Brad D. Smith>: Great. Thank you, Jesse. Let me start with just the interaction model. Our mission is to power prosperity, and for the Consumer Group it is provide financial freedom for consumers, and so financial freedom is a 365-day a year task. Historically, with TurboTax, we enjoy two interactions with customers a year, where Mint enjoyed 112 interactions with customers. The challenge is both were incomplete on a standalone basis, but when you bring them together as a platform and you began to look at the other customer and partner data that we have in our ecosystem, we believe we can provide a platform that can help individuals and families better manage their financial health. The reason being is not unlike what I shared with QuickBooks Capital, because we have access to more data, and it's not only backward-looking, but forward-looking.

Today, with a credit score, what you can basically get with that is access to more credit cards. But if you have debt-to-income ratio, if you have IRS-filed income that's been verified by the government, so it's a real source of income, and you also have a credit score, you can put the combination of those three things together and you can start to do some pretty wonderful things for consumers. You can help them find better financing for student loans. You can help them get lower credit card fees. You can help them get access to mortgages, to get better loans for car loans, and a whole host of other things.

So we fundamentally believe that the data we have, the algorithm that we've written and the partners, the 40 that came with Mint, the more than half a dozen that have already signed up for Turbo, and you put them together with others, we think we're going to be able to start to solve some important financial problems for consumers that others in the market just, quite frankly, can't match today, and that's the excitement. We still have much to prove, so we haven't baked a lot of that into any financials for this year. But we sure have a team focused on it and we think we're on something that could be really meaningful for consumers if we get it right.

<Q - Jesse Hulsing>: That's helpful, Brad. And a question about QuickBooks Online. It looks like ARPU was flat y-over-y, and which is great to see, given the increasing self-employed mix and international mix. It was also flat y-over-y in Q1 last year and then declined y-over-y in the second through fourth quarters. So I'm wondering, do you expect that same pattern to play out through the remainder of this year. Thank you.

<A - Brad D. Smith>: Yeah, you're welcome. I appreciate the question. If you go to our Investor Day deck, Neil did a wonderful job of laying out a page on ARPU and what we expected the trends to be going forward. And basically, if I had to summarize that for you, because it has individual QBO U.S., QBO non-U.S., QuickBooks Self-Employed, you just lay them all out, what you're going to see is the health of the ARPU on a cohort basis is getting stronger across all those cohorts. But when you put it together as a mix, you're going to have downward pressure on ARPU.

So, as you said, I would echo what you said, flat, given the growth we're seeing outside the U.S. and the self-employed is a good thing. But you should know, underneath the ARPU is getting healthier in each of these cohorts, and it's only a good news story over time. So I think Neil's page in the Investor Day deck kind of lays out what our expectations are for ARPU. And I think if you refer back to that, it's pretty much says what you just assumed.

<Q - Kirk Materne>: Brad, now we're through the extended filing season, I was wondering if you had any sort of thoughts when you look back and you got the sort of last pieces of data from last year. Did that inform your view on the upcoming season at all just in terms of the baseline units to start with? I mean, it sounds like everything is pretty much in line with what you thought, but I just wanted to double check on that.

<A - Brad D. Smith>: Yeah. Last year is still one of those years that's going to play out as an anomaly, not unlike 2013. I think when you threw everything in, including extensions, it's still going to be hovering around flat as a tax season with total IRS returns. And we had anticipated between zero and 1% growth. I know we were little more muted in our expectations than many in the industry. However, as we look ahead, we still have that same sort of an outlook for the coming year. We think it's a zero to 1% growth year in total returns.

No one's really been able to diagnose – I was just meeting with the IRS Commissioner and my peers in the industry three weeks ago in Washington. No one had a better hypothesis for what happened in tax season other than, who knows. And we'll just have to gear up and get ready for this season. So it hasn't changed our expectations for this year. I think we're looking at a fairly modest total returns growth happening at the government level.

<Q - Kirk Materne>: Okay. And just with the legislation pushing through Congress right now, does that change any thoughts in terms of just the shape of the season from a seasonal perspective in your view or is it still more of a you'll just have to wait and see what happens?

<A - Brad D. Smith>: Yeah. At this point, it doesn't. You're right, there's still a lot that we're going to have to wait and see. If there is positive news it's both, coming out of the House and Senate most of the recommendations are proactive vs. retroactive. Retroactive becomes an operational challenge for the IRS, and then that cascades down the industry. And sometimes that leads to delayed tax filing season. If Congress can actually get this through, either sometime before the end of the CY or early January, as long as it's proactive, we still believe the shape of the season will be pretty much the same. There's just one caveat there, and the one caveat I'll toss in for those who have looked at the calendar closely. This year's Q2 will have one extra filing day in it. It's just the way that calendar works for us. And one day in 100-day season can move things around just a little bit. But total season, we don't really see anything that we think is going to fundamentally reshape the curve.

<Q - Michael Millman>: And also looking at the IRS kind of information, so really two areas of question. First, on standard deduction increase – assuming increase, how do you see this impacting both low taxpayers now who are using assisted, because they have all these deductions, computations, and now they may not? And sort of similarly, how do you see those who are now using do-it-yourself and say, boy, it's gotten so simple, I can do this myself? And maybe you can sort of put some numbers to those things. And then I have another question.

<A - Brad D. Smith>: Yeah. Thank you, Michael. I think your overall thesis is similar to ours, and that is the more success we have in getting the tax code simplified, the more success that will drive category growth for the do-it-yourself category. Many people turn to an expert today, because they have a nagging question or they think it's too complicated. So we think the simpler Congress gets the tax code, that's better news for the do-it-yourself category. And as you know, that's the number one lever of growth for us. 1 point of category growth is worth several points of revenue for us if it plays out.

The second is the do-it-yourself category, I think software is the answer. I mean, if you look at the IRS, they will tell you they don't have the body to process paper returns like they did even five years ago. So if someone says, it's so simple, I can do it myself, they're going to use software to do it and so we just have to make sure we have the best, most effective software for them to get that done. So I think, by and large, a simplification is good news story for the do-it-yourself category.

<Q - Michael Millman>: Okay. And so related, in simplification is the postcard of return, and I know you fought against this in California. So I got to assume, there's things about it you don't like. And maybe you can talk about what you see coming forward, if indeed we have tax on a postcard.

<A - Brad D. Smith>: Yeah. Thanks, Michael. Let me try to clarify what we were standing for and standing against in California. We were for simplification, we have been for more than a decade, and we were for getting it so simple you could get it done on a postcard. Where we draw the line is we are believers and supporters in voluntary compliance, which is the citizen has the right to determine what they believe they owe the government. And it's the burden of the government to prove that they're wrong, and not the other way around

It shouldn't be the government actually sending out this form and saying, here's what you owe us. And then people who may have English as their second language or people who may be intimidated by the government paying a number that may be overpaid, because they're just nervous. So what we've done, just to be candid with you, is while I was up in Washington a few weeks ago, we've even built prototypes that we've shown Congress and the administration on how private industry can help them build this postcard for them, so that they can execute the plan they want to deliver. We think that would be a wonderful thing. We just believe at the end of the day, it's the individual's right to determine what their tax obligation is and it is not the government's role to come in and say, I am going to tell you what you owe me and pay me the money.

<Q - Michael Millman>: So assuming the government takes your advice, what kind of impact would you see on the do-it-yourself business?

<A - Brad D. Smith>: Well, I'm not sure the government will take my advice. I think the good news is the industry overall, as well as Congress, many members of Congress have been on the record saying, that this is the way the country was founded so many years ago, is we felt that we should have the ability to determine what we owe based upon a set of rules and laws and not have somebody dictate to us what they're going to make us pay. So with that sentiment, and we happen to be in that camp, we believe at the end of the day the simpler this thing gets, the more people are going to move into do-it-yourself. And I think it's going to be a real accelerant, not only for the economy, but for the category, and then ultimately for us, if we do our job.

<Q - Ross MacMillan>: Brad, we did a survey recently looking at TurboTax Live, and there was, I guess, two things that I was interested to ask. I know you're not talking about pricing specifically, but I believe the assisted category has, call it, revenue or dollars per return that are something like 4x what TurboTax currently has. And as you think about the pricing model for this new offering, I'm just curious if you could frame it in that context and, I guess, just trying to think about that envelope and how far you think you may be able to go.

And then secondarily, we also found that other services like audit insurance and fraud protection could also sway customer decisions. And I would think those would be important for folks that are – maybe have more complex filings. So I was just curious for your thoughts around sort of bundling some additional services with the TurboTax Live offering to try to increase participation. Thanks.

<A - Brad D. Smith>: Yeah. Thank you, Ross, and always appreciate the work that you and your team do with the surveys and the in-market discoveries. Your analysis is correct. If you take a look at the average revenue per return we get in TurboTax, it's a little north of $50. If you look at what an average tax store charges, it's in that $180 to $220 range, and you can go to a pro in $300 or $400. So that's multiples of the current price point of TurboTax.

We're not here today to tell you or anybody else on the call that we're announcing a 4x price point on TurboTax Live. In fact, what you should hear is, we think we have a disruptive business model that will allow us to provide better value for the customer and, at the same time, be able to have them be a part of the TurboTax franchise. So just know that somewhere north of where we are and south of where they are is probably going to be in the ZIP Code of where the pricing will be.

And then you're on a really important point. With everything happening in the market today, whether it's cyber threats or other things, whether it's audit insurance or it's fraud protection, those are absolutely the kinds of services we continue to not only market ourselves, but look at creatively bundling with other products. As we get closer to season, you'll hear us talk a little bit more about those things, but that is the right theme. People are looking for peace of mind and some assurance that if anything happens to them, that we've got their back, and that's what we want to continue to be there for.

<Q - Scott Schneeberger>: Just curious, so there's been a lot of talk about timing fiscal second and third quarter, and thanks for the extra filing date. That's interesting. And I realize other things can move around relative to the guidance, like maybe what comes out of the tax bill or other items. But I'm just curious the PATH Act was disruptive last year on the consumer tax side. So, Brad or Neil, what's the consideration in the guidance for the start of the tax season, how strong or weak are you expecting there, and how does that play into the guidance? Thanks.

<A - Brad D. Smith>: Yeah, Scott. We think that last year was an opportunity not only for the market, but for all of us in the industry to adjust to the PATH Act. There was definitely little bit of shock and awe last year no matter how hard we tried to educate the end user. Once they finally fell into that muscle memory of filing their taxes, a lot of them were still surprised they weren't going to be able to get their money until in February.

I think that experience that they went through, plus the experience we all had in conjunction with the IRS is, we anticipate it's going to be a new normal now in terms of what the PATH Act impact will be. So we don't really see any meaningful or material shift y-over-y. That's all subject to no surprises coming out of Congress between now and tax filing season.

<Q - Scott Schneeberger>: Great, thanks. Appreciate that. And then, Neil, if we can bring you on, since it's probably our last chance. Kind of a similar question along the line of, obviously, there are lot of investments going on this year, and I'm just curious how that might affect seasonality in second quarter and third quarter this year, and maybe things we might want to consider on the marketing front. Thank you.

<A - R. Neil Williams>: Yeah, Scott. I think the seasonality for Q2 and Q3 on our investment side both in R&D and in marketing ought to follow a similar path as the last year. It may be invested a little differently in some different ways, but we may have reallocated a bit within the categories, but I wouldn't expect to see any more shifts between quarters than you saw the last few years. Obviously, Q1 and Q4 are the lightest quarters for us, but Q2 and Q3 are the critical periods for us, and the investment levels in those quarters are pretty well baked.

<Q - Jennifer Swanson Lowe>: I wanted to – [ph] actually, (43:12) sort of following-up on the last question, but looking at the OpEx. It looks like in Q1 there was a pretty material step-up q-over-q and y-over-y. And I know, Neil, you commented earlier that there's always some shifting. But I know this year is also going to be an investment focus year for you as well. So as we look at the spending in Q1 and the step-up y-over-y and q-over-q in that metric, how much of that should we think of as maybe spending that normally would have happened later in the year that just happened a little earlier vs. how much is attached to things like hiring that might persist throughout the course of the year?

<A - R. Neil Williams>: Hi, Jennifer. I think the level you saw in Q1 is really reflective of the investments we're making throughout FY2018. So, again, I wouldn't assume that it was necessarily front-end-loaded. But we outlined four areas at Investor Day that we really wanted to lean into in 2018 and make significant progress, areas like machine learning, artificial intelligence, our transition to AWS, improving market productivity, and things like that. So you should expect and assume that, in Q1, it reflects the higher level baked in throughout the year.

<Q - Matthew Wells>: I'm on for Walter Pritchard, and we were at your QBO Connect in San Jose last week. We thought you guys all did a really good job. And we get the sense that you are positioning QuickBooks Desktop to move upstream, essentially targeting SMEs. Can you add anything here? And just maybe comment on how higher ARPU QBE customers are contributing to growth in Desktop? Thanks.

<A - Brad D. Smith>: Yeah. Thank you, Matthew. And first of all, thank you for coming to QuickBooks Connect. For those who weren't able to make it, it was, I think of the four years, perhaps the very best. We had over 5,000 attendees there, over 70,000 streaming live. The energy level amongst the participants was amazing and the speakers was incredible. And also the number of innovations we unveiled was unprecedented for us in any given event. So it was a really upbeat year.

In terms of QuickBooks Enterprise, you're correct. In fact, when Neil walked through total QuickBooks Desktop units down 35%, yet QuickBooks Desktop revenue up 8%, that's really being powered by QuickBooks Enterprise. QuickBooks Enterprise Solutions is a disruptor to the mid-market. It is a fast-growing product in our product lineup. It's priced about 35% cheaper than any of the competitors in that marketplace. And we're going to continue to invest in that product.

So I fundamentally see, as we said, going forward, desktop units overall will be down in the mid-teens, but you're going to see mid-single-digit growth. And that's going to be powered by QuickBooks Enterprise Solutions, which is our upper-end product for the mid-market.

<Q>: I just wanted to see if you could comment on the QuickBook Online for the services revenue how the Payroll and the Payments part is trending?

<A - Brad D. Smith>: I'm sorry. I think you dropped in and out a little bit. Did you ask about how Payroll and Payments are doing in QuickBooks Online?

<Q>: Yes.

<A - Brad D. Smith>: Well, we continue to be encouraged by the performance of our Payroll and Payments business overall. Those that are attached to the QuickBooks Online platform are accelerating at fast growth rates, Payroll in the 20%-plus range, and the Payments in the plus 30% range. We continue to get stronger performance in getting the Payments and Payroll standalone products over on to the QBO platform. In fact, we introduced some innovations with GoPayment. As you may remember, it was a standalone mobile offering, but it off on a different technology stack. We've now had that ported over, so the technology now works with QuickBooks Online. But you should hear confidence and enthusiasm coming out of our Payroll and Payment ecosystem. We still have more work to do, but a lot of the innovation we talked about, both internally and then externally, QuickBooks Connect was focused in these areas.

<Q>: Sounds good. Thanks.

<A - Brad D. Smith>: Yeah.

<Q - James MacDonald>: Just following-up on that last question. What are the prospects for possibly other services or other revenue streams in the other category for QuickBooks Online in addition to Payroll and Payments?

<A - Brad D. Smith>: Jim, are you referring to something on the fact sheet, or are you asking theoretically are there other things we have in the pipeline beyond Payroll and Payments?

<Q - James MacDonald>: Right. That could be significant going forward.

<A - Brad D. Smith>: Yeah. Well, I think there is a combination. Payroll and Payments have a lot of headroom. We've needed to get our execution things straightened out, and I feel like we've got some run rate there. QuickBooks Capital is one that we talked about, we're excited about. As we start to really double down on things like electronic invoicing, or e-invoicing, we're seeing real benefit to customers. The innovation introduced last week at QuickBooks Connect, it used to take 33 clicks and a 48-hour approval period to get your invoice electronic-enabled, pay-enabled. Now it's three clicks and one minute. If you just look at Payroll/Payments, QuickBooks Connect, and then the third-party services with all the different apps being built on the ecosystem, we will start to see what the next opportunities might be. But right now, I would say Payroll and Payments and probably QuickBooks Connect to be the place that I'd put my attention.

<Q - James MacDonald>: Great. Thanks. And then...

<A - Brad D. Smith>: [indiscernible] (49:04).

<Q - James MacDonald>: ...in terms of Q3 number of days for TurboTax, is that going to show a similar decline vs. the increase in Q2?

<A - R. Neil Williams>: Yes.

<A - Brad D. Smith>: Yeah. It's a day shift between the two quarters.

<Q - James MacDonald>: Right. Best wishes, Neil.

<Q - Jackson E. Ader>: One question from our side. How should we be thinking about TurboTax Live vs. the investments that you've made in SmartLook? How do those compare and contrast?

<A - Brad D. Smith>: Yeah. Thanks, Jack. I'm glad you asked this question, because I think I've contributed to some confusion out there, and we probably haven't been as clear. Think of SmartLook as the technology that enables TurboTax Live to happen. TurboTax Live is end-to-end value proposition. It's not only the TurboTax core product. It's an expert on the other end and is the ability to connect through a video, a one-way video and have that sort of interchange between the customer and the expert. That interchange happens over a piece of technology we call SmartLook. So SmartLook was the codename before we got this end-to-end value proposition launched. It's really the technology that enables one-way video. The overall bundle is called TurboTax Live.

<Q - Nandan G. Amladi>: So back on the comment, Brad, about QuickBooks Enterprise. As you build out the road map, you have a new version of the API coming on QuickBooks Online, how do you balance the future road map with QuickBooks Enterprise relative to QuickBooks Online and that online ecosystem?

<A - Brad D. Smith>: Yeah, Nandan, thank you for the question. I would tell you, we're going down a parallel path. We're continuing to build out the feature functionality in QuickBooks Online. And as we do that, we hope to ultimately have a replacement or an alternative rather for QuickBooks Enterprise in the online version. That's going to take us sometime. In the meantime, there's real customer problems in the market that aren't getting solved well by current mid-market solutions, and we're not abandoning the Desktop.

So we're continuing to make the appropriate investments in the Enterprise product to make sure it's got the highest Net Promoter Score, while we're making the investment Neil talked about to strengthen QBO, QuickBooks Online, and an acquisition we recently did was an acquisition of a company that provides sales and use tax. And that's one of the key features that you need in an enterprise-level product. And so that's just an example of what we're doing to build out that functionality in QuickBooks Online.

Brad D. Smith

Q1 Highlights

Batmobile

- I know that this is one of those weeks where we've got a lot of things coming up for those of you in the United States with the holiday
- I did want to go back and thank the Lone Ranger here, Neil Williams
- I often joke that over our years together, it's been like Batman and Robin
- And he's the one that drives the Batmobile, and it's just been a real pleasure and joy to sit by him and to help navigate through this business model transition together and to learn from him
- And his sense of humor and his wit, as you all know, is unparalleled
- And I'm also delighted to see that not only has he left us better than he found us, but he really produced a strong leadership bench
- And in that bench came Michelle, and Michelle is just an outstanding individual
  - She is a great human being
- She's an excellent financial expert
- She's a great thought partner
- And I believe that come February, with the knowledge transfer that they've executed since August, we're really going to hit the ground running
- And I will also tell you all, you should rest easy, because he's taken the Batmobile keys and he's handed them to Michelle

Cockpit

- So once again, I'm not in the driver seat
- I get the chance to sit in the cockpit, but there's no place I'd rather be, whether it's Neil or Michelle
  - So we tip our hat to you one more time, my friend
- You're just a good human being and a great friend, and we love you
- And you will be forever in our Hall of Fame here
- And, Michelle, we can't wait for you to step into his issues and show what you can do with the next set of dancing leg
- So we're going to be ready to rock and roll
- Neil's dancing legs were like mine
  - He tended to step on my toes, but I understand that you're going to bring a whole new level of professionalism.