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TAX - Liberty Tax Inc Earnings Call

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PRESENTATION

Operator

Good morning. My name is Lashonda, and I will be your conference operator today. At this time, I would like to welcome everyone to the Liberty Tax Fiscal 2017 Earnings Conference Call. (Operator Instructions)

I would now turn today's call over to Vanessa Szajnoga to begin. Please go ahead.

Vanessa Szajnoga - *Liberty Tax, Inc. - General Counsel and VP*

Thank you, Lashonda. Good morning, everyone, and thank you for joining us. With me today are John Hewitt, our Founder, Chairman and Chief Executive Officer; Ed Brunot, our Chief Operating Officer; and Kathy Donovan, our Vice President and Chief Financial Officer.

The press release announcing our fiscal 2017 earnings was distributed this morning. The earnings release may be accessed at the Investor Relations section of our website located at www.libertytax.com. A replay of this call will be available shortly after the conclusion of the call. The information to access the replay was in the earnings press release.

I'd like to remind everyone that today's remarks may include forward-looking statements as defined under the Securities Exchange Act of 1934. Such statements are based on current information and management's expectations as of this date and are not guarantees of future performance. Forward-looking statements involve certain risks, uncertainties and assumptions that are difficult to predict. As a result, our actual outcomes and results could differ materially. You can learn more about these risks in our annual report on Form 10-K for the fiscal year ended April 30, 2016, and our other SEC filings. Liberty Tax undertakes no obligation to publicly update these risk factors or forward-looking statements.

This presentation also contains references to certain non-GAAP financial measures, which are metrics that we use internally to measure our operating performance. For a description of these non-GAAP financial measures, including the reasons management uses each and the reconciliations of these non-GAAP financial measures to the most directly comparable financial measures prepared in accordance with generally accepted accounting principles, please see the latest earnings release, which is also available under the Investor Relations section of our website.

I would now like to turn the call over to John Hewitt. John?

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

Thank you, Vanessa. Good morning, everyone, and thank you for joining us today. Before I begin, I would first like to express my sincerest appreciation to all the individuals that have been and continue to be part of the Liberty Tax brand. This tax season marks the 20th anniversary of Liberty Tax Service, serving customers throughout the U.S. and Canada. Over that time period, we have seen significant growth, which would not have been possible without the hard work of our dedicated and loyal franchisees and employees.

The assisted category maintained overall share this tax season. However, as has happened over the last several years, the brand players lost market share to independent tax preparers. It is obvious that the need and desire for paid tax preparation will continue to exist. The United States is not becoming a society of do-it-yourselfers. For many, filing your taxes is the single largest financial transaction of the year. The tax code is extremely complicated. And the peace of mind that paid tax preparation provides the consumer is invaluable. The risk of penalties, inaccurate payments and refunds and potential issues with the IRS will continue to drive individuals to paid tax preparers.

During the most recent 2017 tax season specifically, a new challenge arose, the PATH Act, bringing an uncertainty to the market that I've not seen in my career. Due to the confusion regarding the timing of when refunds were to be processed, consumers delayed their filing of returns. Historical filing patterns shifted later in the season for both Liberty and the market as a whole.

Although Liberty was able to gain back some of the year-over-year decline we reported at the end of the third quarter, we were not able to make up all of the shortfall. This fiscal year, Liberty processed 1.66 million returns in our U.S. stores, which represented a 9.6% decrease from the prior year. The decrease in return counts are in line with our overall reduction in U.S. store count of 9.5%, or roughly 400 locations.

The impact of last year's negative press had an impact on our new territory sales and, ultimately, office count this season. Although we remain confident in the Liberty brand, we believe new and existing franchisees were reluctant to acquire new territories and expand in fiscal 2017. The task force and the management team did an excellent job implementing new controls across the system. And we have worked to improve our relationship not only with our franchisees, but with regulators as well. In an ongoing effort to keep compliance at the forefront of our initiatives, we were honored to have Carol Campbell, Director of the IRS Return Preparers Office, speak at our national convention as recently as a few weeks ago, where approximately 2,000 franchisees and employees were in attendance. We have said and will continue to say there is no room in the Liberty system for individuals who do not meet our standards and follow the law. We look forward to upholding these values.

Another impact on our return counts was the underperformance of our company store operations. We operated [318] (corrected by company after the call) company stores in the United States this tax season as compared to 258 in the prior year. Although we operated more stores in this fiscal year, the total number of returns completed in our company stores declined. We underperformed in stores we took over from franchisees just last year as well as in stores we had owned for several years. These results are totally unacceptable. We made company store operations our priority going into this season and we simply did not deliver. This is something we need to change for next year and the future. There's no reason our company stores do not generate the same return counts and margins that our best franchisees do, and we will fix this problem. I've asked our new Chief Operating Officer, Ed Brunot, to focus on our company store operations. And we will work together to make sure that it's corrected. This is basic blocking and tackling, and we must and we will get better. We've already made personnel changes in this area. And we plan to implement improved processes, controls and measurement systems to ensure our company stores are successful.

In total, our average return per store was flat at 433 returns per store versus 434 last year. Within those figures, there are a few areas to address. Our franchisees did far better than our company-owned stores. On average, the number of returns processed in a company store increased 2%, while the average number of returns done in a company store declined over 20%.

Also on a positive note, we did have a strong year in Canada, where we grabbed market share with an overall return count of 8.8% positive.

Our fiscal 2017 total U.S. system-wide revenue was $386 million compared to $417.6 million in the prior year. From a pricing perspective, we had an increase in fees of 2.2%.

Stepping back and evaluating the market, we have seen a number of changes. Calendar year through April 28, the IRS reported that tax professionals processed 57.7% of all e-filed returns. Over the past 15 years, this figure has consistently been roughly 60%. While the reported figures may seem to have declined, we believe the emergence of shadow or ghost preparers are a source of the small shift in market share. The landscape has changed and we believe individuals who have historically filed tax returns as a paid tax preparer are now using DIY software and filing as self-prepared, thereby passing the regulations put in place to stop things like identity theft and fraud. For example, one of the requirements of a paid tax preparer is to retain copies of backup documentation for individuals who are claiming certain types of credits, one being earned income tax credit. An unscrupulous shadow or ghost preparer may not keep this documentation because they're not signing the return as a paid preparer.

The new challenge, which began once the new administration took office in January, is a reduction in the number of Hispanic filers or filers with ITINs. An ITIN is required for individuals to file taxes if they do not have or are unable to obtain a Social Security number. Although the amount of returns we process with ITINs is not significant in total, we have seen a decrease of roughly 20% in the volume of these filings.

In addition, through market checks within our offices, we have anecdotal information which suggest that Hispanics who have filed with Liberty in the past were choosing not to file in 2017, out of fear of any potential new immigration enforcement.

From a market perspective, we believe shadow tax preparation and immigration, which are current headwinds, will eventually become tailwinds for paid tax preparers. Leveling the playing field between DIY and paid tax preparers by requiring the same document retention criteria for each. It also a priority to combat things like tax fraud and identity theft. And we believe immigration reform will happen. It is only a question of when.

Even though we believe governmental regulations will create future tailwinds, Liberty is not waiting for these things to bear fruit in order to position our brand and develop our strategies to grow market share. There are a number of steps we've already taken and others are in development. While I won't speak about each one, I would like to touch on a few.

First, we remain the only nationally branded Hispanic taxpayer with SiempreTax+. We continue to take strides in this area and are looking to continue to build upon the successes we have had. The opportunity that we have by being the first national brand focused on this growing population in the United States is immense. Each year since its inception, we have continued to gain better understanding of how to best serve the needs of the SiempreTax+ customer and we will continue to build upon the knowledge to perfect the brand.

Another opportunity is the newest member of our Liberty family, 360 Accounting. In 2016 we launched the brand, and expanded it again in 2017. 360 accounting is a higher-end tax payroll and accounting concept, where we can serve the needs of individuals with more complicated tax situations as well as businesses needing CPA, Enrolled Agent and other various accounting services. While still in its infancy, we have begun to see traction and significant interest among our franchisee base in either opening or acquiring a 360 accounting store.

Next, we have recently signed 2 national marketing partnerships, which we are very excited about. One of those is a sponsorship with NASCAR. Liberty will be sponsoring 4 race events this coming season and will have access to promote our brand alongside many other distinguished brands in the space. NASCAR fans are extremely loyal and passionate group, and we are thrilled to be part of this sport.

The second partnership involves the NFL Alumni Association. The Alumni Association is a nonprofit organization consisting of retired players, coaches and their families with the goal of enriching the lives of their members. We're looking forward to a partnership with the NFL Alumni Association, whose reach spans the entire United States. Liberty will be providing free tax preparation to its members in participating locations. Similar to Liberty, the Alumni Association contributes to many charities and fundraising efforts, which makes this partnership a win for both organizations as well as the communities in which they serve.

Lastly, I'd like to formally introduce Ed Brunot, Liberty Tax's new Chief Operating Officer. Ed joins Liberty after moving from a distinguished career in the military to the executive ranks of high-growth retail organizations. Ed will be responsible for the operations of the organization, while I turn my focus to continuing to mentor the franchisee base and growing the brands. Ed has had great success at managing similar businesses in much larger organizations. We look forward to utilizing his skill set to further enhance our franchise and company store operations. The most impactful short-term opportunity we have is to improve our company store operations. And we are turning our focus and attention toward that effort. As I stated, we are not at all satisfied with our 2017 financial or operational results, but remain confident in the market opportunity and the steps that we are taking to grow the brand.

Now I'd like to turn the call over to our new COO, Ed Brunot. Ed?

Edward L. Brunot - *Liberty Tax, Inc. - COO*

Thank you, John, and good morning, everyone. I'd like to start off by thanking John and the Board of Directors for giving me the opportunity to join this great company. I'm excited to be here and believe that we will be able to do great things together. John and I have remained in contact since first meeting 14 months ago, discussing support for Honor and Remember and their Gold Star family events. Since that time, I've spent time evaluating the business. And what I have observed is an industry that is recession-proof and continues to steadily grow year after year. In addition, the highly fragmented paid preparers segment affords significant opportunities to continue to grow this business, both organically and through consolidation.

In addition to the market opportunity, there are many parallels with my prior experiences. I've spent my entire career in the service industry, most recently with a Fortune 500 company which operated over 150 company-owned stores, serviced over 1,800 independent stores throughout the country and supplied the military resale system across the United States and Europe. I've grown to understand that the success of your customer is the only way to drive growth and organizational success. In my last role as President of the military division, we were able to grow sales in excess of $2 billion through well-established processes and procedures, operational excellence and superior customer service. I look forward to sharing what I've learned throughout my career with the franchisees and employees of the company and am looking forward to learning from the knowledge that exists in Liberty today. My goal will be to work with John to position Liberty to deliver consistent growth, market share gains, operational excellence and outstanding financial performance over the long term. I know there are areas where we can do a better job, and I'm going to work quickly to identify and prioritize those areas.

In closing, I was able to meet and talk with many of our outstanding franchisees at Liberty's annual convention a couple of weeks ago. I'm looking forward to working with them to ensure that they are loving their Liberty experience and receiving all the support necessary to grow their business and become entrepreneurs. This is a great brand with a great mission, and I could not be more excited to be here. As we say in the Army, HUA!

Now I'd like to turn the call over to our CFO, Kathy Donovan. Kathy?

Kathleen E. Donovan - *Liberty Tax, Inc. - CFO and VP*

Thanks, Ed. I'd like to start by quickly welcoming you to the company. As you said, we have a lot of work to do and it's great to have you here as part of the team.

Good morning, everyone. As John described earlier, we did not deliver the results we wanted or expected this season. For the full fiscal year, revenue was essentially flat at $174 million. We reported GAAP earnings per share of $0.94 and non-GAAP earnings per share of $1.15.

Starting with revenue first. We saw increases in financial product revenue and assisted tax preparation fees, offset by reductions in royalties, franchise fees and area developer fees. Despite a decline in overall return counts, financial product revenue grew 14% for the year to $51.8 million. This reflects the impact of the Refund Advance product as well as improved pricing on our Refund Transfers. As a result of lower overall tax return volume, the actual number of funded refund transfers declined to 789,000 this year compared to 901,000 last year. The full-year attachment rate also declined slightly from 49.2% to 47.6%, primarily because the majority of the decline in the overall return count happened early in the season when the RT product is the most popular.

Assisted tax preparation fees were also up 37% for the year, reflecting the increased number of company-operated stores. While company store revenue increased, it was not where it should have been based on the number, age and prior performance of the stores we were operating. As John said, we were disappointed with the performance of the stores. We did not attract enough clients into the offices, and we will address that issue aggressively this off-season as we develop our plans for next year.

Offsetting this revenue growth were declines in franchise fees and area developer fees. The decline in franchise fees was due to both reduced payments on previous sales along with fewer new territory sales during the off-season. Area developer fees will continue to trend down as we have sold fewer new areas recently. And revenue from some of the earlier agreements has now been fully recognized over their 10-year life.

Finally, royalty and advertising fees were down 8%. A 9.6% reduction in U.S. return counts was offset by a 2.2% increase in average net fee. In addition, the mix shift in favor of more company-operated stores increased assisted tax prep fees, while reducing royalties.

Turning to expenses. The increase in operating expense was primarily due to higher cost for the expanded Refund Advance product, which is offered to our franchisees at the same cost we pay to our banking partners, along with higher salaries and other costs related to the increased number of company-owned stores. We also recorded higher bad debt expense this year, as write-offs for terminated franchisees increased.

And finally, depreciation and amortization expense was also up. The underperformance of our company stores required us to reduce the value of those assets on our books, resulting in a $3 million impairment charge.

In addition, after the season ended, we chose to close a group of poorly performing stores, resulting in an additional $1.9 million noncash charge.

Offsetting these increases were declines in advertising and area developer expense. The declines in both were driven by the lower royalty and advertising revenue as well as other cost saving initiatives. We took a much more targeted approach in our new franchise advertising this past year and repurchased several areas from area developers who chose to leave the system.

Reported operating expense for the year includes $1.2 million of compliance task force and related expenses. In addition, we recorded a $2.7 million expense in Q4 related to the initial judgment in a lawsuit with a former franchisee who we exited from our system last year. We will appeal the judgment in that case. And while litigation is always unpredictable, we believe we have very strong grounds for reversal.

Our effective tax rate for the year was 37.3%. In the future, excluding the impact of any corporate tax changes that may be implemented, we expect our year-end tax rate would be between 37.5% and 38%. Just as a reminder, we generate over 90% of our profit in the U.S., so any significant reduction in overall corporate tax rates would have a meaningful impact on our earnings.

Now let's take a quick look at the balance sheet and cash flow. Our balance sheet remains solid. We delivered $32 million in cash from operations and ended the year with $16 million of cash on hand. As of tomorrow, we will have met our annual requirement to have no borrowings outstanding under our revolving credit facility for 45 consecutive days during each fiscal year.

Finally, as John and Ed have both said, we believe many of the challenges we faced last season are behind us. We are completing a comprehensive review of our cost structure and all aspects of our operations. And we are committed to driving consistent growth in revenue, market share and earnings per share. We are also committed to delivering value to our shareholders. And as such, the board has approved our 10th consecutive quarterly dividend of $0.16 per share, which will be paid on July 28 to shareholders of record on July 14.

With that, we'd now be happy to take your questions. Lashonda?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Lee Jagoda with CJS Securities.

Robert S. Majek - *CJS Securities, Inc. - Research Analyst*

This is actually Robert Majek on for Lee this morning. What is the number of company locations exiting this season versus the 318 U.S. locations you operated during the season?

Edward L. Brunot - *Liberty Tax, Inc. - COO*

Yes, Robert. This is Ed Brunot. Approximately 260.

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

We -- we'll have about 260, which means an exiting of about 50 locations.

Robert S. Majek - *CJS Securities, Inc. - Research Analyst*

Got it. And this question is for Ed. Knowing you're new to the [seat] thus far, what plans have you come up with to fix the underperforming company-owned locations?

Edward L. Brunot - *Liberty Tax, Inc. - COO*

Yes, Robert. I would say, as John stated in his prepared remarks, our performance with company stores is obviously completely unacceptable. And I would say that being fairly new to the organization, I think the best way for me to answer the question is to say that I've spent my career in companies with much, much lower gross margins and really focusing on expense control, execution and delivery in a differentiated customer experience. And so I'm very happy with the engagement of the team. As John said, we've made some changes in the leadership of that organization. I'm thrilled that they're coming to the table engaged and ready to prepare during this planning season for the upcoming year. And so I'll be intimately involved in that process and look forward to speaking the next time around on some of the things we've specifically done to improve performance.

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

And Robert, we're excited because this is right up -- this is right in Ed's sweet spot. He's run multibillion dollar companies. And this is only $15 million or $20 million of revenues. So it's -- he's only been here almost 2 weeks tomorrow. And I'm working with him closely to make sure that this is done well. And he's by far the best person we've ever hired that can handle this situation.

Robert S. Majek - *CJS Securities, Inc. - Research Analyst*

That's helpful. And then you had touched a little bit on my next question, but at this stage in the new tax season what, if anything, can you tell us about plans for next year and the expectation for growth?

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

Well, as I said, the easiest low-hanging fruit is to turn around the company stores. We took a big hit this year. We are looking to improve it. And the person that we hired, we actually had a significant decrease, so we're going to change that and get -- even if we just got back to where we were last year, it would be a significant improvement. So that is the #1 low-hanging fruit. We're also doing a number of other things. As we said, we're growing our 360 brand, our Siempre+ brand. We're also increasing franchise sales. We expect more expansions. We're spending more money in advertising, on franchising. The headwinds of the compliance issues we had 1.5 years ago are gone. And we feel a very high interest in the market for expanding. We're coming up with some offers; for example, of the hundreds of thousands of independent insurance agents in the country, they'll be able to add a Liberty or a Siempre location to their portfolio for under a $10,000 investment as a trial. So we're doing a number of things to get the growth of offices back on track that has been hurt over the last 6 or 7 years. The -- as we talked about before over the last 7 years, the branded players have had decreases. H&R Block is down over 20% in those 7 years. Jackson Hewitt is down over 30% and Liberty just has a small increase. So we're looking forward to changing that and working in the new paradigm to grow this business.

Operator

Our next question comes from the line of Alex Paris with Barrington Research.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research, Senior MD and Education & Business Services Analyst*

Just wanted to say welcome aboard, Ed. Look forward to working with you.

Edward L. Brunot - *Liberty Tax, Inc. - COO*

Thank you very much, Alex. I appreciate that.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research, Senior MD and Education & Business Services Analyst*

Okay. So I have a number of questions. Just want to get a better feel for franchise selling, franchise terminations. Can you give us a gross number for each this year? I know that you had a reduction in the U.S. of 103 franchisees, right? So you sold a few, you closed a few. Do you share that information?

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

We haven't, Alex. We'll talk about it and see if we can give you some more clarity into that. The number we typically publish is the net number.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research, Senior MD and Education & Business Services Analyst*

Okay, fine. Can you answer this, then? Typically, you cull about 10%, if I recall correctly, of the franchisees per year, either they sell, select out or you select them to be out. Has that changed at all in recent years, including this last year?

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

It -- obviously, with the compliance issues we had last year was an unusual year, and so we expect that to go back to typical norms going forward.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research, Senior MD and Education & Business Services Analyst*

Okay. That was fiscal '16, though. In fiscal '17, was it above that usual 10% as well?

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

Yes, yes.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research, Senior MD and Education & Business Services Analyst*

Okay. And then I noticed that while you had 103 fewer franchisees, you have 462 fewer franchise offices in the U.S. So that means the franchisees that are gone on average had 4.6 stores, while the average franchisee has about 2 stores. So how does that come about? Were they -- obviously, the franchisees that got into trouble had multiple locations. Is there any other explanation?

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

Well, that's part of the explanation. And also, it's a result of some of our existing franchises that are still in the system having closed more offices than they opened. Each year, they have to make decisions whether they're going to add a location or -- even if it's a seasonal location, like a Walmart or a Kmart or a Sears or one of those opportunities. So it's a combination of 2 things. The franchises that exited the system were some of our largest. And they had more than 4.6 offices per franchise. But also it's -- it was a reaction in the entire franchise base to the compliance issues that we had. And we feel those are well behind us. We feel our relationship with the IRS and the states is at a record high. And we feel the mood in the franchise system is strong, and those are not a concern at -- in June of 2017.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research, Senior MD and Education & Business Services Analyst*

Got you. Also obviously, your goal is to have more franchisees and more stores per franchisee going forward. That was the goal for this year. I'm sure you're going to redouble your efforts to do just that. Are there any macro reasons to be encouraged? I know in the past, one of the sources of capital for a new franchisee was a home equity loan and that was constrained for a few years. Is the financial wherewithal of potential franchisees improving for any macro reason?

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

Well, there's -- the financing is certainly better than it was 24 or 36 months ago. It was the worst I've ever seen it after the Great Recession in 2008 and 2009. It's -- it has constantly gotten a little bit better. There are tailwinds waiting to happen that we've been talking about for a long time. For example, one of the proposals in the Trump budget is that all preparers will be required to be certified. That will be big for us. We've been looking for that for 7 or 8 years, hasn't happened yet, but it looks like it's going to happen. A lower tax rate, lower regulations should drive more people to self -- being self-employed. People that are self-employed will typically use an assisted preparer more often than people that are employed. So that's good for our business. The lower regulations, lower taxes will help the return on investment for our franchisees. That's good for business. Immigration reform, we have -- one of our employees is a member of Trump's evangelical committee. And so we believe that there's going to be substantial immigration reform. All of these are tailwinds waiting to happen. We've been waiting for them to happen for years now. So we're not waiting on that. We're looking at the new paradigm and saying, "You know what? There's -- Liberty is going to grow this year." We are investing in that and the mood is -- supports that. We're going to grow our Siempre brand. And we're going to grow our new 360 accounting, which is for individuals that make hundreds of thousands of dollars and -- in low- to medium-sized businesses. So yes, we see a lot of good things happening and -- but we're not going to wait until that happens to make these changes.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research, Senior MD and Education & Business Services Analyst*

I appreciate that. SiempreTax, did you grow stores this year versus last year?

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

Yes. Modestly, we did, yes.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research, Senior MD and Education & Business Services Analyst*

And what was that store count at the end of '17, Siempre?

Kathleen E. Donovan - *Liberty Tax, Inc. - CFO and VP*

154. It was 154.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research, Senior MD and Education & Business Services Analyst*

And then what metrics should I use for 360 accounting? Is it a store thing? X number of stores this year?

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

One metric you can use is, I think H&R Block -- it's a direct competitor of H&R Block Advisors. And they have -- at last count, I remember they have 400 or 500 of them. And they're much more -- they have much more revenue per office because they're a year-round business, including bookkeeping and other services.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research, Senior MD and Education & Business Services Analyst*

And how many 360 accounting stores does Liberty Tax have today?

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

We -- the first year -- 2 years ago, we were very quiet about it. We had just 2. Last year, we expanded that to 8. And we expect that to be growing exponentially, although we're not going to add hundreds of them. But there was -- at a recent convention with over 2,000 franchisees and employees last week, there was a very large interest in adding those across the country.

Alexander Peter Paris - *Barrington Research Associates, Inc., Research Division - Director of Research, Senior MD and Education & Business Services Analyst*

Great. And then, I guess, the last question I have is -- so you have 260 store-owned -- company-owned stores today. You closed roughly 50 locations. I'm curious about the cluster strategy. Were clusters among the 50? And how did clusters perform, generally speaking, relative to non-clusters?

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

The clusters were typically second-year locations and we have been able the previous year to sell most of those to existing franchisees. But their return performance was typically better than the other company stores because they were much newer. And second-year stores do a lot better than 50-year stores in terms of growth.

Operator

Our next question comes from the line of Michael Millman with Millman Research Associates.

Michael Millman - *Millman Research Associates - Founder*

So following up, John, on what we're talking about, chains typically underperforming. Other than certification, what do you see turning that around?

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

Well, there's a couple of things that are going to be impactful. The -- already in the first -- in May of this year, we've seen an increase in returns. We've -- in -- we've had good increases in returns at our offices. We've seen the ITIN filers start coming in. As the Hispanic or the undocumented workers become more comfortable in the new -- with the new Trump administration, we expect immigration reform and more comfort that they have -- that they're not going to be rounded up and deported and that they can come in and file their tax returns. So that's going to be good. And the -- also, we're looking forward to a couple of things the IRS can do to -- that's going to be impactful. One is, right now, preparers -- assisted preparers are required to keep extra documentation that the consumer doesn't have to keep when they file a return. or a shadow preparer or an unscrupulous competitor doesn't have to keep if they don't follow the law. We expect the IRS to add those documents to the tax return itself. And when that's required, it'll make a more even playing field. Also the shadow preparers are preparing millions of returns and the IRS now requires that they use -- that we send the IP address with the tax returns. So it's pretty obvious if more than 5 or 10 or some number of tax returns are being sent from the same computer and they're not putting themselves as a paid preparer, then that's probably a shadow or a ghost preparer. So if the IRS can make that [tine] , including the certification requirement, documentation to be included with the return, going after those shadow preparers that have the same IP address, all of that's going to be good for us as an industry.

Michael Millman - *Millman Research Associates - Founder*

So the IP address I thought was required this year, this past....

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

Yes, it's just been required for the last year. And that -- they haven't used it for any purpose yet. So hopefully, they're going to take that information now and go after those likely paid preparers that aren't reporting themselves as paid preparers.

Michael Millman - *Millman Research Associates - Founder*

Okay. This -- at the beginning of this -- the first half of this year, Block was very aggressive, as you well know, and as a result had reported an increase in EITC returns, an increase in returning filers and, of course, free EZs. To what extent did you see these things affecting you? And do you think that that will continue?

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

No. H&R Block has not been a major impact on the numbers in our offices. It's our own execution that -- when we fail, we fail to execute. And it's not H&R Block. And after all, H&R Block is only about 13% or 14% of the industry. So the major -- our major competitors are the mom and pops -- the 100,000 mom and pops that are doing 5 -- 4 or 5x as many returns as Block in each of our neighborhoods.

Operator

I'll now turn today's call back over to John Hewitt for closing remarks.

John T. Hewitt - *Liberty Tax, Inc. - Founder, Chairman, CEO and President*

Thank you, everyone, for their attention. And as always, our -- we're only going to be successful with happy and successful franchisees and employees, and I thank all of you. Have a great day.

Operator

This concludes today's conference call. You may now disconnect your lines.