

THOMSON REUTERS STREETEVENETS

EDITED TRANSCRIPT

TAX - Q1 2017 Liberty Tax Inc Earnings Call

EVENT DATE/TIME: SEPTEMBER 02, 2016 / 12:30PM GMT



SEPTEMBER 02, 2016 / 12:30PM, TAX - Q1 2017 Liberty Tax Inc Earnings Call

CORPORATE PARTICIPANTS

Vanessa Szajnoga *Liberty Tax, Inc. - VP Legal*

John Hewitt *Liberty Tax, Inc. - Founder, Chairman & CEO*

Kathy Donovan *Liberty Tax, Inc. - VP & CFO*

CONFERENCE CALL PARTICIPANTS

Alex Paris *Barrington Research - Analyst*

Lee Jagoda *CJS Securities - Analyst*

Michael Millman *Millman Research Associates - Analyst*

PRESENTATION

Operator

Good morning, my name is Andrea and I will be a conference operator today. At this time I would like to welcome everyone to the Liberty Tax, Inc. first-quarter fiscal 2017 earnings call. (Operator Instructions). I would like to now turn the call over to your host, Miss Vanessa Szajnoga, you may begin.

Vanessa Szajnoga - *Liberty Tax, Inc. - VP Legal*

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

The press release announcing our first-quarter 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 would 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 Hewitt - *Liberty Tax, Inc. - Founder, Chairman & CEO*

Thank you, Vanessa. Good morning, everyone, and thank you for joining us on our first-quarter call. As many of you know, our business is highly seasonal and the first quarter only represents a very small portion of our total annual revenue. Therefore, I will spend my time today discussing how the entire Liberty team is preparing for the upcoming tax season, as well as any market factors affecting the industry.



SEPTEMBER 02, 2016 / 12:30PM, TAX - Q1 2017 Liberty Tax Inc Earnings Call

As we have stated on previous calls, we are committed to growing both revenue and profit as well as distributing cash to our shareholders in the form of quarterly dividends. In order to do so we must first have a successful planting season in which we train and develop our franchisees to be the best in our industry, as well as work to attract and retain top tier talent in both the franchisee and the area developer base.

We continue to remain bullish on our SiempreTax+ brand. We operated 144 locations last tax season and look to continue to improve that figure for years to come in territories with high Hispanic populations.

As you know, SiempreTax+ is a full year business compared to our traditionally more seasonal Liberty business. Therefore we look forward to increasing the number of additional plus services available to better serve the community and our customers as we grow this business.

One such service, which you may have recently read about, is the offer to provide free ITIN renewal assistance. ITINs are required for individuals who are in eligible for a Social Security number to meet their US tax obligations. Offering this service is one way in which we can provide additional year-round support to our customers and establish a strong brand name in the quickly growing Hispanic community.

In addition, we have continued to expand our training programs across the country. This year we have dubbed our newest version [Megatraining]. This is a robust multi-day offering which brings together various best practice marketing and training techniques which we have developed and expanded over the years.

The training includes our very successful guerilla marketing training which was launched last year to great success, as well as supplementary tax and compliance training. We have already completed a few in the forward to seeing many of our franchisees and area developers at the remaining scheduled events in the coming months.

In fiscal 2016 we operated more than 250 Company stores, more than doubling the prior year. Existing and prospective franchisees have the option to purchase these turnkey locations, which we have primarily established in very attractive markets. These locations provide a hassle free avenue for many prospective and existing franchisees since the store's footing is already in place.

In addition to that fiscal 2016 inventory, we have also been aggressively acquiring many attractive territories in key cities throughout the country at prices below market value. We look forward to increasing our operating profit through the successful management of these stores while they are under our leadership and ultimately getting these locations into the hands of qualified franchisees.

Lastly, as we mentioned on our yearend call, we have continued to intensify our compliance efforts and are committed to a full review in association with the external consultants to ensure all of our franchisees, area developers and employees are held to the highest standards.

Providing a safe and secure customer experience for each person that visits one of our stores is of utmost importance to us. That being said, our executive compliance tax force has done a remarkable job of quickly analyzing, reviewing and evaluating any activity which does not meet these standards.

Shifting gears to the industry, our long-term view of the ACA remains unchanged. It is one of the largest single changes to our tax code in memory. And the further increase of penalties to \$695 or 2.5% of income will start to drive traffic to paid preparers.

Although long-term views are unchanged, we believe in the short-term ACA will continue to have a smaller impact than originally expected until the IRS begins to increase its compliance enforcement.

The other most significant impact to the industry next season will be the PATH Act. Taxpayers who are full-time will file their refunds -- I'm sorry, will file their taxes with refundable credits, including earned income tax credits and refundable education credits, will need to wait until February 15 to receive their refund. This will affect over 10 million of early season tax filers. We feel this will benefit the pay to prepare market who have additional products to offer the consumer.



SEPTEMBER 02, 2016 / 12:30PM, TAX - Q1 2017 Liberty Tax Inc Earnings Call

We are just hitting our stride in the sale season with many events scheduled around the country. We are excited to implement all of our new initiatives over the coming months and look forward to a successful tax season. Our long-term profitability and growth opportunities remain strong and the Company is well-positioned to outperform both the market and our major competition.

Now I would like to turn the call over to our CFO, Kathy Donovan, to take you through the details of our first-quarter results.

Kathy Donovan - *Liberty Tax, Inc. - VP & CFO*

Thanks, John. Good morning, everyone. This quarter we have been focused on off-season training for our franchisees and enhancing compliance processes as we prepare for next season. Our revenue is seasonally low and is not indicative of full-year performance. That said, during the quarter we generated revenue of \$7.1 million compared to \$7.5 million last year.

The majority of this small decline was in area developer fees where, as many of you know, revenue from some of our early AD sales has now been fully recognized over the 10-year life of those agreements.

In addition to that we also saw a reduction in franchise fees for the quarter. This year we've made a slight change in the way we approach the franchise selling season. Based on historical franchise buying and selling patterns, we delayed a portion of our advertising spend from the June/July timeframe to August and September.

We believe this will better align the timing of conversations with potential new franchisees or prospects with the time of year they are most likely to close on the purchase of a new tax franchise. Closing out revenue, interest income increased \$700,000 driven by higher receivable and loan balances.

On the expense side reported operating expenses increased \$1 million mainly due to task force expenses and separation costs for a former executive. Excluding those costs expenses declined slightly to \$20.8 million.

A \$700,000 reduction in advertising costs was offset by increased employee compensation and benefits coming from both the increased number of Company stores coming into the year and the takeover of several other large franchisee stores this off-season.

As a result of the items just mentioned our first-quarter net loss increased on both a reported and adjusted basis. Our quarter one reported net loss was \$9.4 million compared to \$8.5 million last year. And our reported loss per share was \$0.73 compared to \$0.67. On a non-GAAP basis our net loss was \$8.5 million and our non-GAAP loss per share was \$0.66, just slightly more than last year.

Now let's take a look at the balance sheet and cash flow. As expected, we began to draw on our revolver in June. We generally plan to draw on the revolver from June or July through January each year and then pay it back completely by the end of April as we receive funding from the IRS.

We used more cash for operating this year primarily as a result of higher cash tax payments and other yearend expenses along with prepayments which will mostly be recovered during the season. The remainder of the increase was due to higher Company store salaries and slightly lower franchise sales.

We continue to plan for the PATH Act and any potential impact it may have on taxpayer filing patterns in the coming year. We appreciate the support of our banking partners who worked with us to amend our third-quarter covenants to accommodate a possible shift in filers out of the third quarter and into the fourth quarter.

We don't yet know what impact the delay in refunds that John just described will have on actual taxpayer behavior, but we believe we are well positioned for the season.



SEPTEMBER 02, 2016 / 12:30PM, TAX - Q1 2017 Liberty Tax Inc Earnings Call

Finally, our Board has authorized us to issue our seventh quarterly dividend of \$0.16 per share which will be paid on October 24 to shareholders of record on the close of business on October 14. We believe this quarterly dividend shows our continued commitment to enhancing shareholder value and our confidence in future performance and long-term cash flow.

And with that we would now like to turn the call over to Andrea so we can take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Alex Paris, Barrington Research.

Alex Paris - Barrington Research - Analyst

A couple of questions for you -- in this off-season. So, the executive compliance task force charges ran about \$640,000 in the quarter. Will they be running at this level for the balance of the year or is this really just an off-season sort of expense maybe Q1 and Q2?

Kathy Donovan - Liberty Tax, Inc. - VP & CFO

It is still too early to tell at this point, Alex. We are having lots of conversations with the regulators. We are investing in expanding our staff and improving our tools, so it is difficult to give -- and I know this makes it difficult for you to model, but I probably wouldn't expect it to decline for the rest of this year.

Alex Paris - Barrington Research - Analyst

Okay, that helps and those are important investments obviously. I do model on a non-GAAP basis anyway, but that is real cash at the end of the day. How much of the \$640,000 is due to -- how much of the outside \$640,000 is due to outside consultants and how much is due to like additions to staff and things like that (multiple speakers)?

Kathy Donovan - Liberty Tax, Inc. - VP & CFO

Now that is all outside consultants. We are not including any of our internal costs in that and we actually added at the very back of the press release a description of each of the items that we are identifying. And it is really only for outside experts that we are working with.

Alex Paris - Barrington Research - Analyst

Okay, good, that makes sense. Moving on I think, John, you said you had 250 Company stores last year, which is a double over the year ago and kind of a change in the way you are doing to create these clusters to create these turnkeys to be sold.

I know you are probably not going to say anything about how many have been sold year to date or what your expectations are in that regard. But do you expect to finish the year with more Company stores than you started the year with, kind of continuing the trend that began last year?

SEPTEMBER 02, 2016 / 12:30PM, TAX - Q1 2017 Liberty Tax Inc Earnings Call

John Hewitt - Liberty Tax, Inc. - Founder, Chairman & CEO

We do, Alex. We think it is a real opportunity that, if you look at H&R Block for example, they have -- their company stores have profits of hundreds of millions of dollars. And we have been focused on franchising and have not taken advantage of that at this point. So that is something that we are -- a direction change for us.

Alex Paris - Barrington Research - Analyst

Okay. H&R Block is 60% Company owned, 40% franchised. Do you expect -- not necessarily to get to 60%, but do you expect to get to a much bigger number and stay there over time?

John Hewitt - Liberty Tax, Inc. - Founder, Chairman & CEO

I think that our vision of the future, at least in the next three to five years, is having a higher percentage of Company stores. I am not sure what that will look in 10 or 15 years from now, but that is an opportunity that -- both Jackson Hewitt and Block have, as I said, hundreds of millions of dollars of profit from company stores. And we have been focused on franchising and growing the chain. Now it is an opportunity to bring more of the profits to the Company as franchisees are leaving through accretion.

Alex Paris - Barrington Research - Analyst

Got you -- rather than just earning a royalty fee on a franchise store?

John Hewitt - Liberty Tax, Inc. - Founder, Chairman & CEO

Exactly.

Alex Paris - Barrington Research - Analyst

So, on that point, you spent \$7.6 million in the quarter acquiring assets from existing and former franchisees. Anything noteworthy there? Is that a bigger number than usual? There is always that attrition, you are always -- the [Jack Welch] method, getting rid of underperforming or unsuccessful franchisees and granting new franchises. Anything unusual in that number?

John Hewitt - Liberty Tax, Inc. - Founder, Chairman & CEO

Based on the events of this tax season it was an unusual opportunity to acquire offices at a -- below market prices.

Kathy Donovan - Liberty Tax, Inc. - VP & CFO

So it has been part of our task force initiatives, Alex. And we are -- they are immediately available. If we can find strong buyers that we know are going to operate them the right way. But as John said, we have been able to negotiate very favorable pricing and the payments for those stores are being spread out over several seasons. So it has been a great opportunity for us this off-season.



SEPTEMBER 02, 2016 / 12:30PM, TAX - Q1 2017 Liberty Tax Inc Earnings Call

Alex Paris - *Barrington Research - Analyst*

Great. And then to that point -- and this will be my last question, I will get back in the queue. The prices paid -- can you give us some sort of idea on what you typically pay or how you value these franchises? I know it will be different depending on the performance of that franchise, but is it a multiple of revenue, is a multiple of EBITDA? And how much cheaper were these that you made this time?

John Hewitt - *Liberty Tax, Inc. - Founder, Chairman & CEO*

Well, I can't say how much cheaper they are, but we typically value them at a multiple of cash flow. And if I told you the exact formula, not only would I give competitive information out but I would hurt myself in my negotiations in any future purchases.

Alex Paris - *Barrington Research - Analyst*

Okay, fair enough.

Kathy Donovan - *Liberty Tax, Inc. - VP & CFO*

But we have been conscious of the cash flow, we are spreading it over several years and they have been attractive.

Alex Paris - *Barrington Research - Analyst*

Okay, maybe I can sneak in one more and break my promise. But the -- H&R Block said on their call that -- they noted that there was an increase in the number of independent preparers in the market last tax season. That would explain to me why there was growth in the assisted category, yet the major national players had declines in volume.

Do you agree with that assessment, there is more independent players out there? If so, why? And lastly, what you are going to do about it?

John Hewitt - *Liberty Tax, Inc. - Founder, Chairman & CEO*

No, we don't agree with that. I think that was -- that number has not been published anywhere by the IRS or in any form. And anecdotally we did not see that, that -- any significant change in the percentage or the number of mom and pops.

Alex Paris - *Barrington Research - Analyst*

Okay, fair enough. I will get back in the queue. Thank you very much.

Operator

Lee Jagoda, CJS Securities.

Lee Jagoda - *CJS Securities - Analyst*

A couple things. One, I appreciate the candor around more Company owned stores going forward. Given you have always said franchise owners perform a whole lot better than company-owned stores, how does the shift to more Company owned stores change the culture and the dynamic that you have been trying to create through Liberty?



 SEPTEMBER 02, 2016 / 12:30PM, TAX - Q1 2017 Liberty Tax Inc Earnings Call

John Hewitt - Liberty Tax, Inc. - Founder, Chairman & CEO

I think that what we have learned in franchises is one thing they do far better than we have been able to do in Company owned stores is to grow them from scratch. So, if you are building a store towards maturity then the franchisees do a better job of that.

Once a store reaches a profitability of -- and typically the profit in this industry at maturity is about 30%. Once a store is yielding 30% profit then it is not a big impact to turn it over to a Company employee.

Lee Jagoda - CJS Securities - Analyst

Okay. And then I guess you are shifting gears towards that \$7.6 million of asset purchases. Can you give us sort of the breakdown of what the stores you bought look like? Meaning were they first year stores on average? Were they large -- a few large locations with a lot of cash flow? What was the general dynamic?

And further, if I look at the -- some of the negative press we saw about some of the locations that either had to shut or get put on hold during the tax season, how many of those were part of the \$7.6 million?

John Hewitt - Liberty Tax, Inc. - Founder, Chairman & CEO

Well, these are -- the stores that we acquired are primarily larger stores with high percentage of profit. And keep in mind that they are available for sale and we sell many of them to franchisees that are nearby. And the last question I can't answer for competitive reasons.

Lee Jagoda - CJS Securities - Analyst

Okay, I mean I am just trying to size -- broadly size the number of locations. I mean if I look at it on a multiple of what I would think cash flow per location on average would be, it would seem that you acquired upwards of 75 stores. Is that a good way to think about it?

Kathy Donovan - Liberty Tax, Inc. - VP & CFO

I think slightly less than that because they -- as John said, they were large stores, the majority of them.

Lee Jagoda - CJS Securities - Analyst

Okay, so slightly less than the 75.

Kathy Donovan - Liberty Tax, Inc. - VP & CFO

Yes.

Lee Jagoda - CJS Securities - Analyst

And then -- so, I guess the other question I would have is beyond the locations you bought back, can you discuss any trends or changes in trends in franchisee attrition or location closures versus prior tax seasons?



SEPTEMBER 02, 2016 / 12:30PM, TAX - Q1 2017 Liberty Tax Inc Earnings Call

John Hewitt - Liberty Tax, Inc. - Founder, Chairman & CEO

We can't at this point; it is very early in the season and we typically retain over 90% of our franchisees. That is averaged over the last five years. That is not going to be too much different. And, Lee, it takes place all the way from May until January. So, we haven't seen any major change in that number or percentage.

Lee Jagoda - CJS Securities - Analyst

Okay. And then the last one for me and I will hop back in queue. Others in the industry have sort of forecasted they think there will be a continued shift away from assisted into DIY. And although the industry growth rate is probably going to be the same in that 1% to 2%, it might be modestly slower on the assisted side. Do you have a view at this point in the tax season of what you think it might be?

John Hewitt - Liberty Tax, Inc. - Founder, Chairman & CEO

I think that we will continue to -- the assisted preparation has tended to grow over the last few years at almost 1%. I think that will be at least that level this year.

Lee Jagoda - CJS Securities - Analyst

Okay, thanks very much.

Operator

Scott Schneeberger, Oppenheimer.

Unidentified Participant

Hey, everyone, good morning, this is Greg on for Scott. Just thinking overall industry level, what do you expect the total industry volumes to grow in the upcoming season? And with PATH being implemented this season and the likelihood of increased refund and advanced loans, what do you expect -- what do you believe the growth will be in the DIY and assisted categories respectively?

John Hewitt - Liberty Tax, Inc. - Founder, Chairman & CEO

I think that for a change I agree with what the CEO of H&R Block said the other day and that is that we expect the paid preparation to grow by about 1% and the DIY to grow by about 4%.

Unidentified Participant

Okay, great, thank you. And one follow up if I may. How have discussions been with your bank partners in preparation for refund advanced loans in the upcoming tax season? Are there any interesting developments on that front?

John Hewitt - Liberty Tax, Inc. - Founder, Chairman & CEO

There are some interesting developments, but those are competitive and we are going to keep that quiet until December or January.

SEPTEMBER 02, 2016 / 12:30PM, TAX - Q1 2017 Liberty Tax Inc Earnings Call

Unidentified Participant

Okay, understood. Thank you for your time.

Operator

Michael Millman, Millman Research Associates.

Michael Millman - *Millman Research Associates - Analyst*

So, following up on some of the previous questions. Last year -- the last couple years [assisted] IRS have been up about half a point, yet the chains have been down, you almost 4% and Block almost 6% and Jackson Hewitt probably more than that. What do you think is the cause of the independents seemingly growing and the chains seemingly declining?

John Hewitt - *Liberty Tax, Inc. - Founder, Chairman & CEO*

Yes, of course the numbers you said were just last year, that was an unusual poor year for us and that was affected by a lot of our problems with regulations and the IRS. So that was unusual.

But what has happened, Michael, is that with the extensive regulations that the IRS is requiring preparers -- paid preparers now to keep more records and produce more records than do-it-yourself customers, there has been a shift away from the national players who have to abide by those rules to either mom-and-pops who don't abide by the rules or shadow preparers who don't even sign the return and then they are not required to keep any of that documentation.

And so, the major chains have to turn customers away who don't have satisfactory documentation. They go either to a less scrupulous mom-and-pop or they will go to one of those shadow preparers who is even less scrupulous because not only are they not keeping the records, they are not even declaring themselves as paid preparers.

So, until the regulations to monitor DIY equals assisted regulations, that is a concern. Although most of them have already gone to that -- to those preparers. So, we are not going to see a major shift away anymore because of that because that has already happened.

Michael Millman - *Millman Research Associates - Analyst*

So, the gray market, those show up I assume as do-it-yourself rather than as assisted you'd think --.

John Hewitt - *Liberty Tax, Inc. - Founder, Chairman & CEO*

That is exactly right. And I would say that number is a minimum of 5% if not -- and probably more like 10% of all filers.

Michael Millman - *Millman Research Associates - Analyst*

So that differential therefore between the chains and the independents is even more stark considering that some piece of those independents has ended up in a gray market.

John Hewitt - *Liberty Tax, Inc. - Founder, Chairman & CEO*

Exactly.

SEPTEMBER 02, 2016 / 12:30PM, TAX - Q1 2017 Liberty Tax Inc Earnings Call

Michael Millman - *Millman Research Associates - Analyst*

And do you see that changing in the next couple years?

John Hewitt - *Liberty Tax, Inc. - Founder, Chairman & CEO*

I do because the customers we have have already -- they have been weeded out. The people that don't have documentation have already been weeded out and are already in that -- they are either in that gray market or they are in the mom-and-pop market. So there shouldn't be a major change in that direction as has happened over the last two or three years.

Michael Millman - *Millman Research Associates - Analyst*

Okay, thanks, John.

Operator

There are no further questions at this time. Would you (Multiple speakers) closing remarks?

John Hewitt - *Liberty Tax, Inc. - Founder, Chairman & CEO*

Sure I do. And as always I want to thank our employees and our franchisees and our area developers because we are only going to be successful if we have happy, successful franchisees and employees. Thank you, everyone, and have a great day.

Operator

Thank you. Ladies and gentlemen, this does conclude today's conference. You may now disconnect.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2016, Thomson Reuters. All Rights Reserved.