

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

TAX - Q1 2016 Liberty Tax Inc Earnings Call

EVENT DATE/TIME: AUGUST 28, 2015 / 12:30PM GMT



CORPORATE PARTICIPANTS

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

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

Kathy Donovan *Liberty Tax, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Joe Janssen *Barrington Research - Analyst*

Alex Paris *Barrington Research - Analyst*

Lee Jagoda *CJS Securities - Analyst*

Scott Schneeberger *Oppenheimer & Co. - Analyst*

PRESENTATION

Operator

Good morning. My name is Darla and I will be your conference operator today. At this time I would like to welcome everyone to the Liberty Tax, Inc. first-quarter fiscal year 2016 earnings call. (Operator Instructions). Thank you. I would now like to turn the conference over to Vanessa Szajnoga. Please go ahead.

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

Thank you, operator. 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'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, 2015 and our other SEC filings.

Liberty Tax undertakes no obligation to publicly update these risk factors or forward-looking statements. I would now like to turn the call over to John Hewitt. John.

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

Thank you, Vanessa, and good morning, everyone. I plan to use most of my time today to tell you about the progress we are making in our preparations for next tax season.

I am pleased with our sales efforts thus far. The progress we are making to expand our office count and our ability to engage closely with franchisees and area developers to improve return count in existing offices.



This planting season has shown that the Liberty brand remains an attractive entrepreneurial option for many individuals. Compared to last year our seminar visitors are up 48% year-over-year and total franchisee applications are up 27% over that same timeframe. Additionally, our sales team has successfully closed 23% more territory sales than last year. The height of our sales season typically doesn't happen until the Fall, so these strong early numbers are a positive sign leading into the peak season.

New programs and opportunities are also being made available to existing franchisees to maximize the performance of existing stores. We launched a new Guerilla Marketing hands-on-training that teaches franchisees how to use proven Guerilla Marketing techniques to drive success in their market. The training focuses on hands-on-training where they get the opportunity to practice these techniques in a live environment with real customers and local businesses. Interest remains high and over 300 franchisees have attended the training as of August 29. We will also be launching a new SiempreTax Guerilla Marketing interactive training in October which will focus on these same techniques, but will be tailored towards proven marketing strategies in the Hispanic community.

A trend we have seen emerging over the last few years is the desire of some new and existing franchises to grow by acquiring other existing locations rather than starting new stores from scratch. We are running several pilot programs this year to try and expand that demand.

First, we have launched our A+ office program for area developers looking to open and sell new territories in their areas. The A+ program encourages area developers to identify ideal or A+ locations in currently unopened territories in their area. The AD then secures the lease, sets up the office and sells the established location to a franchisee. From a franchisee perspective these A+ stores offer a smooth transition into a new territory where they can focus on rapidly building up their customer base and successfully implementing our marketing techniques.

We are also planning to meet franchisee demand for turnkey offices by opening about 100 Company store locations this year. We will be selecting several cities in which to open clusters of 5 to 10 locations per market initially as Company stores. Once established, the stores will be made available to new and existing franchisees to purchase. We already received interest from existing franchisees in purchasing some of these clusters once we get them up and running. We believe it is important to adapt to the demands of the market and that this approach is one of the things that will help us return to the levels of store growth we need to meet our long-term goals.

Looking forward to the next tax season, we are excited to see the progress and continued expansion of our SiempreTax brand. We have seen increased interest from franchisees to open a SiempreTax office to complement their existing Liberty office.

We believe the growing Hispanic population and Immigration Reform will create an unprecedented opportunity for growth in our industry. Through our SiempreTax offices we will build upon our first-to-market advantage to strengthen our early foothold in the Hispanic community. We have also engaged in numerous strategic partnerships to help advertise the SiempreTax brand and communicate the valued services we aim to provide to the Hispanic community.

Looking at the industry as a whole, we are expecting an increase in overall return count growth next year of over 2% for professional tax preparers. Although the Affordable Care Act did not drive the level of growth we expected last tax season, it should have an important impact on the coming season.

There are several reasons we believe that. First, the penalty per person will more than triple next year to \$325, encouraging many to make the decision to obtain health insurance. With 11.4% of all US adults still uninsured there remains a significant market of those individuals who will begin to apply for health insurance in the coming years.

Second, there were nearly 2 million individuals who obtained a subsidy in the health insurance marketplace last year that either did not file or filed an incorrect tax return. These individuals must file or amend their return to reconcile their subsidy amount or they will lose the subsidy for their health insurance.

Finally, there were 10.2 million individuals who signed up and paid their premium during the 2015 enrollment period, up from the 8 million in the initial enrollment period the previous year. Of these individuals 85% are expected to qualify to receive an advanced premium tax credit which adds

to the complexity of their return. The continued complexity of the new ACA forms individually, individuals newly obtained health insurance, and individuals filing two years of returns paint a positive outlook for how many people will need assistance in filing their tax returns this year.

Another impact to the tax industry next season will be the fight against fraud and identity theft. We remain engaged in partnering with the IRS, the states and other industry leaders to help combat this problem and protect our customers. It is extremely important to Liberty that a customer feels safe and secure when filing a return through us, and we remain committed to assisting the IRS and states throughout the tax season.

The early success of our sales season and the launch of our new growth initiatives such as the A+ program, are the first steps we have taken to ensure a successful 2016 tax season. Additionally, long-term growth opportunities such as the ACA and our SiempreTax brand have Liberty well positioned to once again outperform the industry and to continue to gain valuable market share on our competitors.

Now I'd 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. - CFO*

Thanks, John. Good morning, everyone. As John has already mentioned, our focus during the first quarter is on identifying and working with franchisees who are ready to expand their store count, providing training to maximize results at existing stores and recruiting new franchisees to join the Company. Our revenue is seasonally low in this quarter because we spend our time preparing for the next season.

That said, for the first quarter of fiscal year 2016, we generated revenue of \$7.5 million compared to \$7.8 million in 2015. The majority of this small decline was in Area Developer fees, because 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, cash payments for both ADs and franchise fees declined slightly primarily due to the timing of collections on prior year sales.

Expenses also declined in the quarter. Reported operating expenses declined 2% to \$21.4 million driven by lower depreciation and amortization expense. We expect depreciation and amortization to increase again in the third quarter when we place our next generation of Libpro software into service in all of our offices.

Turning to taxes, our tax rate for the first quarter was 40.3%. We expect the full year rate to come down to approximately 38.5% once Congress renews the R&D tax credit for this year. For planning purposes, the renewal of that credit has occurred during our fiscal third quarter in each of the last several years.

Wrapping up the income statement, our first-quarter net loss improved slightly versus prior year on both a reported and adjusted basis. Our quarter one reported net loss was \$8.5 million compared to \$8.6 million last year and our reported loss per share was \$0.67, unchanged from last year. On an adjusted basis our net loss was \$8.3 million and our adjusted loss per share was \$0.65, also unchanged from last year.

Now let's take a quick look at the Balance Sheet and Cash Flow. As expected, we began to draw on our revolver in July. We generally plan to draw on our revolver from June or July through January each year and then we pay it back completely by the end of March as we receive funding from the IRS. Our cash used in operating activities improved by \$7.3 million versus prior year primarily due to lower cash income tax payments.

On a sequential basis our average basic sharecount for the quarter increased slightly reflecting the full impact of stock option exercises in Q4, partially offset by share repurchases during the first quarter.

And finally, our Board has authorized us to issue a quarterly dividend of \$0.16 per share which will be paid on October 22 to shareholders of record on the close of business on October 15. This quarterly dividend shows our continued commitment to enhancing shareholder value and our confidence in our future performance and long-term cash flow.

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



QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Joe Janssen, Barrington.

Joe Janssen - Barrington Research - Analyst

Let me just start, the 37 new stores, just give me a quick breakdown -- was that all new or a combination of new and existing franchisees? And then maybe just kind of taking it a step further and just give me an idea of that, what was Siempre versus your Liberty Tax stores?

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

I don't have that breakdown right now, but it was new franchisees, not new stores.

Joe Janssen - Barrington Research - Analyst

New franchisees, okay. And how many new franchisees?

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

A franchisee can either acquire an existing store or open a new office and they can either open a Liberty or a Siempre.

Kathy Donovan - Liberty Tax, Inc. - CFO

So those really are all incremental stores, but I don't have the breakout here between Siempre and Liberty.

Joe Janssen - Barrington Research - Analyst

Okay. And then, John, any color you can provide -- I know we are coming into the big selling season here August, September and I think early October. Kind of any color into what you are seeing here in the month of August?

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

August has been a good month for us and we continue the trend of trending higher than last year at this same time.

Joe Janssen - Barrington Research - Analyst

And a question on Siempre, maybe the store level economics. And I think you had [about] 60 last year, and you only have one year of data. But I'm curious how those 60 Siempre stores performed relative to maybe a first-year Liberty store.



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

We don't want to talk too much about it. We don't want to encourage our competition to copy us yet. But we will say we were happy with the numbers, they met our expectations. And we're happy with the number of locations we opened.

Remember 60 years ago H&R Block started with one location, 33 years ago I started Jackson Hewitt with six locations, and Liberty started in the United States in 1998 with five locations. So to open 57 the first year, we were happy with that. And we're forecasting that to more than triple next year.

Joe Janssen - Barrington Research - Analyst

All right, I will ask one more question and I will jump back in queue here. Just real quick, refresh my memory, like at what point of the year do we start to not focus so much more on opening new stores and you kind of shift over to the tax season? Is it early December?

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

Yes, think of Thanksgiving as the key date.

Joe Janssen - Barrington Research - Analyst

Okay.

Alex Paris - Barrington Research - Analyst

John, this is Alex, I am here with Joe. I just had a follow-up question. So you have got 37 new franchisees this year year-to-date versus 30 new franchisees at the same point last year. How many total new franchisees did you have last year?

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

Last year we had 212 new franchisees.

Alex Paris - Barrington Research - Analyst

And given that the start is better than last year, given that you are happy with August so far, you would expect a bigger number this year?

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

Exactly.

Alex Paris - Barrington Research - Analyst

And so, more than 212 new franchisees -- they tend to open up one new store. So these franchisees should yield one new store apiece?

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

Remember only about two-thirds or three-quarters of them buy a new territory. Some of them by an existing franchisee that leaves the system.

Alex Paris - *Barrington Research - Analyst*

Okay. But of the ones that buy new, they tend to open a store in year one?

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

Yes. On average they open about 1.2 stores.

Alex Paris - *Barrington Research - Analyst*

Okay. So, I am taking away that you feel you are on target for your expectations in terms of an increase in store count this year versus last year. Or has there been some reduction in your expectation in the last three months -- or an increase in your expectation in the last three months?

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

We continue to believe that of the two ways to grow our system, one is by adding stores and the other is by increasing same-store sales, we are adequately focused on returning our store growth count to our previous levels.

Alex Paris - *Barrington Research - Analyst*

Okay, well thank you very much, John. Good luck.

Operator

Lee Jagoda, CJS Securities.

Lee Jagoda - *CJS Securities - Analyst*

So just to be clear, in your press release the way it is worded is that you sold 37 new territories. Now did a new franchisee by each of those 37 territories or were some bought by existing franchisees?

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

No. These were territories and in the early part of the season the vast majority are new franchisees.

Lee Jagoda - *CJS Securities - Analyst*

Okay, so on an absolute basis last year it looks like franchisees actually declined by about 70 in total. Given you're 7 above last year in the sign ups through Q1 what were the franchisees that left the system in Q1?

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

We don't announce those numbers. But it is consistent with our expectations. And Lee, we do expect the number of franchisees to grow this year in the system, the total number of franchisees.

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

And a lot of that activity happens later in the season also. So it's very early in that too. But it is totally in line with what we would expect.

Lee Jagoda - *CJS Securities - Analyst*

Okay, and then my next question is, John, I know you just mentioned regarding Siempre that you had 57 stores last year and you expect them to more than triple next year. Would that be this tax season or next tax season?

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

That is for the upcoming tax season in January, 2016.

Lee Jagoda - *CJS Securities - Analyst*

So for this year that 60 should be more like 180?

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

That would be a low estimate, yes.

Lee Jagoda - *CJS Securities - Analyst*

Okay. And then with regard to the A+ program, how many of those 37 new territories were sold under that A+ program? What is the progress in general? And how much expense has been incurred by Liberty with regards to that program and where is it being put in the P&L?

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

I think that our target with A+ locations -- I won't give the exact number but it is over 100. And the initial capital outlay is less than \$35,000, probably less than \$30,000 per location.

Lee Jagoda - *CJS Securities - Analyst*

Okay, and were any of those 37 done under that program?

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

No, that program really didn't get legs until -- we don't want to rent offices too early because it is a needless expense when we are opening in January to open an A+ office in July or August. So we tend to do that more in the September/October timeframe. So it is just getting legs now and we are on track to make our numbers of over 100 A+ locations.

Lee Jagoda - *CJS Securities - Analyst*

Okay, and then in terms of -- if I look at your cash flow, the operating loans to franchisees in Q1 jumped about 50%. What are the drivers of the increase?



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

You know, Lee, I was looking at that and I think in reality what happened is we were just a little bit more efficient in processing all the requests from our franchisees.

We always try to do that in the most efficient way possible so that they can get that behind them and then start focusing on opening new stores and working with us on whether they are going to expand through Siempre or Liberty. And I think it just shows that we did a little bit better job getting things through the pipeline faster this quarter.

Lee Jagoda - *CJS Securities - Analyst*

And then one last question and I will hop back in queue. In terms of the 100 stores you expect to open on a Company owned basis this tax season, have any of the costs been incurred for that? And when they are incurred what do you think the total layout will be for the Company before you hopefully sell most if not all of them?

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

Yes, again, that is just ramping up in September. And so, virtually we won't start paying rent until November-ish. And again, our estimate per location is about \$30,000 to \$35,000, so \$3 million to \$3.5 million.

Lee Jagoda - *CJS Securities - Analyst*

And is it your expectation that you will sell most if not all of them prior to the tax season?

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

No, our expectation is that we will sell most or all of them by the end of the fiscal year.

Lee Jagoda - *CJS Securities - Analyst*

Okay, very good. Thank you.

Operator

Scott Schneeberger, Oppenheimer.

Scott Schneeberger - *Oppenheimer & Co. - Analyst*

I guess first off, John, it sounds like you are trending better this year versus last on new territory sales. One of the hindrances I believe you had last year was preparing for ACA. And I am just curious if you could speak to that, what you see for this year as far as ACA preparation. And will it be similar distraction or what have you learned from last year to this year?



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

Yes, the ACA will not be a distraction in opening offices this year. We are really happy in one sense of even though ACA turned out instead of a positive tailwind of 1 million or 2 million returns; it was a negative headwind of 1 million or 2 million returns last year. So it was a dramatic slowdown in the implementation and the effect in this industry.

We expect that to change this year and I am gratified that our franchisees were not demoralized or put off by the reaction in the industry of the customers that they are signing up; they are continuing to sign up and continuing to get licensed agents in their locations.

And there is an optimistic spirit in the franchise base about the impact of ACA Obama Care during this next tax season. So we feel good about it and we won't have any excuse this year for not expanding our office base because of ACA.

Scott Schneeberger - Oppenheimer & Co. - Analyst

Great, thanks. And I think I heard you say earlier you are expecting IRS industry returns to be about 2% year-over-year in the upcoming tax season. And if you could just, A, validate that that was your statement.

And then B, had a lot of interesting pricing across the competition the last few years, a lot of free involvement where you had one if your big software competitors with an absolute free.

I am just curious how you are looking at the pricing environment heading into this upcoming year. It is hard to get more free than absolute free. I am just curious where you think everything goes from here on a broad pricing dynamic? Thank you.

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

I think what I said is that we expect a 2% increase in paid tax returns this year. But coincidentally we also expect about a 2% increase in total returns filed.

So we conservatively expect to maintain the percentage of assisted returns versus the overall returns and we expect 2% more people to file this year. And there has been the free file alliance of doing free returns for over a decade and it hasn't significantly changed the number of people that seek assistance.

So we don't see that absolute zero or any efforts by our competitors to offer those products online to encroach into the brick-and-mortar. In fact, we are predicting that brick-and-mortar over the next three years should gain margin versus do-it-yourself.

Scott Schneeberger - Oppenheimer & Co. - Analyst

Great, thanks very much. Best of luck.

Operator

I will now hand the call back to John Hewitt for closing remarks.

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

Thank you, operator. And you did a great job of pronouncing everyone's name. I want to say that, again, our goal, our focus -- we have to grow and that we grow in two ways: office count and same-store sales.



We feel confident that we are going to have good growth in both of them, we are going to grab market share. And as always, we know that our success is based on having happy successful franchisees and happy successful employees. Thanks for your attention, everyone have a great day.

Operator

Ladies and gentlemen, this concludes today's conference call. 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.

©2015, Thomson Reuters. All Rights Reserved.