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TAX - Q4 2014 JTH Holding Inc Earnings Conference Call

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PRESENTATION

Operator

Good morning. My name is Kayla and I will be your conference operator today. At this time, I would like to welcome everyone to the JTH Holding, Inc. fiscal 2014 earnings conference call. (Operator Instructions). I would now like to turn the call over to Ms. Cari Fisher, with Liberty Tax Investor Relations. You may begin your conference.

Cari Fisher *- JTH Holding, Inc. - IR*

Thank you. 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 fiscal year 2014 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 risk, 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, 2013 and our other SEC filings. JTH Holding undertakes no obligation to publicly update these risk factors or forward-looking statements. I would now like to turn the call over to our Founder, Chairman and CEO, John Hewitt. John?

John Hewitt *- JTH Holding, Inc. - Chairman, CEO & President*

Thank you, Cari. To start things off, I would like to say that we are pleased with our fiscal 2014 results. This year proved to be another year of growth for our Company, growing faster than the IRS and our competitors. I see good things in our future. It was a very smooth tax season. The IRS did a great job having all forms ready when e-filing began, which in turn allowed for faster acknowledgments and faster funding of refunds. That made our customers very happy.

We held our annual convention a few weeks ago and a record number of our franchisees came this year with an eagerness to learn and a willingness to work harder than they ever have before. Their positive attitude and enthusiasm will help us reach our goals and enjoy the journey along the way.

This year, the IRS reported total growth in returns of 0.7% and e-file paid preparer growth of 0.7% also. Returns in our US offices grew by 5% with overall returns, including online and Canada, increasing 6%. Our Company revenues grew over 8% in fiscal 2014 and our adjusted EBITDA grew 11%. Finally, our systemwide revenue grew by 10.5%. The growth in systemwide revenue was due to our increase in returns, as well as a 6% increase in our average net fee. A part of this increase was due to not having to compete with our major competitor's free 1040EZ program that they had in the past.

We had a significantly lower number of new franchisees than last year due to a shortened sales season, but we were still able to grow our returns and our revenue. Despite the many challenges and setbacks the industry has had throughout the years, Liberty Tax has experienced growth every year since its formation. We believe the reason for our growth is our strong franchise model and our constant efforts to enhance and improve the overall customer experience.

To that end, we have been investing in a new software platform for several years, which will power both our online and in-store tax preparation. We think this will give us a competitive advantage by allowing our customers who start a return online the option to complete the return at one of our offices should they encounter any challenges or if their return proves to be too complex. We successfully launched the first phase of this platform this year with the release of NextGen Online for do-it-yourself returns and are preparing to pilot the in-store platform in 2015.

In technology, overall improvements decreased support requests by more than 25%, which contributed to the smooth tax season and increased franchisee satisfaction. In the industry, there has been a lot of discussion regarding the regulation by the IRS of tax preparers and the related need to address tax fraud. We believe this is important for taxpayers and we have been providing training and certification programs for all of our preparers for the past five years. Once again, all of our approximately 35,000 tax preparers were certified.

Even though the IRS' attempt to require certification seems dead for now, we are supporting the IRS' initiative on voluntary certification and continue to boost our training in the meantime. We focus our preparers on their obligations to make sure our customers file accurate returns and have paid particular attention to reinforcing their responsibilities to be diligent about fraud-prone tax programs such as the earned income credit. We have also continued to refine our efforts to use data analysis to identify possible identity theft and other issues.

We continue to provide leadership in these areas because doing so is good for our customers.

Looking forward, we expect our growth to continue, especially with the new opportunities that have been introduced in the industry, specifically the Affordable Care Act. The ACA has been heavily discussed in the tax industry for good reason. It is a huge opportunity for growth. With the many different requirements of the ACA, we will see an increase in filers in general, an increase in filers who shift to a paid preparer from DIY due to the complexity of the new forms and the additional forms will produce more revenue. Specifically, we believe the average net fee per return will go up as returns get more complicated and include additional forms.

We have several pilots underway to help our customers and our franchisees navigate through the ACA. Our primary focus is training and education. We have extensive training and education materials available to our franchisees that will help them guide the taxpayer through the tax side of ACA, as well as assist them with obtaining health insurance through the ACA. These trainings and materials are available through live seminars, webinars and on our website. 8 million people enrolled through the healthcare.gov for 2014 and we estimate another 20 million plus will enroll over the next few years and we will be ready to help them.

Our online business continues to grow and during fiscal 2014, we purchased certain assets of an online tax preparation software provider, which assisted in driving this growth. We have also expanded our online marketing department bringing in a new AVP of Digital Marketing with significant experience and expertise in online strategy development.

For fiscal 2015, we are looking forward to a full selling season and we expect the excitement of the ACA to drive more franchise sales and to increase store count. We anticipate our growth to continue to exceed the IRS and our competitors. I would be remiss not to mention what a fantastic company culture we have created at Liberty Tax Service. We have over 500 full-time employees, 2000 franchisees and over 50,000 seasonal tax preparers and marketers all who act as brand ambassadors for us. A great culture to me is the key to a successful company. Without it, we would be just another tax company. With it, we are the tax company.

Lastly, I would like to say that in my 45 years in the tax industry, there have only been a few major events that changed the industry significantly. I believe we are on the cusp of another major event with the Affordable Care Act and I am excited to see the changes it will bring. Now I'd like to turn the call over to our CFO, Kathy Donovan.

Kathy Donovan - *JTH Holding, Inc. - CFO*

Thanks, John. Good morning, everyone. As John said, we had a successful tax season growing return count, average net fees, systemwide revenue and financial product attachment rates despite experiencing the shortened selling season for new franchisees last year. Total revenue for fiscal 2014 increased 8% to $159.7 million while GAAP earnings per share increased 21% to $1.51 and non-GAAP adjusted earnings per share grew 4% to $1.45. Our weighted average diluted share count for the year grew by 465,000 shares, or 3%, which reduced our full-year earnings per share. We were able to repurchase and retire 800,000 shares earlier this month, which I will talk about later, which will help to offset this growth in share count.

I'd now like to go through some of the drivers of our revenue growth. As John mentioned, our systemwide revenue increased 10.5% to $421 million, driven by a 4% increase in brick-and-mortar return count and an increase in average net fee of over 6%. Most of the growth in systemwide revenue came from our franchisees and that growth is reflected in a 7% increase in royalty and advertising revenue. We also grew revenue in our Company stores and that is reflected in the tax preparation fee line. We operated fewer total Company stores this year, but we operated more storefronts and fewer Walmart kiosks. So the mix change helped us generate more tax preparation revenue.

Financial product revenue was also a bright spot for us this year growing strongly to $34.5 million, up 14% versus prior year. This was mainly driven by two things. First, more US customers chose to take advantage of our financial product offerings. The total number of refund transfer products in our US stores was 973,000 compared to 868,000 last year, an increase of approximately 12%. We have made a change in how we report the number of refund transfer products. We believe it is more helpful to report total funded products rather than total originated products as we have in the past. This number reflects the total number of RTs actually funded by the IRS.

On another note, there was one other major driver of growth in financial product revenue. As JTH Financial has established itself and taken more share of our volume, we were able to negotiate more favorable revenue splits with our third-party banking providers and this also increased reported revenue. In response to those more favorable splits, we chose to process more of our refund transfers through a third party rather than directly through our in-house provider, JTH Financial. We processed 52% of our refund transfers through third-party banking partners compared to 49% last year. We will continue to evaluate the most advantageous options for processing financial products and will assign our volumes in the future where it makes the most sense.

In the online area, we continue to look for ways to better serve our customers and to expand our online user base. This is reflected in the tax preparation fee line where we saw increases in both the number of DIY returns processed and in total revenue. As John mentioned, we purchased certain assets from an online provider this year, which drove the growth in both online returns and revenue. Offsetting these revenue increases were declines in franchise and area developer fees. As we've discussed, our franchise selling season was shortened last year due to the financial restatement, but we believe that franchise sales will be much stronger this year. Area developer fees have been trending down as we strategically reacquire area developer rights.

Turning to expenses, some of the growth in revenue was offset by higher depreciation, amortization and impairment charges. As John mentioned, we have been investing for the last few years in our next generation of tax preparation software and we placed the online or DIY portion of our new system into service during the third quarter. Next year, when we begin to pilot the new system in our brick-and-mortar stores, we will begin to depreciate the office portion of the product development costs and we will see an additional increase in depreciation and amortization in the third and fourth quarters next year.

We also recorded an impairment for Company stores in Q4 of $1.4 million. We have designated Company stores as assets held for sale and our goal is to find buyers for the majority of these stores before the start of the next tax season. We strongly believe in our franchise model and that franchisees will maximize the productivity of these stores. The best way for us to maximize systemwide revenue is to get these stores into the hands of franchise owners.

Now let's take a look at the balance sheet and cash flow. Our balance sheet remains strong. We delivered strong cash flow from operations and ended the year with $46.1 million of cash, a $27 million increase over prior year. In terms of share count, our average diluted share count for the year increased to 14.5 million shares and the fourth-quarter average diluted share count was 14.9 million, a 5% increase versus prior year. 956,000 stock options were exercised during the year, a large portion during the fourth quarter. We repurchased $13.1 million worth of stock, or 538,000 shares during the year, but we were not able to offset the full number of options exercised. Subsequent to year-end, we chose to invest some of our excess cash by repurchasing and retiring 800,000 additional shares from an affiliate, reducing our Q1 diluted share count by approximately 5%.

There are a couple of housekeeping items that I would also like to address. First, many of you know that we filed an S-1 registration statement in 2011, but went public in 2012 without selling shares under that registration. As of this new fiscal year based on our market cap, we are no longer categorized as a smaller reporting company and we will be eligible to use Form S-3 in October 2014 once we have been current with all SEC filings for a full year. We plan to withdraw the outstanding and outdated S-1 this week and we expect to maintain our flexibility going forward by filing a new S-3 as soon as we are eligible.

Second, in order to eliminate confusion among shareholders and potential investors seeking information about us, we have begun the process of changing our corporate name to Liberty Tax Inc. This name better reflects our primary business and we expect the change to officially take place sometime in July.

In conclusion, we had a strong tax season, especially when you look at productivity per office both in terms of total returns, average net fee and financial product adoption rate. We are excited about the opportunities for the industry next year and we believe we will continue to grow faster than the overall market and will continue gaining marketshare. Now I'd like to turn the call back to John.

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

Thanks, Kathy. Operator, we are now ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Arnie Ursaner, CJS Securities.

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

Welcome, Arnie.

Lee Jagoda - *CJS Securities - Analyst*

Hi, this is actually Lee Jagoda for Arnie. Good morning.

Kathy Donovan - *JTH Holding, Inc. - CFO*

Good morning.

Lee Jagoda - *CJS Securities - Analyst*

So my first question is, if I look at the advertising expense line, it was down year over year while your royalty and ad revenue was actually higher. Can you share a little more detail on what drives that line and where else the advertising expense went?

Kathy Donovan - *JTH Holding, Inc. - CFO*

The advertising is also up in compensation and also in SG&A expenses. Some of the marketing buys and professional services that we use to do advertising are in the SG&A line and then there is also compensation that works on the advertising.

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

And also remember we were dark for a part of our sales season, so we spent less money in advertising for new franchisees last year.

Lee Jagoda - *CJS Securities - Analyst*

Okay. And then, Kathy, can you just quantify the restatement-related impact that hit the SG&A line in 2014?

Kathy Donovan - *JTH Holding, Inc. - CFO*

Yes, it was approximately $900,000 and I think that is on one of the tables in the back. Probably -- is it tax-adjusted? $907,000.

Lee Jagoda - *CJS Securities - Analyst*

Okay. And then just my last question and I will hop back in queue. Do you plan to release any historical information reflecting the new change in the way you report financial products revenue?

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

We are certainly going to report last year. If it is important to you, then off-line we will certainly give you the years preceding that if that is helpful.

Lee Jagoda - *CJS Securities - Analyst*

Okay, terrific. And we look forward to seeing you at our conference next month.

Kathy Donovan - *JTH Holding, Inc. - CFO*

Great, thanks.

Operator

Alex Paris, Barrington Research.

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

Welcome Alex.

Alex Paris - *Barrington Research Associates, Inc. - Analyst*

Hi, guys. Congratulations on a great tax year despite the obstacles you faced. Just to follow up on Lee's question. In a normal year, advertising expense increase or decrease, should match that of the advertising fee received, right?

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

Yes, we charge our franchisees a 5% fee and we have to spend that money, so that is all directly correlated with the increase in systemwide revenue. However, we do have exceptions to that. That would be advertising for new franchisees. So that may vary a little bit, but it would only be a minor variation.

Alex Paris - *Barrington Research Associates, Inc. - Analyst*

Got you. And then to get -- sorry.

Kathy Donovan - *JTH Holding, Inc. - CFO*

WE also, when we quantify the total amount of advertising spend, we do include some of that cost that is up in selling, general and administrative because it is not directly spent just on the advertising buy; it is spent on developing the advertising and the people managing the process.

Alex Paris - *Barrington Research Associates, Inc. - Analyst*

Okay, makes sense. So what you are saying is the 4% you received was spent. It is just not all in that advertising expense line; it is also in comp and SG&A lines.

Kathy Donovan - *JTH Holding, Inc. - CFO*

Correct.

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

Yes, but it is 5%.

Alex Paris - *Barrington Research Associates, Inc. - Analyst*

Okay, 5%. I'm sorry, yes. Then second specific question, how did that big share repurchase come about earlier this month? You bought back 800,000 shares at a discount, I believe, from your largest shareholder. I know it was an effort to put excess cash to work, so did you approach the shareholder or did the shareholder approach you?

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

Well, Alex, as we have talked before, our largest shareholder has a desire to get under the public reporting requirements under the 10% ownership. So we have endeavored to have an offering in the past or offerings to try to help him in that process. We were fortunate this year with a great season and extra cash flow and the ability to help them achieve that a little bit earlier or at least move in that direction. So it was a situation where we had excess cash, they had the desire to continue to sell down to less than 10% and so it was a perfect marriage.

Alex Paris - *Barrington Research Associates, Inc. - Analyst*

Great. Now that accomplishes something for corporate headquarters, that accomplishes something for the shareholder, but that doesn't accomplish -- one of your goals is to increase liquidity and broaden the share ownership. Are you going to continue buying back stock like this from that shareholder or should we continue to expect a public offering with associated roadshow at some point in the future?

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

We are looking for a public offering at some point. This month is the two-year anniversary of being public without adequate float for our shareholders. So we look forward to that event in the future that will help all our shareholders get liquidity.

Alex Paris - *Barrington Research Associates, Inc. - Analyst*

Absolutely. And should contribute to a P/E multiple by my estimation in that the shares would be more liquid and get less of an illiquidity discount.

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

I like the way you think.

Alex Paris - *Barrington Research Associates, Inc. - Analyst*

Last question, and it is really two parts and related. So we had a net decrease in the number of stores this year as a result of the shortened franchise selling season. I would assume there is some pent-up demand by those who wanted to buy but couldn't from at least the existing franchise ranks, as well as probably an increased effort on your part. And by my calculations, I think the average number of stores you have been putting in net have been 300 to 400 in recent years excluding this year. Should we expect something greater than that mean?

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

Well, Alex, while I am not ready to forecast that number today, I will say this that in the 32 years I have been competing with Block, this is the only year that we had a decrease in locations. And there are a lot of factors, a lot of tailwinds that are helping us for next year. As you said, pent-up demand is one of them. Our fanatical goal to be number one by 2020 is another one. And again, the ACA, I cannot downplay that. I have been in this industry for 45 years and there has been three gamechangers and the first was when this industry was computerized and we were part of that. My dad and I invented the first software for Apple computer and the second one was when IRS rolled out electronic filing in 1986 and this is the third big gamechanger and that is, more than the first two, a reason for us to accelerate our growth this year. So we are expecting good things for fiscal 2015 in terms of office count and return count.

Alex Paris - *Barrington Research Associates, Inc. - Analyst*

And average fee.

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

Yes, average fee too.

Alex Paris - *Barrington Research Associates, Inc. - Analyst*

And then to your point, to be the largest by 2020 suggests not only a big number in tax season 2015, but increasingly big numbers over the next few years if you are going to top the largest player out there.

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

Yes, it is hard to say where the largest player is going to be in 2020 since they have decreased four of the last six years in returns, so they are making it easier for us, but we have to -- in order to meet our goal, we have to grow by over 30% a year in return count. So we have to step it up.

Alex Paris - *Barrington Research Associates, Inc. - Analyst*

Good. Well, we will be interested to watch that and invest alongside. Thank you very much.

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

Thanks, Alex.

Operator

(Operator Instructions). Kartik Mehta, Northcoast Research.

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

Hey, Kartik, how are you doing?

Kartik Mehta - *Northcoast Research - Analyst*

I am well, John. How are you?

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

Fantastic.

Kartik Mehta - *Northcoast Research - Analyst*

Hey, John, there has been a lot of talk about ACA and what kind of impact that could have to the tax season. I am wondering if you could provide any more details of what you are thinking about in terms of potential additional revenue that might be gained by being able to charge for the form or maybe what type of increase you would look for in the overall market growth because of ACA?

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

The numbers are difficult to quantify and I haven't seen any -- the IRS or any exact quantification by the government yet. But as I talked about, there's three impacts. More people are going to be required to file in order to pay the penalty and/or take an exemption or get a credit. So we are going to see some more filers. Then a percentage of the current filers are going to change from do-it-yourself to assisted tax preparation and one of the three big reasons that people don't do their own returns, that they do come to an assisted preparer is confusion, complexity, change and this is all of those. So we are going to see a shift, I believe, from do-it-yourself to paid preparation.

And then in quantification, we have said before that we see this as a boost in our revenue per return of about 5%. And we feel that that is based on the fact that somewhere between 25% and 30% of our customers will have additional forms, additional complexity and based on the fees that those forms will likely be. We haven't seen the actual forms yet, but based on the extremely complex circumstances involved with our customers and taxpayers in this country, we see it as higher fees. So we are estimating about a 5% boost in fees just related to ACA.

Kartik Mehta - *Northcoast Research - Analyst*

So are you planning on doing anything differently next year other than -- well, obviously, I am assuming you will be marketing the fact that the ACA is out there and how complicated it can be. But operationally, will you have to do anything differently because of this?

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

We are. We are going to make some major differences, major operating differences. However, I am not going to alert our competitors as to what those are. But in the next call or subsequent to the season, we will be announcing some significant changes in our operating procedures.

Kartik Mehta - *Northcoast Research - Analyst*

Thanks, John. I really appreciate it.

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

Thank you.

Operator

Thank you. This concludes the question-and-answer session. I will now turn the call back over to Mr. John Hewitt for closing remarks.

John Hewitt - *JTH Holding, Inc. - Chairman, CEO & President*

Thank you, everyone, for your attention and have a wonderful day.

Operator

Ladies and gentlemen, that does conclude today's call. You may now disconnect.
