

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

TAX - Q1 2015 Liberty Tax Inc Earnings Call

EVENT DATE/TIME: AUGUST 28, 2014 / 12:30PM GMT



CORPORATE PARTICIPANTS

Carrie Fisher *Liberty Tax Inc - VP Corporate Finance, IR, Senior Financial Analyst*

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

Kathy Donovan *Liberty Tax Inc - CFO*

CONFERENCE CALL PARTICIPANTS

Alex Paris *Barrington Research Assoc. Inc. - Analyst*

Lee Jagoda *CJS Securities - Analyst*

Michael Millman *Millman Research Assoc. - Analyst*

PRESENTATION

Operator

Good morning. My name is Cherice and I will be your conference operator today. At this time, I would like to welcome everyone to the Liberty Tax Incorporation first-quarter fiscal 2015 earnings conference call. (Operator Instructions). Thank you. I would now turn the call over to Carrie Fisher, Investor Relations. Go ahead, Carrie.

Carrie Fisher - *Liberty Tax Inc - VP Corporate Finance, IR, Senior Financial Analyst*

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 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, 2014 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 our founder, Chairman and CEO, John Hewitt. John?

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

Thank you, Carrie, and good morning, everyone.

Our first quarter is the very beginning of our franchise selling season and a time when we focus on improving our operations and preparing for the next tax season. It would be reasonable to compare our first quarter to the first or second inning of a baseball game. You cannot determine the outcome of the entire game after just the first inning, and you cannot determine our full-year results after just our first quarter. The seasonal nature of the tax business causes us to generate the majority of our revenue and all of our profit during the tax season, which of course runs from January to April of each year. We operate at a net loss during the first and second quarters of each fiscal year when we are selling to new franchises, developing new programs, and getting prepared for the following season.



During the first quarter, we brought in approximately the same number of new franchises as the prior-year period. The first quarter of last year was a relatively normal one for us. Our dark period started the second quarter last year in August, so we believe we will see significant year-over-year improvement in the second quarter compared to the shortened selling quarter last year.

At this point, we see our new franchisee numbers trending toward where they were two years ago.

Walmart has significantly increased the rent that they plan to charge for being in their stores this year. As a result, our Walmart presence will be negatively impacted. However, these locations have historically produced much lower volumes than our traditional storefronts, so we do not see this having any material impact on our overall performance.

We have made significant enhancements to our NextGen software to include new mobile and tablet applications. These enhancements will provide customers with fast and convenient access to our online offerings. They will be able to complete many actions such as filing their taxes and checking their refund status directly on their phone or tablet.

You may recall that, last year, we implemented NextGen only for online returns. We plan to test it in over 500 offices during the upcoming tax season. Once the in-store launch of NextGen is in place, this will allow the customers to walk into an office with their partially completed tax filing in hand to make the transition from DIY to paid prepare even smoother.

We are also testing an economy package that our franchisees can use to provide bookings and service for small business customers and have partnered with Kashoo Cloud Accounting for this purpose. We will solely promote a white-label version of Kashoo Liberty Accounting as a recommended small business online accounting solution in our over 4400 offices. This offering will serve our small business customers by giving them a technological edge.

Looking forward to next tax season, the IRS is expecting a growth of 1.5% in the number of individual returns filed for 2015. We believe this growth may actually be 2% to 3%. We see two drivers of this strong growth. First, the number of people employed has grown over 3% since December of 2013 and second, the ACA requirements will bring in new filers who may not have chosen to file their taxes in the past. In order to determine their eligibility for and the amount of subsidy related to the ACA, they will now be forced to file.

The ACA forms were released last month and, as expected, there is a level of complexity that we believe will drive higher DIY customers to a paid preparer. These forms include Form 8962, which will be used if a customer received a premium tax credit, and Form 8965, which will be used to determine if the customer is eligible for an exemption. It is likely that the appearance of these forms, especially the 8962, will be intimidating to the taxpayer and many of them will seek assistance. There will also be a worksheet, which we haven't seen yet, to determine the amount of penalty, if any, that taxpayers will be required to pay if they do not either obtain insurance or qualify for an exemption.

Earlier this month, the Congressional Budget Office and the Joint Committee on Taxation issued a report which lowers the projected number of people expected to pay the penalty for not obtaining insurance due to the multiple number of exemptions that have been recently made available. Because of this, the number of people required to complete the penalty worksheet will be less than we previously expected, delaying a portion of our projected average net fee increase related to the Affordable Care Act from fiscal 2015 to fiscal 2016. We now expect the projected fee increase related to the ACA in 2015 to be 2.5% to 3% versus our earlier projection of 5% with the remainder being pushed to the following year.

We continue to believe that the ACA is a game-changer and we have a multiyear -- and will have a two or three year impact on our growth.

As we continue to grow, our success partly relies on both our franchisees' compliance with IRS and tax authorities. We are proactively working with the states to help them strengthen their fraud prevention programs. There is a positive movement at the state level to require tax preparer certification.

Earlier this year, New York passed the required competency exam for tax preparers and there is an effort in Ohio to pass a similar requirement. We applaud and support the states in this effort because we believe this is important for the integrity of our industry. We were on the forefront of this

progressive initiative. For the past five years, we have acquired all Liberty prepares to pass a certification test before they could prepare tax returns. We also continue to work within our industry to support the IRS in efforts to improve their ability to identify tax fraud and identity theft.

As announced last week, Mark Baumgartner, our Chief Investment Officer and CEO of JPH Financial, will be leaving the Company effective August 30. Mark will be greatly missed and we wish him the best in his future endeavors.

Lastly, we have new initiatives in the works and pilots underway for this upcoming tax season that we believe will be of great benefit to our customers and our franchisees. We plan to announce these in November and more details will be provided at that time.

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

Kathy Donovan - *Liberty Tax Inc - CFO*

Thanks, John. Good morning everyone. As John has already mentioned, the majority of our revenue is generated during the tax season from January to April of each year, and revenue in our first quarter is seasonally low. That said, for the first quarter of fiscal year 2015, we generated revenue of \$7.8 million compared to \$8.1 million in fiscal 2014. Franchise fee revenue declined \$0.3 million versus prior year. Franchise fee revenue is recognized as cash as received, so the revenue we recognize in a quarter represents payments for sales that were made over several prior periods. While the number of franchise sales this quarter were in line with last year, cash payments on prior-year franchise notes were lower.

Turning to expenses, we continue to invest to prepare for and effectively manage the growth of the business. As we have discussed on prior calls, we are investing in new management and technology infrastructure as well as new programs to help us drive toward our long-term growth objectives.

Reported operating expenses grew by \$4.4 million to \$21.9 million in the first quarter. There were nonrecurring items in the first quarter of 2014 and the first quarter of 2015.

In the first quarter of last year, we recorded an \$872,000 one-time benefit from the reclassification of stock options back to equity instruments. And in the first quarter of this year, we incurred \$483,000 of severance costs. Those two items drove \$1.4 million of the expense growth.

Increases in non-cash depreciation and stock compensation accounted for another \$1 million of the increase. And the remainder of the year-over-year variance reflects the investments described above as well as salary increases for existing staff and higher advertising expenses for new franchisees.

For the full year, we expect revenue growth to outpace adjusted expense growth.

Our tax rate for the first quarter was 39.7%. We expect the full rate to come down closer to last year's rate when Congress renews the R&D tax credit for this year.

As a result of the increase in expenses, our Quarter 1 reported net loss increased to \$8.6 million or \$0.67 per share. And our adjusted non-GAAP net loss, excluding the nonrecurring items and stock-based compensation expense, increased to \$8.1 million, or \$0.63 per share.

Now, let's take a 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 pay it back completely by the end of March as we begin to receive funding from the IRS. We drew \$2.7 million less on the revolver this quarter, even after the repurchase of 800,000 shares from an affiliate for \$20 million in June.

Our average basic share count for the quarter dropped approximately 300,000 shares from the fourth quarter. This reflects the benefit of the 8000 shares we repurchased in early June as well as the impact of stock option exercises through the quarter.

Finally, I would also like to thank Mark Baumgartner for his assistance over the last seven months. I have appreciated his insights and I wish him and his family all the best.

Now, I'd like to turn the call back to John.

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

Thanks. Operator, we are now ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Alex Paris, Barrington Research.

Alex Paris - Barrington Research Assoc. Inc. - Analyst

A couple of follow-up questions just to understand everything. First of all, I want to say thank you to Mark Baumgartner myself. He was very helpful in me ramping up on the Company and getting to know it very well. I wish him all the luck in his retirement.

With regard to the price increases associated with ACA. So you've seen the forms now. Can you take us through the mechanics of how you get to 2.5% to 3%? I know, John, you had done in the past, you kind of looked at -- a quarter of your tax filers would be impacted, there would be an additional form, blah, blah, blah. How do you look at that now? What's the rough back-of-the-napkin math on that?

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

Yes, we were anticipating that we would get about \$40 for each of the additional forms, the credit form and the penalty form, and that about 25% of our customers would be required to file them and thus it would be about \$10 and, on our average fee, that would be about a 5% impact.

We're saying now that, because of the numerous exemptions that were put in place, that only about half of the number of customers are going to have to fill out the entire penalty calculation. Many of them will fill out a simpler form, which is the exemption form. So it's more of a check the box form than a calculation, so the fees will be considerably less for those forms.

Alex Paris - Barrington Research Assoc. Inc. - Analyst

Got you. Yet you do expect that roll over into next year. How does that work? The next tax season?

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

Yes, typically, when the IRS implements new penalties and credits, they will make exceptions. And in the past, they have virtually always been a one-year exception. So we think those -- they will just not have the same exemptions next year that they had this year.

Alex Paris - Barrington Research Assoc. Inc. - Analyst

I see. Okay, that makes sense. With regard to franchise selling season, remind me. The prime selling season starts July, ends October? What is that again?



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

The sweet spot for us is really August to October. People that are ready to open a new business in January aren't ready to invest the previous January. They start getting more and more interested as they get closer and closer to tax season. So historically, most of our sales have come in the August, September, and October time period, because once you get to November and December, people think it's too late so they are scared to open. So that's our prime selling season and we lost most of it last year when we were dark in August and in September.

Alex Paris - Barrington Research Assoc. Inc. - Analyst

Okay, so last year, you actually had a net decrease in the number of stores because of that blackout. This year, because you are kind of on the pace that you were two years ago, and that your average number of stores opened over the last few years is 350, do you think you'll do more than 350, 350 or less than 350 this year? What is the target?

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

We're not going to forecast that number except to say that last year was an anomaly and I have been completing with Block for 32 years, and I'm 15 years with Liberty since my noncompete. And we've grown every year. So last year was an anomaly. We had a decrease because of the dark period and we expect to get back to normal this year. And with the tailwinds of ACA and the other initiatives that we're going to announce later in the year, we are more excited about this tax season than I've been in over 20 years.

Alex Paris - Barrington Research Assoc. Inc. - Analyst

That's great. And then with the Walmart issue, it's going to impact the number of kiosks or small stores within Walmart. Does that count in the number of stores? Is that going to have -- even though it's not going to have a material impact on revenue or filings, it is one Walmart store listed as one store in your financials?

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

Yes, that's how we list it.

Alex Paris - Barrington Research Assoc. Inc. - Analyst

Okay.

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

And we do less than 2% of our revenue in Walmart, so it's a very de minimus impact.

Alex Paris - Barrington Research Assoc. Inc. - Analyst

Okay, great. That helps a lot. I'll get back into the queue.

Operator

Thank you. Does that complete your question?

Alex Paris - *Barrington Research Assoc. Inc. - Analyst*

Yes.

Operator

Lee Jagoda, CJS Securities.

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

Welcome, Lee, from CJS.

Lee Jagoda - *CJS Securities - Analyst*

John, can you just repeat the commentary regarding your expectation for industry volumes as it relates to the ACA?

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

Yes. The IRS is projecting a solid increase of 1.5%, and we are thinking that it's going to be 2%, possibly as high as 3%, because of two major impacts -- all of the people that have joined the labor force in the last couple of years, and also the impact of some people who weren't previously required to file are going to need to file to either take their credit on their tax return or pay a penalty or file for an exemption to the penalty, and they are going to have to do that through their tax return.

So for two reasons, we expect the number of filers to increase more substantially than the IRS does.

Lee Jagoda - *CJS Securities - Analyst*

Okay. And I know you said you kind of expect a franchisee growth similar to what you saw two years ago. What feedback early on are you hearing from existing franchisees regarding opening additional locations, given that they probably know as well as anybody the impact or the opportunity that ACA should represent?

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

Yes, our franchisees are -- that's the biggest source of our office openings each year, more impact than our new sales. And our franchisees are prepared for a robust tax season and are more excited than they've ever been. The morale in our organization is the strongest I've seen it.

Lee Jagoda - *CJS Securities - Analyst*

And then one more for me and I'll hop back in queue. Can you just talk about, a little more about the services you provide to small businesses, what percentage of that is -- as a percentage of your total revenue, what does that represent? And then how you expect this new cloud software rollout to change that dynamic from both a volume and a price perspective?



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

Yes, the software -- the partnership with Kashoo is not designed to get us more small business accounting. We are not in the accounting business; we are in the tax business. What it allows us to do is to have our customers who are small businesses or even if they're not small businesses to input their information into an accounting system that will be transitioned right into our tax software. So preparing their tax return will be even easier for them and doing their at-home accounting will be easier for them.

So, our customers win in two ways and our franchisees win because the information from -- that our customers are inputting into Liberty Accounting will be transitioned into the tax return seamlessly.

Lee Jagoda - CJS Securities - Analyst

So is there any revenue share in the fee that they pay to use this service? Does any of that flow through to you or does that all go to your partner?

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

There is no economic impact other than increased customer satisfaction.

Lee Jagoda - CJS Securities - Analyst

Okay, terrific. Thank you.

Operator

Michael Millman, Millman Research.

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

Welcome, Michael.

Michael Millman - Millman Research Assoc. - Analyst

Just kept repeating it earlier, you said that the 8865 and the 8862 each would have a \$40 charge, or together would have a \$40 charge?

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

The easiest way to think of it is it's about \$40 per customer whether they get a credit or pay a penalty. It's per customer, not per form.

Michael Millman - Millman Research Assoc. - Analyst

Okay. And the delayed instructions, do you expect the instructions to have some impact on this \$40, or is it pretty much \$40, whatever the instructions are going to be?

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

Yes, it's \$40 whatever the instructions are going to be.



Michael Millman - *Millman Research Assoc. - Analyst*

Since we're talking about forms, do you see any movement? I think it's the 8868 type of form for the online do-it-yourself?

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

I don't know what you mean by movement?

Michael Millman - *Millman Research Assoc. - Analyst*

Assisted, I think you fill out an 8868 and do it yourself. You don't, which seems to be a big advantage for some filers.

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

Yes. Obviously, on our online software and our competitors', they'll have all the impacted forms. We believe that over the next two or three years, as everyone who is required to purchase insurance, whether they do or not, is confused or confounded by the new laws and the new instructions and the new penalties and credits that there's going to be a switch from do-it-yourself to assisted tax-preparation.

Michael Millman - *Millman Research Assoc. - Analyst*

Sorry, I may have been using the wrong form. I was thinking more of the fraud form.

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

So, I'm not sure what your question is, again?

Michael Millman - *Millman Research Assoc. - Analyst*

So, my question is I thought it was an 8868 that you have to fill out unassisted, that you've asked all these fraud questions but there's nothing like that in the do-it-yourself yet. And that was my question is it changing?

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

Well, you're right. There has been a shift in, over the last four or five years, in earned income credit customers who now are going to do-it-yourself because we as preparers are required to get -- provide more substantiation, ask more questions, do more due diligence than they are required to do online. So there has been a modest shift of a few million customers over the last several years to do-it-yourself and it's primarily in the earned income credit arena.

Michael Millman - *Millman Research Assoc. - Analyst*

Right, and so my question is is there something similar on the horizon for the do-it-yourself?

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

We haven't seen that yet, so we'll have to wait until we see that from the IRS.



Michael Millman - *Millman Research Assoc. - Analyst*

Okay. With Mark leaving, does this suggest that you see less opportunity in the financial products and so related to that, what do you see for RT pricing this year and going forward?

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

No. As a matter of fact, much of -- I really appreciate that Mark told me 12 years ago when he started that he was going to only work until he was 50, and fortunately I got to keep him a couple of years past 50. So it just -- Mark leaving has a lot to do with the quality of his life. And not everyone is a workaholic like me that's going to work until I die, and we appreciate all the things he's done for us in the last 12 years, and he's been obviously the second most important, clearly, in our organization.

But the RT pricing we see across the industry pretty much identical pricing to last year.

Michael Millman - *Millman Research Assoc. - Analyst*

Okay.

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

And we do -- I should say that we do see increased profitability from the RT and bringing more volume in house as we have done in the past.

Michael Millman - *Millman Research Assoc. - Analyst*

A balance sheet -- and maybe I missed this, the tax receivables are up, assets for sale. Maybe you can talk about what that is about? And then it looks like notes receivable are down.

Kathy Donovan - *Liberty Tax Inc - CFO*

Sure, this is Kathy. Assets held for sale we talked about last quarter. It's part of our company stores. We moved them into the category of assets held for sale. And our goal, since we believe that franchisees can operate stores better than employees and we moved them in the fourth quarter, and our goal is to every year sell all of the Company stores that we come into the year with. So that's what happened there. You actually in the fourth quarter saw a reduction in goodwill and an increase in assets held for sale. So that's something that happened in the fourth quarter.

Notes receivable are down and the offset is really just up in trade Accounts Receivable because we used to have a practice where we would take notes that customers hadn't paid -- or Accounts Receivable and put it into a note, and we no longer do that. So, you really have to look at those two in combination.

And I'm sorry, was there a third question?

Michael Millman - *Millman Research Assoc. - Analyst*

I would say it was related. I think you've answered that. Thank you.



Kathy Donovan - *Liberty Tax Inc - CFO*

Okay, great.

Operator

Alex Paris, Barrington Research.

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

Welcome back, Al.

Alex Paris - *Barrington Research Assoc. Inc. - Analyst*

Thank you. I just had one follow-up. Actually, two follow-ups. First of all, with regard to Mark, I think Mike Millman drew it out of you. This wasn't sudden; this was long planned. The day he joined you he said I was going to retire at 50 and he stuck around a couple of extra years because he was needed. And he really believes that while it's definitely your shop, John, that he had a big role there and he wanted to leave it in good hands. Kathy Donovan getting brought on board was a big part of it and I think he made a great choice there. And even Mike Piper running Financial Services. So I personally don't view his departure as anything with regard to the Company. I just wanted to echo your thoughts. And that doesn't require a response unless you want one.

The other question was for Kathy. Back to the price increases, a little clarification. So, I'm still modeling roughly a 5% price increase across the board not related to ACA, just ordinary course of business. And I was modeling an additional 5% bump because of ACA. So now, instead I'm at 7.5% or 8% instead of 10%. I've already actually ran it through my model and it doesn't make a material difference anyway, but is that the right way to think about it?

Kathy Donovan - *Liberty Tax Inc - CFO*

Exactly. That's exactly what we are doing also, yes.

Alex Paris - *Barrington Research Assoc. Inc. - Analyst*

Okay. Well, thanks very much and good luck on the upcoming selling season and tax season.

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

Thank you, Al.

Operator

Thank you. I will now turn the call back over to John Hewitt.

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

Thank you, everyone, for your attention. And again I want to -- we understand that our future is based on happy, successful franchisees and happy, successful employees, and I thank you all. Have a great day.

Kathy Donovan - *Liberty Tax Inc - CFO*

Thank you all.

Operator

Ladies and gentlemen, thank you for joining today's conference. Thank you for your participation. That does conclude the 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.

©2014, Thomson Reuters. All Rights Reserved.

