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# EDITED TRANSCRIPT

TAX - Q2 2014 JTH Holding Inc Earnings Conference Call

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## CORPORATE PARTICIPANTS

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

**Mark Baumgartner** *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

## CONFERENCE CALL PARTICIPANTS

**Arnold Ursaner** *CJS Securities, Inc. - Analyst*

**Joseph Janssen** *Barrington Research Associates - Analyst*

**Scott Schneeberger** *Oppenheimer & Co. - Analyst*

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## PRESENTATION

### Operator

Good afternoon. My name is Hope and I'll be your conference operator today. At this time, I would like to welcome everyone to the Second Quarter Fiscal Year 2014 JTH Holding Earnings Conference Call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session.

(Operator Instructions)

Thank you. Ms. Darby Schoenfeld, Director of Investor Relations, you may begin your conference.

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### **Darby Schoenfeld** - *JTH Holding, Inc. - Director - IR*

Thank you. Good afternoon, everyone, and thank you for joining us. With me today are John Hewitt, our Founder, Chairman, and Chief Executive Officer; and Mark Baumgartner, our Vice President and Chief Financial Officer and CEO of JTH Financials. The press release announcing our second quarter earnings was distributed this afternoon.

The earnings release may be accessed at the Investor Relations section of our website located at [www.libertytax.com](http://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, 2013, and our other SEC filings. JTH Holding, Inc. 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 Hewitt** - JTH Holding, Inc. - Chairman, CEO

Thank you, Darby. We are focused on our preparations and are gearing up for tax season that we believe will see an increase in filers. Even though the IRS has announced it will open one to two weeks later because of the government shutdown, we do not believe that it will have the same impact as it did last year.

For starters, everyone is aware of the delay well in advance. Second, all of the forms should be ready when the IRS does start accepting e-filings as opposed to being released as late as early March as was the case last year.

Finally, a delay in the tax season isn't new to us. We have some lessons learned from last year and are planning accordingly. In fact, we have already seen a rise in US system-wide revenue this fiscal year indicating that some taxpayers may have just delayed filing beyond April.

Last year, the industry also suffered from a decline in filers because the IRS -- of the IRS requiring a higher level of documentation from taxpayers. That was a one-time change and we do not believe it will hinder this tax season.

Also, we believe that the Affordable Care Act will drive some traffic to our offices simply because of the confusion surrounding it. We polled about 800 of our customers and found that approximately one-fourth of them do not have health insurance and about 10% of them had unanswered questions about the ACA.

Our franchises have worked hard in the past few months to position themselves as a source of information regarding the ACA by hosting seminars to educate not only individuals but also small businesses on what the ACA might mean to them.

Based on what we've seen so far, we believe the industry will see an increase in the range of 1.5 million to 2 million more filers this year. Down the road, there's also a possibility of immigration reform that could impact the tax preparation business by generating additional new tax filers. This population aligns well with our current demographic, and we are already making preparations to position Liberty, should a reform package pass in the near future.

At the company level, with the competitive front being what it is from mom-and-pops, we are being contacted by -- more often by those looking to either sell or convert to a Liberty Tax franchise. And since we have pretty much the only game in town to buy a franchise, we continue to see this as a positive impetus for us moving forward.

Our offices continue to mature, and as they do, their return count of repeat customers grow. Our franchise base is maturing and that helps them get ready to expand and open more offices. We have said on many occasions that our model lends itself to a multi-unit operator, and we are looking forward to helping our current franchises to attain that.

We have solidified our relationship with Wal-Mart and are moving into more locations as well as ones that have higher population density than our previous markets and are more likely to have had a tax preparation station in them last year. As we said in the first quarter, we and our franchisees intend to operate key assets in approximately 500 Wal-Mart's in tax season 2014.

During the first half of fiscal 2014, the company added 106 new franchisees, 48 of which purchased 53 new territories. The company sold a total of 65 new territories during the first half of fiscal 2014. This does not include any rent-to-own or try-before-you-buy agreements, which many existing franchisees utilize to expand.

On our last call, we told you that as we came out of the blackout period, we were redoubling our efforts to sell franchises with the goal of making up for lost time. However, because of the time of the year and the time it takes to close deals, which often includes finding an office location, we do not anticipate being able to sell as many territories as we had hoped. We do not expect to add the same number of franchises this year as we have in the past or sell the same number of territories due to our inability to sell during that important part of the second quarter.



I would also remind you that if one of the Wal-Mart locations is in the territory that one of our franchisee already owns, that franchisee does not have to purchase another territory to operate the Wal-Mart. So, there is no franchise fee revenue associated with their expansion.

The number of new territories sold is not necessarily a proxy for the number of new offices we will open because some franchisees may be opening a second office in the territory with the addition of the Wal-Mart location. While we are not giving any specific guidance today on the increase in our office count due to the blackout caused by the restatement, I can tell you that we do not expect our net new offices to match the growth we have had in previous years.

To give you an update on our executive team, shortly after our last call, we announced the addition of Chris Carroll as Vice President of Sales and Marketing. Chris joins us with over 30 years of marketing and advertising experience with time at large franchisers such as Subway and Burger King. We are excited to have someone with such an extensive background of franchising and look forward to utilizing his experience and ideas to help us reach our goals.

We have been interviewing some highly qualified candidates for the CFO role and have made significant process. While we are enthusiastic about the people we have talked to, we do not have a timetable at this time. We will keep you updated on this front. And in the meantime, Mark continues to operate in this dual capacity as our company's CFO and the CEO of our Financial Products business.

We also continue to restructure the responsibilities of our former COO position. The beginning of this was the hiring of Chris to head up the sales and marketing functions. The remaining responsibilities will be split up as we integrate a strong team that will build bench strength for our current executives.

We talk often about happy, successful franchisees being one of the most important things for our growth. So, I would like to share with you some recent awards and accolades that our franchisees have helped us win.

USA TODAY named us as one of the Top 50 Franchises for Minorities in October, US Veterans Magazine named Liberty a Best of the Best for Veterans, and Franchise Business Review named us as a Top 50 Franchise for Veterans and Franchising; finally, Entrepreneur Magazine recently released its annual Franchise 500 list and Liberty was ranked number 21 of all franchises. We are proud of the hard work and the fanatical customer service our franchises provide our customers and are very excited to have been honored with these awards.

Now, I'd like to turn the call over to Mark Baumgartner, our CFO.

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**Mark Baumgartner** - JTH Holding, Inc. - VP, CFO, CEO - JTH Financials

Thank you, John. First, I'd like to update you on where we are in relation to the restatement. The final phase consists of re-filing all our 10-Qs from last year. We filed the first of those, the second quarter of fiscal 2013, in November and continue to be on track to file the remaining two during our third quarter.

Onto the results of the quarter. Total revenues for the second quarter of fiscal 2014 decreased 21.6% to \$7.3 million compared to \$9.3 million in the prior year period. The decrease in total revenues was primarily due to a decrease in the franchise fees because of our inability to sell franchises for a portion of the quarter. This caused a few things to occur. First, the largest impact was a decrease in franchise fee revenue.

Second, since some of our area developers utilize the corporate sales force to sell franchises in their area and the commission payments they make are recognized in our income statement in other revenue, this also decreased. Finally, we also charge a transfer fee when one of our franchisees sells to another. And with the inability to sell as part of the quarter, we were also unable to process transfers.

Operating expenses for the second quarter increased 11.1% to \$20.9 million versus \$18.8 million in the prior year. During the second quarter, we incurred approximately \$693,000 in pre-tax costs related to the restatement. We also expensed approximately \$614,000 pre-tax in one-time severance costs related to the departure of a former executive. These items accounted for the bulk of the increase in expenses.

Our net loss for the quarter was \$8.5 million compared to \$6.1 million in the prior year. Our results were not unexpected and mainly reflect one-time events, which we had previously announced as well as the typical seasonality of our earnings. The main drivers were the inability to sell franchises, causing our total revenue to decline, combined with an uptick in expenses from costs associated with the restatement and severance payments.

Our balance sheet continues to be strong. As is typical of this time of year, our cash balance at the end of the quarter was \$2.6 million, compared to \$1.2 million at October 31, 2012. The amount drawn on our revolver was \$38.5 million at the end of the quarter compared to \$39.7 million last year. Loans to franchisees for operating purposes decreased \$3.4 million, which was offset by an increase of \$2.1 million in the purchases of area developer rights and company-owned offices.

As we look at the 2014 tax season, there are a couple of things we would like to share with you. As John mentioned, when a franchisee opens a second office in a territory, like a Wal-Mart kiosk, we don't receive any revenue associated with that other than the ongoing royalty, advertising fees, and financial products. With our inability to sell franchises for part of the quarter and the expectation that we will have fewer new territories this year than last, you should expect our franchise fee revenue to decline.

Additionally, we have also said that we are over 80% sold out in our area developer program so we will not be adding them at the same pace that we have in the past and we expect an increase in our ability to repurchase them. Just some things to keep in mind as you are looking at how our revenue will fall out this year.

Turning now to financial products. Last year, we piloted the ICA loan program in 27 states during the early season, and this season, we plan to offer the ICA in 21 states. We believe this gives us a strong competitive advantage because we're the only company to offer tax settlement loans to our clientele.

Additionally, very late in the season last year, the OCC gave approval to one of our partners to offer a secured credit card loan based on a customer's anticipated tax refund. Recently, we learned that that re-approval of this product will be delayed because the OCC would like to review this product for consistency with all of its existing policies.

We believe it is a good product for our customers, one that they will want and one that benefits consumers by providing them a path to build credit. I'd now like to turn things back to John. John?

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

Thank you. And hopefully, we're ready to take questions now.

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## QUESTIONS AND ANSWERS

### Operator

Okay. (Operator Instructions). Your first question comes from the line of Arnie Ursaner with CJS Securities.

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

Welcome, Arnie.

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**Arnold Ursaner** - CJS Securities, Inc. - Analyst

Hi, good afternoon, John. I guess my real question is related to the timing of signing up franchises, which I fully understand you had an issue, how much of that do you hope to make up in Q3? And I'll have a follow-up after that.



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

Arnie, I would say that our relative decrease year-to-date will likely continue to the end of the fiscal year.

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**Arnold Ursaner** - CJS Securities, Inc. - Analyst

So, originally you had thought that you could easily make it up, you'd have more than enough time to get this done, but it doesn't sound like that's what you're thinking at this point?

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

I'm not sure the phrase I would use is easily make it up, but we were -- we had hoped to certainly close the ground between what we had anticipated before we had the issue with the SEC and our original goal.

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**Arnold Ursaner** - CJS Securities, Inc. - Analyst

Okay. Two more quick questions if I can. You mentioned you didn't include any rent-to-own or try-before-you-buy agreements with existing franchises this quarter. Is that unusual or was that also related to this? And maybe you could explain why we didn't have any of this quarter.

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**Mark Baumgartner** - JTH Holding, Inc. - VP, CFO, CEO - JTH Financials

Arnie, this is Mark. We have not put in there -- we couldn't do those during the blackout period either, and existing franchisees utilized those programs to expand. So, right now, at the end of October, we're -- there's a number that are in process. They typically close those during calendar year fourth quarter, here at the end right before the season opens.

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**Arnold Ursaner** - CJS Securities, Inc. - Analyst

Okay. My final question --

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

So, it would be similar to last year, yes.

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**Arnold Ursaner** - CJS Securities, Inc. - Analyst

Got it. My final question is you mentioned you planned or hope to operate 500 in Wal-Mart this tax season, but you, if I recall, had 300 in place or so. So, are we only adding a net 200, is that the way to think of this?

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

That's correct.

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**Arnold Ursaner** - CJS Securities, Inc. - Analyst

Okay. Were you hoping to have more?

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

We hope to expand the relationship to be the only vendor in Wal-Mart one day.

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**Arnold Ursaner** - *CJS Securities, Inc. - Analyst*

Okay. I'll jump back in queue. Thank you.

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**Operator**

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

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

Welcome, Alex.

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**Joseph Janssen** - *Barrington Research Associates - Analyst*

Yes, actually, this is Joe filling in for Alex. Just a follow-up on Arnie's question, is there any chance we can get a peek into the selling season in November and maybe how that compares year-over-year? And second part to that, do you -- like last year, around this time, you kind of gave us the expectation of what the total store count would be going into the tax season.

Do you think you'll maybe give a press release later in the month, maybe disclosing how many new stores we'll have go into the tax season or is it is just something we're going to have to wait and play itself out through the tax season?

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

Joe, we'll issue something when we have a good idea of what that number actually is, when we're close to the final count. It could vary today as much as 100 to 200 offices depending on obtaining locations, opening in seasonal locations and so forth. As far as our decrease in November, it was comparable with what had happened in previous months. And keep in mind this, we're talking about a less than 3% of our office count is impacted by bringing -- this year by bringing in these new franchisees.

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**Joseph Janssen** - *Barrington Research Associates - Analyst*

Okay. And let me switch gears a bit. Let me just focus on NextGen here for a second. Maybe you could talk about what your internal expectations are for it during the year, maybe in terms of like total filings as well as kind of how you're thinking about pricing this in the market?

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

We're going to have a couple different pricing models with NextGen. It's going to be primarily online this year. And so, we're going to have a Liberty brand and eSmart brand, several different methods of attack of gaining market share in the DIY market.

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**Joseph Janssen** - *Barrington Research Associates - Analyst*

And maybe you could just comment on maybe your marketing strategy around that and how you plan to drive the customer traffic to the offering? I mean, because before that we was just kind of was sitting out there. I think you had about 150 filings last year. I mean do you plan on putting some marketing dollars behind this and actually push this product this year? Or is it kind of more in a beta test phase?

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

We're happy with the amount of money we spent last year. And we expect to gain market share by offering different channels and different brands in the digital arena. But the marketing spend should be comparable with last year.

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**Joseph Janssen** - *Barrington Research Associates - Analyst*

Okay. And then my last question and I'll jump back in queue. Staying with NextGen, can you kind of give me some financial context around this and what the impact in D&A as well as, I know that is going from capitalized and now it's going run through the P&L, maybe some of the expenses that are associated with running the program?

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

Suffice it to say that we're not making any significant profit at online at this point. Our primary purpose is to -- in the short run, in the next few years, is to drive customers into our storefronts. And we think it gives us a competitive advantage over both Intuit and who has TurboTax and the mom-and-pops because there's many, many customers switch back and forth between online and storefront.

And we can keep them in our web, if you will, and the mom-and-pops can't afford to have online and TurboTax, Intuit, do not have storefronts. So, we're more likely to keep them in our realm if we have both vehicles. So, that's a primary purpose in the short term for our online approach.

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**Joseph Janssen** - *Barrington Research Associates - Analyst*

Okay. All right. I'll jump back in queue. Thanks, John.

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**Operator**

Your next question comes from the line of Scott Schneeberger with Oppenheimer.

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

Hey, Scott, how are you doing?

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**Scott Schneeberger** - *Oppenheimer & Co. - Analyst*

Hey, John. I'm well. How about you?

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

Super.



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**Scott Schneeberger** - *Oppenheimer & Co. - Analyst*

Good. A couple I'm going to shoot around the board here. On your pacing on franchise sales, I heard, I think it was you mentioned only shop in town that's aggregating, I just wanted to get more color on that. Your trend is off a bit. Was that primarily the restatement or is it a little softer out there in acquiring new folks since you are the main aggregator?

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

Yes, when Mark talked about us being the only game in town, the way we view it is Block is totally saturated and really hasn't brought any significant amount of new franchisees in since the 80s. Jackson Hewitt has stalled dramatically in the 21st Century.

They haven't even -- in the last 10 or 12 years, they've averaged less than 20 franchisees a year, new franchisees a year, and much of their areas are sold out of major metropolitan areas. So, we've had a competitive advantage, we're normally the only game in town.

As far as seeing a change in the landscape, no, not at all. What happened is we knew that we were going to have to go dark, and we stopped our advertising and then we actually went dark for about 30 days. So, we lost seven very, very important weeks in our franchise development period. The period -- it's the most important period of the year to us, the August, September period.

And that's because people in December, in January and February and March and April, aren't acquiring franchises, they're opening in the following January. And by the same token, people in November and December, it's too late for them to acquire franchises.

So, the really important period for us starts about July or August and ends about October. And so, we lost in a very, very critical peak period. We lost seven weeks of advertising and four, almost four and a half weeks of being able to just talk to anyone about acquiring a franchise. We believe that next year, we'll go back to our pace that we've maintained over the last five or six years of bringing in over 300 new franchises a year.

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**Scott Schneeberger** - *Oppenheimer & Co. - Analyst*

Great, understood on that timing. Thanks. Switching over to financial products, you had alluded to the OCC, with approving a product offer on speed of refund and then delaying it on re-approval, will that influence your ICA product? If you can just provide a little more color on that. And I missed when Mark said, how many states you anticipate to be in fiscal '14, so if I could just get that too, please?

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**Mark Baumgartner** - *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

Okay, Scott, this is Mark. How are you doing?

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**Scott Schneeberger** - *Oppenheimer & Co. - Analyst*

Fine. Thanks.

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**Mark Baumgartner** - *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

It's 21 states that we will be in. And at this point right now, that partner and that program is operated under the state finance regulations of those individual states. So, we don't anticipate any issues with the OCC.



And so, the program, the secured credit card program is one that we did get approval on very late last season, and the OCC right now has just asked for more time to check it against all of their policies. So, at this point, we've told our franchisees not to expect it for the beginning of the season.

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**Scott Schneeberger** - *Oppenheimer & Co. - Analyst*

Okay. Thanks for that, Mark. And then, John, if I can flip back to you, one more broad one on the ACA, it's a broad question, just love your latest and greatest on you think -- well, we heard a little bit what you think the potential -- what you think tax returns will increase this year and obviously ACA being one of the drivers.

Do you still anticipate a significant pickup in the tax season of 2015 and then your view on storefront versus digital? And also, do you anticipate an incremental form, it doesn't look like it'll be this year, do you still for next year? So a bunch of questions, all tied into one there, please, John, just whatever you care to cover there.

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

Scott, what was the last question, incremental what?

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**Scott Schneeberger** - *Oppenheimer & Co. - Analyst*

Oh a form, if there'll be a specific Federal healthcare form, an incremental form in the tax filing process.

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

Okay. Yes, the last one's the simplest one, is we do believe that there's going to be another form added, and possibly two; one could be a credit and one could be a penalty.

As far as the impact this year, we believe that, as I said in our study, about 10% of Americans have questions and many of those we're reaching through seminars, many of them are calling our offices and we're offering as much help as we can to get in front of those potential customers and many of them will turn into customers.

Now, I would say that industry-wide, that would be in the low single digits this year, the impact. Next year, amazing impact, there's 40 million or 50 million people that are impacted. Many of them aren't filing a return today and will be required to file a form, a tax return. And so, there'll be more filers, we believe that storefronts assisted will get their share, their 60-plus share of that.

Many of the do-it-yourself customers will have changes in their returns. And one of the biggest two or three reasons that people come to an assisted preparation is they have a change in their tax return. And so, we believe that's going to be the biggest impact in my -- that'll be my 46th tax season in 2015. That's the biggest change I've ever seen. So we're very optimistic about what that means to our industry.

As far as digital and storefront, we continue to see the trend last year. As you know, Scott, the Intuit TurboTax posted its worst year ever. In their forecast for next year, they're forecasting similar results for last year. And that's just indicative of the fact that there are very few taxpayers left that are doing paper and pencil at home by themselves.

And primarily, do-it-yourself online have taken share from do-it-yourself at home pencil and paper. So, we don't see that -- any significant change. We continue to believe it'll be 61% or 62% of people will seek assisted in -- assistance next year in a storefront.



**Scott Schneeberger** - *Oppenheimer & Co. - Analyst*

Great. Thanks for covering all those, John. Appreciate it.

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

Sure.

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**Operator**

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

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

Welcome, Michael.

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**Michael Millman** - *Millman Research Associates - Analyst*

Thank you. How are you today?

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

Super.

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**Michael Millman** - *Millman Research Associates - Analyst*

Following up on some Scott's questions, regarding the ACA, the low single digits impact, are those today non-filers or do you see them coming from other filing approaches?

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

So, I would say the vast majority of that would be from people who are filing returns already and required to file that are not covered by insurance that have questions as to what direction they should go. And so, I see many of them in that process of us answering those questions will be converted into paying us for their tax returns.

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**Michael Millman** - *Millman Research Associates - Analyst*

So, they're current filers. To what extent are they your current filers? To what extent are they doing it using other assisted approaches?

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

Well, I'm not an expert in the percentage of income level related to those not covered by insurance. But I think it would be obvious. My gut feeling is that a higher percentage of lower income taxpayers are not covered by insurance. And since we're after the bottom 85% of the income earners in this country, we're not after the people that make hundreds of thousands dollars. I would say most of them aren't covered by insurance. And so, I think a greater percentage of our customers are impacted than the general population.

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**Michael Millman** - *Millman Research Associates - Analyst*

And maybe I mis-asked that question. I was really asking to what extent are some of those questioners current filers with you and with Liberty and --

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

I would say since we have about a 3% market share, then 3% are Liberty customers.

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**Michael Millman** - *Millman Research Associates - Analyst*

I see. Okay. And talking about pricing, to what extent or -- and to what extent are limiting price increases? And what do you see price increases this year?

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

I've always felt that H&R Block as being 800-pound gorilla is the benchmark against which we've had to price. And so H&R Block is a very important part of the pricing policy in this industry, just like McDonald's is in the hamburger industry.

So, we're little bit higher than Block. We have some things that we believe that are clearly demonstrable that we do better. But they maybe the limiting factor. From what we've understood, they're going to go back to a more traditional pricing increase this year. And so, we're looking at -- Liberty is looking at a 3% to 5% pricing growth throughout the industry this year.

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**Michael Millman** - *Millman Research Associates - Analyst*

Do you see continued free or very low-cost EZs?

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

No, I've heard a scuttlebutt that they're -- after providing free 1040EZs for three years, I've heard that they're going to drop that program. As you might remember, we tested that program in a few hundred of our offices in the second year that Block provided it and found it to be very unsuccessful.

So, we quickly stopped that program and don't believe it's very successful. So it wouldn't surprise me. They will drop that program someday, I believe, and this is probably the year they're going to drop it.

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**Michael Millman** - *Millman Research Associates - Analyst*

And just maybe I misheard you talked about the SEC blockage. I was under the opinion that you were all settled with the SEC.

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

So, I was talking about it, and I'll turn it over to Mark, but I was talking about that ran from early August until the end of September.



**Mark Baumgartner** - *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

Yes, Michael, in my comments, the one thing that we still have outstanding with the SEC is the re-filing of our Qs for our fiscal 2013. The first one we re-filed in November, and we publicly said that we anticipate getting the other two done here during our fiscal third quarter.

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**Michael Millman** - *Millman Research Associates - Analyst*

Got it. Thank you.

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**Operator**

Your next question is from the line of Thomas Allen with Morgan Stanley.

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

Welcome, Thomas.

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**Thomas Allen** - *Morgan Stanley - Analyst*

Hey, John. Good afternoon. Just -- you mentioned a stat that I found interesting earlier. You said you surveyed 800 customers and one-fourth of them didn't have health insurance. Did you get any sense of how many of them are planning to get health insurance?

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

Yes, based on the response to that only 10% had questions. So, I guess our gut feeling is as a result of our survey and in talking to our franchisees, in surveying our franchisees is the low penalties that are being imposed in the first year is going to get a low -- a pretty substantial number or percentage of taxpayers not acquiring the necessary insurance.

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**Thomas Allen** - *Morgan Stanley - Analyst*

That's helpful. Thanks. And then, I notice you said that you did ICA loans in 27 states last year and then this year you're going down the 21 states. Why is there the decline?

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**Mark Baumgartner** - *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

That's a third-party product that we offer, and they've decided from an economic perspective, not to offer it in some of the states that they had piloted it in last year.

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**Thomas Allen** - *Morgan Stanley - Analyst*

Okay. So, should we assume in -- does it need scale or do we think that in certain states have high default rates, those states is just not profitable basically?

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**Mark Baumgartner** - *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

It's based on -- Thomas, this whole program is based on the states' consumer finance regs and they differ state-to-state. So, what could have happened in one of those six states is a passage of a new law that changed the fees that could be charged.

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**Thomas Allen** - *Morgan Stanley - Analyst*

That makes a lot of sense. And then just in terms of refund transfers for next year, have you changed your -- are you thinking about changing your pricing at all or are you going to change -- or have you changed pricing at all?

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

We haven't announced that yet.

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**Thomas Allen** - *Morgan Stanley - Analyst*

Okay.

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

But I believe -- Thomas, let me say it this way, that I believe that the pricing of the refund transfer products will continue to decrease going forward and we should be announcing that in the next three weeks.

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**Thomas Allen** - *Morgan Stanley - Analyst*

Okay. And just why do you think it should continue to go down?

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

Because the one thing that helped to keep the fee high in the past was that you could apply for a loan. And since there are very few loan products available in this country, I think that the product will come down in price to meet that. And I can't say that our price won't be very much different at all from last year. It's not a significant change. But we will announce that, and over the years, I suspect that those fees will be reduced to the consumer.

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**Thomas Allen** - *Morgan Stanley - Analyst*

Okay. And then just final two questions just on the IRS. Have you heard any movement on return preparer certifications suit? And then also, I read somewhere that there may be a new head of the IRS. I think one of the candidates was going in front of the Senate Finance Committee today or maybe tomorrow, but any -- do you think that'll have any change on the overall industry? Thanks.

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

As far as the preparer certification, the IRS has appealed the decision, so it's in the appeals court. And they've asked for -- they expect the ruling soon on that. And we believe, Thomas, that if, even if the IRS loses that appeal that they will go to Congress and ask for Congress to pass the appropriate legislation to enable them to do this, because originally, the impetus to do this started with both houses of the Congress as -- three, four years ago actually. Both houses of Congress passed bills requiring the IRS to provide certification of preparers.

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So, it came from Congress and I think it's a good thing. And I think most people agree on that. And so, I think it'll come into play by next year or at worst the year after that.

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**Thomas Allen** - *Morgan Stanley - Analyst*

And just any update on kind of the IRS getting a new commissioner or new head?

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

Well, Thomas, we're not experts on that. I'm not an expert on government, what Obama is doing or on that. But our indications from our bi-weekly meetings with the IRS is they expect that to be -- their new commissioner name by December 31.

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**Thomas Allen** - *Morgan Stanley - Analyst*

Great. Thank you very much.

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**Operator**

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

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

Hey, Joe, welcome back.

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**Alexander Paris** - *Barrington Research Associates - Analyst*

Hey, thanks. It's Alex this time.

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

Oh well, good. We've got the big guy.

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**Alexander Paris** - *Barrington Research Associates - Analyst*

We've got two guys dialed in. Just a couple of quick clarifying questions. So, you did 106 new franchisees year-to-date, fiscal year-to-date this year. I look back on my notes, you did 227 last year during that same period of time, first half fiscal 2013. What'd you do in total last year? And are you saying, I mean I see no reason why you would have any fewer people coming on in the balance of the year, right?

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

Actually, the reason there's fewer people is the time it takes to bring in a new franchise into the fold. And it's about a three-month process from the time they first inquire until the time they come in. And so, if someone inquires after September 30, it's very, very unusual for them to move forward in that fiscal year. They usually wait a year before they'll proceed.



So because we lost that period from early August until the end of September, that had a similar impact on the remaining part of the quarter -- the third quarter.

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**Alexander Paris** - *Barrington Research Associates - Analyst*

I got you. So, in other words, last year's new franchisees that closed in the third quarter, that was started in the second quarter. And then in this case -- so you really don't expect too many more new franchisees besides the 106 you already have?

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

I'm not sure what you mean by not too many, but I think you can use a comparable percentage of decrease through the second quarter for the entire fiscal year.

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**Alexander Paris** - *Barrington Research Associates - Analyst*

What was the number for last year's fiscal year for the full year?

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

I don't have the number off the top of my head. It was in the high 300s.

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**Alexander Paris** - *Barrington Research Associates - Analyst*

High 300s, okay. And if you were down 50% year-to-date, you're going to be down 50% for the full year, that's what you're saying?

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

That's not far off.

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**Alexander Paris** - *Barrington Research Associates - Analyst*

Okay. Then the fact that you're in 21 states with the ICA product as opposed to 27 states, as you had said in response to previous questions, it's based on approvals and that sort of thing. Is that going to have a significant impact on financial services revenue this year versus last?

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**Mark Baumgartner** - *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

No. We do not -- I mean last year, we only offered the program very early part of the season and then turned the program off. And on the loan side of it, only about 2% to 3% of our customers get that product, so it's very small impact.

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**Alexander Paris** - *Barrington Research Associates - Analyst*

Okay. And then last year, again, looking back over my notes, in mid-December you gave guidance for fiscal 2013. You gave office growth number percentage, you gave total revenues in a range, you gave the effective tax rate and you gave net income. Do you expect to do anything like that later this month for fiscal '14?



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

If you can tell me when the IRS is going to open for electronic filing and you can tell me when they're going to start paying refunds. There's just too many questions out there about what the IRS is going to provide this tax season. So, we're not easily able to provide that kind of guidance.

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**Alexander Paris** - *Barrington Research Associates - Analyst*

Yes, that makes sense. Okay, well, I'll follow up with you guys. John, I'll be seeing you tomorrow, I think. So, thank you very much.

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

We look forward to it.

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**Operator**

Your next question comes from the line of Stefan Mykytiuk with TIG Advisors.

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

Welcome, Stefan.

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**Stefan Mykytiuk** - *TIG Advisors - Analyst*

Thank you. Hey, good evening. Couple questions. I guess Mark brought up earlier the concept of acquiring or buying in some area developers. Can you just give us a sense of how many area developers do you have in total and kind of the average size of the area developers?

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

Yes. We have about 140 area developers and I don't know what you mean in average size. Since it's 80% of our chain, you can take 80% of our offices and then that'll tell you about how many offices per area developer.

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**Stefan Mykytiuk** - *TIG Advisors - Analyst*

Okay. Yes, I meant more in terms of how much revenue there -- how much of the royalty revenue there they would collect on average. But I guess, we can see ...

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**Mark Baumgartner** - *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

You can see now the area developer expense which is both the royalty as well as their share of the franchise fee.

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**Stefan Mykytiuk** - *TIG Advisors - Analyst*

Okay.



**Mark Baumgartner** - *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

And that was on the -- go ahead.

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**Stefan Mykytiuk** - *TIG Advisors - Analyst*

Right. I was just going to say is there a wide distribution of how big they are or do they fall into -- like is average a good way to characterize them? Or do they run from being very small to being very large?

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

Yes. They run from anywhere from having two offices to 120 offices. So, there -- but there is -- as Mark said, there's a line item that shows the possible revenue that we can obtain per year by buying them back.

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**Stefan Mykytiuk** - *TIG Advisors - Analyst*

Right. Well, that's right for the whole system. If they vary so much in size, then that may be -- it may be kind of misleading to try average them or look at it that way.

I guess the other questions is would you -- if you were to acquire area developers, would you want to do that kind of outside of the tax, the peak of the tax season, just from a management perspective?

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

We have been reacquiring area developers, and the vast majority of them are exactly that in the first two quarters of each year.

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**Stefan Mykytiuk** - *TIG Advisors - Analyst*

Okay.

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

In the planting season, as we call it.

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**Stefan Mykytiuk** - *TIG Advisors - Analyst*

Okay. And then kind of moving on back to the financial services, the refund transfer product, do you think that the take rate will be similar this year? And do you continue to increase your penetration of the internally offered product versus the external?

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**Mark Baumgartner** - *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

Well, we don't -- I mean the take rate has been very consistent over the last four or five years, low 50%. And we don't anticipate any differences there. The take -- whether we bring a higher percentage in-house, let me just say that we anticipate keeping more of the economics in-house, whether we do that by moving more products in-house or using our leverage of bringing in-house to get better pricing from the third-party providers.



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**Stefan Mykytiuk** - *TIG Advisors - Analyst*

Okay. So even in, I guess, where I was going with it is John was talking about pricing potentially relatively flat this year. If you bring more in-house or keep more of the economics, then that's still a net benefit to the P&L of the company?

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**Mark Baumgartner** - *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

Absolutely, absolutely.

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**Stefan Mykytiuk** - *TIG Advisors - Analyst*

Okay, terrific. Thanks very much.

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**Operator**

Your next question is from the line of Arnie Ursaner with CJS Securities.

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

Arnie, welcome.

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**Mark Baumgartner** - *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

Hi, Arnie.

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**Arnold Ursaner** - *CJS Securities, Inc. - Analyst*

Hi, a couple of follow-ups. The 106 number, just to clarify, that's a net number?

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

No, that's just the number of new franchises.

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**Arnold Ursaner** - *CJS Securities, Inc. - Analyst*

So, franchisees, but is that a net number?

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**Mark Baumgartner** - *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

No, that is the new ones that we brought into the system.

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**Arnold Ursaner** - *CJS Securities, Inc. - Analyst*

Okay. I guess, what I'm trying to head with this is we've modeled roughly 280 franchises locations for the year. And I know you obviously said you expect it to be down, you did 337 a year before, 338 year before that. Is that the magnitude of what you're trying to have us think about for the upcoming year?

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

We're saying it's greatly reduced from those years.

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**Arnold Ursaner** - *CJS Securities, Inc. - Analyst*

Okay. Okay, I assume you don't want to attempt to quantify it on this call.

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

Exactly.

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**Arnold Ursaner** - *CJS Securities, Inc. - Analyst*

Okay. And just to clarify again the business model, you mentioned the three-month process from an inquiry so you can wrap up a new franchise agreement, I'm trying to think more about next year and how you may guide us for next year. To the extent you're not going to get them this year, is there some backlog, some pent-up demand and how should we be thinking about next year's new franchise adds?

And also could you comment on the timing of how we ought going to think the pattern, the seasonality of that should occur?

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

I think from a conservative vantage point that I'm going to say that next year, we'll revert to the same kind of years it's been in the last several years. So, we would say in the 300-plus range of bringing in new franchise. There is pent-up demand, there's a number of people that -- I mean when you think of pent-up demand, think of there's 200,000 seasonal preparers at Block and Jackson, even in Liberty combined.

A certain number or percent of them are going to acquire a new franchise typically every year. That just didn't happen this year because of our dark period. So, they're sitting out waiting a year to do it.

So, from an optimistic vantage point, we can say, well, we're going to get all of that -- those people who waited a year. From a conservative vantage point, we can say, well, we're going to do as well as we've done over the last five years before this year of averaging over 300 new franchisees a year.

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**Arnold Ursaner** - *CJS Securities, Inc. - Analyst*

Okay. Just to go back again on the Wal-Mart, is any of that included in the 106?

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

Yes, but most of the new franchisees are not acquiring Wal-Marts. They're acquiring territories with storefronts. And we didn't get the Wal-Mart list until summer. And so, it's very small percentage of the new franchisees. We've just come in owning a Wal-Mart. The Wal-Mart's work best in an area that has a storefront, and the Wal-Mart is a supplement to the storefront.

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**Arnold Ursaner** - *CJS Securities, Inc. - Analyst*

All right. And you mentioned the re-approval of the OCC has been delayed and may not impact you at the beginning of the tax season. Is there more specific information they're giving you? Or is it just you trying to be conservative?

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**Mark Baumgartner** - *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

No, they just -- we don't -- at this point, the program, we just found out that it is not re-approved, that they have to go through this policy group. And so, we've gone to our franchisees right now and told them with the pending holidays and everything, we don't believe it's going to get through the approval process in time for the start of the season. That doesn't mean we're not trying everything we can to get it through. But at this point, we're not anticipating it for the current season.

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**Arnold Ursaner** - *CJS Securities, Inc. - Analyst*

Okay. Thank you.

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**Operator**

Your next question comes from the line of Ryan Augustitus with Northcoast Research.

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

Welcome, Ryan.

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**Ryan Augustitus** - *Northcoast Research - Analyst*

Hi, thank you. Good evening. I had a couple questions. One is a clarification question on the tax forms with the ACA. You said earlier that potentially two of them, one with a credit, one with a penalty. Would -- are those 2015 or would any of those returns be for this upcoming tax season?

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

That would just be in 2015.

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**Ryan Augustitus** - *Northcoast Research - Analyst*

Okay, great. Thanks. And then last question is regarding like the scrutiny and extra documentation around EITC returns. And I was wondering, are you seeing any kind of trend of independents, kind of, steering clear away from those returns and driving those EITC filers into tax stores?

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

I think the independents were less rigorous on meeting the IRS requirements than the major players last year. So, I think we lost business, all of us, us and Block and Jackson Hewitt, all lost business to some of the mom-and-pops that did not require or meet the standards that the IRS had set up.

But overall, I don't think that was a large amount because there was a decrease in filers and everyone -- the industry and the IRS agreed that there was expected increase of about 1% to 2% in filers and there was actually a 1% decrease. Much of that came from this new due diligence required by the IRS that was a one-time event.

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**Ryan Augustitus** - *Northcoast Research - Analyst*

Okay, great. Thank you very much.

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

Thank you.

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**Operator**

Your next question is a follow-up question from the line of Stefan Mykytiuk with TIG Advisors.

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

Welcome back, Stefan.

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**Stefan Mykytiuk** - *TIG Advisors - Analyst*

Oh thanks. Hey, I just wanted to clarify because I think sometimes I mess up the terminology, but when you talked about 106 new franchisees, is that locations or new franchisees?

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

They're new franchisees. Most of them acquired are going to open an office. We have a percentage each year that buy an existing office. And so that tend to be about 75% of them will open new offices. And I think in my remarks, I gave the exact number as to 53 of them.

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**Darby Schoenfeld** - *JTH Holding, Inc. - Director - IR*

Fifty-three new territories.

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

Okay, that was 53 new territories in the 106 franchise.



**Stefan Mykytiuk** - *TIG Advisors - Analyst*

Okay. And the rest were existing?

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

Right.

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**Stefan Mykytiuk** - *TIG Advisors - Analyst*

Okay. And then -- but if an existing franchisee were to open a new office, wouldn't they typically do it sometime between now? And wouldn't they do it more in your December or in the kind of next couple of months before ...

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

Yes.

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**Mark Baumgartner** - *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

Yes.

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

Ninety percent of our offices open in January, and we don't start paying rent until January. So, that's why it's a bit difficult to give exact numbers right now because there are many, many negotiations that are going on as we speak.

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**Stefan Mykytiuk** - *TIG Advisors - Analyst*

Right. So, the 106 doesn't capture much of the new offices that an existing franchisee would open. And I think you said before, it also doesn't capture much of the Wal-Mart new locations.

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**Mark Baumgartner** - *JTH Holding, Inc. - VP, CFO, CEO - JTH Financials*

Right, correct.

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

It does not capture any of the existing office growth, the existing franchisee growth. That would be -- this is just a brand new franchisee.

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**Stefan Mykytiuk** - *TIG Advisors - Analyst*

Okay. Okay, all right. Thanks very much.

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**Operator**

And I would now like to turn the call back over to Mr. John Hewitt.

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

We want to thank everyone for their attention, and we look forward to having a great season and talking to you shortly.

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**Operator**

Thank you. This does conclude today's conference call. You may now disconnect.

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