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TAX - Q3 2014 JTH Holding Inc Earnings Conference Call

EVENT DATE/TIME: MARCH 13, 2014 / 12:30PM GMT



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Arnie Ursaner *CJS Securities - Analyst*

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Scott Schneeberger *Oppenheimer & Co. - Analyst*

Thomas Allen *Morgan Stanley - Analyst*

PRESENTATION

Operator

Good morning. My name is [Jennifer] and I will be your conference operator today. At this time, I would like to welcome everyone to the JTH Holding's Third Quarter Fiscal Year 2014 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)

I will now turn the conference over to Ms. Schoenfeld, Director of Investor Relations. Please go ahead.

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

Thank you, Jennifer. 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 new Chief Financial Officer. Also available for Q&A is Mark Baumgartner, the CEO of JTH Financial.

The press release announcing our third 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 under the About tab. A replay of this call will be available shortly after the conclusion of this call. The information needed 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, President, CEO*

Thank you Darby. The tax season is off to a good start for Liberty. We increased the number of U.S. customers served during the calendar year through February 28th by 7.7%, while the IRS is showing total tax receipts up 1.4% to the same date.



We continue to take market share and are happy to be able to provide exceptional customer service to an increasing number of customers. The results of the industry thus far continue to outpace last year, while the timing of this year's tax season was similar to last's, the two years have turned out to be very different.

For starters, the delay this year was announced well in advance of the season. Last year, the announcement came in early January and this year was announced in October. Since we found out so much earlier, we were able to plan sooner and better shift some of our advertising dollars into the fourth quarter, where they coincided with the peak of the early season.

Second, this year there was no conversion for states over to the modernized e-filing, so the early season has had very little in a way of technological blips. Third, all forms were ready when the IRS opened its doors for e-filing this year. So we didn't have to hold returns back from the IRS because certain forms weren't available. There is a possibility that some of the people who were unable to file earlier in the season last year due to the missing forms have filed already this year increasing the filed return counts earlier in this year.

Finally, last year, one of the items we believe decreased the number of filings with the change in earned income credit rules, where customers were required to provide documentation that dependents live with them. This year, our customers were aware of those changes and were better prepared.

Because of all the noise between the two seasons, it is difficult to tell where this season will end up. But based on what we have seen so far and our experience in the industry, we still believe that 1.5 million to 2 million or about 1% to 1.5%, more people will file this year versus last year. That increase gets us back to being more in line with where the industry has grown historically and where we think it will be going forward.

On the company front, again we are pleased with where things stand at the moment. Half way through the season, we are meeting our expectations, our franchise will continue to work hard and go above and beyond to make sure that our customers receive the best possible customer service in the industry.

With the late start to the season again this year, we had extended hours with some franchisees staying open 24/7, so that people could file their returns quickly, efficiently and on their own schedule. We are proud of what they have accomplished so far this year.

In regards to the decrease in our office count, we culled almost 15% of our offices, a much higher rate than the typical 10% we normally experience. However, the net decline of 2% in our office count in the U.S. has now significantly impacted our results thus far.

And while due to the restatement, we were unable to bring in as many new franchisees as we normally do, our operational results are still about where we expected them to be. We are pleased that we were able to focus this year on our higher performing franchisees and hope that we can continue to help them achieve their goals with the Liberty family in the future.

The early season success of our franchisees can be seen in our operational results. While in line with our expectations, the results are promising. Our returns processed in offices through February 28th increased 6.1%, and our online returns are up 29.1%. The average net fee has increased as well, and our system wide revenue increased 13.3%

Finally, I would like to mention our efforts surrounding the Affordable Care Act. We have partnered with a third party vendor to create a Liberty branded ACA website and Liberty health exchange and our offices have been referring their customers to it. There, they can not only learn about the ACA but also determine eligibility for a subsidy and sign up for health insurance.

We and our franchisees have spent much of the off season educating our customers through presentations that explain the impact of the ACA, not only on individuals but also on small businesses. This website helps us tie together the education we have given these customers with the ability to sign up and receive affordable healthcare through the exchanges.

Some of our franchisees and area developers have identified other ways to provide their customers with access to health insurance options. And we look forward to analyzing the results of different approaches as we plan for 2015, when we believe the ACA will have a greater impact on the tax business.

With that I would like to turn the call over to Kathy Donovan, our new Chief Financial Officer, who will go through the financial results of the quarter.

Kathleen Donovan - *JTH Holding Inc. - CFO*

Thank you, John. Good morning everyone. I am happy to be here today after my first six weeks with Liberty. I arrived here at the beginning of February just in time to see the whirlwind of tax season begin. I'm excited to start building relationships with everyone on the call and look forward to getting to know you all better.

As John indicated our season is off to a good start. We had a strong third quarter and that continued into February. Focusing on the quarter, our system-wide revenue grew driven by both higher return counts and an increase in average net fee. This drove our royalties and advertising fees higher and the increase in return count also increased our downstream financial products revenue. Our total revenue for the quarter was up 8% and we are up 3.5% for the year.

You probably noticed in our press release that financial products revenue grew faster than royalty revenue. Financial products require a return to be accepted by the IRS before we can originate the refund transfer products and record the associated revenue.

This year, the IRS accepted a much larger portion of our returns by January 31st than they did last year, so financial products revenue was higher. We believe that this was primarily due to the fact that all of the IRS forms were available this year when they opened for e-filing on January 31. That compares to last year when some forms were not available until mid-February or even March.

We believe this is just timing and that the growth in financial products revenue will be much more in line with the growth in royalty revenues by the time this season is over.

Our online business also grew in the quarter. This is reflected in the tax preparation fee line item where we saw increases in both the number of DIY returns processed in one of our online offerings as well in the net -- average net fee online.

We are continuing to work on this area and expect this growth to accelerate in the future as we continue to roll out our NextGen product and look to grow both organically and through acquisition opportunities. Offsetting these revenue increases were declines in franchise and area developer fees.

As John said, we were not able to sell franchises during a portion of the second quarter while we were working to complete our restatement. That is traditionally the time during which we sign up the most new franchisees. The area developer fees are also down because we repurchased several areas from existing ADs during fiscal 2014.

This caused a reduction in area developer fee revenue now, but in the long run will result in lower costs as we no longer need to pass along 50% of the associated royalties to those ADs.

The overall increase in revenue is partially offset by higher operating expenses. For the quarter, we incurred higher bad debt expense reflecting the increased level of office closure that John described.

We also incurred higher area developer expense which is directly related to the higher royalty revenue. As I mentioned earlier, our area developers receive 50% of the royalties that are paid to us by franchisees in their area, so as royalty revenue increases, so does area developer expense.

Finally, depreciation and amortization and impairment charges were also higher than prior years. As planned, we placed our NextGen software into use on the DIY side this year and began depreciating it during the third quarter. We also incurred some higher amortization expense in the quarter from the area developer rights we repurchased earlier this year.

There's one last thing that I should point out on the income statement. During the third quarter, we recorded a gain of approximately \$2 million from the sale of a very successful investment we made last year in one of our strategic partners.

Now, let's take a look at the balance sheet. We ended the quarter with \$3.7 million in cash compared to \$849,000 at January 31st 2013. In addition the amount drawn on our revolver was \$104.6 million at the end of the quarter compared to a \$108.1 million last year. And now, we have completely repaid the revolver almost 3 weeks earlier than we did last year.

In conclusion, we had a great start to the tax season. We believe the increased productivity per office both in terms of total returns and average net fee bodes very well for our plans for next year. As you saw our operational results have been better than the industry and we have continued taking market share.

With that, I'd now like to turn the call back to John.

John Hewitt: Thank you, Kathy. And with that, operator, we're ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question is from Alex Paris with Barrington Research.

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

Welcome, Alex.

Unidentified Participant

Hey, John. This is actually Joe filling in for Alex. Maybe -- Kathy real quick, you mentioned a \$2 million gain on sale during the quarter. Maybe, what was the tax rate have been excluding that and maybe the after tax effect on EPS?

Kathleen Donovan - *JTH Holding Inc. - CFO*

That didn't really have an impact on our full-year tax rate. You may have noticed that the tax rate we booked this quarter is different than earlier. That was a year to date true up. And I think we are looking at our tax rate this year to be about 1% less than last year.

Unidentified Participant

I understand. Well, for the quarter, what would EPS have looked like if you adjusted? Probably, like \$0.18, \$0.19 like kind of a normalized tax rate. Am I thinking about it the right way?

Kathleen Donovan - *JTH Holding Inc. - CFO*

You could look at it that way, but I'd have to do the math. I don't have it in front of me.

Unidentified Participant

Okay. And then from a modeling perspective, you talked about -- the late start, you mentioned you held back on advertising. How should I be thinking about that in Q4 from a modeling point of view, expect that kind of to be -- maybe any guidance on that would be appreciated.

John Hewitt: I think, Joe, the way to think of it is it's already reflected in our results that we now see February 28th. So we spent on [finance] through February 28th, it was just a difference between spend in January versus February. So that's already taken place.

Unidentified Participant

Okay. And then I noticed in the press release, you made a small acquisition of online tax company here in January, maybe just some color on that. And then maybe if you look at your online filing, maybe just kind of split it up between what came in through NextGen and what came in through the acquisition.

John Hewitt: Yes. We're not going to break out what comes from the acquisition and what we -- our results are internally. It's -- Joe, it's just too small. We continue that with the second online purchase we've made over last 24 months. We continue to look for acquisitions in both the storefront and online as they become available. But it's just -- it's only a minor event.

Unidentified Speaker

Okay, okay. Well, I'll jump back in queue, but impressive quarter and very impressive volume growth. Congratulations.

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

Thank you.

Operator

Your next question is from Arnie Ursaner with CJS Securities.

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

Welcome, Arnie.

Arnie Ursaner - *CJS Securities - Analyst*

One of the factors that may have led to your gain this year versus the industry is that last year - this year your competitors decided to charge for the 1040EZ. Last year, it was free and you had charged for it. How do you expect to market share gains to trend as we enter the back end of the tax season, where you get the more sophisticated customers who may have a more complex return? How do you see that evolving?



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

Obviously, there is a modest positive impact with Block charging for the 1040EZ for the first time in -- after 3 years of not charging for it. So it will have a modest impact, but we didn't see a huge part of our gain as a result of customers changing. We believe most of those customers that were having the 1040EZ done for free, a high percentage of them went and did their own return.

Arnie Ursaner - CJS Securities - Analyst

Okay. My second question, maybe a little more difficult for you to answer on a conference call, but you have lower franchise locations, yet your profitability is dramatically improving and you have been perhaps reevaluating some of your franchisees with a goal towards upgrading? Is that a fair statement and where do you think we are in the process?

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

Yes, I think it is. We -- every year we keep 90% of our franchisees and I have said it for a long time, I wish it was just 85%. We have some people that hang on too long. And in the franchise system, the best performers are those that follow our advice and follow the cookie cutter plan. You're just going to get some that are - that are not going to do that. And so we feel good about the team we have going forward and that we have the right franchises.

And there was -- after five years of difficult tax seasons, for one reason or another different reasons for different years. It's finally normalizing and we look forward with the team we have going forward.

Arnie Ursaner - CJS Securities - Analyst

Final question if I could. The preliminary data if you have it regarding financial product mix of in-house versus outsourced and the percent of returns that are using financial products so far this tax season, do you have any of those numbers available?

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

I can say that it's consistent with prior years. We have done for the last decade, in the low 50%, people have used financial products. So that trend continues to make itself clear.

Arnie Ursaner - CJS Securities - Analyst

Thanks very much.

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

Thanks, Arnie.

Operator

Your next question is from Michael Millman with Millman Research.



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

Welcome Michael.

Michael Millman - Millman Research Associates - Analyst

Could you talk about where you think you are picking up clients and maybe you could talk about it on an existing store bases?

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

Yes. Our same-store -- obviously our same-store sales have increased and if we talk about tenuring with first year, second year, third year, fourth year locations and so forth, our tenuring is improving and our performance is improving. From what we've heard from our competitors at Block and Jackson Hewitt, they continue to struggle. So we and the Mom and Pops continue to grab market share.

Michael Millman - Millman Research Associates - Analyst

So you think Mom and Pops are also picking up share?

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

Based on the numbers we have heard from Block and Jackson Hewitt, Yes, that seems certain.

Michael Millman - Millman Research Associates - Analyst

Could you talk about the -- or maybe analyze some of the IRS data, which suggests that all the increases comes from DIY?

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

Yes, that's -- it's hard to tell -- partway through the season, we think that will normalize by the end of the season. And as you know, the number of people that seek assistance in offices has been consistently 61% or 60% for the last 6 or 7 years. We think that trend will continue as we end the tax season. That will be over 60% will have come into brick-and-mortar.

Michael Millman - Millman Research Associates - Analyst

So, would the reason, I believe that has been abnormal in the first half has to do with weather or there's some other things that are occurring?

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

On a big picture, it could be a number of things. Certainly, weather is a factor because if you are sitting at home and not going to work or not going to school or can't get anywhere, you're more likely to do your tax return earlier in the year than later. Also the -- as I said earlier, some of the customers who last year -- over the last few years have had their return done for free at Block, they went online. So that may be a partial reason for that. It's hard to tell. We'll know far better when the season is over.

Michael Millman - Millman Research Associates - Analyst

To what extent do you think the 8867 has helped online and hurt assisted?

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

Well, it's difficult to judge, but the fact that you have to produce extra documentation to file an earn income credit form, we believe is somewhat of a factor in moving people online.

Michael Millman - Millman Research Associates - Analyst

So, you still see the 60/40 despite that, I guess inequality or unequality?

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

Yes, I would bet that it's going to be over 60% at the end of the season. And remember, with ACA, we expect that to increase significantly over the next couple of years as the ACA kicks in. So we expect that 61% or 60% to increase over the next couple of years.

Michael Millman - Millman Research Associates - Analyst

Okay, thanks John.

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

Thank you, Michael.

Operator

Your next question is from Scott Schneeberger with Oppenheimer.

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

Welcome Scott.

Scott Schneeberger - Oppenheimer & Co. - Analyst

Hey, thanks John. Good morning. Just following up on Michael's question, just with regard to pricing, you had mentioned you thought you saw perhaps slightly, a slight benefit from H&R Block going to a paid 1040EZ and a lot of shift to do it yourself from that dynamic, which is a little change and that's what Michael was hitting on.

But you did say, obviously you think it'll rebound with ACA in coming years, do you think there will be a pronounced move in the 60/40 shift this year. I did not, it was fuzzy and I didn't hear the response to that, but I am just curious because that's a bit of a change from your prior perspective, I believe.

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

We still believe that it will be somewhere in that 60% to 62%, will seek to have assistance this year.



Scott Schneeberger - *Oppenheimer & Co. - Analyst*

Okay, thanks. And I am curious, did you do much pricing change with your own forms. I believe that you hadn't, obviously Block made its change, but you had much more success thus far in the season than they have.

So maybe speak a little bit to your -- did you do a lot of pricing activity, increased pricing activity?

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

Yes. I have to say at this point since you talk about Block's success, as far as every season, we have a lot more success than Block does, so that's not at all surprising. And we did increase our fees. You can do the math between the increase in the returns and the increase in systemwide revenue that we have increased our fees 5% or 6%. We believe that that's where about what our competitors have increased their fees, both Block and Jackson Hewitt.

So, and I think obviously, the rest of Block's gain comes from fully monetizing their 1040EZ. So, we are up about 5% or 6%, which we think is, we are looking at that for the next few years with the exception of the bump we are going to get next year from the ACA forms.

Scott Schneeberger - *Oppenheimer & Co. - Analyst*

All right, thanks. And John, any color on your financial products or your consumer finance product. Just any updates you can pass on, on what you see with those this year and anticipate going on with next year?

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

We continue to have more pricing power with the suppliers of the financial products because we are bringing them to market. And since we can do -- we have shown that we can do them in-house, the other banks are giving us better pricing on the products we're placing with them. So, we're very happy with that change from a couple of years ago.

Scott Schneeberger - *Oppenheimer & Co. - Analyst*

Thanks. And then lastly, John, do you still anticipate the incremental form -- federal form for ACA next year? And what type of pricing do you think will surround that? Thanks.

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

Well, Scott, what we think is that about a quarter of our customers next year will have the ACA -- required to have the ACA form with their return. And our best guess right now without having seen the forms or seen the instructions are, they are probably at \$40 or \$50 fee. And so it would have an increase of about \$10 per tax return which for us would be about 5%.

Scott Schneeberger - *Oppenheimer & Co. - Analyst*

Thanks. That's helpful, John. I appreciate it.

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

Thank you.

Operator

Your next question is from Thomas Allen with Morgan Stanley.

Thomas Allen - *Morgan Stanley - Analyst*

Hi, John. Good morning.

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

Good morning.

Thomas Allen - *Morgan Stanley - Analyst*

Just following up on that last question, do you think there is an opportunity to charge an incremental fee for everyone given that they will be a requirement to show insurance? Thanks.

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

It depends on the complexity, Thomas. We haven't seen the forms or the adjustments required. It's certainly possible. But right now, we are taking a conservative \$10 approach and 5% approach.

Thomas Allen - *Morgan Stanley - Analyst*

And then in terms of all the pricing this year, it seems strange for me given that a potential ACA opportunity next year that companies are willing to try and push price maybe at the risk of losing share, how do you think about that?

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

Yes. It's a balance -- always a balance between pricing and market share. And obviously -- if for example, let's say we lowered our fees 50%, we wouldn't double our customer base. So you have to walk a fine line of understanding the customers.

The way we analyze it, Thomas, is we do something that it's rare in any industry and we actually call all of our customers. And we start that early in the season, two days after the customer's been in. So we're taking the pulse of our customers from January 4th until -- throughout the whole season.

If we see any situation where we are driving an inordinate number of customers away from our offices, then we modify our pricing. So we're in constant touch with that throughout the season. So we feel very comfortable that we're at the right price point in our offices.

Thomas Allen - *Morgan Stanley - Analyst*

Very helpful. So you guys obviously know your businesses better than we do. And then just finally in terms of the IRS testing requirements, obviously the court has sided against them. What do you think the chances are, maybe we go a legislative route or even that they happen at all? Thank you.



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

Well, we certainly think it's necessary for this industry. It's amazing that to give someone a haircut you need a license, but to do taxes you don't. So I think that it's important to the industry. We hope that that the IRS finds a way to certify preparers.

We have -- for four years now had our own internal certification. All of our 35,000 preparers are certified. We know that our major competitors are copying that. So it's important to the industry and we hope that if the IRS can't figure another way to do it, that Congress will pass legislation that will enable them to do it. It's important.

Thomas Allen - *Morgan Stanley - Analyst*

Okay, thank you.

Operator

Thank you, ladies and gentlemen. I will now turn the conference back to John Hewitt for closing remarks.

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

Well, thank you everyone. We had a great year and I look forward to meeting you and talking again next quarter. Have a great day everyone.

Operator

Thank you, ladies and gentlemen. This does conclude today's conference call. You may now disconnect your lines.

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