

JTH Holding, Inc.  
Form 10-Q  
December 13, 2013

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

☒ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended October 31, 2013

OR

☐ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number 001-35588

JTH Holding, Inc.  
(Exact name of registrant as specified in its charter)

Delaware  
(State of incorporation)

27-3561876  
(IRS employer identification no.)

1716 Corporate Landing Parkway  
Virginia Beach, Virginia 23454  
(Address of principal executive offices)  
(757) 493-8855  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports); and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☒

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(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  
o No ☒

The number of shares outstanding of the registrant's Common Stock, \$0.01 par value, at the close of business on December 9, 2013 was 12,082,357 shares.

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JTH HOLDING, INC.

Form 10-Q for the Period Ended October 31, 2013

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PART I

ITEM 1  
FINANCIAL STATEMENTS

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## JTH HOLDING, INC. AND SUBSIDIARIES

## Condensed Consolidated Balance Sheets

October 31, 2013 (unaudited) and April 30, 2013

(In thousands, except share data)

|   | (unaudited)<br>October 31, 2013 | April 30, 2013 |
|---|---------------------------------|----------------|
| Assets  |                                 |                |
| Current assets:   |                                 |                |
| Cash and cash equivalents   | \$2,607                         | \$19,013       |
| Receivables (note 2):   |                                 |                |
| Trade accounts  | 20,749                          | 41,856         |
| Notes   | 52,074                          | 34,156         |
| Interest, net   | 3,180                           | 877            |
| Allowance for doubtful accounts   | (4,948)                         | (5,583)        |
| Total receivables, net  | 71,055                          | 71,306         |
| Available-for-sale securities (note 3)  | 4,606                           | 3,619          |
| Income tax receivable   | 11,759                          | 3              |
| Deferred income taxes (note 7)  | 2,875                           | 4,232          |
| Other current assets  | 2,926                           | 4,960          |
| Total current assets  | 95,828                          | 103,133        |
| Property, equipment, and software, net of accumulated depreciation of \$20,355 and \$19,006 as of October 31, 2013 and April 30, 2013, respectively                             | 36,470                          | 33,037         |
| Notes receivable, excluding current portion, net of allowance for uncollectible amounts of \$1,100 and \$1,101 as of October 31, 2013 and April 30, 2013, respectively (note 2) | 16,793                          | 14,352         |
| Goodwill (note 4)   | 7,194                           | 5,685          |
| Other intangible assets, net of accumulated amortization of \$5,327 and \$3,998 as of October 31, 2013 and April 30, 2013, respectively (note 4)                                | 16,316                          | 10,921         |
| Other assets, net   | 2,160                           | 2,402          |
| Total assets  | \$174,761                       | \$169,530      |
| Liabilities and Stockholders' Equity  |                                 |                |
| Current liabilities:  |                                 |                |
| Current installments of long-term debt (note 6)   | \$6,485                         | \$3,400        |
| Accounts payable and accrued expenses   | 7,851                           | 11,954         |
| Due to area developers (note 2)   | 8,315                           | 18,248         |
| Income taxes payable (note 7)   | —                               | 5,897          |
| Deferred revenue - short-term portion   | 6,693                           | 7,555          |
| Total current liabilities   | 29,344                          | 47,054         |
| Long-term debt, excluding current installments (note 6)   | 22,987                          | 24,283         |
| Revolving credit facility (note 6)  | 38,459                          | —              |
| Deferred revenue - long-term portion  | 8,092                           | 10,381         |
| Liability classified stock-based compensation awards (note 9)   | —                               | 5,111          |
| Deferred income taxes (note 7)  | 2,106                           | 865            |
| Total liabilities   | 100,988                         | 87,694         |
| Commitments and contingencies (note 12)   |                                 |                |
| Stockholders' equity (notes 8 and 9):   |                                 |                |
| Class A preferred stock, \$0.01 par value per share, 190,000 shares authorized, 0 shares issued and outstanding   | —                               | —              |
|   | —                               | —              |

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Special voting preferred stock, \$0.01 par value per share, 10 shares authorized,  
issued and outstanding

Class A common stock, \$0.01 par value per share, 21,200,000 shares authorized,  
12,037,721 and 11,975,128 shares issued and outstanding at October 31, 2013 and 120 120  
April 30, 2013, respectively

Class B common stock, \$0.01 par value per share, 1,000,000 shares authorized, 9 9  
900,000 shares issued and outstanding

Exchangeable shares, \$0.01 par value, 100,000 shares issued and outstanding 1 1

Additional paid-in capital 7,818 1,920

Accumulated other comprehensive income, net of taxes 1,639 1,194

Retained earnings 64,186 78,592

Total stockholders' equity 73,773 81,836

Total liabilities and stockholders' equity \$174,761 \$169,530

See accompanying notes to condensed consolidated financial statements.

## JTH HOLDING, INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Operations

Three months and six months ended October 31, 2013 and 2012 (unaudited)

(In thousands, except per share data)

|  | Three Months Ended October 31, |            | Six Months Ended October 31, |             |
|--|--------------------------------|------------|------------------------------|-------------|
|  | 2013                           | 2012       | 2013                         | 2012        |
| Revenues:  |                                |            |                              |             |
| Franchise fees   | \$886                          | \$2,138    | \$1,925                      | \$2,805     |
| Area developer fees  | 1,880                          | 2,079      | 3,683                        | 4,001       |
| Royalties and advertising fees   | 1,180                          | 1,049      | 2,629                        | 2,373       |
| Financial products   | 169                            | 169        | 618                          | 471         |
| Interest income (note 2)   | 2,200                          | 2,651      | 4,434                        | 5,199       |
| Tax preparation fees, net of discounts                                 | 242                            | 225        | 628                          | 441         |
| Other revenue  | 760                            | 1,027      | 1,465                        | 1,292       |
| Total revenues   | 7,317                          | 9,338      | 15,382                       | 16,582      |
| Operating expenses:  |                                |            |                              |             |
| Employee compensation and benefits                                     | 8,196                          | 7,615      | 14,285                       | 14,281      |
| General and administrative expenses                                    | 7,744                          | 6,110      | 14,010                       | 11,926      |
| Area developer expense   | 705                            | 1,115      | 1,533                        | 1,832       |
| Advertising expense  | 2,507                          | 2,539      | 5,191                        | 5,099       |
| Depreciation, amortization, and impairment charges                     | 1,745                          | 1,432      | 3,323                        | 3,023       |
| Total operating expenses   | 20,897                         | 18,811     | 38,342                       | 36,161      |
| Loss from operations   | (13,580                        | ) (9,473   | ) (22,960                    | ) (19,579   |
| Other income (expense):  |                                |            |                              |             |
| Foreign currency transaction gains (losses)                            | (5                             | ) 2        | (12                          | ) 4         |
| Gain on sale of available-for-sale securities                          | 188                            | —          | 188                          | —           |
| Interest expense (note 6)  | (357                           | ) (512     | ) (602                       | ) (804      |
| Loss before income taxes   | (13,754                        | ) (9,983   | ) (23,386                    | ) (20,379   |
| Income tax benefit (note 7)  | (5,276                         | ) (3,872   | ) (8,981                     | ) (7,905    |
| Net loss   | \$(8,478                       | ) \$(6,111 | ) \$(14,405                  | ) \$(12,474 |
| Net loss per share of Class A and Class B common stock:                |                                |            |                              |             |
| Basic and diluted  | \$(0.66                        | ) \$(0.47  | ) \$(1.12                    | ) \$(0.99   |
| See accompanying notes to condensed consolidated financial statements. |                                |            |                              |             |

See accompanying notes to condensed consolidated financial statements.

## JTH HOLDING, INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Comprehensive Loss

Three months and six months ended October 31, 2013 and 2012 (unaudited)

(In thousands)

|  | Three Months Ended October 31, |            | Six Months Ended October 31, |             |
|--|--------------------------------|------------|------------------------------|-------------|
|  | 2013                           | 2012       | 2013                         | 2012        |
| Net loss   | \$(8,478                       | ) \$(6,111 | ) \$(14,405                  | ) \$(12,474 |
| Interest rate swap agreements, net of taxes of \$-, \$67, \$-, and \$95, respectively  | —                              | 110        | —                            | 155         |
| Unrealized gain on equity securities available for sale, net of taxes of \$397, \$93, \$540, and \$93, respectively (note 3)                   | 645                            | 152        | 877                          | 152         |
| Reclassified gain on sale of available-for-sale securities included in income, net of taxes of \$72, \$-, \$72, and \$-, respectively (note 3) | (116                           | ) —        | (116                         | ) —         |
| Foreign currency translation adjustment  | (176                           | ) 35       | (316                         | ) (193      |
| Comprehensive loss   | \$(8,125                       | ) \$(5,814 | ) \$(13,960                  | ) \$(12,360 |

See accompanying notes to condensed consolidated financial statements.



## JTH HOLDING, INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Cash Flows

Six months ended October 31, 2013 and 2012 (unaudited)

(In thousands)

|   | 2013      |   | 2012      |   |
|---|-----------|---|-----------|---|
| Cash flows from operating activities:   |           |   |           |   |
| Net loss  | \$(14,405 | ) | \$(12,474 | ) |
| Adjustments to reconcile net loss to net cash used in operating activities:       |           |   |           |   |
| Provision for doubtful accounts   | 3,430     |   | 3,264     |   |
| Depreciation, amortization and impairment charges                                 | 3,323     |   | 3,023     |   |
| Amortization of deferred financing costs  | 167       |   | 139       |   |
| Stock-based compensation expense related to equity classified awards              | 741       |   | 892       |   |
| Stock-based compensation expense related to liability classified awards           | (872      | ) | —         |   |
| Gain on bargain purchases and sales of company-owned offices                      | (518      | ) | (226      | ) |
| Equity in loss of affiliate   | 101       |   | 69        |   |
| Deferred tax expense  | 2,598     |   | 3,770     |   |
| Gain on sale of available-for-sale securities                                     | (188      | ) | —         |   |
| Changes in assets and liabilities decreasing cash flows from operating activities | (22,258   | ) | (26,098   | ) |
| Net cash used in operating activities   | (27,881   | ) | (27,641   | ) |
| Cash flows from investing activities:   |           |   |           |   |
| Issuance of operating loans to franchisees  | (17,420   | ) | (20,855   | ) |
| Payments received on operating loans to franchisees                               | 1,230     |   | 1,227     |   |
| Purchases of area developer rights and company-owned offices                      | (4,436    | ) | (2,352    | ) |
| Proceeds from sale of company-owned offices and area developer rights             | 205       |   | 1,386     |   |
| Purchase of marketable equity securities  | —         |   | (2,980    | ) |
| Proceeds from sale of available-for-sale securities                               | 456       |   | —         |   |
| Purchase of property and equipment  | (5,463    | ) | (5,673    | ) |
| Net cash used in investing activities   | (25,428   | ) | (29,247   | ) |
| Cash flows from financing activities:   |           |   |           |   |
| Proceeds from the exercise of stock options                                       | 2,998     |   | 1,592     |   |
| Repurchase of common stock  | (2,495    | ) | (1,413    | ) |
| Repayment of long-term debt   | (2,418    | ) | (1,894    | ) |
| Borrowings under revolving credit facility  | 43,104    |   | 40,147    |   |
| Repayments under revolving credit facility  | (4,645    | ) | (475      | ) |
| Payment for debt issue costs  | —         |   | (8        | ) |
| Tax benefit of stock option exercises   | 416       |   | 269       |   |
| Net cash provided by financing activities   | 36,960    |   | 38,218    |   |
| Effect of exchange rate changes on cash, net                                      | (57       | ) | (20       | ) |
| Net decrease in cash and cash equivalents   | (16,406   | ) | (18,690   | ) |
| Cash and cash equivalents at beginning of period                                  | 19,013    |   | 19,848    |   |
| Cash and cash equivalents at end of period  | \$2,607   |   | \$1,158   |   |

See accompanying notes to condensed consolidated financial statements.



## JTH HOLDING, INC. AND SUBSIDIARIES

## Condensed Consolidated Statements of Cash Flows

Six months ended October 31, 2013 and 2012 (unaudited)

(In thousands)

|   | 2013     | 2012      |
|---|----------|-----------|
| Supplemental disclosures of cash flow information:  |          |           |
| Cash paid for interest, net of capitalized interest   | \$455    | \$605     |
| Cash paid for taxes, net of refunds   | 6,143    | 6,837     |
| Supplemental disclosures of noncash investing and financing activities:   |          |           |
| During the six months ended October 31, 2013 and 2012, the Company acquired certain assets from franchisees and area developers as follows: |          |           |
| Fair value of assets purchased  | \$10,770 | \$6,474   |
| Receivables applied   | (6,076)  | ) (5,242) |
| Accounts payable canceled   | 3,187    | 1,902     |
| Notes and accounts payable issued   | (4,716)  | ) (1,508) |
| Elimination of related deferred revenue   | 1,271    | 726       |
| Cash paid to franchisees and area developers  | \$4,436  | \$2,352   |
| During the six months ended October 31, 2013 and 2012, the Company sold certain assets to franchisees and area developers as follows:       |          |           |
| Book value of assets sold   | \$1,872  | \$2,855   |
| Loss on sale  | (39)     | ) (113)   |
| Deferred gain on sale   | —        | 742       |
| Notes received  | (1,628)  | ) (2,098) |
| Cash received from franchisees and area developers  | \$205    | \$1,386   |
| Accrued capitalized software costs included in accounts payable   | \$224    | \$1,135   |
| See accompanying notes to condensed consolidated financial statements.  |          |           |

## JTH HOLDING, INC. AND SUBSIDIARIES

### Notes to Condensed Consolidated Financial Statements

October 31, 2013 and 2012 (Unaudited)

#### (1) Organization and Significant Accounting Policies

##### (a) Organization

JTH Holding, Inc. (the Company), a Delaware corporation, is a holding company engaged through its subsidiaries as a franchisor and operator of a system of income tax preparation offices located in the United States and Canada. The Company's principal operations are conducted through JTH Tax, Inc. (d/b/a Liberty Tax Service) the Company's largest subsidiary. Through this system of income tax preparation offices, the Company also facilitates for its customers' refund-based tax settlement financial products such as instant cash advances, electronic refund checks, and personal income tax refund discounting. The Company also offers online tax preparation services.

Unless specifically noted otherwise, as used throughout these condensed consolidated financial statements, the term "Company" or "Liberty" refers to the consolidated entities of JTH Holding, Inc.

##### (b) Principles of Consolidation and Unaudited Financial Statements

The condensed consolidated financial statements include the accounts of JTH Holding, Inc. and its wholly owned subsidiaries. Assets and liabilities of the Company's Canadian operations have been translated into U.S. dollars using the exchange rate in effect at the end of the period. Revenues and expenses have been translated using the average exchange rates in effect each month of the period. Transaction gains and losses are recognized when incurred. The Company also consolidates any variable interest entities of which it is the primary beneficiary. When the Company does not have a controlling interest in an entity, but exerts significant influence over the entity, the Company applies the equity method of accounting. All significant intercompany balances and transactions have been eliminated in consolidation.

The unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (US GAAP) for interim financial information. The condensed consolidated financial statements, including these notes, are unaudited and exclude some of the disclosures only required in annual financial statements. Consolidated balance sheet data as of April 30, 2013 was derived from the Company's April 30, 2013 Annual Report on Form 10-K.

In the opinion of management, all adjustments necessary for a fair presentation of such financial statements in accordance with US GAAP have been recorded. These adjustments consisted only of normal recurring items. The accompanying condensed consolidated financial statements should be read in conjunction with the Company's financial statements and notes thereto included in its April 30, 2013 Annual Report on Form 10-K.

##### (c) Office Count

The Company operated 4,520 total offices during the 2013 tax season. During the first six months of fiscal 2014 the Company sold 65 franchise territories and purchased 74 territories from franchisees, some of which may be resold and operated by other franchisees during the 2014 tax season or subsequent tax seasons or operated as company-owned stores. Because the Company continues to sell and purchase territories until the start of the 2014 tax season and cannot predict how many offices will operate in each territory, the Company is unable to determine at this time how many

offices will be in operation during the 2014 tax season. The Company expects to be able to report this information for the quarter ended January 31, 2014 because all offices should be opened at that time.

(d) Use of Estimates

Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period, to prepare these condensed consolidated financial statements and accompanying notes in conformity with US GAAP. Actual results could differ from those estimates.

## (e) Foreign Operations

Canadian operations contributed \$286,000 and \$806,000 in revenues for the three and six months ended October 31, 2013, respectively and \$291,000 and \$775,000 in revenues for the three and six months ended October 31, 2012, respectively.

## (f) Seasonality of Business

The Company's operating revenues are seasonal in nature with peak revenues occurring in the months of January through April. Therefore, results for interim periods are not indicative of results to be expected for the full year.

## (2) Notes and Accounts Receivable

The Company provides financing to franchisees for the purchase of franchises, clusters of territories, company-owned offices and/or for working capital and equipment needs. The franchise-related notes generally are payable over five years and the working capital and equipment notes generally are due within one year. All notes bear interest at 12%. Activity related to notes receivable for the six months ended October 31, 2013 and the fiscal year ended April 30, 2013 was as follows:

|  | October 31,<br>2013<br>(In thousands) | April 30, 2013 |
|--|---------------------------------------|----------------|
| Balance at beginning of period                     | \$89,340                              | \$79,838       |
| Notes received for:                                |                                       |                |
| Sales of franchises and clusters of territories    | 2,898                                 | 6,770          |
| Sales of certain assets to franchisees             | 1,628                                 | 15,130         |
| Franchisee to franchisee note assumptions          | 3,889                                 | 11,259         |
| Working capital and equipment loans to franchisees | 17,420                                | 75,642         |
| Refinancing of accounts receivable                 | 7,182                                 | 18,527         |
|  | 33,017                                | 127,328        |
| Repayment of notes                                 | (3,877)                               | (95,664)       |
| Notes canceled                                     | (10,052)                              | (21,981)       |
| Foreign currency adjustment                        | (161)                                 | (181)          |
| Balance at end of period                           | 108,267                               | 89,340         |
| Unrecognized revenue portion of notes receivable   | (38,300)                              | (39,731)       |
| Notes receivable less unrecognized revenue         | \$69,967                              | \$49,609       |

Most of the notes receivable are due from the Company's franchisees and area developers (ADs) and are collateralized by the underlying franchise and are guaranteed by the respective franchisee or AD and franchise or AD owner(s). The franchisees' ability to repay the notes is dependent upon both the performance of the tax preparation industry as a whole and the individual franchisees' or ADs' areas.

The refinancing of accounts receivable results from a franchisee electing to deliver to the Company a promissory note for past-due royalties and advertising fees that have been previously recorded as accounts receivable in the condensed consolidated financial statements. Effective October 1, 2013, the Company reduced the interest rate on its past due accounts receivable to 12% and, therefore, has ceased its practice of refinancing accounts receivable into notes receivable. This is not expected to have a material effect on the Company's condensed consolidated financial statements.

Notes canceled are comprised of the cancellation of existing unpaid notes of selling franchisees in franchisee to franchisee sales that include the assumption of debt by the acquiring franchisee, and any unpaid notes receivable from a franchisee or AD related to specific territories or clusters of territories that the Company reacquires. In the latter transactions, the cancellation of notes is part of the consideration paid by the Company, and any excess of the consideration paid over the fair value of assets acquired is written off to the allowance for doubtful accounts. Unrecognized revenue relates to the financed portion of franchise fees and area developer fees and, in the case of sales of company-owned offices, the financed portion of gains related to these sales, in each case where revenue has not yet been recognized. For franchise fees and gains related to the sale of company-owned offices, revenue is recorded as note payments

are received by the Company. Payments on area developer fee notes receivable generate a corresponding increase in deferred revenue, which is amortized into revenue over the life of the area developer contract, generally 10 years. Management believes that the recorded allowance is adequate based upon its consideration of the estimated value of the franchises and ADs supporting the receivables. Any adverse change in the tax preparation industry or the individual franchisees' or ADs' areas could affect the Company's estimate of the allowance.

Notes and accounts receivable include royalties billed that relate to territories operated by franchisees located in AD territories. The Company has recorded amounts payable to area developers for their share of these receivables of \$8,315,000 and \$18,248,000 at October 31, 2013 and April 30, 2013, respectively.

Activity in the allowance for doubtful accounts for the six months ended October 31, 2013, and 2012 was as follows:

|                              | 2013<br>(In thousands) | 2012    |
|------------------------------|------------------------|---------|
| Beginning balance            | \$6,684                | \$5,290 |
| Additions charged to expense | 3,430                  | 3,264   |
| Write-offs                   | (4,028)                | (2,680) |
| Foreign currency adjustment  | (38)                   | (30)    |
| Ending balance               | \$6,048                | \$5,844 |

Management considers accounts and notes receivable to be impaired if the amounts due exceed the fair value of the underlying franchise and estimates an allowance for doubtful accounts based on that excess. Amounts due include contractually obligated accounts and notes receivable less unrecognized revenue, reduced by the allowance for uncollected interest, amounts due ADs, the related deferred revenue and amounts owed to the franchisee by the Company. In establishing the fair value of the underlying franchise, management considers net fees of open offices earned during the most recently completed tax season and the number of unopened offices.

The allowance for doubtful accounts at October 31, 2013 and April 30, 2013 was allocated as follows:

|  | October 31,<br>2013<br>(In thousands) | April 30, 2013 |
|--|---------------------------------------|----------------|
| Impaired:  |                                       |                |
| Notes receivable, including interest, and less unrecognized revenue  | \$8,478                               | \$9,399        |
| Accounts receivable  | 4,588                                 | 5,907          |
| Less allowance for uncollected interest, amounts due ADs, related deferred revenue and amounts due franchisees | (2,017)                               | (2,336)        |
| Net amount due   | \$11,049                              | \$12,970       |
| Allowance for doubtful accounts for impaired notes and accounts receivable                                     | \$5,255                               | \$6,120        |
| Nonimpaired:   |                                       |                |
| Notes receivable, including interest, and less unrecognized revenue  | \$66,195                              | \$42,459       |
| Accounts receivable  | 18,577                                | 37,650         |
| Less allowance for uncollected interest, amounts due ADs, related deferred revenue and amounts due franchisees | (11,574)                              | (19,992)       |
| Net amount due   | \$73,198                              | \$60,117       |
| Allowance for doubtful accounts for non-impaired notes and accounts receivable                                 | \$793                                 | \$564          |



|                                       |         |         |
|---------------------------------------|---------|---------|
| Total allowance for doubtful accounts | \$6,048 | \$6,684 |
|---------------------------------------|---------|---------|

The aging of accounts and notes receivable at October 31, 2013 was as follows:

|                     | Total<br>Past Due<br>(In thousands) | Allowance<br>for Uncollected<br>Interest | Current    | Total<br>Receivables |
|---------------------|-------------------------------------|--|------------|----------------------|
| Accounts receivable | \$20,153                            | \$(2,416)                                | ) \$3,012  | \$20,749             |
| Notes receivable    | 8,124                               | (1,526)                                  | ) 66,549   | 73,147               |
| Total               | \$28,277                            | \$(3,942)                                | ) \$69,561 | \$93,896             |

Accounts receivable are considered to be past due if unpaid after 30 days and notes receivable are considered past due if unpaid after 90 days, at which time the notes are put on nonaccrual status.

The Company's average investment in impaired notes receivable during the six months ended October 31, 2013 and 2012 was \$8,938,000 and \$6,250,000, respectively. Interest income related to impaired notes was \$161,000 and \$362,000 for the three and six months ended October 31, 2013, respectively, and \$107,000 and \$245,000 for the three and six months ended October 31, 2012, respectively. The Company's investment in notes receivable on nonaccrual status at October 31, 2013 and April 30, 2013 was \$6,598,000 and \$8,375,000, respectively.

At October 31, 2013, the Company had unfunded lending commitments for working capital loans to franchisees and area developers of \$13,308,000.

### (3) Investments

During fiscal 2013, the Company purchased corporate equity securities, as a strategic investment in a business partner, for \$2,980,000. At October 31, 2013, the fair value of the unsold portion of the investment was \$4,606,000. The Company classifies this investment as available-for-sale and recognizes unrealized gain on the available-for-sale securities, net of tax, in accumulated other comprehensive income in the stockholders' equity section of the consolidated balance sheets. The unrealized gain, net of tax, on the available-for-sale securities at October 31, 2013 was \$1,148,000.

Available-for-sale securities with a basis of \$268,000 were sold during the three months ended October 13, 2013. A gain on the sale of \$188,000 was recognized and reclassified out of accumulated other comprehensive income and recorded as other income.

### (4) Goodwill and Intangible Assets

Changes in the carrying amount of goodwill for the six months ended October 31, 2013 are as follows:

|   | Goodwill       | Accumulated<br>impairment<br>loss | Net       |
|---|----------------|-----------------------------------|-----------|
|   | (In thousands) |                                   |           |
| Balance at April 30, 2013                   | \$6,457        | \$(772)                           | ) \$5,685 |
| Acquisitions of assets from franchisees     | 2,763          | —                                 | 2,763     |
| Disposals and foreign currency changes, net | (1,289)        | ) 125                             | (1,164)   |
| Impairments                                 | —              | (90)                              | ) (90)    |
| Balance at October 31, 2013                 | \$7,931        | \$(737)                           | ) \$7,194 |



Components of intangible assets are as follows:

|   | Amortization<br>period<br><br>(In thousands) | As of October 31, 2013      |                             |                           | As of April 30, 2013        |                             |                           |
|---|--|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
|   |  | Gross<br>carrying<br>amount | Accumulated<br>amortization | Net<br>carrying<br>amount | Gross<br>carrying<br>amount | Accumulated<br>amortization | Net<br>carrying<br>amount |
| Amortizable other intangible<br>assets: |  |                             |                             |                           |                             |                             |                           |
| Acquired customer lists                 | 7 years                                      | \$1,603                     | \$(427                      | ) \$1,176                 | \$1,603                     | \$(171                      | ) \$1,432                 |
| Assets acquired from<br>franchisees:    |  |                             |                             |                           |                             |                             |                           |
| Customer lists                          | 4 years                                      | 2,576                       | (722                        | ) 1,854                   | 1,834                       | (582                        | ) 1,252                   |
| Reacquired rights                       | 2 years                                      | 2,203                       | (1,280                      | ) 923                     | 1,640                       | (905                        | ) 735                     |
| Area developer rights                   | 10 years                                     | 15,261                      | (2,898                      | ) 12,363                  | 9,842                       | (2,340                      | ) 7,502                   |
|   |  | \$21,643                    | \$(5,327                    | ) \$16,316                | \$14,919                    | \$(3,998                    | ) \$10,921                |

During the six months ended October 31, 2013, the Company acquired the assets of various franchisees for \$5,181,000. These acquisitions were accounted for as business combinations, with all value allocated to the identifiable intangible assets. The acquired businesses are operated as Company-owned offices until a buyer is found and a new franchise agreement is entered into.

The purchase price of assets acquired from franchisees was allocated as follows:

|                                      | Six Months Ended October 31, |         |
|--------------------------------------|------------------------------|---------|
|                                      | 2013                         | 2012    |
|                                      | (In thousands)               |         |
| Customer lists and reacquired rights | \$2,418                      | \$1,797 |
| Goodwill                             | 2,763                        | 2,353   |
| Total                                | \$5,181                      | \$4,150 |

#### (5) Leases

The Company is obligated under various short-term operating leases for office space that expire at various dates. Total rent expense for operating leases, net of subleases, was \$862,000 and \$1,618,000 for the three and six months ended October 31, 2013, respectively, and \$832,000 and \$1,474,000 for the three and six months ended October 31, 2012, respectively.

#### (6) Debt

The Company has a credit facility that consists of a \$25,000,000 term loan and a revolving credit facility that currently allows borrowing of up to \$143,350,000. Outstanding borrowings accrue interest at one-month London Inter-Bank Offered Rate (LIBOR) plus a margin ranging from 1.50% to 2.25% depending on the Company's leverage ratio. At October 31, 2013, the interest rate was 1.80%, and the average interest rate paid was 1.91% during the six months ended October 31, 2013. The indebtedness is collateralized by substantially all the assets of the Company and both loans mature on April 30, 2017. The credit facility contains certain financial covenants that the Company must meet, including leverage and fixed charge coverage ratios as well as minimum net worth requirements. The Company was

in compliance with the financial covenants at October 31, 2013.

Debt at October 31, 2013 and April 30, 2013 consisted of the following:

|                       | October 31, 2013<br>(In thousands) | April 30, 2013 |
|-----------------------|------------------------------------|----------------|
| Credit Facility:      |                                    |                |
| Revolver              | \$38,459                           | \$—            |
| Term loan             | 22,813                             | 23,750         |
|                       | 61,272                             | 23,750         |
| Other debt            | 6,659                              | 3,933          |
|                       | 67,931                             | 27,683         |
| Less: current portion | (6,485)                            | (3,400)        |
| Long-term debt        | \$61,446                           | \$24,283       |

#### (7) Income Taxes

The Company computes its provision for or benefit from income taxes by applying the estimated annual effective tax rate to income or loss from recurring operations and adding the effects of any discrete income tax items specific to the period.

#### (8) Stockholders' Equity

During the six months ended October 31, 2013 and 2012, activity in stockholders' equity was as follows:

|  | 2013<br>(In thousands) | 2012    |
|--|------------------------|---------|
| Class A common shares issued from the exercise of stock options          | 200                    | 151     |
| Proceeds from exercise of stock options                                  | \$2,998                | \$1,592 |
| Class A common shares repurchased  | 137                    | 103     |
| Payments for repurchased shares  | \$2,495                | \$1,413 |
| Tax benefit of stock option exercises                                    | \$416                  | \$269   |
| Class A common shares issued upon conversion of Class A preferred shares | —                      | 1,703   |

The components of accumulated other comprehensive income at October 31, 2013 and April 30, 2013 are a foreign currency translation adjustment of \$491,000 and \$807,000, respectively, and the unrealized gain on equity securities available for sale, net of taxes, of \$1,148,000 and \$387,000, respectively.

#### Net Loss per Share

Net loss per share of Class A and Class B common stock is computed using the two-class method. Basic net loss per share is computed by allocating undistributed earnings to common shares and participating securities (Class A preferred stock and exchangeable shares) and using the weighted-average number of common shares outstanding during the period. Undistributed losses are not allocated to these participating securities because they do not meet the required criteria for such allocation. During the six months ended October 31, 2012, two of the Company's major shareholders elected to convert 170,320 shares of the Class A preferred stock to 1,703,200 shares of Class A common stock.

Diluted net loss per share is computed using the weighted-average number of common shares and, if dilutive, the potential common shares outstanding during the period. Potential common shares consist of the incremental common shares issuable upon the exercise of stock options. The dilutive effect of outstanding stock options is reflected in

diluted earnings per share by application of the treasury stock method. Additionally, the computation of the diluted net loss per share of Class A common stock assumes the conversion of Class B common stock, Class A preferred stock and exchangeable shares, while the diluted net loss per share of Class B common stock does not assume conversion of those shares.

The rights, including liquidation and dividend rights, of the holders of Class A and Class B common stock are identical, with the exception of the election of directors. As a result, the undistributed earnings for each year are allocated based

on the contractual participation rights of the Class A and Class B common stock as if the earnings for the year had been distributed. Participating securities have dividend rights that are identical to Class A and Class B common stock.

The computation of basic and diluted net loss per share for the three and six months ended October 31, 2013 and 2012 was as follows:

|  | Three Months Ended<br>October 31, 2013                    |                         |
|--|---|-------------------------|
|  | Class A<br>Common Stock                                   | Class B<br>Common Stock |
|  | (in thousands, except for share and per<br>share amounts) |                         |
| Basic and diluted net loss per share:      |   |                         |
| Numerator                                  |   |                         |
| Allocation of undistributed losses         | \$(7,888  | ) \$(590                |
| Denominator                                |   |                         |
| Weighted-average common shares outstanding | 12,026,060  | 900,000                 |
| Basic and diluted net loss per share       | \$(0.66   | ) \$(0.66               |

|  | Six Months Ended<br>October 31, 2013                      |                         |
|--|---|-------------------------|
|  | Class A<br>Common Stock                                   | Class B<br>Common Stock |
|  | (in thousands, except for share and per<br>share amounts) |                         |
| Basic and diluted net loss per share:      |   |                         |
| Numerator                                  |   |                         |
| Allocation of undistributed losses         | \$(13,401   | ) \$(1,004              |
| Denominator                                |   |                         |
| Weighted-average common shares outstanding | 12,010,673  | 900,000                 |
| Basic and diluted net loss per share       | \$(1.12   | ) \$(1.12               |

As a result of the net losses for the periods, diluted net loss per share excludes the impact of shares of potential common stock from the exercise of options to purchase 2,247,000 and 2,375,000 shares for the three and six months ended October 31, 2013, respectively, because the effect would be antidilutive.

|                                       | Three Months Ended<br>October 31, 2012                    |                         |
|---------------------------------------|---|-------------------------|
|                                       | Class A<br>Common Stock                                   | Class B<br>Common Stock |
|                                       | (in thousands, except for share and per<br>share amounts) |                         |
| Basic and diluted net loss per share: |   |                         |
| Numerator                             |   |                         |
| Allocation of undistributed losses    | \$(5,689  | ) \$(422                |
| Denominator                           |   |                         |



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|  |            |             |
|--|------------|-------------|
| Weighted-average common shares outstanding | 12,127,179 | 900,000     |
| Basic and diluted net loss per share       | \$(0.47    | ) \$(0.47 ) |

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|  | Six Months Ended<br>October 31, 2012                      |                         |
|--|---|-------------------------|
|  | Class A<br>Common Stock                                   | Class B<br>Common Stock |
|  | (in thousands, except for share and per<br>share amounts) |                         |
| Basic and diluted net loss per share:      |   |                         |
| Numerator                                  |   |                         |
| Allocation of undistributed losses         | \$(11,583   | ) \$(891                |
| Denominator                                |   |                         |
| Weighted-average common shares outstanding | 11,701,417  | 900,000                 |
| Basic and diluted net loss per share       | \$(0.99   | ) \$(0.99               |

As a result of the net losses for the periods, diluted net loss per share excludes the impact of shares of potential common stock from the exercise of options to purchase 2,760,000 shares and 2,769,000 for the three and six months ended October 31, 2012, respectively, because the effect would be antidilutive.

#### (9) Stock Compensation Plans

##### (a) Stock Options

At October 31, 2013, 1,830,561 shares of Class A common stock are available for grant under the 2011 Equity and Cash Incentive Plan.

The following table summarizes the information for options granted during the six months ended October 31, 2013:

|  | 2013            |   |
|--|-----------------|---|
| Weighted average fair value of options granted | \$6.12          |   |
| Dividend yield                                 | 0.0             | % |
| Expected volatility                            | 34.15% - 36.99% |   |
| Expected terms                                 | 3.7 - 5.3       |   |
| Risk-free interest rates                       | 0.79% - 1.49%   |   |

The Company does not have enough public trading history to calculate volatility for the term of the granted options; it used a 50/50 weighted average volatility, equally weighing our public trading history and that of other public companies in the tax preparation industry.

Stock option activity during the six months ended October 31, 2013 was as follows:

|                                 | Number of<br>options | Weighted<br>average<br>exercise price |
|---------------------------------|----------------------|---------------------------------------|
| Outstanding at April 30, 2013   | 2,534,683            | \$14.81                               |
| Granted                         | 407,374              | 17.98                                 |
| Exercised                       | (199,868             | ) 15.00                               |
| Canceled                        | (234,061             | ) 15.02                               |
| Outstanding at October 31, 2013 | 2,508,128            | 15.29                                 |

The Company granted 407,374 stock options to certain directors and employees in the six months ended October 31, 2013. Stock option generally vest from six months to five years from the date of grant and generally expire five years after the vesting date.

The total intrinsic value of options exercised during the six months ended October 31, 2013 was approximately \$605,454.

Nonvested stock option (options that did not vest in the period in which granted) activity during the six months ended October 31, 2013 was as follows:

|                                 | Nonvested<br>options | Weighted<br>average<br>exercise price |
|---------------------------------|----------------------|---------------------------------------|
| Outstanding at April 30, 2013   | 132,500              | \$15.00                               |
| Granted                         | 407,374              | 17.98                                 |
| Vested                          | (30,000)             | 15.00                                 |
| Canceled                        | —                    | —                                     |
| Outstanding at October 31, 2013 | 509,874              | 17.38                                 |

At October 31, 2013, unrecognized compensation costs related to nonvested stock options were \$2,669,390. These costs are expected to be recognized between fiscal 2014 and fiscal 2016.

The following table summarizes information about stock options outstanding and exercisable at October 31, 2013:

| Number of shares<br>outstanding at<br>October 31, 2013 | Range of exercise<br>prices | Weighted<br>average exercise<br>price | Weighted average<br>remaining<br>contractual life | Number of shares<br>exercisable at<br>October 31, 2013 | Weighted<br>average exercise<br>price |
|--|-----------------------------|---------------------------------------|---|--|---------------------------------------|
| 117,500  | \$10.50                     | \$10.50                               | 1.3   | 117,500  | \$10.50                               |
| 1,734,896  | 14.00-16.50                 | 15.02                                 | 2.6   | 1,632,396  | 15.02                                 |
| 248,358  | 15.00                       | 15.00                                 | 3.4   | 248,358  | 15.00                                 |
| 407,374  | 16.38 - 19.75               | 17.98                                 | 4.9   | —  | 17.98                                 |
| 2,508,128  |                             | 15.29                                 |   | 1,998,254  | 14.75                                 |

During the fiscal year ended April 30, 2013, the settlement of certain stock option transactions caused a change in the classification of certain outstanding stock options to a liability instrument from an equity instrument, which resulted in an increase in stock compensation expense of \$2,625,000. At April 30, 2013, the value of the liability for the 997,824 options that changed classifications from an equity to a liability instrument was \$5,111,000. On June 11, 2013 our board of directors voted to prohibit those types of transactions, and the Company therefore reclassified the stock options back to an equity instrument, resulting in a reduction to stock compensation expense of \$872,000. The liability was removed and the remainder was reclassified to additional paid-in capital.

#### (b) Restricted Stock Units

During the six months ended October 31, 2013, the Company awarded restricted stock units (RSUs) to its non-employee directors and certain employees. The weighted average fair value at grant date was \$16.86 and the weighted average service period is 19 months. Compensation costs associated with these restricted shares are amortized over the service period and recognized as an increase in additional paid-in capital.

Restricted stock activity during the six months ended October 31, 2013 was as follows:

| Number of<br>RSUs | Weighted |
|-------------------|----------|
|-------------------|----------|

|                                 |        | average fair value at<br>grant date |
|---------------------------------|--------|-------------------------------------|
| Outstanding at April 30, 2013   | 15,971 | \$ 13.50                            |
| Granted                         | 23,565 | 16.86                               |
| Exercised                       | —      | —                                   |
| Canceled                        | —      | —                                   |
| Outstanding at October 31, 2013 | 39,536 | 15.50                               |

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At October 31, 2013, unrecognized compensation costs related to restricted stock units were \$319,195. These costs are expected to be recognized during fiscal 2014 and fiscal 2015.

#### (10) Fair Value of Financial Instruments

The Company uses the following methods and assumptions to estimate the fair value of financial instruments.

Cash equivalents, receivables, other current assets, accounts payable and accrued expenses, and due to area developers: The carrying amounts approximate fair value because of the short maturity of these instruments. At October 31, 2013 and April 30, 2013 the Company had cash equivalents of:

|                      | October 31, 2013<br>(In thousands) | April 30, 2013 |
|----------------------|------------------------------------|----------------|
| Money market account | \$—                                | \$ 16,798      |

Notes receivable: The carrying amount of the Company's notes receivable approximates fair value based upon the present value of expected future cash flows discounted at the interest rate currently offered by the Company, which approximates rates currently offered by local lending institutions for loans of similar terms to individuals/entities with comparable credit risk.

Nonfinancial assets and liabilities: The fair value of customer lists is measured on a nonrecurring basis in the period that the Company deemed the assets impaired. Fair value is determined based on historical transactions involving sales of Company-owned offices.

Long-term debt: The carrying amount of the Company's long-term debt approximates fair value based on the present value of expected future cash flows discounted at the interest rates offered by the lenders, which approximates rates currently offered by local lending institutions for loans of similar terms to companies with comparable credit risk.

Concentrations of credit risks: Financial instruments that could potentially subject the Company to concentrations of credit risks consist of accounts and notes receivable with its franchisees.

The Company maintains its cash and cash equivalents in bank deposit accounts, which at times may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risk on its cash and cash equivalents balances.

The Company manages such risk by evaluating the financial position of the franchisee, value of the franchises, as well as the personal guarantee of the individual franchisees. At October 31, 2013 and April 30, 2013, there were no significant concentrations of credit risk associated with any individual franchisee or group of franchisees. The Company maintains an allowance for potential losses based on its expected collectability of the receivables, which the Company believes is adequate for its credit loss exposure.

The condensed consolidated financial statements include various estimated fair value information at October 31, 2013 and April 30, 2013.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial assets and liabilities subject to fair value measurements on a recurring basis are classified according to a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value.

Level 1 — quoted prices for identical assets and liabilities in active markets.

Level 2 — quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, and model-based valuations in which all significant inputs are observable in the market.

Level 3 — unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

At October 31, 2013 and April 30, 2013, the following tables present, for each of the fair value hierarchy levels, the assets and liabilities that are measured at fair value on a recurring and nonrecurring basis (in thousands):

|   | Total    | October 31, 2013<br>Fair value measurements using |         |         |
|---|----------|---|---------|---------|
|   |          | Level 1   | Level 2 | Level 3 |
| Assets:                                     |          |   |         |         |
| Recurring:                                  |          |   |         |         |
| Equity securities, available for sale       | \$4,606  | \$4,606   | \$—     | \$—     |
| Nonrecurring:                               |          |   |         |         |
| Impaired accounts and notes receivable      | 6,624    | —   | —       | 6,624   |
| Total recurring and nonrecurring assets     | \$11,230 | \$4,606   | \$—     | \$6,624 |
|   |          |   |         |         |
|   | Total    | April 30, 2013<br>Fair value measurements using   |         |         |
|   |          | Level 1   | Level 2 | Level 3 |
| Assets:                                     |          |   |         |         |
| Recurring:                                  |          |   |         |         |
| Cash equivalents                            | \$16,798 | \$16,798  | \$—     | \$—     |
| Equity securities, available for sale       | 3,619    | 3,619   | —       | —       |
| Total recurring assets                      | 20,417   | 20,417  | —       | —       |
| Nonrecurring:                               |          |   |         |         |
| Impaired accounts and notes receivable      | 7,973    | —   | —       | 7,973   |
| Impaired goodwill                           | 1,254    | —   | —       | 1,254   |
| Impaired reacquired rights                  | 286      | —   | —       | 286     |
| Impaired customer lists                     | 453      | —   | —       | 453     |
| Total nonrecurring assets                   | 9,966    | —   | —       | 9,966   |
| Total recurring and nonrecurring assets     | \$30,383 | \$20,417  | \$—     | \$9,966 |
| Liabilities:                                |          |   |         |         |
| Recurring:                                  |          |   |         |         |
| Liability classified share-based instrument | \$5,111  | \$—   | \$5,111 | \$—     |

The Company's policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no transfers into or out of level 1 or 2 requiring fair value measurements for the six months ended October 31, 2013.

Fair values for equity securities available for sale are based on published market prices. Equity securities available for sale are carried at their aggregate fair value.

Management considers accounts and notes receivable to be impaired if the amount due exceeds the fair value of the underlying franchise. In establishing the estimated fair value of the underlying franchise, consideration is given to the net fees of open offices earned during the most recently completed tax season and the number of unopened offices.

Management considers intangible assets, reacquired rights, customer lists and goodwill, associated with a company-owned office to be impaired if the net carrying amount exceeds the fair value of the underlying franchise. In establishing the fair value of the underlying franchise, consideration is given to historical transactions involving sales of company-owned offices and the net fees of the underlying franchise.





## (11) Related Party Transactions

The Company considers directors and their affiliated companies, executive officers of the Company, and members of their immediate family to be related parties. For the six months ended October 31, 2013 and 2012, the Company repurchased common stock from related parties as follows (all repurchases were in conjunction with the exercise of stock options):

|                           | 2013        | 2012      |
|---------------------------|-------------|-----------|
| Common stock repurchases: |             |           |
| Shares repurchased        | 122,249     | 20,000    |
| Amount                    | \$2,232,183 | \$301,000 |

## (12) Commitments and Contingencies

ERC class action litigation. The Company was sued in November 2011 in federal courts in Arkansas, California, Florida and Illinois, and additional lawsuits were filed in federal courts in January 2012 in Maryland and North Carolina, in February 2012 in Wisconsin, and in May 2012 in New York and Minnesota, since the initial filings. In April 2012, a motion to consolidate all of the then-pending cases before a single judge in federal court in the Northern District of Illinois was granted, and in June 2012, the plaintiffs filed a new complaint in the consolidated action. The consolidated complaint alleges that an electronic refund check (ERC) represents a form of refund anticipation loan (RAL) because the taxpayer is "loaned" the tax preparation fee, and that an ERC is therefore subject to federal truth-in-lending disclosure and state law requirements regulating RALs. The plaintiffs therefore allege violations of state-specific RAL and other consumer statutes. The lawsuit purports to be a class action, and the plaintiffs allege potential damages in excess of \$5 million, but the Company may be able to recover any damages from the providers of the financial products that designed the programs and related disclosures. The Company is aware that virtually identical lawsuits have been filed against several of its competitors. The Company has not concluded that a loss related to this matter is probable, nor has the Company accrued a loss contingency related to this matter. The Company believes it has meritorious defenses to the claims in this case, and intends to defend the case vigorously, but there can be no assurances as to the outcome or the impact on the Company's consolidated financial position, results of operations and cash flows. The case is at an early procedural stage.

Republic Bank Dispute. In August 2012, the Company terminated an agreement with one of its financial product providers, Republic Bank & Trust Company ("Republic"), which would otherwise have expired in October 2014. The Company's right to terminate the agreement is being disputed by Republic. The parties conducted a contractually-required mediation in late June 2013 and Republic has indicated that it may proceed to arbitration. At this stage, an arbitration proceeding has not been commenced, but the Company believes that the outcome of this dispute will not significantly impact its results of operation, financial position or cash flows.

The Company is also party to claims and lawsuits that are considered to be ordinary, routine litigation incidental to the business, including claims and lawsuits concerning the preparation of customers' income tax returns, the fees charged to customers for various products and services, relationships with franchisees, intellectual property disputes, employment matters and contract disputes. Although the Company cannot provide assurance that it will ultimately prevail in each instance, the Company believes the amount, if any, it will be required to pay in the discharge of liabilities or settlements in these claims will not have a material adverse impact on its consolidated results of operations or cash flows.

## (13) Subsequent Events

On November 11, 2013, the Company granted 45,000 options to an employee of the Company. The exercise price of the options will be \$20.19 per share. The options, which have a fair value of \$6.87 per share, will vest over three years and expire five years from the date of vesting.

## ITEM 2

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### Special Note Regarding Forward-Looking Statements

This quarterly report contains forward-looking statements concerning our business, operations and financial performance and condition as well as our plans, objectives and expectations for our business operations and financial performance and condition. Any statements contained herein that are not of historical facts may be deemed to be forward-looking statements. You can identify these statements by words such as “aim,” “anticipate,” “assume,” “believe,” “could,” “due,” “estimate,” “expect,” “goal,” “intend,” “may,” “objective,” “plan,” “predict,” “potential,” “positioned,” “should,” “would” and other similar expressions that are predictions of or indicate future events and future trends. These forward-looking statements are based on current expectations, estimates, forecasts and projections about our business and the industry in which we operate and our management’s beliefs and assumptions and are not guarantees of future performance or development and involve known and unknown risks, uncertainties and other factors that are in some cases beyond our control. As a result, any or all of our forward-looking statements in this quarterly report may turn out to be inaccurate. Factors that may cause such differences include, but are not limited to, the risks described under “Item 1A—Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended April 30, 2013 and risks described in all other filings with the Securities and Exchange Commission, including:

- our possible inability to sustain growth at our historical pace;
- the seasonality of our business;
- our inability to secure reliable sources of the tax settlement products we make available to our customers;
- the continued service of our senior management team and our ability to attract additional talent;
- government regulation and oversight, including the regulation of our tax settlement products such as electronic refund checks (“ERCs”) and loan settlement products;
- government initiatives that simplify tax return preparation, improve the timing and efficiency of processing tax returns, limit payments to tax preparers or decrease the number of tax returns filed or the size of the refunds;
- government initiatives to pre-populate income tax returns;
- increased regulation of the products and services that we offer;
- the possible characterization of ERCs as a form of loan or extension of credit;
- changes in the tax settlement products offered to our customers that make our services less attractive to customers or more costly to us;
- our ability to maintain relationships with our tax settlement product service providers;
- our ability and the ability of our franchisees to comply with regulatory requirements;
- changes in our franchise sale model that may reduce our revenue;

the ability of our franchisees to open new territories and operate them successfully;

the ability of our franchisees to generate sufficient revenue to repay their indebtedness to us;

our ability to manage an increasing number of company-owned offices and tax kiosks;

our exposure to litigation;

our ability and our franchisees' ability to protect customers' personal information, including from a cyber-security incident;

- an ability to access the credit markets and satisfy our covenants to lenders;
- challenges in deploying accurate tax software in a timely way each tax season;
- competition in the tax preparation market;
- our reliance on technology systems, including the deployment of our NextGen project and electronic communications;
- our ability to deploy our NextGen software in time for the 2014 tax season;
- the impact of any acquisitions or dispositions, including our ability to integrate acquisitions and capitalize on their anticipated synergies;
- potential shareholder litigation as a result of the restatement of our previously issued consolidated financial statements;
- risks relating to our management's determination that there was a material weakness in our internal control over financial reporting, and as a result that our disclosure controls and procedures were not effective during periods at and prior to October 31, 2013; and
- other factors, including the risk factors discussed in this quarterly report.

Potential investors and other readers are urged to consider these factors carefully in evaluating the forward-looking statements and are cautioned not to place undue reliance on the forward-looking statements. These forward-looking statements speak only as of the date of this quarterly report. Unless required by law, we do not intend to publicly update or revise any forward-looking statements to reflect new information or future events or otherwise. A potential investor or other vendor should, however, review the factors and risks we describe in the reports we will file from time to time with the U.S. Securities and Exchange Commission, or SEC, after the date of this quarterly report.

## Overview

We are one of the leading providers of tax preparation services in the United States and Canada. As measured by both the number of returns prepared and the number of retail offices, we are the third largest and fastest growing national retail preparer of individual tax returns in the United States and the second largest retail preparer of individual tax returns in Canada. From 2001 through 2013, we have grown the number of U.S. tax returns prepared in our offices from approximately 137,000 to 1.8 million. Our tax preparation services and related tax settlement products are offered primarily through franchised locations, although we operate a limited number of company-owned offices each tax season. All of the offices are operated under the Liberty Tax Service brand.

From 2001 through 2013, we grew our number of tax offices from 508 to more than 4,500. We and our franchisees operated 4,262 offices in the United States during the 2013 tax season, an 8.7% increase over the 2012 tax season, when we operated 3,920 offices, which was itself a 9.2% increase over the number of offices operated in the 2011 tax season. Approximately 61% of our revenue for fiscal year 2013 was derived from franchise fees, area developer fees, royalties and advertising fees, and for this reason, continued growth in and seasoning of our franchise locations is viewed by management as the key to our future performance.

Our revenue primarily consists of the following components:

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Franchise Fees: Our standard franchise fee per territory is currently \$40,000 and we offer our franchisees flexible structures and financing options for franchise fees. Franchise fee revenue is recognized when our obligations to prepare the franchisee for operation are substantially complete and as cash is received. However, in 2011 we introduced a franchise fee option that forgoes the initial franchise fee payment in favor of a higher royalty rate. The franchise fee revenue we report includes the portion of franchise fees received by us from franchisees but contractually due to area developers. The amount of franchise fees due to area developers is recorded as an expense. As described below, because the restatement of our financial statements prevented us from filing our Annual Report on Form 10-K for the fiscal year ended April 30, 2013 on a timely basis, we were unable to sell franchises for a portion of the quarter ended October 31, 2013. This inability to sell franchises will not only affect our franchise fee revenue for

the fiscal second and third quarters of fiscal 2014, but because as a consequence fewer franchised tax offices will be open during the 2014 tax season, will also affect the advertising fees and royalties we receive in the upcoming tax season.

Area Developer Fees: Our fees for AD areas vary based on our assessment of the revenue potential of each AD area, and also depend on the performance of any existing franchisees within the AD area being sold. Our ADs generally receive 50% of both the franchise fees and royalties derived from territories located in their area.

- Area development fees received are recognized as revenue on a straight-line basis over the initial contract term of each Area Developer agreement with the cumulative amount of revenue recognized not to exceed the amount of cash received.

We amortize our revenue from area developer sales over the length of our area developer agreements, which are typically ten years. For this reason, significant year-to-year trends in our area development sales activity are apparent from our comparative financial results only to the extent that the most recent year is so anomalous as to result in a significant variation in recognized area developer revenue. We will identify trends in these sales even where they do not represent a material year-to-year difference for purposes of area developer revenue recognition.

As described below, we experienced a decrease in area developer fees received during our fiscal 2014 second quarter because of our inability to sell franchises (including area developer territories) during that quarter.

We do expect new area developer sales to become a less significant source of new revenue as we continue to build out our franchise network and have less need to utilize ADs to support that effort.

Advertising Fees: We earn advertising fee revenue from our franchisees. Our franchise agreement requires all franchisees to pay us an advertising fee of 5% of the franchisee's tax preparation revenue, which we use primarily to fund collective advertising efforts.

Royalties: We earn royalty revenue from our franchisees. Our franchise agreement requires franchisees to pay us a base royalty equal to 14% of the franchisee's tax preparation revenue, subject to certain specified minimums.

Franchisees acquiring territories under our "zero franchise fee" alternative are required to pay us franchise royalties of 25% through their first five tax seasons, and thereafter 14% of their tax preparation revenue. Over time, as our offices continue to "season," we expect that our growth in revenue from royalties will continue to outpace our growth in revenue from franchise fees. We also expect to see steadier growth from our royalty revenue, but our franchise fee revenue may decrease if franchisees choose our "zero franchise fee" alternative.

Our reported royalties and advertising fees include the portion of royalties that is paid to us by franchisees but that is contractually due to ADs under our area developer agreements. The amount of royalties due to area developers is recorded as an expense.

Financial Products: We offer two types of tax settlement financial products: "refund transfer" products, such as ERCs, which involve providing a means by which a customer may receive his or her refund more quickly and conveniently, and other tax settlement products, such as ICA refund-based loans. We earn fees from the use of these financial products.

Interest Income: We earn interest income from our franchisees and ADs related to both indebtedness for the unpaid portions of their franchise fees and AD territory fees, and for other loans we extend to our franchisees related to the operation of their territories. For franchise fees and AD loans upon which the underlying revenue has not been recognized, we recognize the interest income only to the extent of actual payment.

Tax Preparation Fees: We also earn tax preparation revenue directly from both the operation of company-owned offices and the provision of tax preparation services through our eSmartTax online product.

The Company restated prior financial statements earlier in fiscal 2014. We currently estimate that the direct costs associated with the restatement will be approximately \$850,000. We incurred and recognized the majority of these costs during the six months ended October 31, 2013. The restatement and the related delay in filing our Annual Report on Form 10-K for the year ended April 30 2013 caused our Franchise Disclosure Document to expire, resulting in an



inability to sell franchises and area developer territories for several weeks during the fiscal 2014 second quarter that is the subject of this quarterly report.

For purposes of this section and throughout this quarterly report, all references to “fiscal 2014” and “fiscal 2013” refer to our fiscal years ended April 30, 2014 and 2013, respectively, and corresponding references to fiscal quarters are references to quarters within those fiscal years. For purposes of this section and throughout this quarterly report, all references to “year” or

“years” are the respective fiscal year or years ended April 30 unless otherwise noted in this quarterly report, and all references to “tax season” refer to the period between January 1 and April 30 of the referenced year.

## Results of Operations

The table below shows results of operations for the three and six months ended October 31, 2013 and 2012.

|                       | Three Months Ended October 31, |          |            |        |  | Six Months Ended October 31, |           |            |        |
|-----------------------|--------------------------------|----------|------------|--------|--|------------------------------|-----------|------------|--------|
|                       |                                |          | Change     |        |  |                              |           | Change     |        |
|                       | 2013                           | 2012     | \$         | %      |  | 2013                         | 2012      | \$         | %      |
|                       | (dollars in thousands)         |          |            |        |  |                              |           |            |        |
| Results of Operations |                                |          |            |        |  |                              |           |            |        |
| Total revenues        | \$7,317                        | \$9,338  | \$(2,021 ) | (22 )% |  | \$15,382                     | \$16,582  | \$(1,200 ) | (7 )%  |
| Loss from operations  | (13,580 )                      | (9,473 ) | (4,107 )   | (43 )% |  | (22,960 )                    | (19,579 ) | (3,381 )   | (17 )% |
| Net loss              | (8,478 )                       | (6,111 ) | (2,367 )   | (39 )% |  | (14,405 )                    | (12,474 ) | (1,931 )   | (15 )% |

Revenues. The table below sets forth the components and changes in our revenues for the three and six months ended October 31, 2013 and 2012.

|  | Three Months Ended October 31, |         |            |        | Six Months Ended October 31, |          |            |        |
|--|--------------------------------|---------|------------|--------|------------------------------|----------|------------|--------|
|  | 2013                           | 2012    | Change     | %      | 2013                         | 2012     | Change     | %      |
|  | (dollars in thousands)         |         |            |        |                              |          |            |        |
| Franchise fees                         | \$886                          | \$2,138 | \$(1,252 ) | (59 )% | \$1,925                      | \$2,805  | \$(880 )   | (31 )% |
| Area developer fees                    | 1,880                          | 2,079   | (199 )     | (10 )% | 3,683                        | 4,001    | (318 )     | (8 )%  |
| Royalties                              | 900                            | 792     | 108        | 14 %   | 2,003                        | 1,798    | 205        | 11 %   |
| Advertising fees                       | 280                            | 257     | 23         | 9 %    | 626                          | 575      | 51         | 9 %    |
| Financial products                     | 169                            | 169     | —          | — %    | 618                          | 471      | 147        | 31 %   |
| Interest income                        | 2,200                          | 2,651   | (451 )     | (17 )% | 4,434                        | 5,199    | (765 )     | (15 )% |
| Tax preparation fees, net of discounts | 242                            | 225     | 17         | 8 %    | 628                          | 441      | 187        | 42 %   |
| Other revenue                          | 760                            | 1,027   | (267 )     | (26 )% | 1,465                        | 1,292    | 173        | 13 %   |
| Total revenues                         | \$7,317                        | \$9,338 | \$(2,021 ) | (22 )% | \$15,382                     | \$16,582 | \$(1,200 ) | (7 )%  |

Total revenues decreased by \$2.0 million and \$1.2 million in the three and six months ended October 31, 2013, representing a 22% and 7% decrease, respectively. The largest components of the decrease were:

A 59% and 31% decrease, respectively, in franchise fees due to a decrease in the number of franchise sales because we were unable to sell franchises for a significant portion of August 2013 and September 2013. These months are typically peak franchise sales months.

A 10% and 8% decrease, respectively, in area developer fees due primarily to lower cash payments on AD loans, which limits our ability to record revenue related to area developer fees.

A 17% and 15% decrease, respectively, in interest income, reflecting lower interest payments on AD loans because of reduced franchise sales that impact the cash received from ADs to pay interest.

A 26% decrease in other revenue for the three months ended October 31, 2013 due to a decrease in commission fees paid by our ADs for selling franchises in their areas and a decrease in transfer fees paid by franchisees who sell their

franchises to other franchisees. Both of these declines may be attributed to our inability to sell franchises for a significant portion of the quarter.

Operating expenses. The table below details the amounts and changes in our operating expenses for the three and six months ended October 31, 2013 and 2012.

|   | Three Months Ended October 31, |          |         |       |    | Six Months Ended October 31, |          |         |       |    |
|---|--------------------------------|----------|---------|-------|----|------------------------------|----------|---------|-------|----|
|   | 2013                           | 2012     | Change  |       |    | 2013                         | 2012     | Change  |       |    |
|   |                                |          | \$      | %     |    |                              |          | \$      | %     |    |
|   | (dollars in thousands)         |          |         |       |    |                              |          |         |       |    |
| Employee compensation and benefits                | \$8,196                        | \$7,615  | \$581   | 8     | %  | \$14,285                     | \$14,281 | \$4     | —     | %  |
| General and administrative expenses               | 7,744                          | 6,110    | 1,634   | 27    | %  | 14,010                       | 11,926   | 2,084   | 17    | %  |
| Area developer expense                            | 705                            | 1,115    | (410    | ) (37 | )% | 1,533                        | 1,832    | (299    | ) (16 | )% |
| Advertising expense                               | 2,507                          | 2,539    | (32     | ) (1  | )% | 5,191                        | 5,099    | 92      | 2     | %  |
| Depreciation, amortization and impairment charges | 1,745                          | 1,432    | 313     | 22    | %  | 3,323                        | 3,023    | 300     | 10    | %  |
| Total operating expenses                          | \$20,897                       | \$18,811 | \$2,086 | 11    | %  | \$38,342                     | \$36,161 | \$2,181 | 6     | %  |

Our total operating expenses increased by \$2.1 million and \$2.2 million in the three and six months ended October 31, 2013, compared to the same period in fiscal 2013, representing an 11% and 6% increase, respectively. The largest components of these increases were:

▲ 27% and 17% increase, respectively, in general and administrative expenses caused primarily by the following: Non-recurring expenses of \$693,000 and \$792,000, respectively, related to the restatement of our prior financial statements.

A \$257,000 and \$511,000 increase, respectively, in computer supply and software expense related to the use of electronic signatures for customer documents.

A \$306,000 increase for the six months ended October 31, 2013 in rent and utilities expense because of an increase in the number of company-owned offices.

An 8% increase in employee compensation and benefits for the three months ended October 31, 2013 primarily related to the accrual of a severance obligation and the acceleration of related stock compensation of \$614,000 to a former executive officer.

A 22% and 10% increase, respectively, in depreciation, amortization and impairment charges due to the additional amortization expense related to the purchase of an online tax preparation software provider in December 2012 and because we purchased more territories from franchisees during the fiscal 2014 periods than we did during the same periods of fiscal 2013.

The increases in general and administrative expense, depreciation, amortization and impairment charges, and employee compensation and benefits were partially offset by a 37% and 16% decrease, respectively, in area developer expense because of the decline in the ADs portion of franchise fee revenue, which declined because of our decrease in franchise sales revenue described above.

Other income (expense). Available-for-sale securities with a cost basis of \$268,000 were sold during the six months ended October 13, 2013. A gain on the sale of \$188,000 was recognized and recorded as a component of other income. There were no other material changes in other income between the first six months and second quarter of fiscal 2014 and the same periods of fiscal 2013.

We recorded income tax benefits in the first three and six months of fiscal 2014 and 2013 with effective rates of 38.4% and 38.8%, respectively. Due to the seasonal nature of our business, we expect the losses we incur through the first three quarters of a fiscal year will be more than offset by the results of our fiscal fourth quarter.

Net loss. For the first six months of fiscal 2014, as compared to fiscal 2013, our net loss increased by 15%, reflecting a 7% reduction in revenues and a 6% increase in operating expenses. For the second quarter of fiscal 2014, as compared to fiscal 2013, our net loss increased by 39%, reflecting a 22% reduction in revenues and an 11% increase in operating expenses.

## Liquidity and Capital Resources

### Overview of factors affecting our liquidity

**Seasonality of cash flow.** Our tax return preparation business is seasonal, and most of our revenues and cash flow are generated during the period from early February through April 30. Following each tax season, from May 1 through early February of the following year, we rely significantly on excess operating cash flow from the previous season, on cash payments made by franchisees and ADs who purchase new territories and areas prior to the next tax season and make cash payments in connection with those purchases, and on the use of our credit facility to fund our operating expenses and invest in the future growth of our business. Our business has historically generated a strong operating cash flow from operations on an annual basis. We devote a significant portion of our cash resources during the off season to finance the working capital needs of our franchisees. We have also incurred significant expenditures in the development of our NextGen project.

**Credit facility.** Our credit facility consists of a \$25 million term loan and a revolving credit facility. The term loan amortizes on a quarterly basis and matures on April 30, 2017; the revolving loan also expires on that date. In December 2012, the Company utilized the accordion feature of the revolving loan, increasing the maximum borrowings under that portion of our credit facility by \$38.4 million to \$143.4 million. The outstanding borrowings on both loans accrue interest at an adjusted one month LIBOR rate plus a margin that varies from 1.50% to 2.25% (an increase of 25 basis points from our previous revolving credit facility), depending on our leverage ratio. The interest rate was 1.80% and 1.95% at October 31, 2013 and April 30, 2014, respectively. This indebtedness is collateralized by substantially all of our assets, including the assets of our subsidiaries.

Under our credit facility, we are subject to a number of covenants that could potentially restrict how we carry out our business or that require us to meet certain periodic tests in the form of financial covenants. The restrictions we consider to be material to our ongoing business include the following:

- We must satisfy a “leverage ratio” test that is based on our outstanding indebtedness at the end of each fiscal quarter,
- We must satisfy a “fixed charge coverage ratio” test at the end of each fiscal quarter, and
- We must reduce the outstanding balance under our revolving loan to zero for a period of at least 45 consecutive days each fiscal year.

In addition, were we to experience certain types of changes in control affecting continuing control of us by our CEO, John Hewitt, or certain changes to the composition of our Board of Directors, we might become subject to an event of default under our credit facility, which may result in the acceleration of our obligations under that facility.

Our credit facility also contains customary affirmative and negative covenants, including limitations on indebtedness, limitations on liens and negative pledges, limitations on investments, loans and acquisitions, limitations on mergers, consolidations, liquidations and dissolutions, limitations on sales of assets, limitations on certain restricted payments and limitations on transactions with affiliates, among others.

We were in compliance with our financial covenants as of October 31, 2013; however, the accounting policy changes that resulted in the restatements of our financial statements resulted in our inability to satisfy several credit facility covenants related to the delivery and accuracy of our financial reports. The Company obtained a waiver of these failures from our bank syndicate in August 2013. At October 31, 2013, our leverage ratio was 1.76:1 and our fixed charge coverage ratio was 3.81:1.

Franchisee lending and potential exposure to credit loss. A substantial portion of our cash flow during the year is utilized to provide funding to our franchisees and ADs. At October 31, 2013, our total balance of loans to franchisees and ADs for working capital and equipment loans, representing cash amounts we had advanced to the franchisees and ADs, was \$28.7 million. In addition, at that date, our franchisees and ADs together owed us an additional \$65.2 million, net of unrecognized revenue of \$38.3 million for unpaid amounts owed to us, typically representing the unpaid purchase price of areas comprising clusters of territories, and other amounts owed to us for royalties and other unpaid amounts for which our franchisees and ADs had outstanding payment obligations.

Our actual exposure to potential credit loss associated with franchisee loans is less than the aggregate amount of those loans because a significant portion of those loans are to franchisees located within AD areas, where our AD is ultimately entitled to a substantial portion of the franchise fee and royalty revenues represented by some of these loans. For this reason, the amount of indebtedness of franchisees to us is effectively offset in part by our related payable obligation to ADs with respect to franchise fees and royalties. As of October 31, 2013, the total indebtedness of franchisees to us where the franchisee

is located in an AD area was \$56.9 million, but \$8.3 million of that indebtedness represents amounts ultimately payable to ADs as their share of franchise fees and royalties.

Our franchisees make electronic return filings for their customers utilizing our facilities. Our franchise agreements allow us to obtain repayment of amounts due to us from our franchisees through an electronic fee intercept program before our franchisees receive net proceeds of the tax preparation and other fees they have charged to their customers on tax returns associated with financial products. Therefore, we are able to minimize the nonpayment risk associated with amounts outstanding to franchisees by obtaining direct electronic payment in the ordinary course throughout the tax season. Our credit risk associated with amounts outstanding to ADs is also mitigated by our electronic fee intercept program, which enables us to obtain repayments of amounts that would otherwise flow through to ADs as their share of franchisee fee and royalty payments, to the extent of an AD's indebtedness to us.

The unpaid amounts owed to us from our franchisees and ADs are collateralized by the underlying franchise or area and are guaranteed by the respective franchisee or AD and the related owner(s). Accordingly, to the extent a franchisee or AD does not satisfy its payment obligations to us, we may repossess the underlying franchise or area in order to resell it in the future. At October 31, 2013, we had an investment in impaired accounts and notes receivable and related interest receivable of approximately \$11.0 million. We consider accounts and notes receivable to be impaired if the amounts due exceed the fair value of the underlying franchise and estimate an allowance for doubtful accounts based on that excess. Amounts due include the recorded value of the accounts and notes receivable reduced by the allowance for uncollected interest, amounts due to ADs for their portion of franchisee receivables, any related deferred revenue and amounts owed to the franchisee or AD by us. In establishing the fair value of the underlying franchise, we consider net fees of open territories and the number of unopened territories. At October 31, 2013, we have recorded an allowance for doubtful accounts for impaired accounts and notes receivable of \$5.3 million. There were no significant concentrations of credit risk with any individual franchisee or AD as of October 31, 2013; we believe our allowance for doubtful accounts as of October 31, 2013 is adequate for our existing loss exposure. We closely monitor the performance of our franchisees and ADs and will adjust our allowances as appropriate if we determine the existing allowances are inadequate to cover estimated losses.

**Dividends.** We have never declared or paid a cash dividend on our capital stock. Although we may pay cash dividends in the future, the payment of dividends will be at the discretion of our Board of Directors and will depend, among other things, on our earnings, capital requirements and financial condition. Our ability to pay dividends will also be subject to compliance with the financial covenants that are contained in our credit facility and may be restricted by any future indebtedness that we incur or issuances of preferred stock.

#### Sources and uses of cash

**Operating activities.** In the first six months of fiscal 2014, we used \$240,000 more cash for our operating activities compared to the first six months of fiscal 2013. Some of the items that contributed to the increase in our negative operating cash flow for the first six months of fiscal 2014 compared to the prior year include:

Higher general and administrative payments of \$2.3 million in the first six months of fiscal 2014, as compared to fiscal 2013, because we incurred more costs to support an increase in company-owned offices and franchisees, as compared to the prior year, as well as the timing of payables.

Higher payments of \$1.7 million to ADs for their portion of 2013 tax season royalties received in fiscal 2014 because the delay in the IRS' commencement of the tax filing season and the related delay in our franchisees' receipt of revenue pushed more royalty payments to us into fiscal 2014, which did not happen in fiscal 2013.

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Lower cash receipts of \$1.2 million for interest income and financial products, reflecting fewer interest payments on AD loans and the timing of receipts related to financial products.

These decreases in cash utilization were partially offset by:

Higher royalty and advertising fee receipts offset by lower franchise fee and AD fee receipts for a net increase of \$2.2 million. The receipts were higher in fiscal 2014 because the delay in the IRS' commencement of the tax filing season and the related delay in our franchisees' receipt of revenue pushed more royalty and advertising payments to us into fiscal 2014, which did not happen in fiscal 2013.

Lower payments of \$2.2 million for financial product rebates to franchisees paid during fiscal 2014, as compared to the previous year. We paid the rebate for the 2012 tax season in the first quarter of fiscal 2013, but did not provide our franchisees the rebate for the 2013 tax season.

Investing activities. In the first six months of fiscal 2014, we utilized \$3.8 million less in cash for investing activities compared to the same period in fiscal 2013. Some of the items that contributed to the decrease in our negative investing cash flow for the first six months of fiscal 2014 compared to the prior year include:

A decrease of \$3.4 million in the issuance of operating loans to our franchisees (including ADs), net of payments received on operating loans. Because some IRS payments that resulted in revenue to our franchisees were delayed into the first quarter of fiscal 2014, some franchisees did not seek operating loans as early as they did in fiscal 2013.

A decrease related to the purchase of \$3.0 million in marketable equity securities that occurred in fiscal 2013, but did not recur in 2014.

The decrease in the issuance of operating loans and purchase of marketable equity securities was partially offset by:

An increase of \$2.1 million in purchases of AD rights and company-owned offices, which was due to AD purchases that occurred in the first six months of fiscal 2014 over those that occurred in the same period of fiscal 2013.

A decrease of \$1.2 million in proceeds from the sale of Company-owned offices and area developer rights because we did not have significant sales of AD rights in fiscal 2014.

Financing activities. In the first six months of fiscal 2014, we generated \$1.3 million less cash from financing activities compared to the same period of fiscal 2013, predominantly because our net repayments under our revolving credit facility increased \$1.2 million because we required less cash for investing activities.

#### Future cash needs and capital requirements

Operating cash flow needs. We believe our cash from operations and our current credit facility will be sufficient to support our cash flow needs for the foreseeable future.

At October 31, 2013, using the leverage ratio applicable under our loan covenants at the end of that quarter, we had available borrowing capacity of \$47.9 million. Under our credit facility, our leverage ratio requirement at the end of each fiscal quarter is 3:1, except at January 31, when it increases to 4:1.

Our credit facility also contains a requirement that we reduce the balance of our revolving loan to zero for a period of at least 45 consecutive days each fiscal year. However, because our term loan will remain outstanding during that 45 day period, and given our historic cash flow experience at the end of and beginning of each fiscal year, we do not anticipate that the unavailability of our revolving loan during that 45 day period each fiscal year will adversely affect our cash flow. We satisfied this requirement for fiscal 2014 during the quarter ended July 31, 2013, and so that requirement will next be required to be satisfied during fiscal 2015.

We believe several factors will affect our cash flow in future periods, including the following:

- The extent to which we extend additional financing to our franchisees and ADs, beyond the levels of prior periods,
- The extent to which we finance any tax settlement products offered by JTH Financial in the future,

The extent and timing of our expenditures related to our NextGen project. Our NextGen project is an integral part of our determination to deliver an improved level of service to our franchisees. In addition to integrating our online and retail-based tax preparation software, we expect the NextGen project, when fully deployed, to improve the ability of our franchisees to comply with financial information protection requirements by moving most tax preparation information to a secure centralized platform, and to provide web-based support services in a way that will be both more accessible to our franchisees and their employees and less expensive for us to provide,

The cash flow effect of selling franchises under our program allowing franchisees to purchase additional territories without making any cash down payment,

• The offsetting impact of the higher royalty rates we receive from franchisees who elect to purchase territories under the zero franchise fee payment plan,

• The extent to which we engage in stock repurchases,

• Our ability to generate fee and other income related to tax settlement products in light of regulatory pressures on us and our business partners,

• The extent to which we repurchase AD areas in order to allow us to receive a full stream of royalties from the franchisees in the AD areas in future periods, and

• The extent, if any, to which our Board of Directors elects to declare dividends on our common stock.

Effect of our credit facility covenants on our future performance. Our credit facility, which matures on April 30, 2017, imposes several restrictive covenants, consistent with the covenants that applied under the revolving credit facility it replaced. The credit facility contains a covenant that requires us to maintain a “leverage ratio” of not more than 4:1 at the end of the fiscal quarter ending January 31, and a ratio of not more than 3:1 at the end of each other fiscal quarter. The higher permitted leverage ratio at the end of the January 31 quarter reflects the fact that as of that date, we have typically extended significant credit to our franchisees for working capital and other needs that is not reflected in revenue that we receive from our franchisees until the period beginning in February each year.

At October 31, 2013, our leverage ratio was 1.76:1. Using the 3:1 test, our available borrowing capacity under the revolving credit facility at October 31, 2013 was \$47.9 million. The leverage ratio is measured only at the end of each fiscal quarter, and so there may be times at which we exceed the quarter-end leverage ratio during the quarter, which we are permitted to do provided that our leverage ratio is within the allowable ratio at quarter-end.

We are additionally obligated to satisfy a fixed charge coverage ratio test which requires that ratio to be not less than 1.50:1 at the end of every fiscal quarter. At October 31, 2013, our fixed charge coverage ratio was 3.81:1.

We were in compliance with our financial covenants as of October 31, 2013; however, the accounting policy changes that resulted in the restatements of our financial statements resulted in our inability to satisfy several credit facility covenants for which we obtained a waiver in August 2013. We expect to be able to manage our cash flow and our operating activities in such a manner that we will be able to satisfy our obligations under the revolving credit facility for the remainder of the term of that facility.

As noted above, although we are subject under our credit facility to a requirement that we reduce the balance of our revolving loan to zero for a period of at least 45 consecutive days each fiscal year, because of the addition of a term loan into our credit facility, we do not believe that this requirement will affect our cash flow or future performance.

#### Seasonality of Operations

Given the seasonal nature of the tax return preparation business, we have historically generated and expect to continue to generate most of our revenues during the period from January 1 through April 30. In fiscal 2013 we earned 26% and of our revenues during our fiscal third quarter ending January 31, and earned 89% of our revenues during the combined fiscal third and fourth quarters. We historically operate at a loss through the first eight months of each fiscal year, during which we incur costs associated with preparing for the upcoming tax season.

#### Off Balance Sheet Arrangements

From time to time, we have been party to interest rate swap agreements that allow us to manage fluctuations in cash flow resulting from changes in the interest rate on our credit facility. These swaps effectively change the variable-rate of our credit facility into a fixed rate credit facility. Under the swaps, we receive a variable interest rate based on the one month LIBOR and pay a fixed interest rate. Our interest rate swap agreements expired in March 2013 and we were not a party to an interest rate swap agreement at October 31, 2013. We may enter into interest rate swap agreements in the future if we determine that it is appropriate to hedge our interest rate risk.

We also enter into forward contracts to eliminate exposure related to foreign currency fluctuations in connection with the short-term advances we make to our Canadian subsidiary in order to fund personal income tax refund discounting for our

Canadian operations. At October 31, 2013, we had not entered into any forward contracts, but we expect to enter into forward contracts during the upcoming Canadian tax season.

### ITEM 3

#### QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in our market risks from those reported at April 30, 2013 in our Annual Report on Form 10-K.

### ITEM 4

#### CONTROLS AND PROCEDURES

##### Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), evaluated the effectiveness of our disclosure controls and procedures as defined under Exchange Act Rule 13a-15(e) and 15d-15(e). Based on the evaluation of our disclosure controls and procedures and because the material weakness in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act), described in Management's Report on Internal Control over Financial Reporting in Item 9A of our Annual Report on Form 10-K for the year ended April 30, 2013, has not yet been remediated, our CEO and CFO have concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q our disclosure controls and procedures were not effective to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission and is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

##### Changes in Internal Control over Financial Reporting

During our most recent fiscal quarter, there has not occurred any change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. However, as described in Plan for Remediation of Material Weakness on Form 10-K for the year ended April 30, 2013, we are dedicating resources to support our efforts to improve the control environment and to remedy the material weakness noted above.

## PART II

## ITEM 1

## LEGAL PROCEEDINGS

There have been no material developments with respect to the legal proceedings reported in our Annual Report on Form 10-K for the year ended April 30, 2013 since the date of that report.

## ITEM 1A

## RISK FACTORS

There have been no material changes in our risk factors from those reported in our Annual Report on Form 10-K for the year ended April 30, 2013.

## ITEM 2

## UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There were no issuances of our Class A Common Stock during the quarter ended October 31, 2013.

## PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

Stock repurchase activity during the three months ended October 31, 2013 was as follows:

| Period                                 | Total Number<br>of Shares<br>Purchased(1) | Average<br>Price Paid<br>per Share | Total Number<br>of Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Plan | Maximum<br>Value<br>of Shares<br>that may<br>Be Purchased<br>Under<br>the Plan(2) |
|--|---|------------------------------------|---|---|
| August 1 through August 31, 2013       | —   | \$—                                | —   | \$1,830,561   |
| September 1 through September 30, 2013 | —   | —                                  | —   | 1,830,561   |
| October 1 through October 31, 2013     | 85,948                                    | 18.99                              | 85,948  | 1,830,561   |
| Total                                  | 85,948                                    | 18.99                              | 85,948  |   |

(1) During the three months ended October 31, 2013, all share repurchases were associated with the exercise of stock options.

(2) On August 29, 2012 we announced that our Board of Directors approved a \$5 million authorization for share repurchases, and did not specify an expiration date for that share repurchase program. The repurchases include deemed repurchases from shareholders exercising options on a net basis. Share repurchases associated with stock option exercises do not reduce the maximum value of shares that may be purchased under the plan.

ITEM 6  
EXHIBITS

We have filed the following exhibits as part of this report:

| Exhibit Number | Exhibit Description                                  | Filed Herewith | Incorporated by Reference |
|----------------|--|----------------|---------------------------|
| 10.1           | Employment agreement for Christopher Carroll         | X              |                           |
| 31.1           | Certification of Chief Executive Officer             | X              |                           |
| 31.2           | Certification of Chief Financial Officer             | X              |                           |
| 32.1(1)        | Section 1350 Certification (Chief Executive Officer) | X              |                           |
| 32.2(1)        | Section 1350 Certification (Chief Financial Officer) | X              |                           |
| 101.INS(2)     | XBRL Instance Document                               | X              |                           |
| 101.SCH(2)     | XBRL Taxonomy Extension Schema                       | X              |                           |
| 101.CAL(2)     | XBRL Taxonomy Extension Calculation Linkbase         | X              |                           |
| 101.LAB(2)     | XBRL Taxonomy Extension Label Linkbase               | X              |                           |
| 101.PRE(2)     | XBRL Taxonomy Extension Presentation Linkbase        | X              |                           |
| 101.DEF(2)     | XBRL Taxonomy Extension Definition Linkbase          | X              |                           |

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(1) This exhibit is intended to be furnished and shall not be deemed “filed” for purposes of the Securities Exchange Act of 1934, as amended.

(2) Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not to be “filed” or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Act of 1934, as amended, and otherwise are not subject to liability under these sections.



SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

JTH HOLDING INC.  
(Registrant)

Dated: December 13, 2013

By: /s/ John T. Hewitt  
John T. Hewitt  
Chief Executive Officer and Chairman of the Board  
(Principal Executive Officer)

Dated: December 13, 2013

By: /s/ Mark F. Baumgartner  
Mark F. Baumgartner  
Chief Financial Officer  
(Principal Financial Officer)

EXHIBIT INDEX

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