

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

Liberty Tax, Inc.
Form 10-Q
December 10, 2018

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, 2018

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

Liberty Tax, Inc.
(Exact name of registrant as specified in its charter)
Delaware 27-3561876
(State of incorporation) (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 Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Emerging growth company

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares outstanding of the registrant's Class A common stock as of December 3, 2018 was 14,036,684 shares.

LIBERTY TAX, INC.

Form 10-Q for the Quarterly Period Ended October 31, 2018

Table of Contents

	Page Number
 <u>PART I - FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements (Unaudited)</u>	1
<u>Condensed Consolidated Balance Sheets as of October 31, 2018, April 30, 2018 and October 31, 2017</u>	2
<u>Condensed Consolidated Statements of Operations for the three and six months ended October 31, 2018 and 2017</u>	3
<u>Condensed Consolidated Statements of Comprehensive Loss for the three and six months ended October 31, 2018 and 2017</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the six months ended October 31, 2018 and 2017</u>	5
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	30
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	41
<u>Item 4. Controls and Procedures</u>	41
 <u>PART II - OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	43
<u>Item 1A. Risk Factors</u>	43
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	43
<u>Item 3. Defaults Upon Senior Securities</u>	44
<u>Item 4. Mine Safety Disclosures</u>	44
<u>Item 5. Other Information</u>	44
<u>Item 6. Exhibits</u>	44
<u>Signatures</u>	45

PART I. FINANCIAL INFORMATION
ITEM 1
FINANCIAL STATEMENTS (UNAUDITED)

1

LIBERTY TAX, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

October 31, 2018, April 30, 2018 and October 31, 2017

(In thousands, except share data)

	October 31, 2018 (unaudited)	April 30, 2018	October 31, 2017 (unaudited)
Assets			
Current assets:			
Cash and cash equivalents	\$5,132	\$18,522	\$5,173
Receivables:			
Accounts receivable	40,089	52,517	41,850
Notes receivable - current	38,014	24,295	39,445
Interest receivable, net of uncollectible amounts	2,500	1,526	3,487
Allowance for doubtful accounts - current	(11,937)	(11,522)	(8,235)
Total current receivables, net	68,666	66,816	76,547
Assets held for sale	4,357	8,941	16,173
Income taxes receivable	14,890	—	14,726
Other current assets	2,928	5,429	3,909
Total current assets	95,973	99,708	116,528
Property, equipment, and software, net	36,185	38,636	39,747
Notes receivable, non-current	10,569	6,554	18,049
Allowance for doubtful accounts, non-current	(1,502)	(965)	(1,614)
Total non-current notes receivables, net	9,067	5,589	16,435
Goodwill	7,550	8,640	7,448
Other intangible assets, net	21,731	22,837	23,029
Deferred income taxes	1,441	343	177
Other assets	2,013	2,250	2,651
Total assets	\$173,960	\$178,003	\$206,015
Liabilities and Stockholders' Equity			
Current liabilities:			
Current installments of long-term obligations	\$15,685	\$18,113	\$5,306
Accounts payable and accrued expenses	15,100	14,521	11,936
Due to Area Developers (ADs)	6,886	17,906	7,484
Income taxes payable	—	4,511	—
Revolving credit facility	48,275	—	—
Deferred revenue - current	3,873	2,021	2,428
Total current liabilities	89,819	57,072	27,154
Long-term obligations, excluding current installments, net	1,979	2,270	17,106
Revolving credit facility	—	—	60,950
Deferred revenue and other - non-current	6,890	4,692	5,611
Deferred income tax liability	919	1,397	3,585
Long-term income taxes payable	1,070	1,070	—
Total liabilities	100,677	66,501	114,406
Commitments and contingencies			
Stockholders' equity:			
Special voting preferred stock, \$0.01 par value per share, 0, 10 and 10 shares authorized, issued and outstanding, respectively	—	—	—

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

Class A common stock, \$0.01 par value per share, 21,200,000 shares authorized, 14,036,684, 12,823,020 and 12,725,472 shares issued and outstanding, respectively	140	128	127
Class B common stock, \$0.01 par value per share, 1,000,000 shares authorized, 0, 200,000 and 200,000 shares issued and outstanding, respectively	—	2	2
Exchangeable shares, \$0.01 par value per share, 1,000,000 shares authorized, 0, 1,000,000 and 1,000,000 shares issued and outstanding, respectively	—	10	10
Additional paid-in capital	11,964	11,570	10,285
Accumulated other comprehensive loss, net of taxes	(1,654	) (1,347	) (1,393
Retained earnings	62,833	101,139	82,578
Total stockholders' equity	73,283	111,502	91,609
Total liabilities and stockholders' equity	\$ 173,960	\$ 178,003	\$ 206,015

See accompanying notes to condensed consolidated financial statements.

LIBERTY TAX, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Operations

Three and Six Months Ended October 31, 2018 (unaudited) and 2017 (unaudited)

(In thousands, except share count and per share data)

	Three Months Ended October 31,		Six Months Ended October 31,	
	2018	2017	2018	2017
Revenue:				
Franchise fees	\$449	\$ 193	\$1,006	\$ 264
Area Developer fees	619	634	1,647	1,702
Royalties and advertising fees	1,474	1,299	3,036	2,988
Financial products	477	636	1,056	1,218
Interest income	1,549	2,101	3,205	4,398
Assisted tax preparation fees, net of discounts	1,382	1,549	2,901	3,189
Electronic filing fees	30	—	58	—
Other revenues	796	1,359	1,031	2,199
Total revenues	6,776	7,771	13,940	15,958
Operating expenses:				
Employee compensation and benefits	9,205	10,712	19,975	20,703
Selling, general, and administrative expenses	10,052	9,554	21,354	18,754
Area Developer expense	401	397	706	769
Advertising expense	1,229	1,702	2,914	4,079
Depreciation, amortization, and impairment charges	3,165	2,334	6,359	4,530
Restructuring expense	1,078	3,371	9,345	3,371
Total operating expenses	25,130	28,070	60,653	52,206
Loss from operations	(18,354)	(20,299)	(46,713)	(36,248)
Other income (expense):				
Foreign currency transaction gain (loss)	(2)	(39)	—	71
Interest expense	(547)	(508)	(1,077)	(789)
Loss before income taxes	(18,903)	(20,846)	(47,790)	(36,966)
Income tax benefit	(6,029)	(7,743)	(15,545)	(14,105)
Net loss	(12,874)	(13,103)	(32,245)	(22,861)
Net loss per share of common stock:				
Basic and diluted	\$(0.92)	\$(1.02)	\$(2.38)	\$(1.77)
Weighted-average shares outstanding basic and diluted	14,033,891	12,903,626	13,555,991	12,893,088
Dividends declared per share of common stock and common stock equivalents	\$—	\$ 0.16	\$0.16	\$ 0.32

See accompanying notes to condensed consolidated financial statements.

LIBERTY TAX, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Loss
 Three and Six Months Ended October 31, 2018 (unaudited) and 2017 (unaudited)
 (In thousands)

	Three Months Ended October 31,		Six Months Ended October 31,	
	2018	2017	2018	2017
Net loss	\$(12,874)	\$(13,103)	\$(32,245)	\$(22,861)
Unrealized gain on interest rate swap agreement, net of taxes of \$4, \$9, \$(1) and \$9, respectively	10	26	20	11
Foreign currency translation adjustment	(125)	(354)	(327)	680
Comprehensive loss	\$(12,989)	\$(13,431)	\$(32,552)	\$(22,170)

See accompanying notes to condensed consolidated financial statements.

LIBERTY TAX, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows
Six Months Ended October 31, 2018 (unaudited) and 2017 (unaudited)
(In thousands)

	Six Months Ended October 31,	
	2018	2017
Cash flows from operating activities:		
Net loss	\$(32,245)	\$(22,861)
Adjustments to reconcile net loss to net cash used in operating activities:		
Provision for doubtful accounts	3,898	3,455
Depreciation, amortization, and impairment charges	6,359	4,530
Amortization of deferred financing costs	138	—
Loss on disposal of fixed and intangible assets	5,330	841
Stock-based compensation expense	439	1,973
Loss on bargain purchases and sales of Company-owned offices	(138)	(729)
Equity in gain of affiliate	46	—
Deferred tax income (expense)	(179)	7
Changes in accrued income taxes	(19,441)	(21,098)
Changes in other assets and liabilities	54	(5,742)
Net cash used in operating activities	(35,739)	(39,624)
Cash flows from investing activities:		
Issuance of operating loans to franchisees and ADs	(18,828)	(21,082)
Payments received on operating loans to franchisees	1,525	2,110
Purchases of AD rights, Company-owned offices and acquired customer lists	(119)	(2,112)
Proceeds from sale of Company-owned offices and AD rights	90	76
Purchases of property, equipment and software	(1,925)	(2,704)
Net cash used in investing activities	(19,257)	(23,712)
Cash flows from financing activities:		
Proceeds from the exercise of stock options	—	95
Dividends paid	(2,244)	(4,482)
Repayment of amounts due to former ADs and franchisees	—	(2,971)
Repayment of long-term obligations	(4,280)	(1,654)
Borrowings under revolving credit facility	48,601	61,257
Repayments under revolving credit facility	(326)	(307)
Cash paid for taxes on exercises/vesting of stock-based compensation	(46)	(153)
Net cash provided by financing activities	41,705	51,785
Effect of exchange rate changes on cash, net	(99)	297
Net decrease in cash and cash equivalents	(13,390)	(11,254)
Cash and cash equivalents at beginning of period	18,522	16,427
Cash and cash equivalents at end of period	\$5,132	\$5,173

See accompanying notes to condensed consolidated financial statements.

LIBERTY TAX, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows
 Six Months Ended October 31, 2018 (unaudited) and 2017 (unaudited)
 (In thousands)

	Six Months Ended October 31,	
	2018	2017
Supplemental disclosures of cash flow information:		
Cash paid for interest, net of capitalized interest of \$16 and \$305, respectively	\$1,010	\$761
Cash paid for taxes, net of refunds	4,030	7,011
Accrued capitalized software costs included in accounts payable	121	70
During the six months ended October 31, 2018 and 2017, the Company acquired certain assets from ADs, franchisees, and third parties as follows:		
Fair value of assets purchased	\$1,748	\$8,002
Receivables applied, net of amounts written off, due ADs and related deferred revenue	(117)	(4,327)
Bargain purchase gains	(48)	(674)
Long-term obligations and accounts payable issued to seller	(1,464)	(889)
Cash paid to ADs, franchisees and third parties	\$119	\$2,112
During the six months ended October 31, 2018 and 2017, the Company sold certain assets to ADs and franchisees as follows:		
Book value of assets sold	\$726	\$305
Gain on sale - revenue deferred	—	18
Loss on sale - loss recognized	(27)	(12)
Notes received	(609)	(235)
Cash received from ADs and franchisees	\$90	\$76

See accompanying notes to condensed consolidated financial statements.

LIBERTY TAX, INC. AND SUBSIDIARIES

Notes to Unaudited Condensed Consolidated Financial Statements

October 31, 2018 and 2017

(1) Organization and Significant Accounting Policies

Description of Business

Liberty Tax, Inc. (the "Company"), a Delaware corporation, is a holding company engaged through its subsidiaries as a franchisor and, to a lesser degree, an operator of a system of income tax preparation offices located in the United States of America (the "U.S.") 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 refund-based tax settlement financial products, such as Refund Transfer products in the U.S. and personal income tax Refund Discounting products in Canada. The Company also offers online tax preparation services. In fiscal 2015, the Company changed its name from JTH Holding, Inc. to Liberty Tax, Inc.

The Company provides a substantial amount of lending to its franchisees and area developers ("ADs"). The Company allows franchisees and ADs to defer a portion of the franchise fee and AD fee, which are paid over time. The Company also offers its franchisees working capital loans to assist in funding their operations between tax seasons.

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.

Unless the context requires otherwise, the terms "Liberty Tax," "Liberty Tax Service," "we," the "Company," "us," and "our" refer to Liberty Tax, Inc. and its consolidated subsidiaries.

Basis of Presentation

The condensed consolidated financial statements include the accounts of the Company 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. Foreign exchange transaction gains and losses are recognized when incurred. The Company reclassifies to accounts payable checks issued in excess of funds available and reports them as cash flow from operating activities. The Company consolidates any entities in which it has a controlling interest, the usual condition of which is ownership of a majority voting interest. The Company also considers for consolidation an entity in which the Company has certain interests where a controlling financial interest may be achieved through arrangements that do not involve voting interests. Such an entity, known as a variable interest entity ("VIE"), is required to be consolidated by its primary beneficiary. The Company does not possess any ownership interests in franchisee entities; however, the Company may provide financial support to franchisee entities. Because the Company's franchise arrangements provide franchisee entities the power to direct the activities that most significantly impact their economic performance, the Company does not consider itself the primary beneficiary of any such entity that might be a VIE. Based on the results of management's analysis of potential VIEs, the Company has not consolidated any franchisee entities. The Company's maximum exposure to loss resulting from involvement with potential VIEs is attributable to accounts and notes receivables and future lease payments due from franchisees. When the Company does not have a controlling interest in an entity but has the ability to exert significant influence over the entity, the Company applies the equity method of accounting. Intercompany balances and transactions have been eliminated in consolidation.

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information. The condensed consolidated financial statements, including these notes, are unaudited and exclude some of the disclosures required only in annual financial statements. The consolidated balance sheet data as of April 30, 2018 was derived from the Company's April 30, 2018 Annual Report on Form 10-K filed on October 5, 2018, as amended by Amendment No. 1 to the Annual Report on Form 10-K filed on October 10, 2018.

In the opinion of management, all adjustments necessary for a fair presentation of such condensed consolidated financial statements in accordance with 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

7

consolidated financial statements and notes thereto included in its April 30, 2018 Annual Report on Form 10-K filed on October 5, 2018, as amended by Amendment No. 1 to the Annual Report on Form 10-K filed on October 10, 2018.

Office Count

As a seasonal business, the Company works throughout the off season to open new offices, and, at the same time, some of our franchisees will choose not to reopen for the next season. Some of these decisions are not made until January of each year, and the Company expects to report office count information for the quarter ended January 31, 2019 once all offices have been opened.

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 GAAP. Actual results could differ from those estimates.

Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-02, "Leases (Topic 842)." This update will replace existing lease guidance in GAAP and will require lessees to recognize lease assets and lease liabilities on the balance sheet for all leases and disclose key information about leasing arrangements, such as information about variable lease payments and options to renew and terminate leases. When implemented, lessees and lessors will be required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The update is effective for interim and annual reporting periods beginning after December 15, 2018. Early adoption is permitted. The Company is currently finalizing its implementation plan and evaluating the impact of the new pronouncement on its consolidated financial statements. The Company expects the adoption of this pronouncement to result in a material increase in the assets and liabilities on its consolidated balance sheets, but does not expect it to have a material impact on its consolidated statements of operations.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230)", which clarifies how companies present and classify certain cash receipts and cash payments in the statement of cash flows. The update is intended to reduce the existing diversity in practice and is effective for the Company beginning with its first quarterly filing in fiscal year 2019. The Company adopted the update for all periods beginning on or after May 1, 2018.

In June 2016, the FASB issued ASU No. 2016-13, "Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments", which changes how companies will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. The standard replaces the "incurred loss" approach with an "expected loss" model for instruments measured at amortized cost (which generally will result in the earlier recognition of allowances for losses) and requires companies to record allowances for available-for-sale debt securities, rather than reduce the carrying amount. In addition, companies will have to disclose significantly more information, including information used to track credit quality by year of origination, for most financing receivables. The ASU should be applied as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the standard is effective. The ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted for all entities for annual periods beginning after December 15, 2018, and interim periods therein. The ASU is effective for the Company beginning in the first quarter of fiscal year 2021. The Company is currently evaluating the impact of the adoption of this newly

issued standard to its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business", which clarifies the definition of a business with the objection of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill and consolidation. The ASU is effective for the Company beginning in the first quarter of fiscal year 2019. The Company adopted the update for all periods beginning on or after May 1, 2018 and it does not have an impact on the Company's current accounting for business combinations.

In January 2017, the FASB issued ASU 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." This new standard eliminates Step 2 from the goodwill impairment test. Instead, an entity should compare the fair value of a reporting unit with its carrying amount and recognize an impairment charge for the amount by

8

which the carrying amount exceeds the reporting unit's fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The standard will be effective for the Company in the first quarter of fiscal year 2021. Early adoption is permitted. The Company is currently evaluating the impact of the adoption of this newly issued standard to its consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Codification ("ASC") 606, "Revenues from Contracts with Customers" which amends the guidance in ASC 605, "Revenue Recognition." The core principle of this new standard is to recognize revenue when control of the promised goods or services is transferred to customers in an amount that reflects the consideration expected to be received for those goods or services. ASC 606 also requires additional disclosures around the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.

The adoption of this new standard did not materially impact the Company's recognition of revenues generated from the following:

- Assisted tax preparation fees, net of discounts, which are recorded at the time the return is filed. The related discounts are recorded as reductions to revenues.

- Financial products, which are recorded at the time the return is filed. A change to certain financial products offered in the third quarter will be disclosed at that time.

- Royalties and advertising fees, which are based on a percent of the franchisees' sales are recognized at the time the underlying sales occur. The Company has elected to use the right to invoice practical expedient for recognition of minimum royalties.

- Interest income on notes receivable, which is recognized based on the outstanding principal note balance unless it is put on non-accrual status. Interest income on notes receivable that are placed on a non-accrual basis is recognized when cash is received. Interest income on accounts receivable is recognized based on the outstanding receivable balance over 30 days old, net of an allowance.

- Gains on sales of Company-owned offices, which are recognized when cash is received. Losses on sales of Company-owned offices are recognized immediately.

The details of the significant changes in revenue recognition and quantitative impact of the changes are discussed below.

Initial Franchise Fees

Typically, franchise rights are granted to franchisees for an initial term of five years with an option to renew at no additional cost. In exchange for initial franchise fees, royalties and advertising fees, the Company is obligated by its franchise agreements to provide training, an operations manual, site selection guidance, tax preparation software, operational assistance, tax and technical support, the ability to perform electronic filing, and marketing and advertising. Under the previous revenue recognition guidance, revenues from initial franchise fees were recognized when the obligations of the Company to prepare the franchisee for operation were substantially complete, up to the amount of cash received.

Under the new guidance, the standard requires that the transaction price received from customers be allocated to each separate and distinct performance obligation. The transaction price attributable to each separate and distinct performance obligation is then recognized as the performance obligations are satisfied. The services that the Company provides related to the initial franchise fees the Company receives from franchisees do not contain separate and distinct performance obligations from the franchise right. Accordingly, under the new standard, initial franchise fees, as constrained for amounts the Company does not expect to collect, will be recognized over the initial term of the franchise agreement, which is generally five years.

AD Fees

Historically, the rights to develop a new territory were granted to an AD for an initial term of six or ten years with an option to renew at no additional cost. Under the previous revenue recognition guidance, AD fees were recognized as revenue on a straight-line basis over the initial contract term of each AD agreement with the cumulative amount of revenue recognized not to exceed the amount of cash received. Under the new guidance, the standard requires the Company to recognize AD fees, as constrained for amounts not expected to be collected, over the initial term of the AD agreement.

The Company also sells a developed territory and simultaneously grants the right to operate as the exclusive AD in such developed territory to a new AD for an initial term of six years or ten years. Under the previous revenue recognition

guidance, gains on sales of developed territories were recognized as revenues over the initial term, with the cumulative amount of revenues recognized not to exceed the amount of cash received. Losses on sales of developed territories were recognized immediately. Such gains and losses represented the difference between the transaction price and the net book value of the intangible asset recorded upon the Company's reacquisition of the developed territory as of the date of the sale. Under the new guidance, the transaction price, as constrained for amounts the Company does not expect to collect, is recognized as revenues over the initial term of the AD agreement. The net book value of the intangible asset is written-off to operating expenses at the date of the sale.

Electronic Filing Fees

Electronic filing fees are recorded in the period the tax return is electronically filed. Under the previous revenue recognition guidance, the electronic filing fees and the franchisees' share in such fees were recorded as revenues and expense in the consolidated income statement, respectively. Under the new guidance, the electronic filing fees, net of the franchisees' share in such fees, will be recorded as revenues in the consolidated statements of operations.

Transition Method

The Company applied the new guidance on all contracts that were not completed as of May 1, 2018 using the modified retrospective method, whereby the cumulative effect of initially adopting the guidance was recognized as an adjustment to the opening balance of retained earnings at May 1, 2018 in the amount of \$3.8 million, net of tax, with corresponding increases in deferred revenue and notes receivable. Therefore, the results of operations from the comparative period have not been adjusted and continue to be reported under the previous revenue recognition guidance.

Impacts on the Condensed Consolidated Financial Statements

The following tables summarize the impacts of adopting ASC 606 on the Company's condensed consolidated financial statements as of and for the six months ended October 31, 2018:

Condensed Consolidated Balance Sheet	As Reported	ASC 606 Adjustment	Balances Without Adoption of ASC 606
	(In thousands)		
Notes receivable, current	\$38,014	\$ 851	\$37,163
Allowance for doubtful accounts - current	(11,937)	331	(12,268)
Income taxes receivable	14,890	(627)	15,517
Notes receivable, non-current	10,569	425	10,144
Other intangible assets, net	21,731	(169)	21,900
Deferred income taxes	1,441	1,111	330
Total assets	173,960	1,924	172,036
Deferred revenue, current	3,873	2,093	1,780
Deferred revenue and other, non-current	6,890	3,127	3,763
Deferred income tax liability	919	(456)	1,375
Total liabilities	100,677	2,270	98,407
Retained earnings	62,833	(346)	63,179
Total stockholders' equity	73,283	(346)	73,629
Total liabilities and stockholders' equity	\$173,960	\$ 1,924	\$172,036

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

Condensed Consolidated Statement of Operations	As Reported	ASC 606 Adjustment	Balances Without Adoption of ASC 606
	(In thousands)		
Franchise fees	\$1,006	\$ 683	\$323
Area Developer fees	1,647	601	1,046
Electronic filing fees	58	(231)	289
Other revenues	1,031	132	899
Total revenues	13,940	1,186	12,754
Selling, general, and administrative expenses	21,354	(232)	21,586
Total operating expenses	60,653	1,247	59,406
Loss from operations	(46,713)	(61)	(46,652)
Loss before income taxes	(47,790)	1,417	(49,207)
Income tax benefit	(15,545)	462	(16,007)
Net loss	\$(32,245)	\$ 955	\$(33,200)

There have been no other significant changes in the Company's condensed consolidated balance sheets or statements of operations and cash flows as a result of the adoption of ASC 606.

Contract Balances

The following table provides information about receivables and contract liabilities (deferred revenue) from contracts with customers:

	October 31, 2018	April 30, 2018
	(In thousands)	
Notes receivable (1)	\$48,583	\$30,849
Deferred revenue (2)	10,149	5,667

(1) Notes receivable increased by \$1.7 million as of May 1, 2018 due to the change in the Company's revenue recognition policy for initial franchise and AD fees upon adoption of ASC 606.

(2) Deferred revenue increased \$6.9 million as of May 1, 2018 due to the cumulative effect of adopting ASC 606.

Significant changes in deferred franchise and AD fees are as follows:

	Six Months Ended October 31, 2018 (In thousands)
Deferred franchise and AD fees at beginning of period	\$ 5,667
ASC 606 deferred franchise and AD fees adoption	6,940
Revenue recognized during the period	(2,652)

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

New deferrals of franchise and AD fees	194
Deferred franchise and AD fees at end of period	\$ 10,149

Anticipated Future Recognition of Deferred Franchise and AD Fees

The following table reflects the estimated franchise and AD fees expected to be recognized in the future related to performance obligations that are unsatisfied at the end of the period:

	Estimate for Fiscal Year (In thousands)
2019 (1)	\$ 1,905
2020	3,413
2021	2,485
2022	1,473
2023	624
Thereafter	249
Total	\$ 10,149

(1) Represents franchise and AD fees expected to be recognized for the remainder of fiscal 2019. The amount does not include \$2.7million of franchise and AD fee revenues recognized for the six months ended October 31, 2018.

The Company has applied the optional exemption, as provided for under ASC 606, which allows the Company not to disclose the transaction price allocated to unsatisfied performance obligations when the transaction price is a sales-based royalty.

Foreign Operations

Canadian operations contributed \$0.4 million and \$0.4 million in revenues for the three months ended October 31, 2018 and 2017, respectively, and \$1.2 million and \$1.4 million in revenues for the six months ended October 31, 2018 and 2017, respectively.

The Company may have exposure to foreign currency fluctuations due to transactions between its U.S. and Canadian subsidiaries.

(2) Accounts and Notes Receivable

The Company provides select financing to ADs and franchisees for the purchase of franchises, areas, Company-owned offices, and operating loans for working capital and equipment needs. The franchise-related notes generally are payable over five years and the operating loans generally are due within one year. Most notes bear interest at an annual rate of 12%.

Most of the notes receivable are due from the Company's ADs and franchisees and are collateralized by the underlying franchise and, when the AD or franchise is an entity, are guaranteed by the owners of the respective entity. The debtors' ability to repay the notes is dependent upon both the performance of the tax preparation industry as a whole and the individual franchise or AD areas.

At October 31, 2018, the Company had unfunded lending commitments for working capital loans to franchisees and ADs of \$13.5 million through the end of the current fiscal year.

Allowance for Doubtful Accounts

The adequacy of the allowance for doubtful accounts is assessed on a quarterly basis and adjusted as deemed necessary. Management believes the recorded allowance is adequate based upon its consideration of the estimated fair value of the franchises and AD areas collateralizing the receivables. Any adverse change in the tax preparation industry or the individual franchise or AD areas could affect the Company's estimate of the allowance.

Activity in the allowance for doubtful accounts for the three and six months ended October 31, 2018 and 2017 was as follows:

	Three Months		Six Months Ended	
	Ended October 31,		October 31,	
	2018	2017	2018	2017
	(In thousands)			
Balance at beginning of period	\$13,559	\$10,625	\$12,487	\$12,020
Provision for doubtful accounts	1,931	2,047	3,870	3,455
Write-offs	(2,040)	(2,773)	(2,880)	(5,723)
Foreign currency adjustment	(11)	(50)	(38)	97
Balance at end of period	\$13,439	\$9,849	\$13,439	\$9,849

Management considers specific accounts and notes receivable to be impaired if the net amounts due exceed the fair value of the underlying franchise at the time of the annual valuation performed as of April 30 of each year, and estimates an allowance for doubtful accounts based on that excess. In establishing the fair value of the underlying franchise, management considers a variety of factors, including recent sales between franchisees, sales of Company-owned stores, net fees of open offices earned during the most recently completed tax season, and the number of unopened offices. The Company performs its impairment analysis annually due to the seasonal nature of its operations. At the end of each fiscal quarter, the Company considers the activity during the period for accounts and notes receivable impaired at each prior fiscal year end and adjusts the allowance for doubtful accounts accordingly. While not specifically identifiable as of the balance sheet date, the Company's analysis of its experience also indicates that a portion of other accounts and notes receivable may not be collectible. Net amounts due include contractually obligated accounts and notes receivable plus accrued interest, reduced by unrecognized revenue, the allowance for uncollected interest, amounts due ADs, and amounts owed to the franchisee by the Company.

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

The allowance for doubtful accounts at October 31, 2018, April 30, 2018 and October 31, 2017, was allocated as follows:

	October 31, 2018	April 30, 2018	October 31, 2017
	(In thousands)		
Impaired:			
Notes and interest receivable, net of unrecognized revenue	\$11,734	\$11,654	\$13,778
Accounts receivable	12,412	13,891	10,026
Less amounts due to ADs and franchisees	(1,604)	(1,907)	(1,010)
Amounts receivable less amounts due to ADs and franchisees	\$22,542	\$23,638	\$22,794
Allowance for doubtful accounts for impaired notes and accounts receivable	\$9,526	\$10,322	\$8,109
Non-impaired:			
Notes and interest receivable, net of unrecognized revenue	\$39,349	\$20,721	\$47,203
Accounts receivable	27,677	38,626	31,824
Less amounts due to ADs and franchisees	(5,476)	(11,722)	(7,024)
Amounts receivable less amounts due to ADs and franchisees	\$61,550	\$47,625	\$72,003
Allowance for doubtful accounts for non-impaired notes and accounts receivable	\$3,913	\$2,165	\$1,740
Total:			
Notes and interest receivable, net of unrecognized revenue	\$51,083	\$32,375	\$60,981
Accounts receivable	40,089	52,517	41,850
Less amounts due to ADs and franchisees	(7,080)	(13,629)	(8,034)
Amounts receivable less amounts due to ADs and franchisees	\$84,092	\$71,263	\$94,797
Total allowance for doubtful accounts	\$13,439	\$12,487	\$9,849

The Company's average investment in impaired receivables during the six months ended October 31, 2018 and 2017 was \$23.1 million and \$23.5 million, respectively.

Analysis of Past Due Receivables

The breakdown of accounts and notes receivable past due at October 31, 2018 was as follows:

	Past due	Current	Interest receivable, net	Total receivables
	(In thousands)			
Accounts receivable	\$34,732	\$5,357	\$ —	\$ 40,089
Notes and interest receivable, net (1)	12,109	36,474	2,500	51,083
Total accounts, notes and interest receivable	\$46,841	\$41,831	\$ 2,500	\$ 91,172

(1) Interest receivable is shown net of an allowance for uncollectible interest of \$3.0 million.

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

Accounts receivable are considered to be past due if unpaid 30 days after billing, and notes receivable are considered past due if unpaid 90 days after the due date. If it is determined the likelihood of collecting substantially all of the notes and accrued interest is not probable, the notes are put on non-accrual status. The Company's investment in notes receivable on non-accrual status was \$12.1 million, \$13.6 million and \$11.3 million at October 31, 2018, April 30, 2018, and October 31, 2017, respectively. Payments received on notes in non-accrual status are applied to the principal until the note is current and then to interest income. Non-accrual notes that are paid current and expected to remain current are moved back into accrual status during the next annual review.

(3) Restructuring Expense

In the six months ended October 31, 2017, the Company began restructuring initiatives involving a review of Company-owned stores and service providers to improve the Company's overall long-term profitability. The Company incurred \$9.3 million of expenses in the six months ended October 31, 2018 related to these initiatives. The expenses incurred are presented in the Restructuring expense line item in the consolidated statements of operations. The composition of the restructuring expenses incurred for the six months ended October 31, 2018 were as follows:

Expense	Cash	Accrued Expenses	Non-cash	Total Expense
	(In thousands)			
Contract termination costs - maintenance	\$37	\$ —	\$ —	\$ 37
Property and intangible impairments and exit costs	1,031	2,718	5,559	9,308
Total	\$1,068	\$ 2,718	\$ 5,559	\$ 9,345

The property and intangible impairments and exit costs, which were primarily recorded in assets held for sale, were comprised of expenses related to lease obligations and non-cash charges associated with intangible write-downs. The accrued restructuring expenses of \$2.7 million are included in "Accounts payable and accrued expenses" in the accompanying consolidated balance sheets.

A summary of the activity in accrued expenses related to restructuring initiatives for the six months ended October 31, 2018 is as follows:

	Contract termination costs - maintenance costs	Property and intangible impairments and exit costs	Total accrued expenses
	(In thousands)		
Balance at beginning of period	\$ 1,359	\$ —	\$ 1,359
Additions accrued against the liability	—	3,749	3,749
Cash payments	—	(1,031)	(1,031)
Balance at end of period	\$ 1,359	2,718	\$ 4,077

(4) Goodwill and Intangible Assets

Changes in the carrying amount of goodwill for the six months ended October 31, 2018 and 2017 were as follows:

	October 31, 2018	October 31, 2017
	(In thousands)	

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

Balance at beginning of period	\$8,640	\$ 8,576
Acquisitions of assets from franchisees and others	118	29
Disposals and foreign currency changes, net	(1,208)	(125)
Purchase price reallocation	—	(1,032)
Balance at end of period	\$7,550	\$ 7,448

15

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

Components of intangible assets were as follows as of October 31, 2018, April 30, 2018 and October 31, 2017:

October 31, 2018				
	Weighted average amortization period	Gross carrying amount	Accumulated amortization	Net carrying amount
(In thousands)				
Customer lists acquired from unrelated third parties	5 years	\$3,187	\$ (1,846)	\$ 1,341
Tradenames	3 years	539	(291)	248
Non-compete agreements	2 years	241	(205)	36
Assets acquired from franchisees:				
Customer lists	4 years	1,235	(1,015)	220
Reacquired rights	2 years	977	(898)	79
AD rights	9 years	32,002	(12,195)	19,807
Total intangible assets		\$38,181	\$ (16,450)	\$21,731
April 30, 2018				
	Weighted average amortization period	Gross carrying amount	Accumulated amortization	Net carrying amount
(In thousands)				
Customer lists acquired from unrelated third parties	5 years	\$3,187	\$ (1,555)	\$ 1,632
Tradenames	3 years	431	(172)	259
Non-compete agreements	2 years	241	(145)	96
Assets acquired from franchisees:				
Customer lists	4 years	1,842	(1,427)	415
Reacquired rights	2 years	1,436	(1,393)	43
AD rights	9 years	30,907	(10,515)	20,392
Total intangible assets		\$38,044	\$ (15,207)	\$22,837
October 31, 2017				
	Weighted average amortization period	Gross carrying amount	Accumulated amortization	Net carrying amount
(In thousands)				
Customer lists acquired from unrelated third parties	5 years	\$3,188	\$ (1,224)	\$ 1,964
Tradenames	3 years	431	(100)	331
Non-compete agreements	2 years	241	(85)	156
Assets acquired from franchisees:				
Customer lists	4 years	1,212	(1,011)	201
Reacquired rights	2 years	946	(926)	20
AD rights	9 years	29,260	(8,903)	20,357
Total intangible assets		\$35,278	\$ (12,249)	\$23,029

The Company acquired \$1.3 million and \$2.8 million of AD rights during the six months ended October 31, 2018 and 2017, respectively.

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

During the six months ended October 31, 2018 and 2017, the Company did not acquire any assets of U.S. or Canadian franchisees, or third parties that were not classified as assets held for sale.

16

(5) Assets Held For Sale

At the end of the second quarter of fiscal 2019 and 2018, assets acquired from U.S. franchisees were classified as assets held for sale. During the six months ended October 31, 2018, the Company acquired \$0.3 million in assets from U.S. franchisees and third parties that were first accounted for as business combinations, with the value allocated to customer lists and reacquired rights of less than \$0.2 million and goodwill of less than \$0.2 million prior to being recorded as assets held for sale. During the six months ended October 31, 2017, the Company acquired \$5.2 million in assets from U.S. franchisees and third parties that were first accounted for as business combinations, with the value allocated to customer lists and reacquired rights of \$2.6 million and goodwill of \$2.6 million prior to being recorded as assets held for sale. The Company intends to sell the majority of assets associated with Company-owned offices within one year. The acquired businesses are operated as Company-owned offices until a buyer is located and a new franchise agreement is entered into. During the six months ended October 31, 2018, the Company sold, terminated, or impaired \$4.9 million in assets from U.S. franchisees, of which \$3.8 million was included in the Company's restructuring initiative.

Changes in the carrying amount of assets held for sale for the six months ended October 31, 2018 and 2017 were as follows:

	Six Months Ended	
	October 31,	
	2018	2017
	(In thousands)	
Balance at beginning of period	\$8,941	\$11,989
Reacquired and acquired from third parties	302	5,231
Sold or terminated, impairments and other	(4,886)	(1,047)
Balance at end of period	\$4,357	\$16,173

During fiscal 2018, the Company reviewed assets held for sale that were deemed unlikely to be sold in the preceding 12 months. Those identified were transferred to assets held for use and amortization expense was recorded on a cumulative basis for customer lists and reacquired rights.

(6) Long-Term Obligations

The Company has a credit facility that consists of a term loan with an original principal amount of \$21.2 million and a revolving credit facility that currently allows borrowing of up to \$170.0 million with an accordion feature that permits the Company to request an increase in availability of up to an additional \$50.0 million. Outstanding borrowings accrue interest, which is paid monthly at a rate of the one-month London Interbank Offered Rate ("LIBOR") plus a margin ranging from 1.50% to 2.25% depending on the Company's leverage ratio.

The average interest rate paid during the six months ended October 31, 2018 and 2017 was 3.78% and 2.91%, respectively. The indebtedness is collateralized by substantially all the assets of the Company, and both loans mature on April 30, 2019.

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. In addition, the Company must reduce the outstanding balance under its revolving credit facility to zero for a period of at least 45 consecutive days each fiscal year. The Company was in compliance with the financial covenants at October 31, 2018.

In December 2016, the Company obtained a mortgage payable to a bank in monthly installments of principal payments plus interest at the one-month LIBOR plus 1.85% through December 2026 with a balloon payment of \$0.8

million due at maturity. The mortgage is collateralized by land and buildings.

In December 2016, in connection with obtaining a mortgage payable to a bank, the Company entered into an interest rate swap agreement that allows it to manage fluctuations in cash flow resulting from changes in the interest rate on the mortgage. This swap effectively changes the variable-rate of the Company's mortgage into a fixed rate of 4.12%. The Company has designated this swap agreement as a cash flow hedge. At October 31, 2018, the fair value of the interest rate swap is less than \$0.1 million and is included in other current assets. The interest rate swap expires in December 2026.

Long-term obligations at October 31, 2018, April 30, 2018, and October 31, 2017 consisted of the following:

	October 31, 2018	April 30, 2018	October 31, 2017
	(In thousands)		
Credit Facility:			
Revolver	\$48,275	\$—	\$60,950
Term loan, net of debt issuance costs	13,680	14,855	15,898
Total credit facility	61,955	14,855	76,848
Long-Term Obligations			
Term loan, net of debt issuance costs	13,680	14,855	15,898
Due former ADs, franchisees and third parties	2,008	3,490	4,414
Mortgages	1,976	2,038	2,100
	17,664	20,383	22,412
Less: current installments	(15,685)	(18,113)	(5,306)
Long-term obligations, excluding current installments, net	\$1,979	\$2,270	\$17,106

(7) Income Taxes

During the second quarter of fiscal 2019, the Company continued its assessment of the corporate income tax impacts expected to result from the Tax Cuts and Jobs Act (the “Tax Act”). During the six months ended October 31, 2018, the Company did not adjust its provisional amounts recorded as of April 30, 2018. The Company is finalizing its assessment of the impact of the Tax Act and the provisional estimates may change because of additional analysis of the underlying calculations or additional regulatory guidance.

Similar to prior years, pre-tax book income estimated in the fourth quarter of fiscal 2019 is expected to offset pre-tax book loss for the six months ended October 31, 2018 due to the established pattern of seasonality in the Company's primary business operations. Management has determined it is at least more-likely-than-not that realization of tax benefits recorded in the Company's financial statements will occur during fiscal 2019. The amount of tax benefit recorded for the six months ended October 31, 2018 reflects the Company's estimated annual effective tax rate applied to the year-to-date loss from continuing operations adjusted for the tax impact of discrete items.

The Company's effective tax rate from continuing operations, including discrete income tax items, was 31.9% and 32.5% for the three and six months ended October 31, 2018, respectively and 37.1% and 38.2% for the three and six months ended October 31, 2017, respectively. The reduced effective tax rate results primarily from the decrease in the U.S. federal corporate income tax rate from 35% to 21%, effective after December 31, 2017.

(8) Stockholders' Equity

Stockholders' Equity Activity

During the six months ended October 31, 2018 and 2017, activity in stockholders' equity was as follows:

	Six Months Ended October 31,	
	2018	2017
	(In thousands, except for share amounts)	
Class A common stock issued from the vesting of restricted stock and as director compensation	13,664	33,922
Class B common stock converted to Class A common stock	200,000	—
Exchangeable shares exchanged for Class A common stock	1,000,000	—
Proceeds from exercise of stock options	\$ —	\$ 95
Stock-based compensation expense	\$ 439	\$ 1,973
Dividends declared	\$ 2,267	\$ 4,590

In July 2018, the sole holder of the Company's Class B common stock entered into a stock purchase agreement to sell all of their outstanding shares of the Company's Class A common stock and Class B common stock owned directly and indirectly by them. In connection with the sale, the shares of the Company's Class B common stock converted into shares of the Company's Class A common stock on a one-for-one basis and for no additional consideration. As of October 31, 2018, no shares of the Company's Class B common stock remained outstanding. In addition, the sole holder of the Company's exchangeable shares elected to exchange all of the exchangeable shares held by it for shares of the Company's Class A common stock on a one-for-one basis and for no additional consideration. In connection with such exchange, the Company redeemed all ten of its outstanding shares of special voting preferred stock for a price of \$1.00 per share. As of October 31, 2018, no shares of the Company's exchangeable shares or special voting preferred stock remained outstanding or authorized to issue.

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss at October 31, 2018, April 30, 2018 and October 31, 2017 were as follows.

	October 31, 2018	April 30, 2018	October 31, 2017
	(In thousands)		
Foreign currency adjustment	\$(1,708)	\$(1,381)	\$(1,380)
Unrealized gain on interest rate swap agreement, net of taxes	54	34	(13)
Total accumulated other comprehensive loss	\$(1,654)	\$(1,347)	\$(1,393)
Net Loss per Share			

Net income (loss) per share of Class A and Class B common stock is computed using the two-class method. Basic net income (loss) per share is computed by allocating undistributed earnings to common stock and participating securities (exchangeable shares) and using the weighted-average number of common stock outstanding during the period. Undistributed losses are not allocated to participating securities because they do not meet the required criteria for such allocation.

Diluted net income (loss) per share is computed using the weighted-average number of common stock and, if dilutive, the potential common stock outstanding during the period. Potential common stock consists of the incremental common stock issuable upon the exercise of stock options and vesting of restricted stock units. The dilutive effect of

outstanding stock options and restricted stock units is reflected in diluted earnings per share by application of the treasury stock method. Additionally, the computation of the diluted net income (loss) per share of Class A common stock assumes the conversion of Class B common stock and exchangeable shares, if dilutive, while the diluted net loss per share of Class B common stock does not assume conversion of those shares.

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

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 six months ended October 31, 2018 and 2017 is as follows:

	Three Months Ended October 31, 2018		Three Months Ended October 31, 2017	
	Class A	Class B	Class A	Class B
	Common Stock		Common Stock	
	(In thousands, except for share and per share amounts)			
Basic and diluted net loss per share:				
Numerator				
Allocation of undistributed losses	\$ (12,874)	\$ —	\$ (12,900)	\$ (203)
Denominator				
Weighted-average common stock outstanding	14,033,895	—	12,703,626	200,000
Basic and diluted net loss per share	\$ (0.92)	\$ —	\$ (1.02)	\$ (1.02)

As a result of the net losses for the periods shown, diluted net loss per share excludes the impact of shares of potential common stock from the exercise of options to purchase 417,083 and 1,067,327 shares for the three months ended October 31, 2018 and 2017, respectively, because the effect would be anti-dilutive.

	Six Months Ended October 31, 2018		Six Months Ended October 31, 2017	
	Class A	Class B	Class A	Class B
	Common Stock		Common Stock	
	(In thousands, except for share and per share amounts)			
Basic and diluted net loss per share:				
Numerator				
Allocation of undistributed losses	\$ (32,012)	\$ (233)	\$ (22,506)	\$ (355)
Denominator				
Weighted-average common shares outstanding	13,458,167	797,826	12,693,088	200,000
Basic and diluted net loss per share	\$ (2.38)	\$ (2.38)	\$ (1.77)	\$ (1.77)

As a result of the net losses for the periods shown, diluted net loss per share excludes the impact of shares of potential common stock from the exercise of options to purchase 634,498 and 1,362,807 shares for the six months ended October 31, 2018 and 2017, respectively, because the effect would be anti-dilutive.

(9) Stock Compensation Plans

Stock Options

The Company has an equity and cash incentive plan, for the issuance of up to 2,500,000 shares of Class A common stock in which employees and outside directors are eligible to receive awards. At October 31, 2018, 1,609,224 shares

of Class A common stock remain available for grant.

20

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

Stock option activity during the six months ended October 31, 2018 was as follows:

	Number of options	Weighted average exercise price
Balance at beginning of period	472,503	\$ 17.41
Granted	572,569	9.78
Expired or forfeited	(366,704)	17.99
Balance at end of period	678,368	\$ 10.66

Intrinsic value is defined as the fair value of the stock less the cost to exercise. No options were exercised during the six months ended October 31, 2018. The total intrinsic value of stock options outstanding at October 31, 2018 was \$0.6 million. Stock options vest from the date of grant to five years after the date of grant and expire from four to seven years after the vesting date.

Nonvested stock options activity during the six months ended October 31, 2018 was as follows:

	Nonvested options	Weighted average exercise price
Balance at beginning of period	267,433	\$ 14.27
Granted	572,569	9.78
Vested	(92,207)	9.49
Forfeited	(225,226)	14.22
Balance at end of period	522,569	\$ 9.93

At October 31, 2018, unrecognized compensation costs related to nonvested stock options were \$0.9 million. These costs are expected to be recognized through fiscal 2022.

The following table summarizes information about stock options outstanding and exercisable at October 31, 2018:

Range of exercise prices	Options Outstanding			Options Exercisable	
	Number of shares outstanding	Weighted average exercise price	Weighted average remaining contractual life (in years)	Number of options	Weighted average exercise price
\$0.00 - \$10.89	572,569	\$ 9.78	6.4	50,000	\$ 8.30
\$10.90 - \$16.38	78,469	11.77	3.5	78,469	11.77
\$16.39 - \$26.17	18,858	22.57	1.8	18,858	22.57
\$26.18 - \$33.38	8,472	33.38	0.9	8,472	33.38
	678,368	\$ 10.66		155,799	\$ 13.14

Restricted Stock Units

Restricted stock activity during the six months ended October 31, 2018 was as follows:

	Number of Restricted stock units	Weighted average fair value at grant date
Balance at beginning of period	127,030	\$ 12.48
Granted	112,923	9.86
Vested	(17,671)	14.70

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

Forfeited	(77,770)	12.31
Balance at end of period	144,512	\$ 10.24

21

At October 31, 2018, unrecognized compensation costs related to restricted stock units were \$1.2 million. These costs are expected to be recognized through fiscal 2022.

(10) Fair Value of Financial Instruments

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. Valuation methodologies for the fair value hierarchy are as follows:

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.

The Company measures or monitors certain of its assets and liabilities on a fair value basis. Fair value is used on a recurring basis for those assets and liabilities for which fair value is the primary basis of accounting. Other assets and liabilities are measured at fair value on a nonrecurring basis; that is, they are subject to fair value adjustments in certain circumstances, such as when there is evidence of impairment. The following tables present, at October 31, 2018, April 30, 2018 and October 31, 2017, 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):

	October 31, 2018		
	Total	Level 1	Level 2 Level 3
Assets:			
Recurring assets:			
Interest rate swap agreement	\$ 75	\$ —	\$ 75
Total recurring assets	75	—	75
Nonrecurring assets:			
Impaired accounts and notes receivable, net of unearned revenue	14,620	—	—
Total nonrecurring assets	14,620	—	—
Total recurring and nonrecurring assets	\$ 14,695	\$ —	\$ 75
Liabilities:			
Recurring liabilities:			
Contingent consideration included in obligations due to former ADs, franchisees and others	\$ 1,432	\$ —	\$ —
Total recurring liabilities	\$ 1,432	\$ —	\$ —

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

	April 30, 2018			
	Total	Fair value measurements using		
		Level 1	Level 2	Level 3
Assets:				
Recurring assets:				
Cash equivalents	\$12,056	\$ 12,056	\$ —	\$ —
Interest rate swap agreement	57	—	57	—
Total recurring assets	12,113	12,056	57	—
Nonrecurring assets:				
Impaired accounts and notes receivable, net of unearned revenue	15,223	—	—	15,223
Impaired goodwill	109	—	—	109
Impaired customer lists	4	—	—	4
Assets held for sale	8,941	—	—	8,941
Total nonrecurring assets	24,277	—	—	24,277
Total recurring and nonrecurring assets	\$36,390	\$ 12,056	\$ 57	\$ 24,277
Liabilities:				
Recurring liabilities:				
Contingent consideration included in obligations due to former ADs, franchisees and others	\$1,545	\$ —	\$ —	\$ 1,545
Total recurring liabilities	\$1,545	\$ —	\$ —	\$ 1,545

	October 31, 2017			
	Total	Fair value measurements using		
		Level 1	Level 2	Level 3
Assets:				
Nonrecurring assets:				
Impaired accounts and notes receivable, net of unearned revenue	\$ 15,695	\$ —	\$ —	\$ 15,695
Total recurring and nonrecurring assets	\$ 15,695	\$ —	\$ —	\$ 15,695
Liabilities:				
Recurring liabilities:				
Interest rate swap agreement	\$ 22	\$ —	\$ 22	\$ —
Contingent consideration included in obligations due to former ADs, franchisees and others	3,405	—	—	3,405
Total recurring liabilities	\$3,427	\$ —	\$ 22	\$ 3,405

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 each of the six months ended October 31, 2018 and 2017.

The following methods and assumptions are used to estimate the fair value of our financial instruments.

Cash equivalents: The carrying amounts approximate fair value because of the short maturity of these instruments. Cash equivalent financial instruments consist of money market accounts.

Impaired accounts and notes receivable, net of unrecognized revenue: Accounts and notes receivable are considered to be impaired if the net amounts due exceed the fair value of the underlying franchise or if management considers it probable

that all principal and interest will not be collected when contractually due. In establishing the estimated fair value of the underlying franchise, consideration is given to recent sales between franchisees, sales of Company-owned stores, the net fees of open offices, and the number of unopened offices.

Impaired goodwill, reacquired rights, and customer lists: Goodwill, reacquired rights and customer lists associated with a Company-owned office are considered to be impaired if the net carrying amount exceeds the fair value of the underlying office. In establishing the fair value of the underlying office, consideration is given to the related net fees and third-party transactions of franchises and when appropriate a discounted cash flow model.

Assets held for sale: Assets held for sale are recorded at the lower of the carrying value or the sales price, less costs to sell, which approximates fair value. The sales price is calculated as a percentage of prior year net fees and marketplace transactions.

Contingent consideration included in obligations due to former ADs, franchisee and others: Obligations due to former ADs and franchisees related to estimated contingent consideration are carried at fair value. The fair value of these obligations was determined using a discounted cash flow model.

Interest rate swap agreement: Value of interest rate swap on variable rate mortgage debt. The fair value of this instrument was determined based on third-party market research.

Other Fair Value Measurements

Additionally, accounting standards require the disclosure of the estimated fair value of financial instruments that are not recorded at fair value. For the financial instruments that the Company does not record at fair value, estimates of fair value are made at a point in time based on relevant market data and information about the financial instrument. No readily available market exists for a significant portion of the Company's financial instruments. Fair value estimates for these instruments are based on current economic conditions, interest rate risk characteristics, and other factors. Many of these estimates involve uncertainties and matters of significant judgment and cannot be determined with precision. Therefore, the calculated fair value estimates in many instances cannot be substantiated by comparison to independent markets and, in many cases, may not be realizable in a current sale of the instrument. In addition, changes in assumptions could significantly affect these fair value estimates. The following methods and assumptions were used by the Company in estimating fair value of these financial instruments.

Notes receivable: The carrying amount approximates fair value because the interest rate charged by the Company on these notes approximates rates currently offered by local lending institutions for loans of similar terms to individuals/entities with comparable credit risk (Level 3).

Long-term obligations: The carrying amount approximates fair value because the interest rate paid has a variable component (Level 2).

(11) Related Party Transactions

The Company considers directors and their affiliated companies, as well as named executive officers and members of their immediate families, to be related parties.

Nicole Ossenfort's (Chief Executive Officer) franchise agreement

The Company is or was a participant in the following related party transactions with Ms. Ossenfort since the beginning of fiscal 2019:

Ossenfort Franchise. Ms. Ossenfort, together with her husband, Scott Ossenfort (together, with Ms. Ossenfort, the “Ossenforts”), jointly own a Company franchise through JL Enterprises. JL Enterprises borrows operating funds for working capital to operate the franchises each year. During the six months ended October 31, 2018, JL Enterprises did not borrow operating funds for working capital to operate the franchise. During the six months ended October 31, 2018, the Company has recorded \$38,459 of accounts receivable from the Ossenforts for royalties, advertising and financial product charges, of which a balance of \$8,173 remained outstanding and payable to the Company as of October 31, 2018.

Shaun York's (Chief Operating Officer) franchises and AD agreements

The Company is or was a participant in the following related party transactions with Mr. York since the beginning of fiscal 2019:

York Franchises. Mr. York operates eleven Company franchises through Yorkcompany LLC, S&P Holding Group LLC, My Business Group LLC and Core Fitness Partners LLC (the "York Franchise Entities"). The York Franchise Entities borrow operating funds from the Company for working capital to operate the franchises each year. During the six months ended October 31, 2018, the York Franchise Entities borrowed operating funds in the amount of \$99,476, of which \$99,476 remained outstanding and payable to the Company as of October 31, 2018. In addition, during the six months ended October 31, 2018, the Company recorded \$52,098 of accounts receivable from the York Franchise Entities for royalties, advertising and financial product charges, of which \$36,909 remained outstanding and payable to the Company as of October 31, 2018.

York AD. Mr. York has Area Development arrangements with the Company that are conducted through Yorkcompany LLC, S&P Holding Group LLC and TNT Florida Investments LLC (the "York AD Entities"). The York AD Entities were acquired by Mr. York through various transactions with the Company and through third party agreements with AD sellers. In connection with those transactions, the York AD Entities financed a total of \$4,059,460 through the Company to acquire the Area Development territories and associated rights. The loans are payable by the York AD Entities in annual installments at 12% interest. As of October 31, 2018, the aggregate outstanding principal balance owed by the York AD Entities on the notes was \$1,789,040.

As of October 31, 2018, the Company had accounts receivable from the York AD Entities of \$425. The York AD Entities earned \$94,175 for their portion of franchise fees, royalties and interest during the six months ended October 31, 2018.

York Debt Guarantees. Mr. York also has entered into multiple guarantee agreements with the Company whereby Mr. York has guaranteed all or a portion of the indebtedness owed by other franchisees and ADs to the Company as related to certain financial transactions for which Mr. York had an interest. The indebtedness owed by these franchisees and ADs as of October 31, 2018 is approximately \$3,662,677.

John Seal's (Director) AD agreement

The Company is or was a participant in the following related party transactions with Mr. Seal since the beginning of fiscal 2019:

JMS Tax, an entity controlled by Mr. Seal, a former director of the Company, owns an AD territory in Texas which a portion of the purchase price was financed through a note issued by the Company. There was no outstanding principal balance on the note as of October 31, 2018.

As of October 31, 2018, the Company had accounts receivable from JMS Tax of \$3,663. JMS Tax earned \$30,217 for their portion of franchise fees, royalties and interest during the six months ended October 31, 2018.

(12) Commitments and Contingencies

In the ordinary course of operations, the Company may become a party to legal proceedings. Based upon information currently available, management believes that such legal proceedings, individually or in the aggregate, will not have a material adverse effect on the Company's business, financial condition, cash flows, or results of operations except as provided below.

Delaware Derivative Litigation

Asbestos Workers' Philadelphia Pension Fund, derivatively on behalf of Liberty Tax, Inc., v. John Hewitt, Defendant, and Liberty Tax, Inc., Nominal Defendant, Case No. 2017-0883, filed in the Court of Chancery of the State of Delaware on December 12, 2017. Plaintiff alleges that the Company's former CEO, John T. Hewitt ("Hewitt"), breached his fiduciary duties as an officer based upon certain allegations of misconduct on his part. The Plaintiff also alleges breach of fiduciary duty against Hewitt in his capacity as a director of LT, Inc. The Complaint seeks compensatory damages and attorney's fees. No claim or relief is asserted against the Company, which is named solely as a Nominal Defendant.

Erie County Employees Retirement System, derivatively on behalf of Liberty Tax, Inc., v. John T. Hewitt, Defendant, and Liberty Tax, Inc., Nominal Defendant, Case No. 2017-0914, brought a second derivative suit filed in the Court of Chancery of the State of Delaware on December 22, 2017. Plaintiff also alleges that Hewitt breached his fiduciary duties as an officer

based upon certain allegations of misconduct on his part. The Plaintiff also alleges breach of fiduciary duty against Hewitt in his capacity as a director of the Company. The Complaint seeks to enjoin Hewitt from managing our business operations, and seeks compensatory damages and attorney's fees.

On December 27, 2017, the two above-referenced shareholder matters were consolidated into the case with the caption In Re: Liberty Tax, Inc. Stockholder Litigation, C.A. No. 2017-0883. On April 17, 2018, Plaintiffs filed an amended complaint (the "Amended Complaint"). The Amended Complaint added Gordon D'Angelo, Ellen McDowell, Nicole Ossenfort, and John Seal, with Hewitt as individual defendants (the "Individual Defendants") and asserted class action allegations. Plaintiffs seek (i) a declaration that the Individual Defendants have breached the Company's Nominating Charter; (ii) a declaration that the Individual Defendants have breached their fiduciary duties; (iii) an award to the Plaintiffs and the Class in the amount of damages sustained as a result of the Individual breaches; (iv) certification of the action as a class action; (v) an award to the Company in the amount of damages sustained as a result of the Individual Defendants' breaches of their fiduciary duties; (vi) a grant of further appropriate equitable relief to remedy the Individual Defendants' breaches, including injunctive relief; (vii) an award to Plaintiffs of the costs and disbursements of this action, including reasonable attorneys' fees, accountants' and experts' fees, costs and expenses; and (viii) such further relief as the Court deems just and proper. The Company has answered the Amended Complaint and discovery is underway. The individuals have filed a notice of motion to dismiss. No briefing schedule has been set on the motion. A mediation took place on November 12, 2018 but did not result in a resolution. A scheduling order has been entered which currently schedules trial in this matter to begin on March 18, 2019.

Eastern District of New York Securities Litigation

Rose Mauro, individually and on behalf of all others similarly situated v. Liberty Tax, Inc., Edward L. Brunot, John T. Hewitt, and Kathleen E. Donovan, filed in the United States District Court for the Eastern District of New York on January 12, 2018, Case No. 18 CV 245. Plaintiff filed a securities class action asserting violations of Section 10(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and Rule 10b-5 against all defendants and a second count for violations of Section 20(a) of the Exchange Act against the individual defendants. According to the complaint, throughout the class period, the Company allegedly issued materially false and misleading statements and/or failed to disclose that: (1) Hewitt created an inappropriate tone at the top; (2) the inappropriate tone at the top led to ineffective entity level controls over the organization; and (3) as a result, defendants' statements about the operations and prospects were materially false and misleading and/or lacked a reasonable basis at all relevant times.

Patrick Beland, individually and on behalf of all others similarly situated vs. Liberty Tax, Inc., Edward L. Brunot, John T. Hewitt, and Kathleen E. Donovan, filed in the United States District Court for the Eastern District of New York on December 15, 2017, case number 17 CV 7327. Plaintiff filed a securities class action asserting violations of Section 10(b) of the Exchange Act and Rule 10b-5 against all defendants and a second count for violations of Section 20(a) of the Exchange Act against the individual defendants. According to the complaint, throughout the class period, the Company allegedly issued materially false and misleading statements and/or failed to disclose that: (1) Hewitt created an inappropriate tone at the top; (2) the inappropriate tone at the top led to ineffective entity level controls over the organization; and (3) as a result, defendants' statements about the business, operations and prospects were materially false and misleading and/or lacked a reasonable basis at all relevant times.

These actions were consolidated with the caption In Re Liberty Tax, Inc. Securities Litigation, Case No. 27 CV 07327 and IBEW Local 98 Pension Fund was appointed the Lead Plaintiff ("Lead Plaintiff"). On June 12, 2018, Lead Plaintiff filed its Consolidated Amended Class Action Complaint, which removed Brunot as a defendant, and added additional securities claim based on Section 14(a) of the Exchange Act and Rules 14a-3 and 14a-9. The Consolidated Amended Class Action Complaint, among other things, asserts that the Company's SEC filings over a multi-year period failed to disclose the alleged misconduct of the individual defendants and that disclosure of the alleged misconduct caused the Company's stock price to drop and, thereby harm the purported class of shareholders. The Class

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

Period is alleged to be October 1, 2013 through February 23, 2018. The defendants filed a joint motion to dismiss the Consolidated Amended Class Action Complaint on September 17, 2018. Lead Plaintiff served their opposition on November 1, 2018 and the defendants filed their reply brief on November 27, 2018. A mediation took place on November 12, 2018 but did not result in a resolution.

Eastern District of Virginia Securities and Derivative Litigation

RSL Senior Partners LLC, derivatively and on behalf of Liberty Tax, Inc. v. Edward L. Brunot, John T. Hewitt, Kathleen E. Donovan, Gordon D'Angelo, John Garel, Thomas Herskovits, Robert M. Howard, Ross N. Longfield, Steven Ibbotson, Ellen M. McDowell, Nicole Ossenfort, George Robson and John Seal and Liberty Tax, Inc. (Nominal Defendant), Case No. 18 cv 127, filed on March 7, 2018 in the United States District Court for the Eastern District of Virginia. This shareholder derivative action was filed on behalf of the Company seeking to address the alleged wrongs of the Company's

directors and officers. The complaint alleges that certain conduct created an inappropriate tone at the top, which resulted in the loss of key executives, employees, directors and otherwise harmed the Company. The complaint asserts claims under Section 14(a) of the Exchange Act, 10(b) and 10b-5 and 20(a) of the Exchange Act, breach of fiduciary duty, unjust enrichment, abuse of control, gross mismanagement, and waste of corporate assets. The Complaint seeks the following relief: (a) declaring that Plaintiff may maintain this action on behalf of the Company, and that Plaintiff is an adequate representative of the Company; (b) declaring that the Individual Defendants have breached and/or aided and abetted the breach of their fiduciary duties to the Company; (c) determining and awarding to the Company the damages sustained by it as a result of the violations set forth above from each of the Individual Defendants, jointly and severally, together with pre-judgment and post-judgment interest thereon; (d) directing the Company and the Individual Defendants to take all necessary actions to reform and improve its corporate governance and internal procedures to comply with applicable laws and to protect the Company and its shareholders from a repeat of the damaging events described herein, including, but not limited to, putting forward for shareholder vote the following resolutions for amendments to the Company's Bylaws or Articles of Incorporation and the following actions as may be necessary to ensure proper corporate governance policies: (1) a proposal to strengthen the Board's supervision of operations and develop and implement procedures for greater shareholder input into the policies and guidelines of the board; (2) a provision to permit the Class A shareholders of the Company to nominate at least five candidates for election to the board; (3) a proposal to ensure the establishment of effective oversight of compliance with applicable laws, rules, and regulations; (4) a proposal to revise the Code of Conduct to include provisions prohibiting sexual harassment and discrimination, and governing the maintenance and disclosure of sexual and romantic relationships between individuals associated with the Company; (e) awarding the Company restitution from Individual Defendants; (f) awarding Plaintiff the costs and disbursements of this action, including reasonable attorneys' and experts' fees, costs, and expenses; and (g) granting such other and further relief as the Court may deem just and proper.

No claim or relief is asserted against the Company, which is named solely as a Nominal Defendant.

On July 30, 2018, various motions were filed: (i) Defendants Hewitt, McDowell, Ossenfort and Seal collectively moved to dismiss the Complaint; (ii) Defendants Garel, Herskovits, Howard, Ibbotson, Longfield, and Robson collectively moved to dismiss the Complaint; (iii) Defendants Brunot and Donovan collectively moved to dismiss the Complaint; (iv) Company moved to stay the action pending resolution of parallel state (Delaware) and/or federal (New York) proceedings. Plaintiff's oppositions were due by August 31, 2018. Defendants' replies to Plaintiff's oppositions were filed on September 10, 2018. A mediation took place on November 12, 2018 but did not result in a resolution. The Court has set a hearing date for December 13, 2018 for the respective motions.

Franchise Litigation

JTH Tax, Inc. and SiempreTax LLC v. Gregory Aime, Aime Consulting, LLC, Aime Consulting, Inc. and Wolf Ventures, Inc. The Company filed suit in the United States District Court for the Eastern District of Virginia against the defendants, former Company franchisees, on June 9, 2016, as amended on June 22, 2016, claiming the defendants breached the purchase and sale agreement (the "PSA") entered between the parties on January 21, 2016 and that the defendants had failed to comply with the post termination obligations of the franchise agreements (together with the PSA, the "Aime Agreements"). The Company sought damages in an amount equal to three times the defendants' earnings and profits, as well as injunctive relief to enforce the defendants to comply with the post termination obligations of the Aime Agreements, to be determined by the trier of fact. The Company specifically sought, in part, to enjoin the defendants from continued operation of a tax preparation business using the Company's protected trademarks, enforcement of the non-compete provision of the Aime Agreements, and an order that the defendants assign all of the leases related to the franchised businesses to the Company. On July 1, 2016, the Magistrate Judge issued a report and recommendation finding a likelihood of success on the merits and recommending entry of the requested temporary restraining order (the "TRO") in favor of the Company, which was adopted in part on August 3, 2016. On September 9, 2016, the defendants filed an answer and counterclaim against the Company, alleging breach

of the PSA, breach of the implied covenant of good faith and fair dealing and fraud and seeking approximately \$2.4 million in damages, plus future loss profits, punitive damages and other expenses. After a three-day bench trial, on January 13, 2017, the court vacated the TRO, finding in favor of the defendants. On February 15, 2017, the court issued its written opinion and order granting the defendants' breach of contract and breach of the implied covenant of good faith and fair dealing claims, denying the Company's claims against the defendants and finding certain post termination obligations to be unenforceable. Judgment was entered in favor of the defendants for approximately \$2.7 million. The Company accrued \$2.7 million as of the fourth quarter of fiscal 2017 in connection with the judgment, which is recorded in "Accounts payable and accrued expense" in the accompanying consolidated balance sheets. The Company has filed an appeal of the judgment with the Fourth Circuit Court of Appeals.

On August 8, 2018, the Fourth Circuit Court of Appeals issued an unpublished opinion affirming in part, vacating in part, and remanding to the District Court with instructions via the opinion. The Court of Appeals affirmed the District Courts

finding that the Company breached the PSA first, however, the Court of Appeals concluded the District Court erred as a matter of law when it determined that the defendants were entitled to lost profits based on the purported extension of the PSA buyback deadline. The Court of Appeals held the alleged extension was not supported by independent consideration and thus not enforceable. It remanded the case for the District Court to recalculate damages consistent with said opinion.

On August 22, 2018, the defendants filed a petition for rehearing of the Fourth Circuit's decision. On September 5, 2018 the Fourth Circuit issued an order denying the petition for rehearing. On September 13, 2018 the Fourth Circuit issued a mandate that the judgment of the Fourth Circuit entered August 8, 2018 takes effect as of the same date of said filing. The matter has now officially been sent back to the District Court to recalculate damages consistent with the Fourth Circuit's decision. The District Court entered an order on October 18, 2018 ordering Aime to provide the Court with a brief on damages within ten days of the entry of the Order and the Company has ten days to respond after the filing of the defendants' brief. The parties have filed their respective briefs and the Court held a hearing on damages on November 28, 2018. On November 29, 2018, the Court issued an order awarding Aime approximately \$0.3 million in damages. Aime filed a petition for appeal to the United States Supreme Court on December 4, 2018, therefore the ultimate outcome of this action and the timing of such outcome is uncertain and there can be no assurance that the Company will benefit financially from such litigation.

Class Action Litigation

Broward Psychology P.A., v. JTH Tax, Inc. (Case 0:18-cv-60412). On February 26, 2018, a class action complaint was filed in the U.S. District Court for the Southern District of Florida by an individual plaintiff for itself and on behalf of all other "similarly situated" persons. The Complaint alleges, among other things, that from March 10, 2014 to 2018, the Company allegedly violated the Telephone Consumer Protection Act of 1991, as amended by the Junk Fax Prevention Act of 2005 (collectively, the "TCPA"), by sending a facsimile advertisement to plaintiff and other putative class members that either were unsolicited and/or did not contain a valid opt-out notice. The complaint seeks certification of the lawsuit as a class action and the award to class members of the greater of actual damages or the sum of \$500 for each violation and injunctive and other relief. Under the TCPA, the statutory remedy of \$500 per violation may be trebled (i.e., \$1,500 per violation) if the court finds the violations to be willful or knowing. On March 30, 2018 the Company filed a dispositive motion arguing that Plaintiff lacked Article III standing to sue Company. By Order dated August 21, 2018, the Court denied the Company's motion. A mediation was held on September 20, 2018 and the case was settled for an immaterial amount.

Rene Labrado v. JTH Tax, Inc. (Case BC 715076). On July 3, 2018, a class action complaint was filed in the Superior Court of California, County of Los Angeles by a former employee for herself and on behalf of all other "similarly situated" persons. The Complaint alleges, among other things, that the Company allegedly violated various provisions of the California Labor Code, including: unpaid overtime, unpaid meal period premiums, unpaid rest premiums, unpaid minimum wages, final wages not timely paid, wages not timely paid, non-compliant wage statements, failure to keep pay records, unreimbursed business expenses and violation of California Business and Profession Code Section 17200. The Complaint seeks actual, consequential and incidental losses and damages, injunctive relief and other damages. The Company highly disputes the allegations set forth in the Complaint and plans on filing a dispositive motion. The Company intends to defend the case vigorously.

Other Matters

From time to time, certain of our franchisees and Company-owned offices are the subject of IRS investigations to review their tax return preparation activities, and in certain cases the Department of Justice has sought injunctions and other remedies with respect to some of our former franchisees or area developers. In addition to those activities, the IRS has been conducting an investigation of our policies, practices and procedures in connection with such tax return

preparation activities. We are cooperating fully with the government in connection with these matters, including by providing documents and other information. The Company is unable to predict what action, if any, might be taken in the future as a result of these matters or the impact, if any, of the cost of responding to the government or any potential remedies as a result of these matters could have on the Company. It is possible, however, that any such remedies could have a material adverse impact on the Company's consolidated results of operations, 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, it 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, financial position, or cash flows.

(13) Subsequent Events

On November 28, 2018, the Company announced the receipt of an unsolicited and non-binding proposal from an unaffiliated private equity fund to acquire all of the outstanding shares. The Board of Directors intends to carefully review the unsolicited proposal and other strategic alternatives that may be available to the Company in consultation with its advisors.

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, 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,” “target,” “will,” “would” expressions that are predictions of or indicate future events and future trends. These forward-looking statements are based on current expectations, estimates, forecasts, projections about our business and the industry in which we operate, and our management’s beliefs and assumptions. They 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 or could cause our actual results to differ materially from historical results or from any results expressed or implied by such forward-looking statements. 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, 2018 and other filings with the U.S. Securities and Exchange Commission (“SEC”), including:

- our inability to grow on a sustainable basis;
- the seasonality of our business;
- departures of key executives or directors;
- our ability to attract additional talent to our senior management team;
- our delisting determination by Nasdaq;
- the review and consideration of any unsolicited proposal received by the Company, the review and evaluation of strategic alternatives, and the outcome of such review and evaluation;
- our inability to secure reliable sources of the tax settlement products we make available to our customers;
- government regulation and oversight, including the regulation of tax preparers or settlement products such as refund transfers 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;
- the effect of regulation of the products and services that we offer, including changes in laws and regulations;
- the possible characterization of refund transfers 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;
- any potential non-compliance, fraud or other misconduct by our franchisees or employees;
- our ability and the ability of our franchisees to comply with legal and regulatory requirements;
- failures by our franchisees and their employees to comply with their contractual obligations to us and with laws and regulations, to the extent these failures affect our reputation or subject us to legal risk;
- 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 Company-owned offices;
- our exposure to litigation;

- our ability and our franchisees' ability to protect customers' personal information, including from a cyber-security incident;
- the impact of identity-theft concerns on customer attitudes toward our services;
- our 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;
- the impact of the Tax Cuts and Job Act (the "Tax Act"), including, but not limited to, the effect of the lower corporate tax rate, including on the valuation of our tax assets and liabilities;
- any future refinements to our preliminary analysis of the impact of the Tax Act;
- changes in the effect of the Tax Act due to issuance of interpretive regulatory guidance or enactment of corrective or supplement legislation;
- delays in the commencement of the tax season attributable to Congressional action affecting tax matters and the resulting inability of federal and state tax agencies to accept tax returns on a timely basis, or other changes that have the effect of delaying the tax refund cycle;
- competition in the tax preparation market;
- the effect of federal and state legislation that affects the demand for paid tax preparation, such as the Affordable Care Act and potential immigration reform;
- our reliance on technology systems and electronic communications;
- our ability to effectively deploy software in a timely manner and with all the features our customers require;
- the impact of any acquisitions or dispositions, including our ability to integrate acquisitions and capitalize on their anticipated synergies; and
- other factors, including the risk factors discussed in our latest annual report filed with the SEC.

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 SEC after the date of this quarterly report.

Overview

We are one of the largest providers of tax preparation services in the U.S. and Canada. In fiscal year 2018, we operated 3,610 tax offices. 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. See Note 1 "Description of Business and Summary of Significant Accounting Policies" in the notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended April 30, 2018, for details of the U.S. office activity and the number of Canadian and Company-owned offices for the years ended April 30, 2018, 2017 and 2016.

Our revenue primarily consists of the following components:

Franchise Fees: Our standard franchise fee per territory is \$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.

Area Developer ("AD") 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 franchise fees, royalties, and a portion of the interest income derived from territories located in their area. AD fees received are recognized as revenue on a straight-line basis over the initial contract term of each AD agreement.

Royalties: Our franchise agreements require franchisees to pay us a base royalty typically equal to 14% of the franchisees' tax preparation revenue, generally subject to certain specified minimums.

Advertising Fees: Our franchise agreements require all franchisees to pay us an advertising fee of 5% of the franchisees' tax preparation revenue, which we use primarily to fund collective advertising efforts.

Financial Products: We offer two types of tax settlement financial products: refund transfer products, which involve providing a means by which a customer may receive his or her refund more quickly and conveniently, and refund-based loans. We earn fees from the arranging of the sale 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 and AD fees, and for other loans we extend to our franchisees related to the operation of their territories. We also earn interest on our accounts receivable.

Assisted Tax Preparation Fees: We earn tax preparation fees, net of discounts, directly from the operation of Company-owned offices in the U.S. and Canada.

Electronic Filing Fees: We earn fees for the electronic filing of federal returns prepared in U.S. franchisee owned offices. Each location determines if they want to charge an electronic filing fee.

We operate Company-owned offices, substantially all of which are held for sale. If these offices remain unsold at the start of a tax season we will operate them for the tax season with the intent of selling them to qualified franchisees the next year, and, as a result, the number of Company-owned offices will vary from year to year. Going forward, the number of Company-owned offices may increase if the Company reacquires more offices from existing franchisees and does not find a suitable buyer to take over the office. During the six months ended October 31, 2018, the Company closed Company-owned offices as part of its restructuring initiatives. The Company incurred approximately \$9.3 million of expenses related to restructuring initiatives during the six months ended October 31, 2018.

For purposes of this section and throughout this quarterly report, all references to “fiscal 2019” and “fiscal 2018” refer to our fiscal years ending April 30, 2019 and ended April 30, 2018, 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, 2018 and 2017.

	Three Months Ended October 31,				Six Months Ended October 31,			
	2018	2017	Change		2018	2017	Change	
			\$	%			\$	%
(dollars in thousands)								
Total revenues	\$6,776	\$7,771	\$(995)	(13)%	\$13,940	\$15,958	\$(2,018)	(13)%
Loss from operations	(18,354)	(20,299)	1,945	(10)%	(46,713)	(36,248)	(10,465)	29 %
Net loss	(12,874)	(13,103)	229	(2)%	(32,245)	(22,861)	(9,384)	41 %

Revenues. The table below sets forth the components and changes in our revenues for the three and six months ended October 31, 2018 and 2017.

	Three Months Ended October 31,				Six Months Ended October 31,			
	2018	2017	Change		2018	2017	Change	
(dollars in thousands)			\$	%			\$	%
Franchise fees	\$449	\$193	\$256	133 %	\$1,006	\$264	\$742	281 %
Area Developer fees	619	634	(15)	(2)%	1,647	1,702	(55)	(3)%
Royalties and advertising fees	1,474	1,299	175	13 %	3,036	2,988	48	2 %
Financial products	477	636	(159)	(25)%	1,056	1,218	(162)	(13)%
Interest income	1,549	2,101	(552)	(26)%	3,205	4,398	(1,193)	(27)%
Assisted tax preparation fees, net of discounts	1,382	1,549	(167)	(11)%	2,901	3,189	(288)	(9)%
Electronic filing fees	30	—	30	— %	58	—	58	— %
Other revenues	796	1,359	(563)	(41)%	1,031	2,199	(1,168)	(53)%
Total revenues	\$6,776	\$7,771	\$(995)	(13)%	\$13,940	\$15,958	\$(2,018)	(13)%

For the three months ended October 31, 2018, total revenues decreased \$1.0 million, or 13%, to \$6.8 million compared to \$7.8 million in the same period last year. This decrease was primarily due to the following:

- a decrease of \$0.6 million in interest income related to a reduction in working capital loans to franchisees as well as a decrease in the loans due from reacquired ADs and franchisees; and

- a decrease of \$0.6 million in other revenues primarily related to gains recorded in 2018 on AD and franchisee acquisitions where the consideration was less than the value of the acquired asset; and

- an increase of \$0.3 million in franchise fees primarily due to the implementation of ASC 606.

For the six months ended October 31, 2018, total revenues decreased \$2.0 million, or 13%, to \$13.9 million compared to \$16.0 million in the same period last year. This decrease was primarily due to the following:

- a decrease of \$1.2 million in interest income related to a reduction in working capital loans to franchisees as well as a decrease in the loans due from reacquired ADs and franchisees; and

- a decrease of \$1.2 million in other revenues primarily related to gains recorded in 2018 on AD and franchisee acquisitions where the consideration was less than the value of the acquired asset; and

- an increase of \$0.7 million in franchise fees primarily due to the implementation of ASC 606.

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

Operating expenses. The table below details the amounts and changes in our operating expenses for the three and six months ended October 31, 2018 and 2017.

	Three Months Ended October 31,				Six Months Ended October 31,			
	2018	2017	Change		2018	2017	Change	
(dollars in thousands)			\$	%			\$	%
Employee compensation and benefits	\$9,205	\$10,712	\$(1,507)	(14)%	\$19,975	\$20,703	\$(728)	(4)%
Selling, general, and administrative expenses	10,052	9,554	498	5%	21,354	18,754	2,600	14%
Area Developer expense	401	397	4	1%	706	769	(63)	(8)%
Advertising expense	1,229	1,702	(473)	(28)%	2,914	4,079	(1,165)	(29)%
Depreciation, amortization, and impairment charges	3,165	2,334	831	36%	6,359	4,530	1,829	40%
Restructuring expense	1,078	3,371	(2,293)	(68)%	9,345	3,371	5,974	177%
Total operating expenses	\$25,130	\$28,070	\$(2,940)	(10)%	\$60,653	\$52,206	\$8,447	16%

For the three months ended October 31, 2018, total operating expenses were \$25.1 million compared to \$28.1 million in the same period last year, representing a decrease of \$2.9 million, or 10%. The decrease was primarily driven by the net of the following:

- a \$2.3 million decrease in restructuring expenses related to Company-store exit costs and a contract termination recorded in 2018; and

- a \$1.5 million decrease in employee compensation and benefits primarily due to lower severance costs compared to fiscal 2018 due to the termination of our former CEO in 2018; and

- a \$0.8 million increase in depreciation, amortization, and impairment expense mainly due to assets put into service.

For the six months ended October 31, 2018, total operating expenses were \$60.7 million compared to \$52.2 million in the same period last year, representing an increase of \$8.4 million, or 16%. The increase was primarily driven by the net of the following:

- a \$6.0 million increase in restructuring expenses related to Company-store exit costs partially offset by a contract termination recorded in 2018; and

- a \$2.6 million increase in selling, general and administrative expenses primarily due to audit and legal costs related to fiscal 2018 and 2019 SEC filings; and

- a \$1.8 million increase in depreciation, amortization, and impairment expense mainly due to assets put into service; and

- a \$0.7 million decrease in employee compensation and benefits primarily due to lower severance costs compared to fiscal 2018 due to the termination of our former CEO in 2018; and

- a \$1.2 million decrease in advertising expenses mainly due to the timing of spending.

Income tax benefit. We recorded income tax benefits with effective rates of 31.9% and 32.5% during the three and six months ended October 31, 2018, respectively and 37.1% and 38.2% for the three and six months ended October 31, 2017, respectively. The decrease in the tax rate was primarily due to lower corporate income taxes rates from the Tax Act. Due to the seasonal nature of our business, we expect any losses that we incur through the first eight months

of each fiscal year will be more than offset by the results of the last four months of the fiscal year.

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 late January through April 30. Following each tax season, from May 1 through late January of the following year, we rely significantly on excess operating cash flow from the previous season, from cash payments made by franchisees and ADs who purchase new territories and areas prior to the next tax season, 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 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, and expenditures for property, equipment and software.

Credit facility. Our amended credit facility consists of a \$21.2 million term loan and a revolving credit facility that currently allows borrowing of up to \$170.0 million with an accordion feature that permits the Company to request an increase in availability of up to an additional \$50.0 million.

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.

• We must reduce the outstanding balance under our revolving loan to zero for a period of at least 45 consecutive days each fiscal year.

• We must also maintain a minimum net worth requirement, measured at April 30 of each year.

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, 2018.

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. At October 31, 2018, 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 \$25.8 million. In addition, at that date, our franchisees and ADs together owed us an additional \$65.4 million, net of unrecognized revenue of \$9.2 million, for amounts representing the unpaid purchase price for franchise territories or areas comprising clusters of territories and other amounts owed to us for royalties and other amounts for which our franchisees and ADs had outstanding payment obligations. The following table provides a breakdown of our potential exposure to credit loss:

(In millions)	At October 31, 2018
Loans to franchisees and ADs for working capital and equipment	\$ 25.8

loans		
Unpaid purchase price of franchise territories, royalties and other amounts, gross	74.6	
Unrecognized revenue	(9.2)
Unpaid purchase price of franchise territories, royalties and other amounts, net		65.4
Book balance of amounts due		91.2
AD share of royalties and franchise fees	(6.9)
Exposure to potential credit loss	\$	84.3

Our franchisees make electronic return filings for their customers utilizing our systems. 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 the net proceeds from tax preparation and other fees they have charged to their customers on tax returns associated with tax settlement products. Therefore, we are able to minimize the nonpayment risk associated with amounts

outstanding from 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 retain repayments of amounts that would otherwise flow through to ADs as their share of franchise fee and royalty payments, to the extent of an AD's indebtedness to us.

The unpaid amounts owed to us from our ADs and franchisees are collateralized by the underlying franchise or area and, when the franchise or area owner is an entity, are generally guaranteed by the related owners of the respective entity. 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, 2018, we had an investment in impaired accounts and notes receivable and related interest receivable of approximately \$22.5 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 unrecognized 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, 2018, we have recorded an allowance for doubtful accounts for impaired accounts and notes receivable of \$9.5 million. There were no significant concentrations of credit risk with any individual franchisee or AD as of October 31, 2018. We believe our allowance for doubtful accounts as of October 31, 2018 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. Beginning in April 2015, we announced a \$0.16 per share quarterly cash dividend and may continue to 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 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. In addition, applicable law requires our Board of Directors to determine that we have adequate surplus prior to the declaration of dividends. We cannot provide an assurance that we will continue to pay dividends at any specific level or at all.

Sources and uses of cash

Operating activities. In the six months ended October 31, 2018, we used \$3.9 million less cash in our operating activities compared to the same period in fiscal 2018. The decrease is primarily due to lower trade receivables and higher accrued expenses partially offset by higher deferred revenue.

Investing activities. In the six months ended October 31, 2018, we utilized \$4.5 million less cash for investing activities compared to the same period in fiscal 2018. This decrease is largely due to a \$1.7 million reduction in net cash used for the issuance of operating loans to franchisees and ADs, net of repayments and \$2.0 million less in the purchases of AD rights, Company-owned offices and acquired customer lists.

Financing activities. In the six months ended October 31, 2018, cash provided by financing activities decreased \$10.1 million compared to the same period in fiscal 2018. This decrease was driven by a reduction of \$12.7 million in net borrowings under our revolving credit facility partially offset by a \$2.2 million decrease in dividends paid compared to the same period in fiscal 2018.

Future cash needs and capital requirements

Operating cash flow needs. We believe our credit facility entered into on April 30, 2012, as amended, will be sufficient to support our cash flow needs for the current fiscal year. At October 31, 2018, using the leverage ratio applicable under our loan covenants at the end of the quarter, our maximum unused borrowing capacity was \$104.1 million. We are currently in negotiations on a new credit facility to replace our existing credit facility which matures on April 30, 2019.

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. As of June 14, 2018, we had maintained a zero balance on our revolver for the required 45 days and thus have already met the requirement for fiscal 2019.

Several factors could affect our cash flow in future periods, including the following:

- the delay by the IRS to issue refunds to taxpayers who claim the Earned Income Tax Credit or the Child Tax Credit;

- the extent to which we extend operating financing to our franchisees and ADs and the extent that our franchisees and ADs repay their notes to us;

- the extent and timing of capital expenditures;

- the cash flow effect of stock option exercises and the extent to which we engage in stock repurchases;

- our ability to generate fees 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, which will involve the use of cash in the short-term, but improve cash receipts in future periods from what would have been the AD's share of royalties and franchise fees;

- the extent to which we repurchase certain assets from franchisees and third parties and our ability to operate these assets profitably;

- the extent, if any, to which our Board of Directors elects to continue to declare cash dividends on our common stock;

- the extent and timing of payments related to litigation settlements; and

- our ability to enter into a new credit facility prior to the maturity of our current facility on April 30, 2019.

Effect of our credit facility covenants on our future performance. Our credit facility, which matures on April 30, 2019, imposes several restrictive covenants, including a covenant that requires us to maintain a leverage ratio of not more than 5.5:1 at the end of each fiscal quarter ending January 31 and a leverage ratio of not more than 3.0:1 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 repayments received from our franchisees until the period beginning in February each year. At October 31, 2018, our leverage ratio was 1.9:1.

We continue to be obligated under our credit facility 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, 2018, our fixed charge coverage ratio was 2.4:1.

We were in compliance with the ratio tests described in this section as of October 31, 2018. We expect to be able to manage our cash flow and our operating activities in such a manner that we will continue to be able to satisfy our obligations under the credit facility for the remainder of the term of that facility.

Non-GAAP Financial Information. We report our consolidated financial results in accordance with GAAP; however, we believe that earnings before interest, taxes, depreciation, amortization and impairment ("EBITDA") and other non-GAAP results should be evaluated, in addition to, and not as an alternative for, net loss, as determined in accordance with GAAP. We consider our non-GAAP consolidated financial results to be a useful metric for management and investors to evaluate and compare current year results with prior periods. Because not all companies use the same calculations, our definition of EBITDA may not be comparable to similarly titled figures from other companies. In addition, when evaluating non-GAAP results, we exclude certain items that are not considered to be

part of future operating results. Descriptions of the items which are excluded are as follows:

Executive severance and related costs, including stock-based compensation: We exclude from our non-GAAP financial measures cash and non-cash stock-based compensation, related third-party expenses and perquisites associated with the separation of employment with executives of the Company.

• Compliance Task Force and related costs: We exclude from our non-GAAP financial measures third-party expenses we incur related to our Compliance Task Force. These expenses include professional and legal fees.

• Restructuring expense: We exclude from our non-GAAP financial measures cash and non-cash expenses of restructuring activities. These expenses include property and intangible impairments and exit costs.

• Executive recruitment costs: We exclude from our non-GAAP financial measures one-time costs incurred to recruit and hire new executives.

• Shareholder litigation costs: We exclude from our non-GAAP financial measures one-time costs incurred related to shareholder litigation.

The following is a reconciliation of GAAP Net Loss to EBITDA:

	Three Months Ended		Six Months Ended	
	October 31,		October 31,	
	2018	2017	2018	2017
	(In thousands)		(In thousands)	
Net loss - as reported	\$ (12,874)	\$ (13,103)	\$ (32,245)	\$ (22,861)
Add back:				
Interest expense	547	508	1,077	789
Income tax benefit	(6,029)	(7,743)	(15,545)	(14,105)
Depreciation, amortization, and impairment charges:				
As reported	3,165	2,334	6,359	4,530
Total Adjustments	(2,317)	(4,901)	(8,109)	(8,786)
EBITDA	\$ (15,191)	\$ (18,004)	\$ (40,354)	\$ (31,647)

Included in restructuring expense on the condensed consolidated statement of operations for the three months ended October 31, 2018 and 2017 is \$1.3 million and \$0.8 million, respectively, of depreciation, amortization, and impairment charges. EBITDA is \$13.8 million and \$17.2 million in the three months ended October 31, 2018 and 2017 with these expenses included. Included in restructuring expense on the condensed consolidated statement of operations for the six months ended October 31, 2018 and 2017 is \$5.6 million and \$0.8 million, respectively, of depreciation, amortization, and impairment charges. EBITDA is \$34.8 million and \$30.8 million in the six months ended October 31, 2018 and 2017, respectively, with these expenses included.

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

The following is a reconciliation of our reported net loss to our non-GAAP financial measures. Amounts may not add or recalculate due to rounding.

Three Months Ended October 31, 2018

(In thousands except per share data)

	Revenues	Operating Expenses	Loss from Operations	EBITDA	Pre-tax Loss	Net Loss	Basic and Diluted EPS
As Reported	\$ 6,776	\$ 25,130	\$ (18,354)	\$(15,191)	\$(18,903)	\$(12,874)	\$(0.92)
Adjustments: (1)							
Shareholder litigation costs	—	(4)	4	4	4	3	—
Restructuring expense	—	(1,078)	1,078	1,078	1,078	787	0.06
Total adjustments	—	(1,082)	1,082	1,082	1,082	790	0.06
Non-GAAP	\$ 6,776	\$ 24,048	\$ (17,272)	\$(14,109)	\$(17,821)	\$(12,084)	\$(0.86)

Three Months Ended October 31, 2017

(In thousands except per share data)

	Revenues	Operating Expenses	Loss from Operations	EBITDA	Pre-tax Loss	Net Loss	Basic and Diluted EPS
As Reported	\$ 7,771	\$ 28,070	\$ (20,299)	\$(18,004)	\$(20,846)	\$(13,103)	\$(1.02)
Adjustments: (1)							
CEO separation and related costs	—	(2,417)	2,417	2,417	2,417	1,519	0.12
Compliance Task Force and related costs	—	(153)	153	153	153	96	0.01
Restructuring expense	—	(3,371)	3,371	3,371	3,371	2,119	0.16
Total adjustments	—	(5,942)	5,942	5,941	5,942	3,735	0.29
Non-GAAP	\$ 7,771	\$ 22,128	\$ (14,357)	\$(12,063)	\$(14,904)	\$(9,368)	\$(0.73)

(1) The net loss impact of the adjustments is calculated using the effective tax rate for the period.

Edgar Filing: Liberty Tax, Inc. - Form 10-Q

Six Months Ended October 31, 2018

(In thousands except per share data)

	Revenues	Operating Expenses	Loss from Operations	EBITDA	Pre-tax Loss	Net Loss	Basic and Diluted EPS
As Reported	\$ 13,940	60,653	\$(46,713)	\$(40,354)	\$(47,790)	\$(32,245)	\$(2.38)
Adjustments: (1)							
Executive severance including stock-based compensation	—	(933)	)933	933	933	681	0.05
Executive recruitment costs	—	(725)	)725	725	725	529	0.04
Shareholder litigation costs	—	(59)	)59	59	59	43	—
Restructuring expense	—	(9,345)	)9,345	9,345	9,345	6,822	0.50
Total adjustments	—	(11,062)	)11,062	11,062	11,062	8,075	0.59
Non-GAAP	\$ 13,940	\$ 49,591	\$(35,651)	\$(29,292)	\$(36,728)	\$(24,170)	\$(1.79)

Six Months Ended October 31, 2017

(In thousands except per share data)

	Revenues	Operating Expenses	Loss from Operations	EBITDA	Pre-tax Loss	Net Loss	Basic and Diluted EPS
As Reported	\$ 15,958	\$ 52,206	\$(36,248)	\$(31,647)	\$(36,966)	\$(22,861)	\$(1.77)
Adjustments: (1)							
CEO separation and related costs	—	(2,417)	)2,417	2,417	2,417	1,495	0.12
Executive recruiting costs	—	(325)	)325	325	325	201	0.02
Compliance Task Force and related costs	—	(325)	)325	325	325	201	0.02
Restructuring expense	—	(3,371)	)3,371	3,371	3,371	2,085	0.16
Total adjustments	—	(6,438)	)6,438	6,438	6,438	3,981	0.31
Non-GAAP	\$ 15,958	\$ 45,768	\$(29,810)	\$(25,209)	\$(30,528)	\$(18,880)	\$(1.46)

(1) The net loss impact of the adjustments is calculated using the effective tax rate for the period.

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 consolidated revenues during the period from January 1 through April 30 of each year. For example, in fiscal 2018 we earned 28% of our annual consolidated revenues during our fiscal third quarter ended January 31 and 91% of our annual revenues during the combined fiscal third and fourth quarters of 2018. 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

We are a party to an interest rate swap agreement that allows us to manage fluctuations in cash flow resulting from changes in the interest rate on our variable rate mortgage. This swap effectively changes the variable-rate of our mortgage into a fixed rate of 4.12%. At October 31, 2018, the fair value of our interest rate swap was an asset of less than \$0.1 million and was included in other current assets. The interest rate swap expires in December 2026.

ITEM 3

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in our market risks from those reported in our Annual Report on Form 10-K for the fiscal year ended April 30, 2018.

ITEM 4

CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of October 31, 2018. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of October 31, 2018, the Company's disclosure controls and procedures were not effective due to a material weakness in the Company's internal control over financial reporting as described below.

The Company concluded that, notwithstanding the material weakness in the Company's internal control over financial reporting, the consolidated financial statements included in this report fairly present, in all material respects, the Company's financial position, results of operations and cash flows for the periods presented in conformity with accounting principles generally accepted in the United States of America.

Changes in Internal Control over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). The Company's internal control over financial reporting is designed to provide reasonable assurance to the Company's management and Board of Directors regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with GAAP.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of the Company's internal control over financial reporting as of October 31, 2018. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework (2013). A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. In connection with management's assessment of our internal control over financial reporting described above, management has identified the following deficiencies that constituted individually, or in the aggregate, a material weakness in our internal control over financial reporting as of October 31, 2018.

The control environment, risk assessment, control activities, information and communication, and monitoring controls were not effective. "Tone at the top" issues contributed to an ineffective control environment. The deficiencies aggregating to this material weakness are set forth below.

Control Environment - control deficiencies contributing to the material weakness relating to: (i) commitment to integrity and ethical values, (ii) the ability of the board of directors to effectively exercise oversight of the development and performance of internal control, as a result of failure to communicate relevant information within the organization and, in some cases, withholding information, (iii) appropriate organizational structure, reporting lines, and authority and responsibilities in pursuit of objectives, (iv) commitment to attract, develop, and retain competent individuals, and (v) holding individuals accountable for their internal control related responsibilities.

Risk Assessment - control deficiencies contributing to the material weakness relating to: (i) identifying, assessing, and communicating appropriate objectives, (ii) identifying and analyzing risks to achieve these objectives, (iii) contemplating fraud risks, and (iv) identifying and assessing changes in the business that could impact the system of internal controls.

Control Activities - control deficiencies contributing to the material weakness relating to: (i) selecting and developing control activities and information technology that contribute to the mitigation of risks and support achievement of objectives and (ii) deploying control activities through policies that establish what is expected and procedures that put policies into action.

Information and Communication - control deficiencies contributing to the material weakness relating to: (i) obtaining, generating, and using relevant quality information to support the function of internal control, and (ii) communicating accurate information internally and externally, including providing information pursuant to objectives, responsibilities, and functions of internal control.

Monitoring - control deficiencies contributing to the material weakness relating to: (i) selecting, developing, and performing ongoing evaluation to ascertain whether the components of internal controls are present and functioning, and (ii) evaluating and communicating internal control deficiencies in a timely manner to those parties responsible for taking corrective action.

Because of this material weakness, management has concluded that we did not maintain effective internal control over financial reporting as of October 31, 2018.

Remediation Efforts to Address Material Weakness

The Company's management has worked, and continues to work, to strengthen the internal control over financial reporting. The Company is committed to ensuring that such controls are designed and operating effectively. Since identifying the material weakness in the internal controls over financial reporting relating to the Company's former CEO and Chairman of the Board and his control of the Board of Directors through his ownership of Class B common stock, the Company has developed and implemented remediation plans to address these control failures. The Company's Board of Directors and management take internal controls over financial reporting and the integrity of the Company's financial statements seriously and believe that the remediation steps described below, including with respect to personnel changes, were and are essential steps to maintaining strong and effective internal controls over financial reporting and a strong internal control environment.

The Company has taken significant steps to address the material weakness set forth above. The Company believes that making the following changes are critical steps toward addressing the "tone at the top" concerns that contributed to the material weakness it has identified. The following steps are among the measures that have been implemented or will be implemented as soon as practicable after the date of this filing:

On July 24, 2018, the Company's former President and Chief Executive Officer and Chairman of the Board of Directors, entered into a stock purchase agreement to sell all of the shares of the Company's Class A common stock and Class B common stock owned directly and indirectly by him. As a result of this transaction, Mr. Hewitt resigned as Chairman of the Board.

In addition to the resignation of Mr. Hewitt as Chairman of the Board, all remaining Class B directors previously appointed by our former Chairman tendered their resignation to the Board.

In February 2018, the Board of Directors appointed Nicole Ossenfort as the Company's new President and Chief Executive Officer. Ms. Ossenfort has brought expertise and leadership to the Company and has helped establish open lines of communication with her internal business unit leaders and the finance and accounting team.

In June 2018, the Company hired a new Chief Financial Officer, Michael S. Piper, who has brought expertise and leadership to the Company and our finance and accounting team.

Most recently, the Company elected five new Class A directors through written consent executed by stockholders representing a majority of the outstanding shares of the Company's Class A common stock that are "independent" for purposes of the Nasdaq Listing Rules.

- ¶The Board of Directors has elected Andrew M. Laurence as the Chairman of our Board of Directors.
- ¶The Company hired Ernst & Young to conduct a review of its corporate governance practices.

The Company is committed to maintaining a strong internal control environment, and believes that these remediation actions represent significant improvements in its controls. Additional remediation measures continue to be considered and will be implemented as appropriate. The Company will continue to assess the effectiveness of its remediation efforts in connection with its evaluations of internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1

LEGAL PROCEEDINGS

For information regarding legal proceedings, please see "Note 12. Commitments and Contingencies" in Financial Statements, which information is incorporated herein by reference.

ITEM 1A

RISK FACTORS

There have been no material changes to our risk factors previously disclosed in Part I, Item 1A in our Annual Report on Form 10-K for the fiscal year ended April 30, 2018 and in Part II, Item 1A in our Quarterly Report on Form 10-Q for the fiscal quarter ended July 31, 2018.

ITEM 2

UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There were no issuances of unregistered securities during the six months ended October 31, 2018.

SHARE REPURCHASES

Our Board of Directors has authorized up to \$10.0 million for share repurchases. This authorization has no specific expiration date and cash proceeds from stock option exercises increase the amount of the authorization. In addition, the Board of Directors authorized an AD repurchase program, which reduces the amount of the share repurchase authorization on a dollar-for-dollar basis. Shares repurchased from option exercises and RSUs vesting that are net-share settled by us and shares repurchased in privately negotiated transactions are not considered share repurchases under this authorization. The Company had no share repurchases and no purchases as part of its AD repurchase program during the quarter.

ITEM 3
DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4
MINE SAFETY DISCLOSURES

None.

ITEM 5
OTHER INFORMATION

None.

ITEM 6
EXHIBITS

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

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference
<u>31.1</u>	<u>Certification of Chief Executive Officer</u>	X	
<u>31.2</u>	<u>Certification of Chief Financial Officer</u>	X	
<u>32.1(1)</u>	<u>Section 1350 Certification (Chief Executive Officer)</u>	X	
<u>32.2(1)</u>	<u>Section 1350 Certification (Chief Financial Officer)</u>	X	
101.INS	XBRL Instance Document	X	
101.SCH	XBRL Taxonomy Extension Schema	X	
101.CAL	XBRL Taxonomy Extension Calculation Linkbase	X	
101.LAB	XBRL Taxonomy Extension Label Linkbase	X	
101.PRE	XBRL Taxonomy Extension Presentation Linkbase	X	
101.DEF	XBRL Taxonomy Extension Definition Linkbase	X	

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

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.

Liberty Tax, Inc.
(Registrant)

December 10, 2018 B/s/ Nicole Ossenfort
Nicole Ossenfort
Chief Executive Officer
(Principal Executive Officer)

December 10, 2018 B/s/ Michael S. Piper
Michael S. Piper
Chief Financial Officer
(Principal Financial Officer)