H&R BLOCK INC
Form 10-Q
December 09, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

þ	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the quarterly period ended October 31, 2014
	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 1-6089
H&R Block, Inc.
(Exact name of registrant as specified in its charter)

MISSOURI	44-0607856
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One H&R Block Way, Kansas City, Missouri 64105
(Address of principal executive offices, including zip code)
(816) 854-3000
(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 þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes þ No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one)
Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No þ
The number of shares outstanding of the registrant's Common Stock, without par value, at the close of business on November 30, 2014: 275,168,156 shares.

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Form 10-Q for the Period Ended October 31, 2014

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PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS) (unaudited, in 000s, except per share amounts)

	Three months ended October 31,		Six months ended October 31,	
	2014	2013	2014	2013
REVENUES:				
Service revenues	$115,442	$112,432	$230,915	$220,232
Royalty, product and other revenues	9,756	11,282	18,570	19,480
Interest income	9,430	10,626	18,729	21,823
	134,628	134,340	268,214	261,535
OPERATING EXPENSES:				
Cost of revenues:				
Compensation and benefits	69,381	60,526	121,236	106,838
Occupancy and equipment	87,626	82,358	170,932	161,094
Provision for bad debt and loan losses	385	2,849	4,749	14,340
Depreciation and amortization	28,429	22,095	53,514	40,715
Other	35,876	39,235	68,992	80,326
	221,697	207,063	419,423	403,313
Selling, general and administrative:				
Marketing and advertising	12,513	13,601	20,658	20,724
Compensation and benefits	54,353	54,818	115,317	107,865
Depreciation and amortization	10,500	4,573	19,101	8,827
Other selling, general and administrative	20,013	21,100	39,503	53,373
	97,379	94,092	194,579	190,789
Total operating expenses	319,076	301,155	614,002	594,102
Other income (expense), net	(2,282)	1,254	(2,963)	(3,685)
Interest expense on borrowings	13,843	13,801	27,638	27,604
Loss from continuing operations before income tax benefit	(200,573)	(179,362)	(376,389)	(363,856)
Income tax benefit	(87,346)	(76,347)	(154,311)	(147,571)
Net loss from continuing operations	(113,227)	(103,015)	(222,078)	(216,285)
Net income (loss) from discontinued operations, net of tax (benefits) of $766 and ($1,218), ($3,798) and $(2,427)	1,229	(1,928)	(6,152)	(3,845)
NET LOSS	$(111,998)	$(104,943)	$(228,230)	$(220,130)
BASIC AND DILUTED LOSS PER SHARE:				
Continuing operations	$(0.41)	$(0.38)	$(0.81)	$(0.79)
Discontinued operations	—	(0.01)	(0.02)	(0.01)
Consolidated	$(0.41)	$(0.39)	$(0.83)	$(0.80)
DIVIDENDS DECLARED PER SHARE	$0.20	$0.20	$0.40	$0.40
COMPREHENSIVE INCOME (LOSS):				
Net loss	$(111,998)	$(104,943)	$(228,230)	$(220,130)

Unrealized gains (losses) on securities, net of taxes:				
Unrealized holding gains (losses) arising during the period	5,493	1,138	4,770	(6,577)
Reclassification adjustment for gains included in income	(589)	—	(15)	—
Change in foreign currency translation adjustments	(3,810)	582	(3,355)	(2,510)
Other comprehensive income (loss)	1,094	1,720	1,400	(9,087)
Comprehensive loss	$(110,904)	$(103,223)	$(226,830)	$(229,217)

See accompanying notes to consolidated financial statements.

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CONSOLIDATED BALANCE SHEETS	(unaudited, in 000s, except share and per share amounts)		
As of	October 31, 2014	October 31, 2013	April 30, 2014
ASSETS			
Cash and cash equivalents	$627,490	$790,772	$2,185,307
Cash and cash equivalents - restricted	55,543	47,521	115,319
Receivables, less allowance for doubtful accounts of $51,746, $52,969 and $52,578	107,705	131,701	191,618
Prepaid expenses and other current assets	285,463	225,660	198,267
Investments in available-for-sale securities	381,180	—	423,495
Total current assets	1,457,381	1,195,654	3,114,006
Mortgage loans held for investment, less allowance for loan losses of $9,761, $12,704 and $11,272	251,092	295,907	268,428
Investments in available-for-sale securities	9,774	465,344	4,329
Property and equipment, at cost less accumulated depreciation and amortization of $491,153, $449,738 and $446,049	318,225	311,157	304,911
Intangible assets, net	414,045	296,213	355,622
Goodwill	464,182	442,812	436,117
Other assets	176,591	267,426	210,116
Total assets	$3,091,290	$3,274,513	$4,693,529
LIABILITIES AND STOCKHOLDERS' EQUITY			
LIABILITIES:			
Customer banking deposits	$454,860	$655,129	$769,785
Accounts payable, accrued expenses and other current liabilities	436,830	426,994	569,007
Accrued salaries, wages and payroll taxes	36,215	41,584	167,032
Accrued income taxes	147,000	22,475	406,655
Current portion of long-term debt	772	400,503	400,637
Total current liabilities	1,075,677	1,546,685	2,313,116
Long-term debt	505,588	506,078	505,837
Other noncurrent liabilities	271,349	266,775	318,027
Total liabilities	1,852,614	2,319,538	3,136,980
COMMITMENTS AND CONTINGENCIES			
STOCKHOLDERS' EQUITY:			
Common stock, no par, stated value $.01 per share, 800,000,000 shares authorized, shares issued of 316,628,110	3,166	3,166	3,166
Convertible preferred stock, no par, stated value $0.01 per share, 500,000 shares authorized	—	—	—
Additional paid-in capital	772,662	757,828	766,654
Accumulated other comprehensive income	6,577	1,463	5,177
Retained earnings	1,250,465	1,003,842	1,589,297
Less treasury shares, at cost	(794,194)	(811,324)	(807,745)
Total stockholders' equity	1,238,676	954,975	1,556,549
Total liabilities and stockholders' equity	$3,091,290	$3,274,513	$4,693,529

See accompanying notes to consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS	(unaudited, in 000s)	
Six months ended October 31,	2014	2013
NET CASH USED IN OPERATING ACTIVITIES	$(627,577)	$(492,373)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale securities	(100)	(45,158)
Maturities of and payments received on available-for-sale securities	49,013	55,615
Principal payments on mortgage loans held for investment, net	13,451	24,340
Capital expenditures	(70,927)	(86,926)
Payments made for business acquisitions, net of cash acquired	(94,230)	(20,927)
Franchise loans:		
Loans funded	(18,251)	(22,114)
Payments received	29,637	15,883
Other, net	10,685	15,255
Net cash used in investing activities	(80,722)	(64,032)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term debt	(400,000)	—
Customer banking deposits, net	(316,269)	(275,800)
Dividends paid	(109,871)	(109,324)
Proceeds from exercise of stock options	14,477	24,536
Other, net	(33,639)	(31,948)
Net cash used in financing activities	(845,302)	(392,536)
Effects of exchange rate changes on cash	(4,216)	(7,871)
Net decrease in cash and cash equivalents	(1,557,817)	(956,812)
Cash and cash equivalents at beginning of the period	2,185,307	1,747,584
Cash and cash equivalents at end of the period	$627,490	$790,772
SUPPLEMENTARY CASH FLOW DATA:		
Income taxes paid, net of refunds received	$157,680	$116,099
Interest paid on borrowings	27,379	27,804
Interest paid on deposits	341	1,180
Transfers of foreclosed loans to other assets	3,155	3,889
Accrued additions to property and equipment	3,243	6,729
Conversion of investment in preferred stock to available-for-sale common stock	5,000	—
Transfer of mortgage loans held for investment to held for sale	—	7,608

See accompanying notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION – The consolidated balance sheets as of October 31, 2014 and 2013, the consolidated statements of operations and comprehensive income (loss) for the three and six months ended October 31, 2014 and 2013, and the condensed consolidated statements of cash flows for the six months ended October 31, 2014 and 2013 have been prepared by the Company, without audit. In the opinion of management, all adjustments, which include only normal recurring adjustments, necessary to present fairly the financial position, results of operations and cash flows as of October 31, 2014 and 2013 and for all periods presented have been made.

"H&R Block," "the Company," "we," "our" and "us" are used interchangeably to refer to H&R Block, Inc. or to H&R Block, Inc. and its subsidiaries, as appropriate to the context.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the U. S. (GAAP) have been condensed or omitted. These consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in our April 30, 2014 Annual Report to Shareholders on Form 10-K. All amounts presented herein as of April 30, 2014 or for the year then ended are derived from our April 30, 2014 Annual Report to Shareholders on Form 10-K.

MANAGEMENT ESTIMATES – The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates, assumptions and judgments are applied in the evaluation of contingent losses arising from our discontinued mortgage business, contingent losses associated with pending claims and litigation, valuation allowances on deferred tax assets, reserves for uncertain tax positions and related matters. Estimates have been prepared based on the best information available as of each balance sheet date. As such, actual results could differ materially from those estimates.

SEASONALITY OF BUSINESS – Our operating revenues are seasonal in nature with peak revenues typically occurring in the months of February through April. Therefore, results for interim periods are not indicative of results to be expected for the full year.

DISCONTINUED OPERATIONS – Our discontinued operations include the results of operations of Sand Canyon Corporation, previously known as Option One Mortgage Corporation (including its subsidiaries, collectively, SCC), which exited its mortgage business in fiscal year 2008. See notes 13 and 14 for additional information on litigation, claims and other loss contingencies related to our discontinued operations.

NOTE 2: H&R BLOCK BANK

In April 2014, our subsidiaries, H&R Block Bank (HRB Bank) and Block Financial LLC, the sole shareholder of HRB Bank (Block Financial), entered into a definitive Purchase and Assumption Agreement (P&A Agreement) with BofI Federal Bank, a federal savings bank (BofI). The P&A Agreement is subject to various closing conditions, including the receipt of certain required approvals, entry into certain additional agreements, and the fulfillment of various other customary conditions. If the closing conditions (including regulatory approvals) are satisfied, we will complete a transaction in which we will sell assets and assign certain liabilities, including all of HRB Bank's deposit liabilities, to BofI (P&A Transaction). The parties to the P&A Agreement entered into a Letter Agreement, effective October 23, 2014 (Letter Agreement), which, among other things, extended the date after which any party is permitted to terminate the P&A Agreement from October 31, 2014 to May 31, 2015. The Letter Agreement was filed as an exhibit to our current report on Form 8-K on October 23, 2014.

Due to the lack of regulatory approval, we do not expect to consummate the P&A Transaction this calendar year. Therefore, we will continue offering financial services products to our clients through HRB Bank for the upcoming tax season.

If a closing had occurred as of October 31, 2014, we would have made a cash payment to BofI for the difference in the carrying value of assets sold and the carrying value of liabilities (including deposit liabilities) transferred of approximately $437 million. The amount of the cash payment made at closing will primarily be equal to the carrying value of the liabilities to be transferred since the carrying value of the assets to be transferred is immaterial. Due to

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the seasonality of our business, the timing of any closing of the P&A Transaction will impact the amount of deposit liabilities transferred. In connection with the closing we intend to liquidate the available-for-sale (AFS) securities held by HRB Bank, which totaled $381 million at October 31, 2014.

In connection with the additional agreements expected to be entered into upon the closing of the P&A Transaction, BofI would offer H&R Block-branded financial products distributed by the Company to the Company's clients. An operating subsidiary of the Company would provide certain marketing, servicing and operational support to BofI with respect to such financial products.

The P&A Transaction is part of a three-step transaction pursuant to which the Company plans to divest HRB Bank (Divestiture Transaction), including: (1) the conversion of HRB Bank from a federal savings bank to a national bank; (2) the sale of certain HRB Bank assets to and assignment of certain liabilities (including all deposit liabilities) to BofI in the P&A Transaction; and (3) the merger of HRB Bank with and into Block Financial.

H&R Block, Inc., H&R Block Group, Inc. and Block Financial (our Holding Companies) are savings and loan holding companies (SLHCs) because they control HRB Bank. By consummating the Divestiture Transaction, our Holding Companies would cease to be SLHCs and would no longer be subject to regulation by the Board of Governors of the Federal Reserve System (Federal Reserve) as SLHCs or to the regulatory capital requirements applicable to SLHCs.

The obligations of the parties to complete the P&A Transaction are subject to the fulfillment of numerous conditions, including regulatory approval. We cannot be certain when or if the conditions to the P&A Transaction will be satisfied, or whether the P&A Transaction will be completed. In addition, there may be changes to the terms and conditions of the P&A Agreement and other contemplated agreements as part of the regulatory approval process.

NOTE 3: LOSS PER SHARE AND STOCKHOLDERS' EQUITY

LOSS PER SHARE – Basic and diluted loss per share is computed using the two-class method. The two-class method is an earnings allocation formula that determines net income per share for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. Per share amounts are computed by dividing net income from continuing operations attributable to common shareholders by the weighted average shares outstanding during each period. The dilutive effect of potential common shares is included in diluted earnings per share except in those periods with a loss from continuing operations. Diluted earnings per share excludes the impact of shares of common stock issuable upon the lapse of certain restrictions or the exercise of options to purchase 5.4 million shares for the three and six months ended October 31, 2014, and 6.0 million shares for the three and six months ended October 31, 2013, as the effect would be antidilutive due to the net loss from continuing operations during those periods.

The computations of basic and diluted earnings per share from continuing operations are as follows:

(in 000s, except per share amounts)

	Three months ended October 31,		Six months ended October 31,	
	2014	2013	2014	2013
Net loss from continuing operations attributable to shareholders	$(113,227)	$(103,015)	$(222,078)	$(216,285)
Amounts allocated to participating securities	(97)	(92)	(186)	(154)
Net loss from continuing operations attributable to common shareholders	$(113,324)	$(103,107)	$(222,264)	$(216,439)
Basic weighted average common shares	275,106	273,907	274,841	273,494
Potential dilutive shares	—	—	—	—
Dilutive weighted average common shares	275,106	273,907	274,841	273,494
Loss per share from continuing operations attributable to common shareholders:				
Basic	$(0.41)	$(0.38)	$(0.81)	$(0.79)
Diluted	(0.41)	(0.38)	(0.81)	(0.79)

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STOCK-BASED COMPENSATION – During the six months ended October 31, 2014, we acquired 0.3 million shares of our common stock at an aggregate cost of $10.2 million. These shares represent shares swapped or surrendered to us in connection with the vesting or exercise of stock-based awards. During the six months ended October 31, 2013, we acquired 0.2 million shares at an aggregate cost of $5.3 million for similar purposes.

During the six months ended October 31, 2014 and 2013, we issued 1.2 million and 1.6 million shares of common stock, respectively, due to the vesting or exercise of stock-based awards.

During the six months ended October 31, 2014, we granted equity awards equivalent to 1.0 million shares under our stock-based compensation plans, consisting primarily of nonvested units. Nonvested units generally either vest over a three-year period with one-third vesting each year or cliff vest at the end of a three-year period. Stock-based compensation expense of our continuing operations totaled $7.1 million and $14.6 million for the three and six months ended October 31, 2014, respectively, and $6.2 million and $10.8 million for the three and six months ended October 31, 2013, respectively. As of October 31, 2014, unrecognized compensation cost for stock options totaled $0.4 million, and for nonvested shares and units totaled $43.2 million.

OTHER COMPREHENSIVE INCOME – Components of other comprehensive income include foreign currency translation adjustments and the change in net unrealized gains or losses on AFS marketable securities, and are as follows:

(in 000s)

	Foreign Currency Translation Adjustments	Unrealized Gain (Loss) on AFS Securities	Total
Balances as of May 1, 2014	$3,334	$1,843	$5,177
Other comprehensive income (loss) before reclassifications:			
Gross gains (losses) arising during the year	(3,355)	7,483	4,128
Income taxes	—	2,713	2,713
	(3,355)	4,770	1,415
Amounts reclassified to net income:			
Gross amount reclassified	—	(24)	(24)
Income taxes	—	(9)	(9)
	—	(15)	(15)
Net other comprehensive income (loss)	(3,355)	4,755	1,400
Balances as of October 31, 2014	$(21)	$6,598	$6,577
Balances as of May 1, 2013	$6,809	$3,741	$10,550
Other comprehensive income (loss) before reclassifications:			
Gross losses arising during the year	(2,510)	(10,914)	(13,424)
Income taxes	—	(4,337)	(4,337)
Net other comprehensive loss	(2,510)	(6,577)	(9,087)
Balances as of October 31, 2013	$4,299	$(2,836)	$1,463

Gross amounts reclassified out of accumulated other comprehensive income are included in other income (expense), net in the consolidated statements of operations.

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NOTE 4: RECEIVABLES

Receivables consist of the following:

(in 000s)						
As of	October 31, 2014		October 31, 2013		April 30, 2014	
	Short-term	Long-term	Short-term	Long-term	Short-term	Long-term
Loans to franchisees	$62,568	$84,462	$70,390	$108,874	$63,716	$90,747
Receivables for tax preparation and related fees	36,369	—	35,927	—	45,619	—
Cash Back® receivables	1,955	—	2,036	—	48,812	—
Emerald Advance lines of credit	20,073	2,778	21,692	6,161	20,577	3,862
Royalties from franchisees	10,060	—	10,732	—	9,978	—
Note receivable	—	—	—	62,786	—	—
Other	28,426	14,565	43,893	23,868	55,494	17,186
	159,451	101,805	184,670	201,689	244,196	111,795
Allowance for doubtful accounts	(51,746)	—	(52,969)	(3,092)	(52,578)	—
	$107,705	$101,805	$131,701	$198,597	$191,618	$111,795

Balances presented above as short-term are included in receivables, while the long-term portions are included in other assets in the consolidated balance sheets.

LOANS TO FRANCHISEES – Franchisee loan balances as of October 31, 2014 and 2013 and April 30, 2014, consisted of $100.6 million, $126.3 million and $109.1 million, respectively, in term loans made primarily to finance the purchase of franchises and $46.4 million, $53.0 million and $45.4 million, respectively, in revolving lines of credit primarily for the purpose of funding off-season working capital needs.

As of October 31, 2014 and 2013, loans with a principal balance of $2.4 million and $0.1 million, respectively, were more than 30 days past due, while we had no loans more than 30 days past due at April 30, 2014. We had no loans to franchisees on non-accrual status.

CANADIAN CASH BACK® PROGRAM – Refunds advanced under the Cash Back program are not subject to credit approval, therefore the primary indicator of credit quality is the age of the receivable amount. Cash Back amounts are generally received within 60 days of filing the client's return. As of October 31, 2014 and 2013 and April 30, 2014, $27 thousand, $0.1 million and $1.9 million of Cash Back balances were more than 60 days old, respectively.

H&R BLOCK EMERALD ADVANCE® LINES OF CREDIT – We review the credit quality of our H&R Block Emerald Advance® lines of credit (EA) receivables based on pools, which are segregated by the year of origination, with older years being deemed more unlikely to be repaid. These amounts as of October 31, 2014, by year of origination, are as follows:

(in 000s)	
Credit Quality Indicator – Year of origination:	
2014	$3,802
2013	1,553
2012 and prior	4,412
Revolving loans	13,084
	$22,851

As of October 31, 2014 and 2013 and April 30, 2014, $20.0 million, $26.2 million and $20.7 million of EAs were on non-accrual status and classified as impaired, or more than 60 days past due, respectively.

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ALLOWANCE FOR DOUBTFUL ACCOUNTS – Activity in the allowance for doubtful accounts for our short-term and long-term receivables for the six months ended October 31, 2014 and 2013 is as follows:
(in 000s)

	EAs	Loans to Franchisees	Cash Back ®	All Other	Total
Balances as of May 1, 2014	$7,530	$—	$3,002	$42,046	$52,578
Provision	380	—	149	2,195	2,724
Charge-offs	—	—	(1,074)	(2,482)	(3,556)
Balances as of October 31, 2014	$7,910	$—	$2,077	$41,759	$51,746
Balances as of May 1, 2013	$7,390	$—	$2,769	$47,544	$57,703
Provision	—	—	188	5,923	6,111
Charge-offs	—	—	(479)	(7,274)	(7,753)
Balances as of October 31, 2013	$7,390	$—	$2,478	$46,193	$56,061

NOTE 5: MORTGAGE LOANS HELD FOR INVESTMENT
The composition of our mortgage loan portfolio is as follows:
(dollars in 000s)

As of	October 31, 2014		October 31, 2013		April 30, 2014	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
Adjustable-rate loans	$138,808	54 %	$165,289	54 %	$149,480	54 %
Fixed-rate loans	119,920	46 %	140,814	46 %	127,943	46 %
	258,728	100 %	306,103	100 %	277,423	100 %
Unamortized deferred fees and costs	2,125		2,508		2,277	
Less: Allowance for loan losses	(9,761)		(12,704)		(11,272)	
	$251,092		$295,907		$268,428	

Our loan loss allowance as a percent of mortgage loans was 3.8% as of October 31, 2014, compared to 4.2% as of October 31, 2013 and 4.1% as of April 30, 2014.
Activity in the allowance for loan losses for the six months ended October 31, 2014 and 2013 is as follows:
(in 000s)

Six months ended October 31,	2014	2013
Balance at beginning of the period	$11,272	$14,314
Provision	735	7,224
Recoveries	911	2,409
Charge-offs	(3,157)	(11,243)
Balance at end of the period	$9,761	$12,704

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When determining our allowance for loan losses, we evaluate loans less than 60 days past due on a pooled basis, while loans we consider impaired, including those loans more than 60 days past due or modified as a troubled debt restructuring (TDR), are evaluated individually. The balance of these loans and the related allowance is as follows: