H&R BLOCK INC
Form 10-Q
December 10, 2013

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, 2013
	OR
¨	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the transition period from to

Commission file number 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, 2013: 274,046,273 shares.

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

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PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS	(in 000s, except share and per share amounts)		
As of	October 31, 2013	October 31, 2012	April 30, 2013
	(unaudited)	(unaudited)	
ASSETS			
Cash and cash equivalents	$790,772	$1,260,901	$1,747,584
Cash and cash equivalents — restricted	47,521	38,667	117,837
Receivables, less allowance for doubtful accounts of $52,969, $42,761 and $50,399	131,701	124,511	206,835
Prepaid expenses and other current assets	225,660	282,874	390,087
Total current assets	1,195,654	1,706,953	2,462,343
Mortgage loans held for investment, less allowance for loan losses of $12,704, $18,125 and $14,314	295,907	370,850	338,789
Investments in available-for-sale securities	465,344	388,640	486,876
Property and equipment, at cost less accumulated depreciation and amortization of $449,738, $492,670 and $420,318	311,157	272,438	267,880
Intangible assets, net	296,213	275,193	284,439
Goodwill	442,812	434,492	434,782
Other assets	267,426	448,164	262,670
Total assets	$3,274,513	$3,896,730	$4,537,779
LIABILITIES AND STOCKHOLDERS' EQUITY			
LIABILITIES:			
Customer banking deposits	$655,129	$790,106	$936,464
Accounts payable, accrued expenses and other current liabilities	426,994	406,447	523,921
Accrued salaries, wages and payroll taxes	41,584	39,345	134,970
Accrued income taxes	22,475	95,126	416,128
Current portion of long-term debt	400,503	600,678	722
Total current liabilities	1,546,685	1,931,702	2,012,205
Long-term debt	506,078	906,125	905,958
Other noncurrent liabilities	266,775	365,970	356,069
Total liabilities	2,319,538	3,203,797	3,274,232
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	757,828	748,298	752,483
Accumulated other comprehensive income	1,463	8,685	10,550
Retained earnings	1,003,842	795,707	1,333,445
Less treasury shares, at cost	(811,324)	(862,923)	(836,097)
Total stockholders' equity	954,975	692,933	1,263,547
Total liabilities and stockholders' equity	$3,274,513	$3,896,730	$4,537,779

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(unaudited, in 000s, except per share amounts)

	Three months ended October 31, 2013	Three months ended October 31, 2012	Six months ended October 31, 2013	Six months ended October 31, 2012
REVENUES:				
Service revenues	$112,432	$116,438	$220,232	$196,334
Product and other revenues	11,282	10,966	19,480	17,686
Interest income	10,626	9,859	21,823	19,732
	134,340	137,263	261,535	233,752
OPERATING EXPENSES:				
Cost of revenues:				
Compensation and benefits	60,526	54,764	106,838	94,349
Occupancy and equipment	82,358	82,398	161,094	162,349
Provision for bad debt and loan losses	2,849	3,725	14,340	8,370
Interest	14,314	23,390	28,760	45,467
Depreciation of property and equipment	20,144	16,196	36,948	30,730
Other	40,673	31,538	82,937	64,170
	220,864	212,011	430,917	405,435
Selling, general and administrative	94,092	90,327	190,789	165,805
	314,956	302,338	621,706	571,240
Operating loss	(180,616)	(165,075)	(360,171)	(337,488)
Other income (expense), net	1,254	2,787	(3,685)	5,931
Loss from continuing operations before income tax benefit	(179,362)	(162,288)	(363,856)	(331,557)
Income tax benefit	(76,347)	(61,089)	(147,571)	(124,708)
Net loss from continuing operations	(103,015)	(101,199)	(216,285)	(206,849)
Net loss from discontinued operations	(1,928)	(4,044)	(3,845)	(5,835)
NET LOSS	$(104,943)	$(105,243)	$(220,130)	$(212,684)
BASIC AND DILUTED LOSS PER SHARE:				
Continuing operations	$(0.38)	$(0.37)	$(0.79)	$(0.76)
Discontinued operations	(0.01)	(0.02)	(0.01)	(0.02)
Consolidated	$(0.39)	$(0.39)	$(0.80)	$(0.78)
DIVIDENDS PER SHARE	$0.20	$0.20	$0.40	$0.40
COMPREHENSIVE INCOME (LOSS):				
Net loss	$(104,943)	$(105,243)	$(220,130)	$(212,684)
Unrealized gains (losses) on available-for-sale securities, net of taxes:				
Unrealized holding gains (losses) arising during the period, net of taxes (benefit) of $728, $131, ($4,337) and $283	1,138	187	(6,577)	357
Reclassification adjustment for gains included in income, net of taxes of $ -, $71, $ - and $71	—	(104)	—	(104)
Change in foreign currency translation adjustments	582	1,252	(2,510)	(3,713)
Other comprehensive income (loss)	1,720	1,335	(9,087)	(3,460)

Comprehensive loss	$(103,223)	$(103,908)	$(229,217)	$(216,144)

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,	2013	2012
NET CASH USED IN OPERATING ACTIVITIES	$(492,373)	$(567,036)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of available-for-sale securities	(45,158)	(67,474)
Maturities of and payments received on available-for-sale securities	55,615	53,098
Principal payments on mortgage loans held for investment, net	24,340	23,608
Purchases of property and equipment	(86,926)	(60,720)
Payments made for business acquisitions, net of cash acquired	(20,927)	(10,442)
Franchise loans:		
Loans funded	(22,114)	(20,670)
Payments received	15,883	8,303
Other, net	15,255	10,218
Net cash used in investing activities	(64,032)	(64,079)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments of long-term debt	—	(30,831)
Proceeds from issuance of long-term debt	—	497,185
Customer banking deposits, net	(275,800)	(37,913)
Dividends paid	(109,324)	(108,428)
Repurchase of common stock, including shares surrendered	(5,329)	(339,919)
Proceeds from exercise of stock options	24,536	1,288
Other, net	(26,619)	(33,004)
Net cash used in financing activities	(392,536)	(51,622)
Effects of exchange rates on cash	(7,871)	(696)
Net decrease in cash and cash equivalents	(956,812)	(683,433)
Cash and cash equivalents at beginning of the period	1,747,584	1,944,334
Cash and cash equivalents at end of the period	$790,772	$1,260,901
SUPPLEMENTARY CASH FLOW DATA:		
Income taxes paid, net of refunds received	$116,099	$48,201
Interest paid on borrowings	27,804	42,106
Interest paid on deposits	1,180	2,683
Transfers of foreclosed loans to other assets	3,889	5,312
Accrued additions to property and equipment	6,729	10,273
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, 2013 and 2012, the consolidated statements of operations and comprehensive income (loss) for the three and six months ended October 31, 2013 and 2012, and the condensed consolidated statements of cash flows for the six months ended October 31, 2013 and 2012 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 at October 31, 2013 and 2012 and for all periods presented have been made. See note 14 for discussion of our presentation of discontinued operations.

“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 U.S. generally accepted accounting principles 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, 2013 Annual Report to Shareholders on Form 10-K. All amounts presented herein as of April 30, 2013 or for the year then ended, are derived from our April 30, 2013 Annual Report to Shareholders on Form 10-K.

Management Estimates - The preparation of financial statements in conformity with generally accepted accounting principles 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, allowance for loan losses, valuation allowances based on future taxable income, reserves for uncertain tax positions and related matters. Estimates have been prepared on the basis of the most current and 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 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.

Recently Issued or Newly Adopted Accounting Standards - In February 2013, the Financial Accounting Standards Board issued guidance which expands disclosure requirements for other comprehensive income. The guidance requires the reporting of the effect of the reclassification of items out of accumulated other comprehensive income on each affected net income line item. The guidance is effective for interim and annual periods beginning on or after December 15, 2012 and is to be applied prospectively. This guidance, which we adopted as of May 1, 2013, did not have a material impact on our financial statements.

NOTE 2: H&R BLOCK BANK

In July 2013, H&R Block Bank (HRB Bank) and Block Financial LLC (Block Financial) entered into a definitive Purchase and Assumption Agreement (P&A Agreement) with Republic Bank & Trust Company (Republic Bank) subject to various closing conditions, including the finalization of various operating agreements and receipt of certain required approvals (P&A Transaction). Prior to entering into the P&A Agreement, Republic Bank, which currently operates under a state bank charter and is regulated primarily by the Federal Deposit Insurance Corporation (FDIC), filed an application with the Office of the Comptroller of the Currency (OCC) for approval to convert to a national banking association. Approval and completion of this conversion were conditions to closing the P&A Transaction.

In October 2013, Republic Bank informed us that it had withdrawn its application for the conversion and its application for approval of the P&A Transaction, which was contingent upon the approval of the conversion. As a result, HRB Bank and Block Financial provided notice to Republic Bank of termination of the P&A Agreement.

We plan to continue offering financial services and products to our clients through HRB Bank during the 2014 tax season. We continue to explore alternatives for delivering financial products and services to our customers while

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ceasing to be regulated as a savings and loan holding company (SLHC); however, we cannot predict the timing or the likelihood of ceasing to be regulated as an SLHC.

NOTE 3: LOSS PER SHARE AND STOCKHOLDERS' EQUITY

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 6.0 million shares for the three and six months ended October 31, 2013, and 8.9 million shares for the three and six months ended October 31, 2012, 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,	
	2013	2012	2013	2012
Net loss from continuing operations attributable to shareholders	$(103,015)	$(101,199)	$(216,285)	$(206,849)
Amounts allocated to participating securities	(92)	(64)	(154)	(137)
Net loss from continuing operations attributable to common shareholders	$(103,107)	$(101,263)	$(216,439)	$(206,986)
Basic weighted average common shares	273,907	271,145	273,494	274,150
Potential dilutive shares	—	—	—	—
Dilutive weighted average common shares	273,907	271,145	273,494	274,150
Loss per share from continuing operations attributable to common shareholders:				
Basic	$(0.38)	$(0.37)	$(0.79)	$(0.76)
Diluted	(0.38)	(0.37)	(0.79)	(0.76)

During the six months ended October 31, 2012, we purchased and immediately retired 21.3 million shares of our common stock at a cost of $315.0 million.

During the six months ended October 31, 2013, we acquired 0.2 million shares of our common stock at an aggregate cost of $5.3 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, 2012, we acquired 0.1 million shares at an aggregate cost of $2.4 million for similar purposes.

During the six months ended October 31, 2013 and 2012, we issued 1.6 million and 0.5 million shares of common stock, respectively, due to the vesting or exercise of stock-based awards.

During the six months ended October 31, 2013, we granted equity awards equivalent to approximately 0.8 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 $6.2 million and $10.8 million for the three and six months ended October 31, 2013, respectively, and $5.4 million and $7.8 million for the three and six months ended October 31, 2012, respectively. As of October 31, 2013, unrecognized compensation cost for stock options totaled $2.0 million, and for nonvested shares and units totaled $33.3 million.

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NOTE 4: RECEIVABLES

Short-term receivables consist of the following:

(in 000s)

As of	October 31, 2013	October 31, 2012	April 30, 2013
Loans to franchisees	$70,390	$69,110	$65,413
Receivables for tax preparation and related fees	35,927	34,083	49,356
Canadian CashBack receivables	2,036	3,863	47,658
Emerald Advance lines of credit	21,692	23,630	23,218
Royalties from franchisees	10,732	8,744	10,722
Credit cards	6,115	—	7,733
Other	37,778	27,842	53,134
	184,670	167,272	257,234
Allowance for doubtful accounts	(52,969)	(42,761)	(50,399)
	$131,701	$124,511	$206,835

The short-term portions of Emerald Advance lines of credit (EAs), loans made to franchisees, CashBack balances and credit card balances are included in receivables, while the long-term portions are included in other assets in the consolidated balance sheets. These amounts are as follows:

(in 000s)

	EAs	Loans to Franchisees	CashBack	Credit Cards
As of October 31, 2013:				
Short-term	$21,692	$70,390	$2,036	$6,115
Long-term	6,161	108,874	—	13,603
	$27,853	$179,264	$2,036	$19,718
As of October 31, 2012:				
Short-term	$23,630	$69,110	$3,863	$—
Long-term	10,825	119,102	—	—
	$34,455	$188,212	$3,863	$—
As of April 30, 2013:				
Short-term	$23,218	$65,413	$47,658	$7,733
Long-term	9,819	103,047	—	15,538
	$33,037	$168,460	$47,658	$23,271

EAs – We review the credit quality of our EA receivables based on pools, which are segmented by the year of origination, with older years being deemed more unlikely to be repaid. Amounts as of October 31, 2013, by year of origination, are as follows:

(in 000s)

Credit Quality Indicator – Year of origination:	
2013	$7,817
2012	1,069
2011	1,987
2010 and prior	6,238
Revolving loans	10,742
	$27,853

As of October 31, 2013 and 2012 and April 30, 2013, $26.2 million, $30.3 million and $30.0 million of EAs were on non-accrual status and classified as impaired, or more than 60 days past due, respectively.

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Loans to Franchisees – Loans made to franchisees as of October 31, 2013 and 2012 and April 30, 2013, consisted of $126.3 million, $136.9 million and $121.2 million, respectively, in term loans made primarily to finance the purchase of franchises and $53.0 million, $51.3 million and $47.3 million, respectively, in revolving lines of credit primarily for the purpose of funding off-season working capital needs.

As of October 31, 2013 and 2012 and April 30, 2013, loans with a principal amount of $0.1 million, $0.0 million and $0.1 million, respectively, were more than 30 days past due, however we had no loans to franchisees on non-accrual status.

Canadian CashBack Program – During the tax season our Canadian operations advance refunds due to certain clients from the Canada Revenue Agency for a fee (the CashBack program). Refunds advanced under the CashBack program are not subject to credit approval, therefore the primary indicator of credit quality is the age of the receivable amount. CashBack amounts are generally received within 60 days of filing the client's return. In September of each fiscal year, any balances more than 90 days old are charged-off against the related allowance. As of October 31, 2013 and 2012 and April 30, 2013, $0.1 million, $0.4 million and $1.8 million of CashBack balances were more than 60 days old, respectively.

Credit Cards – We utilize a four-tier underwriting approach at origination. Each of the four tiers, with Tier 4 representing the most risk, is comprised of a combination of FICO scores ranging from 521 to 680, generic and custom credit bureau based risk scores and client attributes. The criteria in the tiers are not subsequently updated. The population also includes certain clients which are “unscorable.” Although we utilize the borrower's credit score for underwriting, we do not consider the credit score to be a primary measure of credit quality, since it tends to be a lagging indicator. Credit card receivable balances as of October 31, 2013, by credit tier, are as follows:

(in 000s)	
Tier 1	$4,880
Tier 2	8,078
Tier 3	2,456
Tier 4	4,304
	$19,718

An aging of our credit card receivable balances as of October 31, 2013 is as follows:

(in 000s)	
Current	$13,069
Less than 30 days past due	1,411
30 - 59 days past due	932
60 - 89 days past due	847
90 days or more past due	3,459
	$19,718

As of October 31, 2013 and April 30, 2013, a total of $0.3 million and $2.1 million in unamortized deferred fees and costs were capitalized related to our credit card balances, respectively.

Long-Term Note Receivable – We have a long-term note receivable in the amount of $54.0 million due from McGladrey & Pullen LLP (M&P) related to the sale of RSM McGladrey, Inc. (RSM) in November 2011. This note is unsecured and bears interest at a rate of 8.0%, with all principal and accrued interest due in May 2017. As of October 31, 2013, there is no allowance recorded related to this note. We continue to monitor publicly available information relevant to the financial condition of M&P to assess future collectibility. This note is included in other assets on the consolidated balance sheet, with a total of $62.8 million, $58.0 million and $60.4 million in principal and accrued interest recorded as of October 31, 2013 and 2012 and April 30, 2013, 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, 2013 and 2012 is as follows:
(in 000s)

	EAs	Loans to Franchisees	CashBack	Credit Cards	All Other	Total
Balances as of May 1, 2013	$7,390	$—	$2,769	$7,304	$40,240	$57,703
Provision	—	—	188	4,957	966	6,111
Charge-offs	—	—	(479)	(6,225)	(1,049)	(7,753)
Balances as of October 31, 2013	$7,390	$—	$2,478	$6,036	$40,157	$56,061
Balances as of May 1, 2012	$6,200	$—	$2,279	$—	$36,110	$44,589
Provision	310	—	290	—	550	1,150
Charge-offs	—	—	(1,507)	—	(1,471)	(2,978)
Balances as of October 31, 2012	$6,510	$—	$1,062	$—	$35,189	$42,761

There were no changes to our methodology for estimating our allowance for doubtful accounts during fiscal year 2014.

NOTE 5: MORTGAGE LOANS HELD FOR INVESTMENT AND RELATED ASSETS

The composition of our mortgage loan portfolio is as follows:
(dollars in 000s)

As of	October 31, 2013		October 31, 2012		April 30, 2013	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
Adjustable-rate loans	$165,289	54%	$210,610	55%	$191,093	55%
Fixed-rate loans	140,814	46%	175,257	45%	159,142	45%
	306,103	100%	385,867	100%	350,235	100%
Unamortized deferred fees and costs	2,508		3,108		2,868	
Less: Allowance for loan losses	(12,704)		(18,125)		(14,314)	
	$295,907		$370,850		$338,789	

Our loan loss allowance as a percent of mortgage loans was 4.2% as of October 31, 2013, compared to 4.7% as of October 31, 2012 and 4.1% as of April 30, 2013.

Activity in the allowance for loan losses for the six months ended October 31, 2013 and 2012 is as follows:
(in 000s)

Six months ended October 31,	2013	2012
Balance at beginning of the period	$14,314	$26,540
Provision	7,224	6,750
Recoveries	2,409	2,291
Charge-offs	(11,243)	(17,456)
Balance at end of the period	$12,704	$18,125

During the first quarter of fiscal year 2014, we transferred $7.6 million of mortgage loans into the held-for-sale portfolio from the held-for-investment portfolio. At the time of the transfer, the amount by which cost exceeded fair value totaled $2.9 million. This write-down to fair value was recorded as a provision during the six months ended October 31, 2013 and subsequently charged-off. These loans were sold during the three months ended October 31, 2013.

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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:

(in 000s)

As of	October 31, 2013		October 31, 2012		April 30, 2013	
	Portfolio Balance	Related Allowance	Portfolio Balance	Related Allowance	Portfolio Balance	Related Allowance
Pooled (less than 60 days past due)	$178,497	$5,523	$229,761	$6,892	$207,319	$5,628
Impaired:						