H&R BLOCK INC
Form 10-Q
September 05, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 31, 2012

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 Ö 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 Ö 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	Ö	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 Ö

The number of shares outstanding of the registrant s Common Stock, without par value, at the close of business on August 31, 2012 was 271,109,828 shares.

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Form 10-Q for the Period Ended July 31, 2012

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CONSOLIDATED BALANCE SHEETS

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

As of	July 31, 2012 (Unaudited)	April 30, 2012
ASSETS		
Cash and cash equivalents	$ 939,871	$ 1,944,334
Cash and cash equivalents restricted	43,109	48,100
Receivables, less allowance for doubtful accounts of $43,477 and $44,589	116,357	193,858
Prepaid expenses and other current assets	318,262	314,702
Total current assets	1,417,599	2,500,994
Mortgage loans held for investment, less allowance for loan losses of $22,185 and $26,540	386,759	406,201
Investments in available-for-sale securities	380,765	371,315
Property and equipment, at cost, less accumulated depreciation and amortization of $636,384 and $622,313	253,993	252,985
Intangible assets, net	260,125	264,451
Goodwill	431,101	427,566
Other assets	463,935	426,055
Total assets	$3,594,277	$ 4,649,567
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Customer banking deposits	$648,378	$827,549
Accounts payable, accrued expenses and other current liabilities	414,604	567,079
Accrued salaries, wages and payroll taxes	35,234	163,992
Accrued income taxes	278,539	336,374
Current portion of long-term debt	600,642	631,434
Total current liabilities	1,977,397	2,526,428
Long-term debt	408,992	409,115
Other noncurrent liabilities	362,215	388,132
Total liabilities	2,748,604	3,323,675
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 and 397,886,599	3,166	3,979
Additional paid-in capital	744,616	796,784
Accumulated other comprehensive income	7,350	12,145
Retained earnings	955,873	2,523,997
Less treasury shares, at cost	(865,332)	(2,011,013)

Total stockholders equity	845,673	1,325,892
Total liabilities and stockholders equity	$3,594,277	$ 4,649,567

See Notes to Consolidated Financial Statements

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CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, amounts in 000s,

except per share amounts)

AND COMPREHENSIVE INCOME (LOSS)

Three months ended July 31,	2012	2011
Revenues:		
Service revenues	$ 79,896	$ 83,020
Interest income	9,873	10,340
Product and other revenues	6,720	7,263
	96,489	100,623
Expenses:		
Cost of revenues:		
Compensation and benefits	39,585	47,221
Occupancy and equipment	79,951	83,503
Depreciation and amortization of property and equipment	16,305	16,472
Provision for bad debt and loan losses	4,645	7,291
Interest	22,077	22,936
Other	30,861	35,161
	193,424	212,584
Selling, general and administrative expenses	75,478	92,653
	268,902	305,237
Operating loss	(172,413)	(204,614)
Other income, net	3,144	4,013
Loss from continuing operations before tax benefit	(169,269)	(200,601)
Income tax benefit	(63,619)	(81,446)
Net loss from continuing operations	(105,650)	(119,155)
Net loss from discontinued operations	(1,791)	(55,943)
Net loss	$ (107,441)	$ (175,098)
Basic and diluted loss per share:		
Net loss from continuing operations	$ (0.38)	$ (0.39)
Net loss from discontinued operations	(0.01)	(0.18)
Net loss	$ (0.39)	$ (0.57)

Basic and diluted shares	277,155	305,491
Dividends paid per share	$ 0.20	$ 0.15
Comprehensive income (loss):		
Net loss	$ (107,441)	$ (175,098)
Unrealized gains on securities, net of taxes:		
Unrealized holding gains arising during the period, net of taxes of $152 and $704	170	1,069
Reclassification adjustment for gains (losses) included in income, net of taxes of $ and $58		(94)
Change in foreign currency translation adjustments	(4,965)	484
Other comprehensive income (loss)	(4,795)	1,459
Comprehensive loss	$ (112,236)	$ (173,639)

See Notes to Consolidated Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, amounts in 000s)

Three months ended July 31,	2012	2011
Net cash used in operating activities	$ (373,140)	$ (394,549)
Cash flows from investing activities:		
Purchases of available-for-sale securities	(28,990)	(39,275)
Principal repayments on mortgage loans held for investment, net	12,652	11,192
Purchases of property and equipment, net	(13,273)	(10,953)
Payments made for business acquisitions, net	(2,972)	(3,457)
Proceeds from sale of businesses, net		21,230
Franchise loans:		
Loans funded	(5,062)	(16,477)
Payments received	5,154	5,320
Other, net	25,776	18,167
Net cash used in investing activities	(6,715)	(14,253)
Cash flows from financing activities:		
Repayments of long-term debt	(30,831)	
Customer banking deposits, net	(179,519)	(186,245)
Dividends paid	(54,201)	(45,894)
Repurchase of common stock, including shares surrendered	(339,088)	(2,002)
Proceeds from exercise of stock options, net	468	1,762
Other, net	(19,939)	(24,916)
Net cash used in financing activities	(623,110)	(257,295)
Effects of exchange rates on cash	(1,498)	962
Net decrease in cash and cash equivalents	(1,004,463)	(665,135)
Cash and cash equivalents at beginning of the period	1,944,334	1,677,844
Cash and cash equivalents at end of the period	$ 939,871	$ 1,012,709
Supplementary cash flow data:		
Income taxes paid	$ 19,747	$ 99,357
Interest paid on borrowings	13,494	37,634
Interest paid on deposits	1,336	1,820
Transfers of foreclosed loans to other assets	3,074	1,573
Accrued additions to property and equipment	7,107	3,376

See Notes to Consolidated Financial Statements

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated balance sheet as of July 31, 2012, the consolidated statements of operations and comprehensive income (loss) for the three months ended July 31, 2012 and 2011, and the condensed consolidated statements of cash flows for the three months ended July 31, 2012 and 2011 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 July 31, 2012 and for all periods presented have been made. See note 13 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, a 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, 2012 Annual Report to Shareholders on Form 10-K. All amounts presented herein as of April 30, 2012 or for the year then ended, are derived from our April 30, 2012 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 determination of contingent losses arising from our discontinued mortgage business, contingent losses associated with pending claims and litigation, allowance for loan losses, fair value of reporting units, 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.

2. 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 9.2 million shares for the three months ended July 31, 2012, and 14.5 million shares for the three months ended July 31, 2011, as the effect would be antidilutive due to the net loss from continuing operations during those periods.

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

	(in 000s, except per share amounts)	
Three months ended July 31,	2012	2011
Net loss from continuing operations attributable to shareholders	$ (105,650)	$ (119,155)
Amounts allocated to participating securities (nonvested shares)	(73)	(114)
Net loss from continuing operations attributable to common shareholders	$ (105,723)	$ (119,269)
Basic weighted average common shares	277,155	305,491
Potential dilutive shares		
Dilutive weighted average common shares	277,155	305,491
Loss per share from continuing operations:		
Basic	$ (0.38)	$ (0.39)
Diluted	(0.38)	(0.39)

The weighted average shares outstanding for the three months ended July 31, 2012 decreased to 277.2 million from 305.5 million for the three months ended July 31, 2011, primarily due to share repurchases completed during fiscal years 2013 and 2012. During the three months ended July 31, 2012, we purchased and immediately retired 21.3 million shares of our common stock at a cost of $315.0 million. The cost of shares retired during the current period was allocated to the components of stockholders equity as follows:

	(in 000s)
Common stock	$ 213
Additional paid-in capital	12,578
Retained earnings	302,209
	$ 315,000

In addition to the shares we repurchased as described above, during the three months ended July 31, 2012, we acquired 0.1 million shares of our common stock at an aggregate cost of $1.6 million. These shares represent shares swapped or surrendered to us in connection with the vesting or exercise of stock-based awards. During the three months ended July 31, 2011, we acquired 0.1 million shares at an aggregate cost of $2.0 million for similar purposes.

We also retired 60.0 million shares of treasury stock during the three months ended July 31, 2012. This retirement of treasury stock had no impact on our total consolidated stockholders equity. The cost of treasury shares retired during the current period was allocated to the following components of stockholders equity:

	(in 000s)
Common stock	$ 600
Additional paid-in capital	36,000
Retained earnings	1,104,197
	$ 1,140,797

During the three months ended July 31, 2012 and 2011, we issued 0.3 million and 0.5 million shares of common stock, respectively, due to the vesting or exercise of stock-based awards.

During the three months ended July 31, 2012, we granted 0.3 million stock options and 1.3 million nonvested units under our stock-based compensation plans. The weighted average fair value of options granted was $2.36. These awards 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 $2.4 million and $3.3 million for the three months ended July 31, 2012 and 2011, respectively. At July 31, 2012, unrecognized compensation cost for options totaled $6.0 million, and for nonvested shares and units totaled $31.8 million.

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3. Receivables

Short-term receivables of our continuing operations consist of the following:

			(in 000s)
As of	July 31, 2012	July 31, 2011	April 30, 2012
Loans to franchisees	$ 60,459	$ 62,313	$ 61,252
Receivables for tax preparation and related fees	35,194	36,203	42,286
Emerald Advance lines of credit	24,215	30,699	23,717
Royalties from franchisees	2,096	707	5,781
Other	37,870	42,652	105,411
	159,834	172,574	238,447
Allowance for doubtful accounts	(43,477)	(48,692)	(44,589)
	$ 116,357	$ 123,882	$ 193,858

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

		(in 000s)
	Emerald Advance Lines of Credit	Loans to Franchisees
As of July 31, 2012:		
Short-term	$ 24,215	$ 60,459
Long-term	11,689	112,810
	$ 35,904	$ 173,269
As of July 31, 2011:		
Short-term	$ 30,699	$ 62,313
Long-term	18,539	123,962
	$ 49,238	$ 186,275
As of April 30, 2012:		
Short-term	$ 23,717	$ 61,252
Long-term	13,007	109,837
	$ 36,724	$ 171,089

We review the credit quality of our 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 July 31, 2012, by year of origination, are as follows:

	(in 000s)
2012	$ 7,756
2011	6,637
2010	3,546

2009 and prior	5,111
Revolving loans	12,854
	$ 35,904

As of July 31, 2012 and April 30, 2012, $30.3 million and $31.4 million, respectively, of EAs were on non-accrual status and classified as impaired, or more than 60 days past due.

Loans made to franchisees at July 31, 2012 totaled $173.3 million, and consisted of $129.3 million in term loans made to finance the purchase of franchises and $44.0 million in revolving lines of credit made to existing franchisees primarily for the purpose of funding their off-season needs. Loans made to franchisees at April 30, 2012 totaled $171.1 million, and consisted of $127.0 million in term loans made to finance the purchase of franchises and $44.1 million in revolving lines of credit. As of July 31, 2012, loans totaling $1.1 million were past due; however, we had no loans to franchisees on non-accrual status.

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Activity in the allowance for doubtful accounts for the three months ended July 31, 2012 and 2011 is as follows:

				(in 000s)
	Emerald Advance Lines of Credit	Loans to Franchisees	All Other	Total
Balance as of April 30, 2012	$ 6,200	$	$ 38,389	$ 44,589
Provision			297	297
Charge-offs			(1,409)	(1,409)
Balance as of July 31, 2012	$ 6,200	$	$ 37,277	$ 43,477
Balance as of April 30, 2011	$ 4,400	$	$ 43,543	$ 47,943
Provision	950		423	1,373
Charge-offs			(624)	(624)
Balance as of July 31, 2011	$ 5,350	$	$ 43,342	$ 48,692

There were no changes to our methodology related to the calculation of our allowance for doubtful accounts during the three months ended July 31, 2012.

4. Mortgage Loans Held for Investment and Related Assets

The composition of our mortgage loan portfolio as of July 31, 2012 and April 30, 2012 is as follows:

				(dollars in 000s)
As of	July 31, 2012		April 30, 2012	
	Amount	% of Total	Amount	% of Total
Adjustable-rate loans	$ 222,474	55%	$ 238,442	56%
Fixed-rate loans	183,196	45%	190,870	44%
	405,670	100%	429,312	100%
Unamortized deferred fees and costs	3,274		3,429	
Less: Allowance for loan losses	(22,185)		(26,540)	
	$ 386,759		$ 406,201	

Our loan loss allowance as a percent of mortgage loans was 5.5% at July 31, 2012, compared to 6.2% at April 30, 2012.

Activity in the allowance for loan losses for the three months ended July 31, 2012 and 2011 is as follows:

		(in 000s)
Three months ended July 31,	2012	2011
Balance, beginning of the period	$ 26,540	$ 92,087
Provision	4,000	5,625

Recoveries	1,186	49
Charge-offs	(9,541)	(6,458)
Balance, end of the period	$ 22,185	$ 91,303

Our allowance decreased significantly from the prior year primarily due to a change in the fourth quarter of fiscal year 2012, whereby we now charge-off loans 180 days past due to the value of the collateral less costs to sell.

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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 TDRs, are evaluated individually. The balance of these loans and the related allowance is as follows:

(in 000s)

As of	July 31, 2012		April 30, 2012	
	Portfolio Balance	Related Allowance	Portfolio Balance	Related Allowance
Pooled	$ 238,999	$ 7,701	$ 248,772	$ 9,237
Impaired:				
Individually (TDRs)	67,587	6,931	71,949	7,752
Individually	99,084	7,553	108,591	9,551
	$ 405,670	$ 22,185	$ 429,312	$ 26,540

Our portfolio includes loans originated by Sand Canyon Corporation, previously known as Option One Mortgage Corporation, and its subsidiaries (SCC) and purchased by H&R Block Bank (HRB Bank), which constitute 58% of the total loan portfolio at July 31, 2012. We have experienced higher rates of delinquency and believe that we have greater exposure to loss with respect to this segment of our loan portfolio. Our remaining loan portfolio totaled $171.6 million at July 31, 2012 and is characteristic of a prime loan portfolio, and we believe therefore subject to a lower loss exposure. Detail of our mortgage loans held for investment and the related allowance at July 31, 2012 is as follows:

(dollars in 000s)

	Outstanding Principal Balance	Loan Loss Allowance Amount	Loan Loss Allowance % of Principal	% 30+ Days Past Due
Purchased from SCC	$ 234,040	$ 17,724	7.6%	34.9%
All other	171,630	4,461	2.6%	9.5%
	$ 405,670	$ 22,185	5.5%	24.1%

Credit quality indicators at July 31, 2012 include the following:

(in 000s)

Credit Quality Indicators	Purchased from SCC	All Other	Total Portfolio
Occupancy status:			
Owner occupied	$ 168,756	$ 109,934	$ 278,690
Non-owner occupied	65,284	61,696	126,980
	$ 234,040	$ 171,630	$ 405,670
Documentation level:			
Full documentation	$ 74,959	$ 125,811	$ 200,770
Limited documentation	7,080	17,750	24,830
Stated income	131,633	17,447	149,080
No documentation	20,368	10,622	30,990
	$ 234,040	$ 171,630	$ 405,670

Internal risk rating:			
High	$ 80,268	$	$ 80,268
Medium	153,772		153,772
Low		171,630	171,630
	$ 234,040	$ 171,630	$ 405,670

Loans given our internal risk rating of high were originated by SCC, generally have no documentation or are stated income, and are non-owner occupied. Loans given our internal risk rating of medium were generally full documentation or stated income, with loan-to-value at origination of more than 80%, and have credit scores at origination below 700. Loans given our internal risk rating of low were generally full documentation, with loan-to-value at origination of less than 80% and have credit scores greater than 700.

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Our mortgage loans held for investment include concentrations of loans to borrowers in certain states, which may result in increased exposure to loss as a result of changes in real estate values and underlying economic or market conditions related to a particular geographical location. Approximately 58% of our mortgage loan portfolio consists of loans to borrowers located in the states of Florida, California, New York and Wisconsin.

Detail of the aging of the mortgage loans in our portfolio as of July 31, 2012 is as follows:

						(in 000s)
	Less than 60 Days Past Due	60 89 Days Past Due	90+ Days Past Due [1]	Total Past Due	Current	Total
Purchased from SCC	$ 21,167	$ 2,658	$ 77,457	$ 101,282	$ 132,758	$ 234,040
All other	6,436	1,828	13,830	22,094	149,536	171,630
	$ 27,603	$ 4,486	$ 91,287	$ 123,376	$ 282,294	$ 405,670

[1] We do not accrue interest on loans past due 90 days or more.

Information related to our non-accrual loans is as follows:

		(in 000s)
As of	July 31, 2012	April 30, 2012
Loans:		
Purchased from SCC	$ 81,539	$ 88,347
Other	16,178	16,626
	97,717	104,973
TDRs:		
Purchased from SCC	3,398	3,166
Other	509	1,270
	3,907	4,436
Total non-accrual loans	$ 101,624	$ 109,409

Information related to impaired loans is as follows:

				(in 000s)
	Balance With Allowance	Balance With No Allowance	Total Impaired Loans	Related Allowance

As of July 31, 2012:								
Purchased from SCC	$	45,719	$	94,184	$	139,903	$	11,653
Other		8,199		18,569		26,768		2,831
	$	53,918	$	112,753	$	166,671	$	14,484
As of April 30, 2012:								
Purchased from SCC	$	56,128	$	97,591	$	153,719	$	14,917
Other		7,137		19,684		26,821		2,386
	$	63,265	$	117,275	$	180,540	$	17,303

Information related to the allowance for impaired loans is as follows:

		(in 000s)
As of	July 31, 2012	April 30, 2012
Portion of total allowance for loan losses allocated to impaired loans and TDR loans:		
Based on collateral value method	$ 7,553	$ 9,551
Based on discounted cash flow method	6,931	7,752
	$ 14,484	$ 17,303

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Information related to activities of our non-performing assets is as follows:

		(in 000s)
Three months ended July 31,	2012	2011
Average impaired loans:		
Purchased from SCC	$ 147,555	$ 230,150
All other	26,841	36,477
	$ 174,396	$ 266,627
Interest income on impaired loans:		
Purchased from SCC	$ 1,011	$ 1,556
All other	82	119
	$ 1,093	$ 1,675
Interest income on impaired loans recognized on a cash basis on non-accrual status:		
Purchased from SCC	$ 994	$ 1,498
All other	73	114
	$ 1,067	$ 1,612

Activity related to our real estate owned (REO) is as follows:

		(in 000s)
Three months ended July 31,	2012	2011
Balance, beginning of the period	$ 14,972	$ 19,532
Additions	3,074	1,573
Sales	(1,801)	(3,722)
Writedowns	(788)	(793)
Balance, end of the period	$ 15,457	$ 16,590

5. Investments in Available-for-Sale Securities

The amortized cost and fair value of securities classified as available-for-sale (AFS) held at July 31, 2012 and April 30, 2012 are summarized below:

								(in 000s)
As of	July 31, 2012				April 30, 2012			
	Amortized	Gross	Gross	Fair	Amortized	Gross	Gross	Fair

	Cost	Unrealized Gains	Unrealized Losses (1)	Value	Cost	Unrealized Gains	Unrealized Losses (1)	Value
Short-term:								
Municipal bonds	$ 1,006	$ 20	$	$ 1,026	$ 1,008	$ 29	$	$ 1,037
Long-term:								
Mortgage-backed securities	370,318	5,898	(78)	376,138	361,184	5,620	(121)	366,683
Municipal bonds	4,221	406		4,627	4,236	396		4,632
	374,539	6,304	(78)	380,765	365,420	6,016	(121)	371,315
Total	$ 375,545	$ 6,324	$ (78)	$ 381,791	$ 366,428	$ 6,045	$ (121)	$ 372,352