



JTH TAX, INC. AND SUBSIDIARIES
(d/b/a Liberty Tax Service)

Consolidated Financial Statements

April 30, 2010 and 2009

(With Independent Auditors' Report Thereon)



KPMG LLP
2100 Dominion Tower
999 Waterside Drive
Norfolk, VA 23510-3310

Independent Auditors' Report

The Board of Directors and Stockholders
JTH Tax, Inc.:

We have audited the accompanying consolidated balance sheets of JTH Tax, Inc. and subsidiaries (d/b/a Liberty Tax Service) (the Company) as of April 30, 2010 and 2009, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended April 30, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of JTH Tax, Inc. and subsidiaries as of April 30, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the three-year period ended April 30, 2010, in conformity with U.S. generally accepted accounting principles.

KPMG LLP

June 18, 2010

JTH TAX, INC. AND SUBSIDIARIES

(d/b/a Liberty Tax Service)

Consolidated Balance Sheets

April 30, 2010 and 2009

(In thousands)

Assets (Notes 6 and 7)	2010	2009
Current assets:		
Cash and cash equivalents	\$ 2,112	1,930
Short-term investments	—	13,336
Receivables (note 2):		
Trade accounts	30,914	27,775
Notes	28,379	27,203
Bank product and tax discounting, net	4,028	4,652
Interest	2,641	2,919
Allowance for uncollectible amounts	(3,786)	(4,045)
Total receivables, net	62,176	58,504
Prepaid expenses and other current assets	672	385
Deferred income taxes (note 9)	341	407
Total current assets	65,301	74,562
Property, equipment, and software, net (note 3)	13,127	17,426
Notes receivable, excluding current portion, net of allowance for uncollectible amounts of \$1,811 and \$1,949 for 2010 and 2009, respectively (note 2)	29,409	27,381
Goodwill	1,913	1,913
Other intangible assets, net (note 4)	16,107	10,237
Other assets, net	1,029	1,207
Total assets	<u>\$ 126,886</u>	<u>132,726</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Current installments of long-term debt (note 7)	\$ 2,079	2,710
Accounts payable and accrued expenses (notes 8 and 15)	8,384	9,707
Due to area developers	17,965	16,662
Income taxes payable (note 9)	6,579	7,045
Deferred revenue	5,213	4,571
Total current liabilities	40,220	40,695
Long-term debt, excluding current installments (note 7)	2,655	2,495
Line of credit (notes 6 and 8)	—	10,002
Deferred income taxes (note 9)	8,815	10,041
Total liabilities	51,690	63,233
Stockholders' equity (notes 8, 10, 11, and 13):		
Preferred stock	2,375	2,375
Special voting preferred stock	—	—
Common stock	11,630	11,860
Exchangeable shares	100	100
Additional paid-in capital	—	2,689
Accumulated other comprehensive income, net of taxes	121	47
Retained earnings	60,970	52,422
Total stockholders' equity	75,196	69,493
Commitments, contingencies, and subsequent events (notes 2, 3, 5, 6, 7, 15, and 16)		
Total liabilities and stockholders' equity	<u>\$ 126,886</u>	<u>132,726</u>

See accompanying notes to consolidated financial statements.

JTH TAX, INC. AND SUBSIDIARIES

(d/b/a Liberty Tax Service)

Consolidated Statements of Income

Years ended April 30, 2010, 2009, and 2008

(In thousands)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Revenues:			
Franchise fees, net of provision for franchise fee refunds of \$1,656 in 2010, \$1,193 in 2009, and \$1,821 in 2008	\$ 9,632	10,283	21,393
Royalties and advertising fees	39,760	31,639	26,341
Bank product and tax discounting income	20,343	23,868	22,546
Interest income (note 2)	8,876	8,783	7,511
Tax preparation fees, net of discounts	5,371	4,571	4,481
Gain on sale of intangibles and property and equipment, net	1,275	970	841
Other revenue	4,268	2,254	4,520
Total revenues	<u>89,525</u>	<u>82,368</u>	<u>87,633</u>
Operating expenses:			
Employee compensation and benefits	24,526	21,418	20,180
General and administrative expenses	21,775	20,352	22,459
Advertising expense	12,872	12,085	10,133
Interest expense (notes 6, 7, and 8)	1,749	1,574	2,002
Loss on discontinued use of software (note 3)	5,570	—	—
Depreciation, amortization, and impairment charges (notes 3 and 4)	7,503	5,508	4,975
Total operating expenses	<u>73,995</u>	<u>60,937</u>	<u>59,749</u>
Other, net	<u>2,354</u>	<u>(615)</u>	<u>96</u>
Income before income taxes	17,884	20,816	27,980
Income tax expense (note 9)	<u>6,882</u>	<u>8,737</u>	<u>11,114</u>
Net income	<u>\$ 11,002</u>	<u>12,079</u>	<u>16,866</u>

See accompanying notes to consolidated financial statements.

JTH TAX, INC. AND SUBSIDIARIES
(d/b/a Liberty Tax Service)

Consolidated Statement of Stockholders' Equity and Comprehensive Income

Year ended April 30, 2010

(In thousands)

	Common stock, Class A		Common stock, Class B		Preferred stock, Class A		Special voting preferred stock	
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount
Balance at May 1, 2009	10,960	\$ 10,960	900	\$ 900	190	\$ 2,375	—	\$ —
Exercise of stock options (note 11)	457	457	—	—	—	—	—	—
Repurchase of outstanding stock	(687)	(687)	—	—	—	—	—	—
Balance at April 30, 2010	10,730	\$ 10,730	900	\$ 900	190	\$ 2,375	—	\$ —

	Exchangeable shares		Additional paid-in capital	Accumulated other comprehensive income	Retained earnings	Total
	Shares	Amount				
Balance at May 1, 2009	100	\$ 100	2,689	47	52,422	69,493
Exercise of stock options (note 11)	—	—	2,821	—	—	3,278
Repurchase of outstanding stock	—	—	(7,077)	—	(2,454)	(10,218)
Stock-based compensation expense (note 11)	—	—	1,000	—	—	1,000
Stock option income tax benefit (note 9)	—	—	567	—	—	567
Net income	—	—	—	—	11,002	11,002
Interest rate swap derivative, net of taxes (note 8)	—	—	—	(470)	—	(470)
Foreign currency translation adjustment, net of taxes	—	—	—	544	—	544
Comprehensive income	—	—	—	—	—	11,076
Balance at April 30, 2010	100	\$ 100	—	121	60,970	75,196

See accompanying notes to consolidated financial statements.

JTH TAX, INC. AND SUBSIDIARIES
(d/b/a Liberty Tax Service)

Consolidated Statement of Stockholders' Equity and Comprehensive Income

Year ended April 30, 2009

(In thousands)

	Common stock, Class A		Common stock, Class B		Preferred stock, Class A		Special voting preferred stock	
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount
Balance at May 1, 2008	10,622	\$ 10,622	900	\$ 900	190	\$ 2,375	—	\$ —
Issuance of common stock in connection with purchase of customer lists (note 10)	42	42	—	—	—	—	—	—
Exercise of stock options (note 11)	443	443	—	—	—	—	—	—
Issuance of common stock (note 13)	424	424	—	—	—	—	—	—
Repurchase of outstanding stock	(571)	(571)	—	—	—	—	—	—
Balance at April 30, 2009	<u>10,960</u>	<u>\$ 10,960</u>	<u>900</u>	<u>\$ 900</u>	<u>190</u>	<u>\$ 2,375</u>	<u>—</u>	<u>\$ —</u>

	Exchangeable shares		Additional paid-in capital	Accumulated other comprehensive income	Retained earnings	Total
	Shares	Amount				
Balance at May 1, 2008	100	\$ 100	—	358	40,343	54,698
Issuance of common stock in connection with purchase of customer lists (note 10)	—	—	587	—	—	629
Exercise of stock options (note 11)	—	—	1,856	—	—	2,299
Issuance of common stock (note 13)	—	—	6,663	—	—	7,087
Repurchase of outstanding stock	—	—	(7,978)	—	—	(8,549)
Stock-based compensation expense (note 11)	—	—	1,055	—	—	1,055
Stock option income tax benefit (note 9)	—	—	506	—	—	506
Net income	—	—	—	—	12,079	12,079
Foreign currency translation adjustment, net of taxes	—	—	—	(311)	—	(311)
Comprehensive income	—	—	—	—	—	11,768
Balance at April 30, 2009	<u>100</u>	<u>\$ 100</u>	<u>2,689</u>	<u>47</u>	<u>52,422</u>	<u>69,493</u>

See accompanying notes to consolidated financial statements.

JTH TAX, INC. AND SUBSIDIARIES
(d/b/a Liberty Tax Service)

Consolidated Statement of Stockholders' Equity and Comprehensive Income

Year ended April 30, 2008

(In thousands)

	Common stock, Class A		Common stock, Class B		Preferred stock, Class A		Preferred stock, Class B	
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount
Balance at May 1, 2007	11,361	\$ 11,361	900	\$ 900	190	\$ 2,375	25	\$ 498
Issuance of common stock in connection with purchase of customer lists (note 10)	4	4	—	—	—	—	—	—
Exercise of stock options (note 11)	374	374	—	—	—	—	—	—
Repurchase of outstanding stock	(1,117)	(1,117)	—	—	—	—	(25)	(498)
Balance at April 30, 2008	<u>10,622</u>	<u>\$ 10,622</u>	<u>900</u>	<u>\$ 900</u>	<u>190</u>	<u>\$ 2,375</u>	<u>—</u>	<u>\$ —</u>

	Special voting preferred stock		Exchangeable shares		Additional paid-in capital	Accumulated other comprehensive income	Retained earnings	Total
	Shares	Amount	Shares	Amount				
Balance at May 1, 2007	—	\$ —	100	\$ 100	4,389	374	37,725	57,722
Issuance of common stock in connection with purchase of customer lists (note 10)	—	—	—	—	52	—	—	56
Exercise of stock options (note 11)	—	—	—	—	945	—	—	1,319
Repurchase of outstanding stock and stock options	—	—	—	—	(6,796)	—	(14,248)	(22,659)
Stock-based compensation expense (note 11)	—	—	—	—	869	—	—	869
Stock option income tax benefit (note 9)	—	—	—	—	541	—	—	541
Net income	—	—	—	—	—	—	16,866	16,866
Foreign currency translation adjustment, net of taxes	—	—	—	—	—	(16)	—	(16)
Comprehensive income	—	—	—	—	—	—	—	16,850
Balance at April 30, 2008	<u>—</u>	<u>\$ —</u>	<u>100</u>	<u>\$ 100</u>	<u>—</u>	<u>358</u>	<u>40,343</u>	<u>54,698</u>

See accompanying notes to consolidated financial statements.

JTH TAX, INC. AND SUBSIDIARIES
(d/b/a Liberty Tax Service)

Consolidated Statements of Cash Flows
Years ended April 30, 2010, 2009, and 2008

(In thousands)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Cash flows from operating activities:			
Net income	\$ 11,002	12,079	16,866
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	6,587	5,368	4,788
Write-down of impaired customer lists	916	140	187
Loss on discontinued use of software	5,570	—	—
Stock-based compensation	1,000	1,055	869
Provision for doubtful accounts and franchise fee refunds	4,095	5,459	5,374
Gain on sale of intangible assets and property and equipment, net	(1,275)	(970)	(841)
Deferred tax expense (benefit)	(1,203)	988	379
Unrealized loss on interest rate swap derivative	46	—	—
Unrealized loss on short-term investments	—	702	19
Realized gain on short-term investments	(2,454)	(1,464)	(23)
Changes in assets and liabilities increasing (decreasing) cash flows from operating activities:			
Trade accounts receivable	(16,114)	(13,305)	(12,133)
Notes receivable	5,129	8,084	(1,357)
Bank product and tax discounting receivables	1,284	(955)	536
Interest receivable	(607)	(1,396)	(819)
Prepaid expenses and other current assets	(287)	257	(188)
Other assets	(36)	22	(108)
Accounts payable and accrued expenses	1,322	2,174	3,600
Dividend receivable	—	51	(51)
Income taxes payable	(466)	(2,865)	3,211
Deferred revenue	3,531	(3,148)	4,327
Net cash provided by operating activities	<u>18,040</u>	<u>12,276</u>	<u>24,636</u>
Cash flows from investing activities:			
Issuance of operating loans to franchisees	(32,488)	(23,977)	(13,710)
Payments received on operating loans from franchisees	27,335	20,243	12,232
Purchases of assets from franchisees	(2,959)	(4,223)	(2,368)
Proceeds from sale of customer lists and other assets	419	424	879
Proceeds from sale of short-term investments	16,964	36,149	806
Purchases of short-term investments	(2,114)	(38,442)	(10,121)
Purchases of property and equipment	(5,514)	(2,866)	(1,737)
Net cash provided (used) in investing activities	<u>1,643</u>	<u>(12,692)</u>	<u>(14,019)</u>
Cash flows from financing activities:			
Proceeds from the exercise of stock options	3,278	2,299	1,319
Repayment of long-term debt	(2,720)	(2,706)	(16,286)
Repurchase of outstanding stock and stock options	(10,218)	(8,549)	(22,659)
Proceeds from the issuance of common stock	—	7,087	—
Net borrowings (repayments) under line of credit	(10,002)	164	9,838
Payment for debt issuance costs	—	(70)	(861)
Tax benefit of stock option exercises	567	506	541
Net cash used in financing activities	<u>(19,095)</u>	<u>(1,269)</u>	<u>(28,108)</u>
Effect of exchange rate changes on cash, net	<u>(406)</u>	<u>685</u>	<u>(493)</u>
Net increase (decrease) in cash and cash equivalents	182	(1,000)	(17,984)
Cash and cash equivalents at beginning of year	<u>1,930</u>	<u>2,930</u>	<u>20,914</u>
Cash and cash equivalents at end of year	\$ <u>2,112</u>	<u>1,930</u>	<u>2,930</u>

JTH TAX, INC. AND SUBSIDIARIES
(d/b/a Liberty Tax Service)

Consolidated Statements of Cash Flows
Years ended April 30, 2010, 2009, and 2008

(In thousands)

	2010	2009	2008
Supplemental disclosures of cash flow information:			
Cash paid for interest	\$ 1,830	1,694	2,357
Cash paid for taxes	8,087	10,217	6,958
Supplemental disclosures of noncash investing and financing activities:			
During the years ended April 30, 2010, 2009, and 2008, the Company acquired certain assets from franchisees as follows:			
Fair value of assets purchased	\$ 13,749	9,316	6,412
Receivables applied	(14,259)	(10,491)	(6,132)
Accounts payable canceled	2,709	1,535	1,449
Liabilities assumed	—	(4)	(47)
Notes payable issued	(2,257)	(1,603)	—
Deferred revenue recognized	3,231	5,110	682
Common stock issued	—	(629)	(30)
Applied from sales of franchise territories	(214)	989	34
Cash paid to franchisees	\$ 2,959	4,223	2,368
During the years ended April 30, 2010, 2009, and 2008, the Company sold certain assets to franchisees as follows:			
Book value of assets sold	\$ 4,925	3,761	4,162
Gain on sale	546	1,899	476
Deferred gain on sale	1,745	662	1,218
Applied from acquisitions of franchise territories	(204)	(56)	(248)
Notes received	(6,593)	(5,842)	(4,729)
Cash received from franchisees	\$ 419	424	879

See accompanying notes to consolidated financial statements.

JTH TAX, INC. AND SUBSIDIARIES
(d/b/a Liberty Tax Service)

Notes to Consolidated Financial Statements

April 30, 2010 and 2009

(1) Organization and Significant Accounting Policies

(a) Organization

JTH Tax, Inc. and subsidiaries (d/b/a Liberty Tax Service) (the Company) is a franchisor and operator of a system of offices in the United States and Canada engaged in the preparation of income tax returns. Through this system of offices, the Company also facilitates to its customers refund-based financial products such as refund anticipation loans, electronic refund checks, and personal income tax refund discounting. The Company operates under the trade name “Liberty Tax Service.” The Company also offers online tax preparation services. The Company was formed in October 1996 as a Delaware corporation.

(b) Principles of Consolidation

The consolidated financial statements include the accounts of JTH Tax, Inc. and its wholly owned subsidiaries. Assets and liabilities of the Canadian subsidiary have been translated into U.S. dollars using the exchange rate in effect at the end of the year. The revenues and expenses have been translated using the average exchange rates in effect each month of the year. Transaction gains and losses are recognized in income when incurred. In accordance with the Variable Interest Entity (VIE) Subsections of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 810-10 *Consolidation – Overall* (FASB Interpretation No. 46(R), *Consolidation of Variable Interest Entities*), the Company also consolidates any variable interest entities of which it is the primary beneficiary, as defined. When the Company does not have a controlling interest in an entity, but exerts significant influence over the entity, the Company applies the equity method of accounting. All significant intercompany balances and transactions have been eliminated in consolidation.

(c) Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, the Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

(d) Short-Term Investments

Short-term investments consist of equity securities and related dividends receivable. The Company has classified these investments as trading securities in accordance with FASB ASC Topic 320, *Investments – Debt and Equity Securities* (FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*). Trading securities are recorded at fair value with changes in fair value reported within the consolidated statements of income. Net realized gains on trading securities and unrealized losses on trading securities held at each year-end are included in “other income (expense), net.” Fair value of all short-term investments is based on Level 1 inputs (note 12).

(e) Trade Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount and bear interest at 18% annually once they have aged greater than 30 days. Finance charges are fully reserved and are only recognized in income when they have been paid. The allowance for doubtful accounts includes the Company’s best estimate of the amount of probable credit losses in the Company’s existing accounts receivable.

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Because the repayment of accounts receivable is dependent on the performance of the underlying franchisees, management estimates the amount of the allowance for doubtful accounts based on a comparison of amounts due to the estimated fair value of the underlying franchise. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance-sheet credit exposure related to its accounts receivable.

(f) Notes Receivable

Notes receivable are recorded at cost, less the related allowance for doubtful accounts. Because the repayment of the notes receivable is dependent on the performance of the underlying franchise that collateralizes the note, management estimates the amount of the allowance for doubtful accounts based on a comparison of amounts due to the estimated fair value of the underlying franchise. The Company provides an allowance against accrued interest on a delinquent note when a scheduled payment becomes 90 days past due or the recorded value of the note receivable exceeds the value of the underlying franchise. Loans are written off against the allowance when all possible means of collection have been exhausted and the potential for recovery is considered remote.

(g) Property, Equipment, and Software

Property, equipment, and software are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are calculated using the straight-line method over the estimated useful lives of the depreciable assets, generally three to five years for computer equipment, three to seven years for software, seven years for furniture and fixtures, and twenty to thirty-five years for buildings. Leasehold improvements are amortized over the lesser of the lease term or the estimated useful lives of the assets.

(h) Goodwill

Goodwill represents the excess of costs over fair value of assets of businesses acquired. Goodwill is not amortized, but instead tested for impairment at least annually in accordance with the provisions of FASB ASC Topic 350, *Intangibles – Goodwill and Other* (FASB Statement No. 142, *Goodwill and Other Intangible Assets*). Goodwill is tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. This determination is made at the reporting unit level and consists of two steps. First, the Company determines the fair value of a reporting unit and compares it with its carrying amount. Second, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with FASB ASC Topic 805, *Business Combinations* (FASB Statement No. 141, *Business Combinations*). The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed.

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Notes to Consolidated Financial Statements

April 30, 2010 and 2009

During 2010, 2009, and 2008, the Company performed its annual impairment review of goodwill and concluded that there was no impairment.

(i) *Deferred Revenue*

The Company may receive all or part of the initial franchise fee or proceeds from the gain on sale of Company-owned stores prior to the execution of the franchise agreement or completion of the earnings process. These amounts are classified as deferred revenue until the franchise fee or gain qualifies to be recognized as revenue or is refunded.

(j) *Revenue Recognition*

Franchise fee revenue, net of a provision for franchise fee refunds, is recognized when obligations of the Company to prepare the franchisee for operation have been substantially completed. Franchise fees are also recognized from area developer sales wherein the Company sells a cluster of territories to an individual. Franchise fees that are financed by the Company are recorded as deferred revenue until such time as the unit franchisee or area developer has made a significant financial commitment (20% of the franchise fee).

Royalties and advertising fees are recognized currently as the franchised territory generates sales. Tax return preparation fees, bank product, and tax discounting fees are recognized as revenue in the period the related tax return is filed or prepared for the customer. Discounts for promotional programs are recorded at the time the return is prepared.

Gains on sales of Company-owned stores, which are financed by the Company, are deferred until the franchisee has made a significant financial commitment (20%). Losses on sales of Company-owned stores are recognized immediately.

(k) *Derivative Instruments and Hedging Activities*

The Company accounts for derivatives and hedging activities in accordance with FASB ASC Topic 815, *Derivatives and Hedging* (FASB Statement No. 133, *Accounting for Derivative Instruments and Certain Hedging Activities*, as amended), which requires entities to recognize all derivative instruments as either assets or liabilities in the balance sheet at their respective fair values. For derivatives designated in hedging relationships, changes in the fair value are either offset through earnings against the change in fair value of the hedged item attributable to the risk being hedged or recognized in accumulated other comprehensive income, to the extent the derivative is effective at offsetting the changes in cash flows being hedged until the hedged item affects earnings. Fair value of derivatives is based on Level 2 inputs (note 12).

The Company only enters into derivative contracts that it intends to designate as a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge). For all hedging relationships, the Company formally documents the hedging relationship and its risk-management objective and strategy for undertaking the hedge, the hedging instrument, the hedged transaction, the nature of the risk being hedged, how the hedging instrument's effectiveness in offsetting the hedged risk will be assessed prospectively and retrospectively, and a description of the method used to measure ineffectiveness. The Company also

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Notes to Consolidated Financial Statements

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formally assesses, both at the inception of the hedging relationship and on an ongoing basis, whether the derivatives that are used in hedging relationships are highly effective in offsetting changes in cash flows of hedged transactions. For derivative instruments that are designated and qualify as part of a cash flow hedging relationship, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

The Company discontinues hedge accounting prospectively when it determines that the derivative is no longer effective in offsetting cash flows attributable to the hedged risk, the derivative expires or is sold, terminated, or exercised, the cash flow hedge is dedesignated because a forecasted transaction is not probable of occurring, or management determines to remove the designation of the cash flow hedge.

In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Company continues to carry the derivative at its fair value on the balance sheet and recognizes any subsequent changes in its fair value in earnings. When it is no longer probable that a forecasted transaction will occur, the Company discontinues hedge accounting and recognizes immediately in earnings gains and losses that were accumulated in other comprehensive income related to the hedging relationship.

On May 1, 2009, the Company adopted the provisions of FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (included in ASC Subtopic 815-10, *Derivatives and Hedging – Overall*), which amends the disclosure requirements for derivative instruments and hedging activities. The amended disclosures require entities to provide information to enable users of the financial statements to understand how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under ASC Topic 815, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows.

(l) Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

In July 2006, the FASB Interpretation No. 48 (FIN 48) issued, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (included in FASB ASC Subtopic 740-10, *Income Taxes – Overall*). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a threshold of more likely than not for recognition of tax benefits of uncertain tax positions taken or expected to be taken in a tax return.

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FIN 48 also provides related guidance on measurement, derecognition, classification, interest and penalties, and disclosure. FIN 48 requires the recognition of interest, if the tax law would require interest to be paid on the underpayment of taxes, and recognition of penalties, if a tax position does not meet the minimum statutory threshold to avoid payment of penalties. Penalties and interest may be classified as either penalties and interest expense or income tax expense. Management has elected to classify accrued interest in interest expense and accrued penalties in general and administrative expenses. The Company adopted the provisions of FIN 48 effective May 1, 2006.

(m) Long-Lived Assets

In accordance with FASB ASC Subtopic 360-10, *Property, Plant, and Equipment – Overall – Impairment of Long Lived Assets* (FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*), long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values, and third-party independent appraisals, as considered necessary. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held-for-sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

(n) Comprehensive Income

Comprehensive income consists of net income, the foreign currency translation adjustment, and the interest rate swap derivative and is presented in the accompanying consolidated statements of stockholders' equity and comprehensive income.

(o) Advertising Expenses

Advertising costs are expensed in the period incurred.

(p) Stock-Based Compensation

The Company accounts for its employee stock-based compensation awards in accordance with ASC Topic 718, *Compensation – Stock Compensation*. ASC Topic 718 requires that all employee stock-based compensation is recognized as a cost in the financial statements and that for equity-classified awards, such cost is measured at the grant-date fair value of the award. The Company estimates grant-date fair value using the Black-Scholes-Merton option pricing model. ASC Topic 718 also requires that excess tax benefits recognized in equity related to stock option exercises are reflected as financing cash inflows.

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(q) Use of Estimates

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period to prepare these consolidated financial statements and accompanying notes in conformity with U.S. generally accepted accounting principles. Actual results could differ from those estimates.

(r) Reclassification

Certain 2009 and 2008 amounts have been reclassified to conform to the 2010 financial statement presentation.

(s) Recently Issued Accounting Standards

The FASB issued Accounting Standard Update (ASU) 2009-17, *Consolidations* (Topic 810): *Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities* (FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*), in December 2009. ASU 2009-17, which amends the VIE Subsections of ASC Subtopic 810-10, revises the test for determining the primary beneficiary of a VIE from a primarily quantitative risks and rewards analysis based on the VIE's expected losses and expected residual returns to a primarily qualitative analysis based on identifying the party or related-party group (if any) with (a) the power to direct the activities that most significantly impact the VIE's economic performance and (b) the obligation to absorb losses of, or the right to receive benefits from, the VIE that could potentially be significant to the VIE. The ASU requires kick-out rights and participating rights to be ignored in evaluating whether a variable interest holder meets the power criterion unless those rights are unilaterally exercisable by a single party or related-party group. The ASU also revises the criteria for determining whether fees paid by an entity to a decision maker or another service provider are a variable interest in the entity and revises the Topic 810 scope characteristic that identifies an entity as a VIE if the equity-at-risk investors as a group do not have the right to control the entity through their equity interests to address the impact of kick-out rights and participating rights on the analysis. Finally, the ASU adds a new requirement to reconsider whether an entity is a VIE if the holders of the equity investment at risk as a group lose the power, through the rights of those interests, to direct the activities that most significantly impact the VIE's economic performance, and requires a company to reassess on an ongoing basis whether it is deemed to be the primary beneficiary of a VIE. ASU 2009-17 is effective for the year ending April 30, 2011 and may not be early adopted. The Company expects that the adoption of ASU 2009-17 will not have a material impact on its consolidated financial statements.

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(2) Notes and Accounts Receivable

The Company provides financing to franchisees for the purchase of franchises and/or for working capital and equipment needs. The franchise-related notes generally are payable over five years and the working capital and equipment notes generally are payable within one year. The notes typically bear interest at 12%. Transactions for 2010 and 2009 are as follows:

	2010	2009
	(In thousands)	
Balance at beginning of year	\$ 56,533	60,498
Notes issued:		
Sales of franchise territories	10,600	5,691
Sales of Company-owned stores	6,593	5,842
Franchisee to franchisee note assumptions	6,094	5,312
Operating loans to franchisees	32,488	23,977
Refinancing of notes and accounts receivable	12,441	6,055
Repayment of notes	(43,844)	(33,167)
Notes canceled	(21,925)	(17,084)
Foreign currency adjustment	619	(591)
Balance at end of year	\$ 59,599	56,533

Notes receivable reflected on the accompanying consolidated balance sheets include notes related to the sale of Company-owned stores, as well as loans to franchisees for franchise fees, working capital, and equipment. Most of the notes receivable reflected on the accompanying consolidated balance sheets are due from the Company's franchisees. The notes are collateralized by the underlying franchise and are guaranteed by the respective franchisee and franchise owner(s). The franchisees' ability to repay the notes is dependent upon both the performance of the tax preparation industry as a whole and the individual franchisee. Management believes that the recorded allowance is adequate based upon its consideration of the estimated value of the franchises supporting the receivables. Any adverse change in the tax preparation industry could affect the Company's estimate of the allowance.

Notes and accounts receivable on the accompanying consolidated balance sheets include royalties billed and loans to franchisees for franchise fees that relate to territories operated by franchisees under area developers. The Company has recorded amounts payable to area developers relating to these receivables of \$17,965,000 and \$16,662,000 at April 30, 2010 and 2009, respectively.

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At April 30, 2010 and 2009, the Company had an investment in impaired notes and related interest receivable of \$8,117,000 and \$9,150,000, respectively, which had recorded values that exceeded the fair value of the underlying collateral by approximately \$229,000 and \$429,000, respectively. In addition, the Company had trade accounts receivable due from these franchisees of \$3,990,000 and \$3,853,000 at April 30, 2010 and 2009, respectively. The Company has reflected an allowance of \$4,219,000 and \$4,282,000, respectively, for this impairment in the accompanying consolidated balance sheets. Activity in the allowance for doubtful accounts for the years ended April 30, 2010, 2009, and 2008 is summarized as follows:

	2010	2009	2008
		(In thousands)	
Beginning balance	\$ 5,994	5,865	5,177
Additions charged to expense	2,439	4,266	3,553
Provision for franchise fee refunds	1,656	1,193	1,821
Write-offs	(4,683)	(5,185)	(4,733)
Foreign currency adjustment	191	(145)	47
Ending balance	\$ 5,597	5,994	5,865

The Company's average investment in impaired notes receivable during the years ended April 30, 2010 and 2009 was \$8,646,000 and \$8,429,000, respectively. Interest income related to impaired notes was \$368,000, \$914,000, and \$417,000 for the years ended April 30, 2010, 2009, and 2008, respectively. The Company's investment in notes receivable on nonaccrual status as of April 30, 2010 and 2009 was \$10,148,000 and \$10,955,000, respectively.

(3) Property, Equipment, and Software, Net

Property, equipment, and software, net consists of the following at April 30, 2010 and 2009:

	2010	2009
	(In thousands)	
Land	\$ 947	935
Buildings	6,997	3,526
Leasehold improvements	276	243
Furniture, fixtures, and equipment	3,832	3,062
Software	11,232	19,664
Construction in progress	—	594
	23,284	28,024
Less accumulated depreciation and amortization	10,157	10,598
Property, equipment, and software, net	\$ 13,127	17,426

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The software included above includes both internally developed software and purchased software. In April 2010, the Company decided to discontinue its use of the software associated with its online tax preparation services in April 2010. This software had a net book value of \$5,570,000 when the decision was made and was expensed for the year ended April 30, 2010.

(4) Other Intangible Assets, Net

Other intangible assets, net consist of the following at April 30, 2010 and 2009:

	Amortization period	2010	2009
		(In thousands)	
Customer lists	5 years	\$ 4,742	3,477
Area franchise rights	10 years	14,502	8,560
		19,244	12,037
Less accumulated amortization		3,137	1,800
Intangible assets, net		\$ 16,107	10,237

Amortization and impairment charges for the years ended April 30, 2010, 2009, and 2008 were \$3,270,000, \$1,650,000, and \$1,331,000, respectively. Estimated amortization expense for the next five years is \$2,387,000 in 2011, \$2,347,000 in 2012, \$2,298,000 in 2013, \$2,130,000 in 2014, and \$1,803,000 in 2015.

(5) Leases

The Company is obligated under various operating leases for office space that expire at various dates. Future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) together with amounts due from franchisees under subleases as of April 30, 2010 are (in thousands):

	Lease payments	Sublease receipts
Year ending April 30:		
2011	\$ 2,916	1,818
2012	2,295	1,493
2013	1,331	868
2014	517	421
2015	286	244
Thereafter	272	272
Total minimum lease payments	\$ 7,617	5,116

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Total rent expense for operating leases, net of subleases, was approximately \$1,815,000, \$1,658,000, and \$1,373,000 for the years ended April 30, 2010, 2009, and 2008, respectively.

(6) Line of Credit

In June 2007, the Company entered into a line of credit allowing borrowings up to \$60,000,000 at LIBOR plus 1.450%, which was scheduled to expire on August 31, 2009. During February 2008, the Company replaced the \$60,000,000 line of credit with a syndicated line of credit with 10 financial institutions, which allows for borrowings up to \$100,000,000 and accrues interest at one-month LIBOR plus a margin ranging from 1.250% to 2.000% depending on the Company's leverage ratio. At April 30, 2010, the rate was 1.624%. The line is collateralized by all the assets of the Company and expires on March 31, 2013. The line of credit contains certain financial covenants, which the Company must meet, including leverage and fixed charge coverage ratios as well as minimum net worth requirements and capital expenditure limitations. Based on these ratios, the Company's borrowing capacity on the line of credit at April 30, 2010 was \$93,943,000.

(7) Long-Term Debt

Long-term debt at April 30, 2010 and 2009 consists of the following:

	2010	2009
	(In thousands)	
Mortgage note payable to a bank in monthly installments of \$16 including interest at 6.06% through September 2016; at which time a balloon payment of \$2,213 is payable; collateralized by land and building.	\$ 2,486	2,521
Notes payable for acquired assets from franchisees, interest rates ranging from 4% to 12%; due May 2010 through May 2011.	2,248	837
Term note payable for software purchase, payable in three annual installments of \$2,000 at 0% interest beginning December 2007; interest has been imputed at 8%.	—	1,847
Total long-term debt	4,734	5,205
Less current installments	2,079	2,710
Total long-term debt, less current installments	\$ 2,655	2,495

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Aggregate maturities of long-term debt as of April 30, 2010 are as follows (in thousands):

Year ending April 30:		
2011	\$	2,079
2012		244
2013		41
2014		44
2015		47
Thereafter		<u>2,279</u>
Total long-term debt	\$	<u><u>4,734</u></u>

(8) Derivative Instruments and Hedging Activities

The Company uses interest-rate-related derivative instruments to manage its exposure related to changes in interest rates on its variable-rate line of credit. The Company does not enter into derivative instruments for any purpose other than cash flow hedging. The Company does not speculate using derivative instruments.

By using derivative financial instruments to hedge exposures to changes in interest rates, the Company exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Company, which creates credit risk for the Company. When the fair value of a derivative contract is negative, the Company owes the counterparty, and therefore, the Company is not exposed to the counterparty's credit risk in those circumstances. The Company minimizes counterparty credit risk in derivative instruments by entering into transactions with high-quality counterparties. The derivative instruments entered into by the Company do not contain credit-risk-related contingent features.

Market risk is the adverse effect on the value of a derivative instrument that results from a change in interest rates. The market risk associated with interest-rate contracts is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

The Company assesses interest rate risk by continually identifying and monitoring changes in interest rate exposures that may adversely impact expected future cash flows and by evaluating hedging opportunities. The Company maintains risk management control systems to monitor interest rate risk attributable to both the Company's outstanding or forecasted debt obligations as well as the Company's offsetting hedge positions. The risk management control systems involve the use of analytical techniques, including cash flow sensitivity analysis, to estimate the expected impact of changes in interest rates on the Company's future cash flows.

The Company uses borrowings under a line of credit, which bears interest at the variable-rate London Interbank Offered Rate (LIBOR), to finance its operations. The debt obligations expose the Company to variability in interest payments due to changes in interest rates. Management believes that it is prudent to limit the variability of a portion of its interest payments. To meet this objective, management entered into LIBOR based interest rate swap agreements on July 1, 2009 to manage fluctuations in cash flows resulting from changes in the benchmark interest rate of LIBOR. These swaps change the variable-rate cash flow exposure on the debt obligations to fixed cash flows. Under the terms of the interest rate swaps, the

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Company receives LIBOR based variable interest rate payments and makes fixed interest rate payments, thereby creating the equivalent of fixed-rate debt for the notional amount of its debt hedged. As of April 30, 2010, the total notional amount of the Company's outstanding interest-rate swap agreements that were entered into to hedge outstanding or forecasted debt obligations varies from \$10,000,000 to \$70,000,000, in correlation to the Company's forecasted seasonal borrowings throughout the fiscal year.

Changes in the fair value of interest rate swaps designated as hedging instruments that effectively offset the variability of cash flows associated with variable-rate, long-term debt obligations are reported in accumulated other comprehensive income. These amounts subsequently are reclassified into interest expense as a yield adjustment of the hedged interest payments in the same period in which the related interest affects earnings.

As of April 30, 2010, there are no deferred gains on derivative instruments accumulated in other comprehensive income that are expected to be reclassified to earnings during the next 12 months. There were no cash flow hedges discontinued during 2010.

As of April 30, 2010, the fair value of interest rate swaps designated as hedging instruments held was \$821,000 and was included in accounts payable and accrued expenses.

(9) Income Taxes

Total income taxes were allocated as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
		(In thousands)	
Income from continuing operations	\$ 6,882	8,737	11,114
Stock option income tax benefit	(567)	(506)	(541)
Interest rate swap derivative	(305)	—	—
Foreign currency translation adjustment	351	(206)	238
Total income taxes	<u>\$ 6,361</u>	<u>8,025</u>	<u>10,811</u>

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Components of income tax expense for the years ended April 30, 2010, 2009, and 2008 were as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
		(In thousands)	
Current:			
Federal	\$ 5,857	6,318	8,392
State	1,215	1,137	1,530
Foreign	1,013	294	813
Current tax expense	<u>8,085</u>	<u>7,749</u>	<u>10,735</u>
Deferred:			
Federal	(991)	838	324
State	(206)	150	59
Foreign	(6)	—	(4)
Deferred tax expense (benefit)	<u>(1,203)</u>	<u>988</u>	<u>379</u>
Total income tax expense	<u>\$ 6,882</u>	<u>8,737</u>	<u>11,114</u>

The Company's effective tax expense (computed by multiplying income before income taxes by the U.S. federal statutory rate of 35% in 2010, 2009, and 2008) differs from tax expense for the years ended April 30, 2010, 2009, and 2008 as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
		(In thousands)	
Computed "expected" income tax expense	\$ 6,259	7,285	9,793
Increase (decrease) in income taxes resulting from:			
State income taxes, net of federal benefit	676	836	1,033
Change in taxes resulting from permanent differences, net	295	753	270
Other	(348)	(137)	18
Total income tax expense	<u>\$ 6,882</u>	<u>8,737</u>	<u>11,114</u>

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The tax effect of temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities that give rise to significant portions of deferred tax assets and liabilities at April 30, 2010 and 2009 are as follows:

	2010	2009
	(In thousands)	
Deferred tax assets:		
Unexercised nonqualified stock options	\$ 586	393
Accounts payable and accrued liabilities	84	122
Allowance for doubtful accounts	2,442	2,948
Interest rate swap derivative	305	—
Total deferred tax assets	3,417	3,463
Deferred tax liabilities:		
Property, equipment, and software and other intangible assets	3,213	4,386
Deferred revenue	8,062	8,554
Prepaid expenses	233	125
Foreign currency translation adjustment	383	32
Total deferred tax liabilities	11,891	13,097
Net deferred tax liability	\$ (8,474)	(9,634)

In assessing the realizability of the gross deferred tax assets, management considers whether it is more likely than not that some portion or all the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences.

In April 2008, the Internal Revenue Service completed audits of 2005 and 2006. As of April 30, 2010, the tax years that remain subject to examination by the Internal Revenue Service are 2007 and subsequent years, and years that remain open for other major taxing jurisdictions are 2007 and subsequent years.

(10) Stockholders' Equity

(a) Preferred Stock and Exchangeable Shares

The Company has 3,200,000 shares of authorized preferred stock with a par value of \$1.

The holders of the Class A preferred stock are entitled to a dividend if a dividend is declared for common stock and shall receive a dividend as if each share of preferred stock had been converted to Class A common stock in accordance with the conversion ratio, and a liquidation preference upon

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the liquidation, dissolution, or consolidation of the Company. In the event of liquidation, dissolution, or consolidation, the holders of Class A preferred stock will be entitled to receive out of the assets of the Company, after payment or provision for payment of the debts or other liabilities of the Company, the original issue price per share for each share of preferred stock then outstanding, plus an amount equal to the original issue price per share multiplied by 10% per annum from the original issue date, compounded annually to the date of such distribution. The liquidation value of the Class A preferred stock was \$6,776,000 and \$6,160,000 as of April 30, 2010 and 2009, respectively. Its carrying amount was \$2,375,000 at April 30, 2010 and 2009.

A holder of the Class A preferred stock may, at the holder's option, elect to convert each share of the Class A preferred stock into 10 shares of fully paid and nonassessable shares of Class A common stock.

During 2008, the Company reacquired all outstanding shares of Class B preferred stock and dissolved this class of stock.

In October 2001, the Company acquired the remaining 40% of the outstanding common stock of the Canadian subsidiary in a transaction, which was accounted for as a purchase. The Company issued consideration to the minority shareholder consisting of 1,600,000 shares of Class A common stock, 10 shares of special voting preferred stock, and 100,000 shares of exchangeable shares in exchange for \$2,000,000 in cash and the 40% minority interest in the Canadian subsidiary. The 100,000 exchangeable shares are exchangeable at any time at a 10:1 ratio into the Class A common stock of the Company. The special voting preferred shares issued have a \$1 par value and no liquidation value and entitle the holder to vote each share as if it represented 100,000 shares of Class A common stock. These shares will be canceled as the holder exchanges the exchangeable shares.

(b) Common Stock

The Company is authorized to issue 21,200,000 shares of Class A common stock, par value \$1 per share and 1,000,000 shares of Class B common stock, par value \$1 per share. Class A common stock and Class B common stock entitle the holders thereof to the same rights and privileges and are identical in all respects as to all matters, except the holders of Class B common stock are entitled to elect one more director than the number of directors elected by holders of all other classes of stock combined. Also, a holder of Class B common stock may, at the holder's option, elect to convert the Class B common stock into an equal number of fully paid and nonassessable shares of Class A common stock.

During 2009 and 2008, in connection with the acquisition of certain assets, the Company issued a total of 42,000 and 4,000 shares, respectively, of Class A common stock.

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(11) Stock Compensation Plan

In May 1998, the board of directors approved the JTH Tax, Inc. Stock Option Plan (the Plan). Employees and outside directors are eligible to receive awards under the Plan, and 5,500,000 shares of Class A common stock have been authorized for grant under the Plan. At April 30, 2010, approximately 927,000 shares of Class A common stock are available for grant under the Plan. Stock options vest from six months to five years from the date of grant and generally expire five years from the vesting date.

The weighted average fair value of each option granted in 2010 was \$1.95 estimated on the dates of grant using an option pricing model with the following assumptions: dividend yield of 0%, expected volatility of 12.87% – 13.18%, risk-free interest rates of 1.47% – 2.48%, and expected lives of four to five years. The weighted average fair value of each option granted in 2009 was \$3.02 estimated on the dates of grant using an option pricing model with the following assumptions: dividend yield of 0%, expected volatility of 13.81% – 14.46%, risk-free interest rates of 2.06% – 3.57%, and expected lives of four to six years.

The following table summarizes all stock option activity during the periods indicated:

	Number of options	Weighted average exercise price
Outstanding at April 30, 2007	2,064,250	\$ 6.34
Granted	530,120	10.87
Exercised	(373,450)	3.53
Canceled	(108,550)	8.60
Outstanding at April 30, 2008	2,112,370	7.85
Granted	558,800	15.02
Exercised	(442,700)	5.19
Canceled	(114,700)	11.97
Outstanding at April 30, 2009	2,113,770	10.08
Granted	384,200	15.02
Exercised	(457,350)	7.17
Canceled	(69,900)	13.01
Outstanding at April 30, 2010	<u>1,970,720</u>	11.61

All stock options were granted to employees of the Company except for options issued to nonemployee directors. Nonemployee directors were granted a total of 50,000, 80,000, and 50,000 stock options during the years ended April 30, 2010, 2009, and 2008, respectively.

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The following table summarizes nonvested stock option activity during the periods indicated:

	Nonvested options	Weighted average exercise price
Outstanding at April 30, 2007	106,664	\$ 7.25
Granted	265,000	11.21
Vested	(163,332)	9.02
Canceled	(11,666)	9.00
Outstanding at April 30, 2008	196,666	11.17
Granted	270,000	15.00
Vested	(126,666)	12.78
Canceled	(65,000)	12.40
Outstanding at April 30, 2009	275,000	13.90
Granted	40,000	15.00
Vested	(107,500)	12.76
Canceled	(30,000)	15.00
Outstanding at April 30, 2010	177,500	14.65

At April 30, 2010, there were \$550,000 of total unrecognized compensation costs related to nonvested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized between 2011 and 2013.

The following tables summarize information about stock options outstanding and exercisable at April 30, 2010:

Number of shares outstanding at April 30, 2010	Range of exercise prices	Weighted average exercise price	Weighted average remaining contractual life	Number of shares exercisable at April 30, 2010	Weighted average exercise price
160,000	\$ 5.50 – 6.25	5.69	1.8 years	160,000	\$ 5.69
93,332	7.00 – 7.50	7.21	1.2 years	93,332	7.21
199,718	8.50 – 9.00	8.55	0.8 year	199,718	8.55
241,100	9.00 – 9.90	9.04	1.0 year	241,100	9.04
387,720	10.50 – 11.55	10.52	3.1 years	375,220	10.52
888,850	14.00 – 16.50	15.00	4.3 years	723,850	15.01

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(12) Fair Value of Financial Instruments

The consolidated financial statements include various estimated fair value information as of April 30, 2010 and 2009. FASB ASC Topic 820, *Fair Value Measurements and Disclosures*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial assets and liabilities subject to fair value measurements on a recurring basis are classified according to a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. Level 1 represents observable inputs such as quoted prices in active markets. Level 2 is defined as quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuations in which all significant inputs are observable in the market. Level 3 is defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. Disclosure of the estimated fair values of financial instruments often requires the use of estimates. The Company uses the following methods and assumptions to estimate the fair value of financial instruments.

Cash and cash equivalents, trade accounts receivable, bank product and tax discounting, other current assets, accounts payable and accrued expenses, due to area developers, and deferred revenue: The carrying amounts approximate fair value because of the short maturity of these instruments.

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

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

Financial instruments that could potentially subject the Company to concentrations of credit risks consist of accounts and notes receivable with its franchisees. The Company manages such risk by evaluating the financial position, value of the franchises, as well as the personal guarantee of the individual franchisees. As of April 30, 2010 and 2009, there were no significant concentrations of credit risk associated with any individual franchisee or group of franchisees. The Company maintains an allowance for potential losses based on its expected collectibility of the receivables, which the Company believes is adequate for its credit loss exposure.

(13) Related-Party Transactions

During 2010, 2009, and 2008, the Company assisted in the sale of 210,000, 213,000, and 83,000 shares of common stock for related parties, respectively. Proceeds to related parties under these transactions were \$3,155,000, \$3,188,000, and \$1,336,000, respectively. During 2009, the Company sold 424,000 shares of common stock to related parties. Proceeds from these sales were \$7,087,000.

JTH TAX, INC. AND SUBSIDIARIES
(d/b/a Liberty Tax Service)

Notes to Consolidated Financial Statements

April 30, 2010 and 2009

(14) Employee 401(k) Plan

The Company sponsors a defined contribution 401(k) profit sharing plan. Under the plan, employees who are 18 years of age and have completed 90 days of service are eligible to make voluntary contributions to the plan. The Company matches 50% of each employee's contribution up to 6% of the employee's salary. Total compensation expense related to these contributions was \$295,000, \$263,000, and \$240,000 for the years ended April 30, 2010, 2009, and 2008, respectively.

(15) Commitments and Contingencies

The Company is a defendant in certain lawsuits and is aware of other threatened claims generally incidental to its business as a franchisor. Management is of the opinion that the accompanying consolidated financial statements will not be materially affected by the ultimate resolution of litigation pending or threatened as of April 30, 2010.

(16) Subsequent Events

On June 4, 2010, the Company authorized the grant of 769,400 stock options to certain employees and 80,000 stock options to the nonemployee directors of the Company. The exercise price of these options will be \$15 per share, which management believes was the fair value of the common stock at the date of the grant. The options will vest between six months and three years and may generally be exercised over a five-year period after the vesting date.

The Company has evaluated subsequent events from the balance sheet date through June 18, 2010, the date at which the financial statements were available to be issued, and determined there are no other items to disclose.