



JTH HOLDING, INC. AND SUBSIDIARIES

Consolidated Financial Statements

April 30, 2011 and 2010

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 1900
440 Monticello Avenue
Norfolk, VA 23510

Independent Auditors' Report

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

We have audited the accompanying consolidated balance sheets of JTH Holding, Inc. and subsidiaries (the Company) as of April 30, 2011 and 2010, 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, 2011. 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 the standards of the Public Company Accounting Oversight Board (United States). 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 Holding, Inc. and subsidiaries as of April 30, 2011 and 2010, and the results of their operations and their cash flows for each of the years in the three-year period ended April 30, 2011, in conformity with U.S. generally accepted accounting principles.

KPMG LLP

Norfolk, Virginia
June 10, 2011, except as to notes 10(d) and 16, which are as of September 2, 2011

JTH HOLDING, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

April 30, 2011 and 2010

(In thousands)

	2011	2010
Assets		
Current assets:		
Cash and cash equivalents.....	\$1,662	\$2,112
Receivables (note 2):		
Trade accounts	35,953	30,195
Notes	32,859	28,379
Interest	2,275	2,641
Allowance for doubtful accounts.....	(4,699)	(3,786)
Total receivables, net.....	66,388	57,429
Prepaid expenses	635	672
Other current assets	4,351	4,028
Income tax receivable.....	138	—
Deferred income taxes (note 9)	257	341
Total current assets.....	73,431	64,582
Property, equipment, and software, net (notes 3 and 7).....	18,228	13,127
Notes receivable, excluding current portion, net of allowance for uncollectible amounts of \$2,135 and \$1,811 for 2011 and 2010, respectively (note 2)	35,570	29,409
Goodwill	1,913	1,913
Other intangible assets, net (note 4)	17,253	16,107
Other assets, net	1,398	1,748
Total assets (note 6).....	\$147,793	\$126,886
Liabilities and Stockholders' Equity		
Current liabilities:		
Current installments of long-term debt (note 7).....	\$1,973	\$2,079
Accounts payable and accrued expenses (notes 8 and 15).....	15,625	8,384
Due to area developers (note 2).....	20,623	17,965
Income taxes payable (note 9).....	6,778	6,579
Deferred revenue	5,152	5,213
Total current liabilities	50,151	40,220
Long-term debt, excluding current installments (note 7).....	2,485	2,655
Revolving credit facility (notes 6 and 8)	—	—
Deferred income taxes (note 9)	11,030	8,815
Total liabilities	63,666	51,690
Stockholders' equity (notes 8, 10, 11, and 13):		
Class A preferred stock, \$.01 par value per share, 190,000 shares authorized, 170,320 and 190,000 shares issued and outstanding, at April 30, 2011 and 2010, respectively.....	2,129	2,375
Special voting preferred stock, \$.01 par value per share, 10 shares authorized, issued and outstanding.....	—	—
Class A common stock, \$.01 par value per share, 21,200,000 shares authorized, 10,519,286 and 10,729,820 shares issued and outstanding, at April 30, 2011 and 2010, respectively	105	107
Class B common stock, \$.01 par value per share, 1,000,000 shares authorized, 900,000 shares issued and outstanding	9	9
Exchangeable shares, \$.01 par value, 100,000 shares issued and outstanding	1	1
Additional paid-in capital.....	4,811	9,159
Accumulated other comprehensive income, net of taxes	381	121
Retained earnings	76,691	63,424
Total stockholders' equity	84,127	75,196
Commitments, contingencies, and subsequent events (notes 5, 6, 15, and 16)		
Total liabilities and stockholders' equity.....	\$147,793	\$126,886

See accompanying notes to consolidated financial statements.

JTH HOLDING, INC. AND SUBSIDIARIES

Consolidated Statements of Income

Years ended April 30, 2011, 2010, and 2009

(In thousands, except per share data)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Revenues:			
Franchise fees, net of provision for refunds of \$1,206 in 2011, \$1,656 in 2010, and \$1,193 in 2009	\$13,148	\$9,632	\$10,283
Royalties and advertising fees	46,879	41,413	33,093
Financial products.....	16,507	14,175	18,560
Interest income (note 2)	10,110	8,876	8,783
Tax preparation fees, net of discounts	4,789	5,982	5,075
Net gain on sale of customer lists and other assets and other revenue.....	4,091	4,549	3,484
Total revenues.....	<u>95,524</u>	<u>84,627</u>	<u>79,278</u>
Operating expenses:			
Employee compensation and benefits.....	25,162	24,526	21,418
General and administrative expenses	20,537	17,871	16,551
Advertising expense.....	15,078	12,872	12,085
Depreciation, amortization, and impairment charges (notes 3 and 4).....	6,062	7,305	5,313
Loss on discontinued use of software (note 3).....	—	5,570	—
Other expense	170	120	1,637
Total operating expenses	<u>67,009</u>	<u>68,264</u>	<u>57,004</u>
Income from operations	28,515	16,363	22,274
Other income (expense):			
Foreign currency transaction gains (losses)	75	1,014	(451)
Net gain on short-term investments	—	2,454	762
Interest expense (notes 6, 7, and 8).....	<u>(1,954)</u>	<u>(1,947)</u>	<u>(1,769)</u>
Income before income taxes	26,636	17,884	20,816
Income tax expense (note 9)	<u>10,874</u>	<u>6,882</u>	<u>8,737</u>
Net income.....	<u>\$15,762</u>	<u>\$11,002</u>	<u>\$12,079</u>
Net income per share of Class A and Class B common stock:			
Basic	<u>\$1.10</u>	<u>\$0.75</u>	<u>\$0.82</u>
Diluted	<u>\$1.08</u>	<u>\$0.73</u>	<u>\$0.78</u>

See accompanying notes to consolidated financial statements.

JTH HOLDING, INC. AND SUBSIDIARIES

Consolidated Statement of Stockholders' Equity and Comprehensive Income

Year ended April 30, 2011

(In thousands)

	Class A Common stock		Class B Common stock		Class A Preferred stock		Special voting preferred stock	
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount
Balance at May 1, 2010	10,730	\$107	900	\$9	190	\$2,375	—	\$ —
Exercise of stock options (note 11).....	460	5	—	—	—	—	—	—
Repurchase of common stock.....	(686)	(7)	—	—	—	—	—	—
Repurchase of preferred stock.....	—	—	—	—	(18)	(227)	—	—
Conversion of preferred stock to common stock ...	15	—	—	—	(2)	(19)	—	—
Balance at April 30, 2011	<u>10,519</u>	<u>\$105</u>	<u>900</u>	<u>\$9</u>	<u>170</u>	<u>\$2,129</u>	<u>—</u>	<u>\$ —</u>

	Exchangeable shares		Additional paid-in capital	Accumulated other comprehensive income	Retained earnings	Total
	Shares	Amount				
Balance at May 1, 2010	100	\$1	\$9,159	\$121	\$63,424	\$75,196
Exercise of stock options (note 11)	—	—	3,800	—	—	3,805
Repurchase of common stock	—	—	(10,069)	—	—	(10,076)
Repurchase of preferred stock	—	—	—	—	(2,495)	(2,722)
Conversion of preferred stock to common stock.....	—	—	19	—	—	—
Stock-based compensation expense (note 11).....	—	—	1,494	—	—	1,494
Tax benefit of stock option exercises (note 9).....	—	—	408	—	—	408
Net income.....	—	—	—	—	15,762	15,762
Interest rate swap agreements, net of taxes (note 8).....	—	—	—	(164)	—	(164)
Foreign currency translation adjustment, net of taxes	—	—	—	424	—	424
Comprehensive income.....	—	—	—	—	—	16,022
Balance at April 30, 2011	<u>100</u>	<u>\$1</u>	<u>\$4,811</u>	<u>\$381</u>	<u>\$76,691</u>	<u>\$84,127</u>

See accompanying notes to consolidated financial statements.

JTH HOLDING, INC. AND SUBSIDIARIES

Consolidated Statement of Stockholders' Equity and Comprehensive Income

Year ended April 30, 2010

(In thousands)

	Class A Common stock		Class B Common stock		Class A Preferred stock		Special voting preferred stock	
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount
Balance at May 1, 2009	10,960	\$109	900	\$9	190	\$2,375	—	\$ —
Exercise of stock options (note 11).....	457	5	—	—	—	—	—	—
Repurchase of common stock.....	(687)	(7)	—	—	—	—	—	—
Balance at April 30, 2010	<u>10,730</u>	<u>\$107</u>	<u>900</u>	<u>\$9</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, 2009	100	\$1	\$14,530	\$47	\$52,422	\$69,493
Exercise of stock options (note 11)	—	—	3,273	—	—	3,278
Repurchase of common stock	—	—	(10,211)	—	—	(10,218)
Stock-based compensation expense (note 11).....	—	—	1,000	—	—	1,000
Tax benefit of stock option exercises (note 9)	—	—	567	—	—	567
Net income	—	—	—	—	11,002	11,002
Interest rate swap agreements, 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	<u>100</u>	<u>\$1</u>	<u>\$9,159</u>	<u>\$121</u>	<u>\$63,424</u>	<u>\$75,196</u>

See accompanying notes to consolidated financial statements.

JTH HOLDING, INC. AND SUBSIDIARIES

Consolidated Statement of Stockholders' Equity and Comprehensive Income

Year ended April 30, 2009

(In thousands)

	Class A Common stock		Class B Common stock		Class A Preferred stock		Special voting preferred stock	
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount
Balance at May 1, 2008	10,622	\$106	900	\$9	190	\$2,375	—	\$ —
Issuance of common stock in connection with purchase of customer lists (note 10)	42	—	—	—	—	—	—	—
Exercise of stock options (note 11).....	443	4	—	—	—	—	—	—
Issuance of common stock (note 13).....	424	4	—	—	—	—	—	—
Repurchase of common stock.....	(571)	(5)	—	—	—	—	—	—
Balance at April 30, 2009	<u>10,960</u>	<u>\$109</u>	<u>900</u>	<u>\$9</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	\$1	\$11,506	\$358	\$40,343	\$54,698
Issuance of common stock in connection with purchase of customer lists (note 10).....	—	—	629	—	—	629
Exercise of stock options (note 11)....	—	—	2,295	—	—	2,299
Issuance of common stock (note 13)..	—	—	7,083	—	—	7,087
Repurchase of common stock	—	—	(8,544)	—	—	(8,549)
Stock-based compensation expense (note 11).....	—	—	1,055	—	—	1,055
Tax benefit of stock option exercises (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>\$1</u>	<u>\$14,530</u>	<u>\$47</u>	<u>\$52,422</u>	<u>\$69,493</u>

See accompanying notes to consolidated financial statements.

JTH HOLDING, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended April 30, 2011, 2010, and 2009

(In thousands)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:			
Net income	\$15,762	\$11,002	\$12,079
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for doubtful accounts and franchise fee refunds	4,938	4,095	5,459
Depreciation and amortization	5,855	6,389	5,173
Amortization of deferred financing costs	254	198	195
Write-down of customer lists	207	916	140
Loss on discontinued use of software	—	5,570	—
Stock-based compensation	1,494	1,000	1,055
Gain on sale of customer lists and other assets	(1,179)	(1,275)	(970)
Deferred tax expense (benefit)	2,403	(1,203)	988
Unrealized loss on short-term investments	—	—	702
Realized gain on short-term investments	—	(2,454)	(1,464)
Changes in assets and liabilities increasing (decreasing) cash flows from operating activities:			
Trade receivable	(20,803)	(15,454)	(13,941)
Notes and interest receivable	8,060	4,522	6,688
Prepaid expenses and other assets	149	301	11
Accounts payable and accrued expenses	4,041	(2,469)	(2,078)
Due to area developers	4,974	3,837	4,252
Income taxes	61	(466)	(2,865)
Deferred revenue	(1,441)	3,531	(3,148)
Net cash provided by operating activities	<u>24,775</u>	<u>18,040</u>	<u>12,276</u>
Cash flows from investing activities:			
Issuance of operating loans to franchisees	(56,400)	(32,488)	(23,977)
Payments received on operating loans from franchisees	50,921	27,335	20,243
Purchases of assets from franchisees and area developers	(3,091)	(2,959)	(4,223)
Proceeds from sale of customer lists and other assets	1,711	419	424
Purchases of property and equipment	(7,051)	(5,514)	(2,866)
Proceeds from sale of short-term investments	—	16,964	36,149
Purchases of short-term investments	—	(2,114)	(38,442)
Net cash provided by (used in) investing activities	<u>(13,910)</u>	<u>1,643</u>	<u>(12,692)</u>
Cash flows from financing activities:			
Proceeds from the exercise of stock options	3,805	3,278	2,299
Repurchase of common stock	(10,076)	(10,218)	(8,549)
Repurchase of preferred stock	(2,722)	—	—
Proceeds from the issuance of common stock	—	—	7,087
Repayment of long-term debt	(2,284)	(2,720)	(2,706)
Borrowings under revolving credit facility	135,484	93,450	108,421
Repayments under revolving credit facility	(135,484)	(103,452)	(108,257)
Deferred financing costs	(333)	—	(70)
Tax benefit of stock option exercises	408	567	506
Net cash used in financing activities	<u>(11,202)</u>	<u>(19,095)</u>	<u>(1,269)</u>
Effect of exchange rate changes on cash, net	(113)	(406)	685
Net increase (decrease) in cash and cash equivalents	(450)	182	(1,000)
Cash and cash equivalents at beginning of year	2,112	1,930	2,930
Cash and cash equivalents at end of year	<u>\$1,662</u>	<u>\$2,112</u>	<u>\$1,930</u>

JTH HOLDING, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended April 30, 2011, 2010, and 2009

(In thousands)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Supplemental disclosures of cash flow information:			
Cash paid for interest.....	\$1,671	\$1,830	\$1,694
Cash paid for taxes	8,032	8,087	10,217
Supplemental disclosures of noncash investing and financing activities:			
During the years ended April 30, 2011, 2010, and 2009, the Company acquired certain assets from franchisees and area developers as follows:			
Fair value of assets purchased.....	10,481	13,749	9,316
Receivables applied	(11,267)	(14,259)	(10,491)
Accounts payable canceled	2,384	2,709	1,535
Notes payable issued.....	(1,935)	(2,257)	(1,607)
Elimination of related deferred revenue.....	3,428	3,231	5,110
Common stock issued	—	—	(629)
Applied from sales of franchise territories.....	—	(214)	989
Cash paid to franchisees and area developers.....	<u>\$3,091</u>	<u>\$2,959</u>	<u>\$4,223</u>
During the years ended April 30, 2011, 2010, and 2009, the Company sold certain assets to franchisees and area developers as follows:			
Book value of assets sold.....	\$8,798	\$4,925	\$3,761
Gain on sale	601	546	1,899
Deferred gain on sale	5,269	1,745	662
Applied from acquisitions of franchise territories.....	(120)	(204)	(56)
Notes received	<u>(12,837)</u>	<u>(6,593)</u>	<u>(5,842)</u>
Cash received from franchisees and area developers	<u>\$1,711</u>	<u>\$419</u>	<u>\$424</u>
Accrued capitalized software costs included in accounts payable.....	<u>\$1,368</u>	<u>\$ —</u>	<u>\$ —</u>

See accompanying notes to consolidated financial statements.

JTH HOLDING, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

April 30, 2011 and 2010

(1) Organization and Significant Accounting Policies

(a) Organization and Plan of Reorganization

JTH Holding, Inc. (JTH Holding), a Delaware corporation, is a holding company engaged through its subsidiaries as a franchisor and operator of a system of income tax preparation offices located in the United States and Canada. JTH Holding's principal operations are conducted through JTH Tax, Inc. (d/b/a Liberty Tax Service) JTH Holding's largest subsidiary. Through this system of income tax preparation offices, JTH Holding also facilitates to its customers refund-based tax settlement financial products such as refund anticipation loans, electronic refund checks, and personal income tax refund discounting. JTH Holding also offers online tax preparation services.

On September 30, 2010, JTH Tax, Inc. (JTH Tax) entered into an Agreement of Merger and Plan of Reorganization with JTH Holding. At the closing of the merger on September 30, 2010, JTH Tax merged with and became a wholly owned subsidiary of JTH Holding, and each issued and outstanding share of JTH Tax's authorized Class A preferred stock and Class A and Class B common stock was converted into one share of similar classes of JTH Holding's stock. The converted shares have the same preferences, rights, and limitations as previous shares in JTH Tax. JTH Holding was deemed to be the acquiring company for accounting purposes and the transaction was accounted for as a merger of entities under common control in accordance with U.S. generally accepted accounting principles. This transaction was considered a tax-free exchange under Section 368(a) of the Internal Revenue Code of 1986.

Unless specifically noted otherwise, as used throughout these consolidated financial statements, the term "Company" or "Liberty" refers to the consolidated entities after the merger and the business of JTH Tax before the merger. The terms JTH Tax and JTH Holding refer to such entities' standalone business prior to the merger.

(b) Principles of Consolidation

The consolidated financial statements include the accounts of JTH Holding, Inc. and its wholly owned subsidiaries. Assets and liabilities of the Company's Canadian operations have been translated into U.S. dollars using the exchange rate in effect at the end of the 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. 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.

JTH HOLDING, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

April 30, 2011 and 2010

(d) Short-Term Investments

During 2010 and 2009, the Company had short-term investments, which consisted of equity securities. The Company has classified these investments as trading securities and records them at fair value with the 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 presented in "net gain on short-term investments." Cash flows from the purchases and sales of the Company's short-term investments are classified as investing activities due to the nature and intent of these investments. At April 30, 2011 and 2010, the Company did not have any short-term investments.

(e) Trade Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount less an allowance for doubtful accounts and accrue finance charges at 18% annually if unpaid after 30 days. Finance charges are fully reserved and are only recognized in income when they have been paid. 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 trade accounts receivable.

(f) Notes Receivable

Notes receivable are recorded at cost, less an allowance for doubtful accounts. 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. Notes are written off against the allowance when all possible means of collection have been exhausted and the potential for recovery is considered remote.

(g) Allowance for doubtful accounts

The allowance for doubtful accounts includes the Company's best estimate of the amount of probable credit losses in the Company's existing accounts and notes receivable. Because the repayment of accounts and notes 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.

(h) 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. Certain allowable costs of software developed or obtained for internal use are capitalized and typically amortized over 36 months.

(i) 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. 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. The residual fair value after

JTH HOLDING, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

April 30, 2011 and 2010

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.

During 2011, 2010, and 2009, the Company performed its annual impairment review of goodwill and concluded that there was no impairment.

(j) 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 fees and gains are classified as deferred revenue until they qualify for revenue recognition or are refunded.

(k) Revenue Recognition

Franchise fee revenue, net of a provision for franchise fee refunds, for the sales of individual territories is recognized when obligations of the Company to prepare the franchisee for operation have been substantially completed. Franchise fees also include area developer (AD's) sales wherein the Company sells a cluster of territories to an entity. Franchise and AD 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) and meet certain other criteria.

Royalties, net of amounts due area developers, and advertising fees are recognized currently as franchised territories generate sales. Tax return preparation fees and financial products 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 and are recorded as reductions to revenues.

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

(l) Derivative Instruments and Hedging Activities

The Company accounts for derivatives and hedging activities and recognizes 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.

The Company only enters into a derivative contract when it intends to designate the contract 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 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.

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Notes to Consolidated Financial Statements

April 30, 2011 and 2010

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 de-designated 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 disclosure requirements for derivative instruments and hedging activities.

(m) 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.

The Company has elected to classify accrued interest in interest expense and accrued penalties in general and administrative expenses.

(n) Long-Lived Assets

The Company's 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. Recognition and measurement of a potential impairment is performed for these assets at the lowest level where cash flows are individually identifiable. 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 disposal group classified as held-for-sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

(o) Comprehensive Income

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

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(p) Advertising Expenses

Advertising costs are expensed in the period incurred.

(q) Stock-Based Compensation

The Company records costs of its employee stock-based compensation based on the grant-date fair value of awards using the Black-Scholes-Merton option pricing model. The Company reflects the excess tax benefits recognized in equity related to stock option exercises as financing cash flows. The Company recognizes compensation costs for an award that has a graded vesting schedule on a straight-line basis over the requisite service period for the entire award.

(r) Use of Estimates

Management 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.

(s) Recently Issued Accounting Standards

For the year ended April 30, 2011, the Company adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2009-17, *Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities* (formerly FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*). The adoption of ASU No. 2009-17 did not have a material effect on the Company's consolidated financial statements.

In April 2010, the FASB issued FASB ASU 2010-17, *Revenue Recognition — Milestone Method of Revenue Recognition*, under FASB Accounting Standards Codification (ASC) 605, *Revenue Recognition*. The new guidance defines specific criteria for evaluating whether the milestone method is appropriate for the purposes of assessing revenue recognition. FASB ASU 2010-17 stipulates that consideration tied to the achievement of a milestone may only be recognized if it meets all of the defined criteria for the milestone to be considered substantive. The guidance also requires expanded disclosures about the overall arrangement, the nature of the milestones, the consideration and the assessment of whether the milestones are substantive. FASB ASU 2010-17 is effective for the Company on a prospective basis for milestones achieved in fiscal years and interim periods beginning in the year ended April 30, 2012. The Company does not expect that the adoption of FASB ASU 2010-17 will have a material effect on its consolidated financial statements.

In July 2010, the FASB issued FASB ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. This guidance requires enhanced disclosures about the allowance for credit losses and the credit quality of financing receivables and applies to financing receivables held by all creditors. The additional disclosure requirements are included in Note 2.

In December 2010, the FASB issued FASB ASU 2010-28, *Intangibles — Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*. The amendments affect reporting units whose carrying amount is zero or negative, and require performance of Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, a reporting unit would consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with existing guidance. The reporting unit would evaluate if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. This guidance is effective beginning in the year ended April 30, 2012. The Company does not expect that this guidance will have a material effect on its consolidated financial statements.

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In December 2010, the FASB issued ASU 2010-29, *Business Combinations* (ASC Topic 805) — *Disclosure of Supplementary Pro Forma Information for Business Combinations*. This amendment expands the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. This amendment is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. The Company intends to adopt this guidance in the year ended April 30, 2012. Other than requiring additional disclosures with any potential acquisitions, the adoption of this new guidance will not have a material effect on its consolidated financial statements.

In May 2011, FASB issued ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*. This ASU amends the language and methods used in ASC 820, *Fair Value Measurements*, to be consistent with language and methods used in International Financial Reporting Standards (“IFRS”). This ASU is part of FASB’s ongoing effort to converge U.S. GAAP with IFRS. The Company intends to adopt this guidance in the quarter ending January 31, 2012. The Company does not expect that this guidance will have a material effect on its consolidated financial statements.

In June 2011, FASB issued ASU 2011-05, *Presentation of Comprehensive Income*. This update changes the methods for presenting comprehensive income, and eliminates the method of including comprehensive income in the statement of stockholders’ equity. After adoption, an entity will have the option of presenting to total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments in this ASU do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The Company intends to adopt this guidance in the quarter ending January 31, 2012. Because it only affects presentation, the Company does not expect that this guidance will have a material effect on its consolidated financial statements.

(t) Segment Reporting

Management has identified two operating segments, U.S. operations and Canadian operations. Although there are two operating segments, each segment is engaged in providing tax return preparation and related services and products. These two operating segments have been aggregated into a single reporting segment as both segments are similar in the nature of services offered, production process, type of customer, the distribution methods, regulatory environment that they operate in and have similar gross margin and sales trends.

Canadian operations contributed \$6,710,000, \$6,864,000 and \$5,057,000 in revenues for the years ended April 30, 2011, 2010 and 2009, respectively.

(u) Supplier Concentration

The Company relies on a third-party financial institution to provide certain financial products to its customers, pursuant to an agreement which expires on October 16, 2012. For the year ended April 30, 2011, substantially all of the Company’s customers’ financial products were provided by this financial institution. While the Company presently believes it could obtain access to similar products from other financial institutions with similar terms, the ongoing availability of these products is subject to changes in market conditions and the related regulatory environment.

(2) Notes and Accounts Receivable

The Company provides financing to franchisees for the purchase of franchises, clusters of territories, Company-owned stores and/or for working capital and equipment needs. The franchise-related notes generally are payable over five years and the

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Notes to Consolidated Financial Statements

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working capital and equipment notes generally are due within one year. All notes bear interest at 12%. Activity related to notes receivable for the years ended April 30, 2011 and 2010 is as follows:

	<u>2011</u>	<u>2010</u>
	<u>(In thousands)</u>	
Balance at beginning of year	\$59,599	\$56,533
Notes received for:		
Sales of franchises and clusters of territories.....	10,589	10,600
Sales of Company-owned stores.....	12,837	6,593
Franchisee to franchisee note assumptions.....	7,467	6,094
Working capital and equipment loans to franchisees	56,400	32,488
Refinancing of accounts receivable	14,459	12,441
	<u>101,752</u>	<u>68,216</u>
Repayment of notes	(70,793)	(43,844)
Notes canceled.....	(20,221)	(21,925)
Foreign currency adjustment	227	619
Balance at end of year	<u>\$70,564</u>	<u>\$59,599</u>

Most of the notes receivable are due from the Company's franchisees and 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 franchise. 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 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 \$20,623,000 and \$17,965,000 at April 30, 2011 and 2010, respectively.

Activity in the allowance for doubtful accounts for the years ended April 30, 2011, 2010, and 2009 is as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
	<u>(In thousands)</u>		
Beginning balance	\$5,597	\$5,994	\$5,865
Additions charged to expense	3,732	2,439	4,266
Provision for franchise fee refunds	1,206	1,656	1,193
Write-offs.....	(3,800)	(4,683)	(5,185)
Foreign currency adjustment	99	191	(145)
Ending balance.....	<u>\$6,834</u>	<u>\$5,597</u>	<u>\$5,994</u>

(2) Notes and Accounts Receivable

Management considers accounts and notes receivable to be impaired if the amounts due exceed the fair value of the underlying franchise and estimates an allowance for doubtful accounts based on that excess. Amounts due include the recorded value of the accounts and notes receivable reduced by the allowance for uncollected interest, amounts due area developers, the related deferred revenue and amounts owed to the franchisee by the Company. In establishing the fair value of the underlying franchise, management considers net fees of open stores and the number of unopened stores.

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For accounts and notes receivable not impaired, management determines the allowance for doubtful accounts based on an estimate of expected refunds of the initial franchise fee, taking into consideration the number of unopened stores.

The allowance for doubtful accounts at for the years ended April 30, 2011, and 2010 is allocated as follows:

	<u>2011</u>	<u>2010</u>
	<u>(In thousands)</u>	
Impaired:		
Notes receivable.....	\$9,407	\$8,182
Accounts receivable.....	4,599	4,054
Less allowance for uncollected interest, amounts due AD's, related deferred revenue and amounts due franchisees	<u>(3,554)</u>	<u>(2,809)</u>
Net amount due.....	<u>\$10,452</u>	<u>\$9,427</u>
Allowance for doubtful accounts for impaired notes and accounts receivable.....	<u><u>\$(5,322)</u></u>	<u><u>\$(4,311)</u></u>
Non-impaired:		
Notes receivable.....	\$64,624	\$55,371
Accounts receivable.....	33,144	27,415
Less allowance for uncollected interest, amounts due AD's, related deferred revenue and amounts due franchisees	<u>(28,202)</u>	<u>(25,807)</u>
Net amount due.....	<u>\$69,566</u>	<u>\$56,979</u>
Allowance for doubtful accounts for non-impaired notes and accounts receivable.....	<u><u>\$(1,512)</u></u>	<u><u>\$(1,286)</u></u>
Total allowance for doubtful accounts.....	<u><u>\$(6,834)</u></u>	<u><u>\$(5,597)</u></u>

The aging of accounts and notes receivable at April 30, 2011 is as follows:

	<u>2011</u>			
	<u>Total</u>	<u>Allowance</u>		<u>Total</u>
	<u>Past Due</u>	<u>for Uncollected</u>	<u>Current</u>	<u>Receivables</u>
		<u>Interest</u>		
		<u>(In thousands)</u>		
Accounts receivable.....	\$17,113	\$(1,790)	\$20,630	\$35,953
Notes receivable.....	10,987	(1,192)	63,044	72,839
Total.....	<u>\$28,100</u>	<u>\$(2,982)</u>	<u>\$83,674</u>	<u>\$108,792</u>

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Accounts receivable are considered to be past due if unpaid after 30 days and notes receivable are considered past due if unpaid after 90 days, at which time the notes are put on nonaccrual status.

The Company's average investment in impaired notes receivable during the years ended April 30, 2011 and 2010 was \$8,295,000 and \$8,646,000, respectively. Interest income related to impaired notes was \$559,000, \$368,000, and \$914,000 for the years ended April 30, 2011, 2010, and 2009, respectively. The Company's investment in notes receivable on nonaccrual status at April 30, 2011 and 2010 was \$9,795,000 and \$10,148,000, respectively.

(3) Property, Equipment, and Software, Net

Property, equipment, and software at April 30, 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
	<u>(In thousands)</u>	
Land.....	\$997	\$947
Buildings and building improvements.....	6,795	6,997
Leasehold improvements.....	259	276
Furniture, fixtures, and equipment	4,542	3,832
Software	<u>19,069</u>	<u>11,232</u>
	31,662	23,284
Less accumulated depreciation and amortization	<u>13,434</u>	<u>10,157</u>
Property, equipment, and software, net	<u>\$18,228</u>	<u>\$13,127</u>

Total depreciation expense was \$3,438,000, \$4,233,000, and \$3,858,000 for the years ended April 30, 2011, 2010, and 2009, respectively.

The software included above includes both internally developed software and purchased software. Included in software are \$6,598,000 and \$768,000 of assets that had not been placed in service at April 30, 2011 and 2010, respectively. In April 2010, the Company decided to discontinue its use of the software associated with its online tax preparation services. This software had a net book value of \$5,570,000 when the decision was made and was expensed in the year ended April 30, 2010.

(4) Goodwill and Other Intangible Assets

Acquired Intangible Assets

		<u>April 30, 2011</u>		
		<u>(In thousands)</u>		
	<u>Weighted average amortization period</u>	<u>Gross carrying amount</u>	<u>Accumulated amortization</u>	<u>Net carrying amount</u>
Amortizable intangible assets:				
Customer lists	5 years	\$3,348	\$(793)	\$2,555
Area franchise rights.....	10 years	17,760	(3,062)	14,698
Total.....		<u>\$21,108</u>	<u>\$(3,855)</u>	<u>\$17,253</u>

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April 30, 2011 and 2010

	April 30, 2010			
	(In thousands)			
	Weighted average amortization period	Gross carrying amount	Accumulated amortization	Net carrying amount
Amortizable intangible assets:				
Customer lists	5 years	\$4,742	\$(1,064)	\$3,678
Area franchise rights	10 years	14,502	(2,073)	12,429
Total		<u>\$19,244</u>	<u>\$(3,137)</u>	<u>\$16,107</u>

For the years ended April 30, 2011 and 2010, the Company acquired the assets of various franchisees for \$3,852,000 and \$6,805,000, respectively. These acquisitions were accounted for as business combinations, with all value allocated to the identifiable intangible assets. The acquired businesses are operated as Company-owned stores, until a buyer is found.

For the years ended April 30, 2011, 2010 and 2009, amortization expense, customer list impairment charges, and write-downs are as follows:

	2011	2010	2009
	(In thousands)		
Amortization expense, excluding impairment charges	<u>\$2,417</u>	<u>\$2,156</u>	<u>\$1,315</u>
Customer lists:			
Impairment charges	\$134	\$80	\$140
Write-downs	73	836	—
	<u>\$207</u>	<u>\$916</u>	<u>\$140</u>

The Company expects that the assets will be sold before the end of their estimated useful life. Therefore, during the years ended April 30, 2011, 2010 and 2009, impairment analyses were performed for amortizable intangible assets. As a result, the carrying values of customer lists were reduced by the amounts disclosed in the table above, and were recorded to depreciation, amortization, and impairment charges on the consolidated statements of income. The Company estimated the fair value of the customer lists based on historical transactions involving sales of Company-owned stores. Write-downs of customer lists relate to purchases of stores, which the Company decided not to operate.

Estimated amortization expense for the next five years is as follows:

	Amortization expense
	(in thousands)
Year ending April 30:	
2012	\$2,414
2013	2,399
2014	2,345
2015	2,227
2016	2,012
	<u>\$11,397</u>

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(5) Leases

The Company is obligated under various operating leases for office space that expire at various dates. At April 30, 2011, 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 at April 30, 2011 are as follows:

	<u>Lease payments</u>	<u>Sublease receipts</u>
	<u>(in thousands)</u>	
Year ending April 30:		
2012.....	\$3,127	\$2,342
2013.....	1,883	1,478
2014.....	915	760
2015.....	485	372
2016.....	130	130
Thereafter	<u>185</u>	<u>185</u>
Total minimum lease payments.....	<u>\$6,725</u>	<u>\$5,267</u>

Total rent expense for operating leases, net of subleases, was \$1,805,000, \$1,815,000, and \$1,658,000 for the years ended April 30, 2011, 2010, and 2009, respectively.

(6) Revolving Credit Facility

During February 2008, the Company entered into a syndicated revolving credit facility with 10 financial institutions, which allows for borrowings up to \$100,000,000. In December 2010, the Company amended this facility to allow borrowings up to \$125,000,000. Outstanding borrowings accrue interest at an adjusted one-month London Interbank Offered Rate (LIBOR) plus a margin ranging from 1.25% to 2.00% depending on the Company's leverage ratio. At April 30, 2011, the interest rate was 1.62%. This facility is collateralized by substantially all the assets of the Company and expires on March 31, 2013.

The revolving credit facility contains certain financial covenants, which the Company must meet, including leverage and fixed charge coverage ratios as well as minimum net worth requirements. The Company's borrowing availability on the revolving credit facility at April 30, 2011 was \$102,455,000. At April 30, 2011 and 2010, the Company had no outstanding borrowings under its revolving credit facility.

(7) Long-Term Debt

Long-term debt at April 30, 2011 and 2010 is as follows:

	<u>2011</u>	<u>2010</u>
	<u>(In thousands)</u>	
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.....	\$2,450	\$2,486
Notes payable for acquired assets from franchisees, interest rates ranging from 0% to 12%; due May 2011 through May 2012.....	1,915	2,248
Other debt	<u>93</u>	<u>—</u>
Total long-term debt	4,458	4,734
Less current installments	<u>1,973</u>	<u>2,079</u>
Total long-term debt, less current installments	<u>\$2,485</u>	<u>\$2,655</u>

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Aggregate maturities of long-term debt at April 30, 2011 are as follows (in thousands):

<u>Year ending April 30:</u>	
2012.....	\$1,973
2013.....	62
2014.....	65
2015.....	68
2016.....	60
Thereafter	<u>2,230</u>
Total long-term debt.....	<u>\$4,458</u>

(8) Derivative Instruments and Hedging Activities

The Company uses interest-rate-related derivative financial instruments to manage its exposure related to changes in interest rates on its variable-rate revolving credit facility and forward contracts to manage its exposure to foreign currency fluctuation related to short-term advances made to its Canadian subsidiary. The Company does not speculate using derivative instruments nor does it enter into derivative instruments for any purpose other than cash flow hedging.

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 rates 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 rates 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 and forecasted revenues 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 and foreign currency rates on the Company's future cash flows.

It is the policy of the Company to enter into forward contracts at the time short-term advances are made to its Canadian subsidiary.

Interest rate swap agreements: On July 1, 2009, the Company has entered into interest rate swaps agreements with a financial institution to manage fluctuations in cash flows resulting from changes in the one-month LIBOR interest rate on its revolving credit facility. These swaps effectively change the variable-rate revolving credit facility into a fixed-rate revolving credit facility. For the notional amounts, the Company receives a variable interest rate based on the one-month LIBOR and pays a fixed interest rate of 2.49% to 2.52%, depending on the agreement. The notional amounts of the interest rate swaps vary from \$10,000,000 to \$70,000,000 per month, in relation to the Company's forecasted seasonal borrowings. These interest rate swaps are designated as cash flow hedges. At April 30, 2011 and 2010, the fair value of interest rate swaps was a liability of \$1,134,000 and \$821,000, respectively, and was included in accounts payable and accrued expenses. During the

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years ended April 30, 2011 and 2010, \$11,000 and \$46,000 were recognized in the consolidated statements of income due to the ineffectiveness of these interest rate swaps.

Forward contracts related to foreign currency exchange rates: In connection with short-term advances made to its Canadian subsidiary related to personal income tax refund discounting, the Company enters into forward contracts to eliminate the exposure related to foreign currency fluctuations. Under the terms of the forward currency contracts, the exchange rate for repayments is fixed at the time advance is made and the advances are repaid prior to April 30 of year. These forward contracts are designated as cash flow hedges. At April 30, 2011 and 2010, there were no forward contracts outstanding. During the years ended April 30, 2011, 2010, and 2009, no amounts have been recognized in the statements of income due to the ineffectiveness of these foreign currency hedges.

At April 30, 2011, 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 2011.

(9) Income Taxes

Total income taxes were calculated for the years ended April 30, 2011, 2010, and 2009 as follows:

	2011	2010	2009
	(In thousands)		
Income from continuing operations	\$10,874	\$6,882	\$8,737
Tax benefit of stock option exercises.....	(408)	(567)	(506)
Interest rate swap agreements	(104)	(305)	—
Foreign currency translation adjustment.....	167	351	(206)
Total income taxes	\$10,529	\$6,361	\$8,025

Components of income tax expense for the years ended April 30, 2011, 2010, and 2009 are as follows:

	2011	2010	2009
	(In thousands)		
Current:			
Federal	\$6,390	\$5,857	\$6,318
State	1,227	1,215	1,137
Foreign.....	854	1,013	294
Current tax expense	8,471	8,085	7,749
Deferred:			
Federal	2,028	(991)	838
State	390	(206)	150
Foreign.....	(15)	(6)	—
Deferred tax expense (benefit).....	2,403	(1,203)	988
Total income tax expense	\$10,874	\$6,882	\$8,737

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For the years ended April 30, 2011, 2010, and 2009, income before taxes consists of the following:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
	<u>(In thousands)</u>		
U.S. operations.....	\$24,221	\$14,876	\$19,657
Foreign operations	2,415	3,008	1,159
	<u>\$26,636</u>	<u>\$17,884</u>	<u>\$20,816</u>

Income tax expense differed from the amounts computed by applying the U.S. federal income tax rate of 35% to pretax income from continuing operations as a result of the following for the years ended April 30, 2011, 2010, and 2009:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
	<u>(In thousands)</u>		
Computed "expected" income tax expense.....	\$9,323	\$6,259	\$7,285
Increase (decrease) in income taxes resulting from:			
State income taxes, net of federal benefit	1,083	676	836
Change in taxes resulting from permanent differences, net	356	295	753
Other	112	(348)	(137)
Total income tax expense	<u>\$10,874</u>	<u>\$6,882</u>	<u>\$8,737</u>

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, 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
	<u>(In thousands)</u>	
Deferred tax assets:		
Unexercised nonqualified stock options	\$909	\$586
Allowance for doubtful accounts	2,615	2,442
Interest rate swap agreements	409	305
Other	77	84
Total deferred tax assets	<u>4,010</u>	<u>3,417</u>
Deferred tax liabilities:		
Property, equipment, software, and other intangible assets	5,727	3,213
Deferred revenue	8,348	8,062
Prepaid expenses	158	233
Foreign currency translation adjustment	550	383
Total deferred tax liabilities	<u>14,783</u>	<u>11,891</u>
Net deferred tax liabilities.....	<u>\$(10,773)</u>	<u>\$(8,474)</u>

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.

JTH HOLDING, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

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The Company has adopted the accounting and disclosure requirements for uncertain tax positions, which require a two-step approach to evaluate tax positions. This approach involves recognizing any tax positions that are more likely not to occur and then measuring those positions to determine the amounts to be recognized in the financial statements. The Company has determined no reserves for uncertain tax positions were required at April 30, 2011 or 2010 or during the years then ended.

In May 2011, the Internal Revenue Service completed an audit of the Company's 2009 tax return and made no adjustments. At April 30, 2011, the tax years that remain subject to examination by the Internal Revenue Service are 2008 and 2010, and years that remain open for other major taxing jurisdictions are 2008 and subsequent years.

(10) Stockholders' Equity

As discussed in Note 16, a change in par value from \$1 to \$.01 was approved on July 14, 2011.

(a) Preferred Stock and Exchangeable Shares

The Company has 190,000 shares of authorized Class A preferred stock with a par value of \$.01, and are carried on the consolidated balance sheet at their original purchase price.

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 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 Class A 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 a share of outstanding Class A preferred stock was \$39.23 and \$35.66 at April 30, 2011 and 2010, respectively.

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 2011, the Company repurchased 18,146 shares of its Class A preferred stock for \$2,722,000.

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 of a Canadian subsidiary 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 to 1 ratio into the Class A common stock of the Company. The special voting preferred shares issued have a \$.01 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 \$.01 per share, and 1,000,000 shares of Class B common stock, par value \$.01 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.

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During 2009, in connection with the acquisition of certain assets, the Company issued a total of 42,000 shares of Class A common stock. There were no issuances of Class A common stock in connection with the acquisitions of assets in 2011 or 2010.

(c) Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income at April 30, 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
	<u>(In thousands)</u>	
Foreign currency adjustment, net of tax	\$1,015	\$591
Interest rate swap agreements, net of tax.....	<u>(634)</u>	<u>(470)</u>
	<u>\$381</u>	<u>\$121</u>

(d) Earnings per Share

Net income per share of Class A and Class B common stock is computed using the two-class method. Basic net income per share is computed by allocating undistributed earnings to common shares and participating securities (Class A preferred stock and exchangeable shares) and using the weighted-average number of common shares outstanding during the period.

Diluted net income per share is computed using the weighted-average number of common shares and, if dilutive, the potential common shares outstanding during the period. Potential common shares consist of the incremental common shares issuable upon the exercise of stock options. The dilutive effect of outstanding stock options is reflected in diluted earnings per share by application of the treasury stock method. Additionally, the computation of the diluted net income per share of Class A common stock assumes the conversion of Class B common stock, Class A preferred stock and exchangeable shares, while the diluted net income per share of Class B common stock does not assume conversion of those shares.

The rights, including liquidation and dividends rights, of the holders of Class A and Class B common stock are identical, except with respect to voting. As a result, the undistributed earnings for each year are allocated based on the contractual participation rights of the Class A and Class B as if the earnings for the year had been distributed. Participating securities include Class A preferred stock and exchangeable shares which have dividend rights that are identical to Class A and Class B common stock.

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The computation of basic and diluted net income per share for the years ended April 30, 2011, 2010 and 2009 is as follows:

	2011	
	Class A Common Stock	Class B Common Stock
	(in thousands, except for share and per share amounts)	
Basic net income per share:		
<i>Numerator</i>		
Allocation of undistributed earnings.....	\$14,527	\$1,235
Amounts allocated to participating securities:		
Class A preferred stock.....	(1,875)	(159)
Exchangeable shares	(1,013)	(86)
Net income attributable to common stockholders.....	\$11,639	\$990
<i>Denominator</i>		
Weighted-average common shares outstanding.....	10,588,954	900,000
Basic net income per share	\$1.10	\$1.10
Diluted net income per share:		
<i>Numerator</i>		
Allocation of undistributed earnings for basic computation.....	\$11,639	\$990
Reallocation of undistributed earnings as a result of assumed conversion of:		
Class B common stock to Class A common stock.....	990	—
Class A preferred stock to Class A common stock	2,034	—
Exchangeable shares to Class A common stock	1,099	—
	\$15,762	\$990
<i>Denominator</i>		
Number of shares used in basic computation.....	10,588,954	900,000
Weighted-average effect of dilutive securities		
Add the conversion or exercise of:		
Class B common stock to Class A common stock.....	900,000	—
Class A preferred stock to Class A common stock	1,850,800	—
Exchangeable shares to Class A common stock	1,000,000	—
Employee stock options	322,559	20,245
	14,662,313	920,245
Diluted net income per share	\$1.08	\$1.08

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	2010	
	Class A Common Stock	Class B Common Stock
	(in thousands, except for share and per share amounts)	
Basic net income per share:		
<i>Numerator</i>		
Allocation of undistributed earnings.....	\$10,154	\$848
Amounts allocated to participating securities:		
Class A preferred stock.....	(1,323)	(110)
Exchangeable shares.....	(697)	(59)
Net income attributable to common stockholders.....	\$8,134	\$679
<i>Denominator</i>		
Weighted-average common shares outstanding.....	10,779,038	900,000
Basic net income per share	\$0.75	\$0.75
Diluted net income per share:		
<i>Numerator</i>		
Allocation of undistributed earnings for basic computation.....	\$8,134	\$679
Reallocation of undistributed earnings as a result of assumed conversion of:		
Class B common stock to Class A common stock.....	679	—
Class A preferred stock to Class A common stock.....	1,433	—
Exchangeable shares to Class A common stock.....	756	—
	\$11,002	\$679
<i>Denominator</i>		
Number of shares used in basic computation.....	10,779,038	900,000
Weighted-average effect of dilutive securities		
Add the conversion or exercise of:		
Class B common stock to Class A common stock.....	900,000	—
Class A preferred stock to Class A common stock.....	1,900,000	—
Exchangeable shares to Class A common stock.....	1,000,000	—
Employee stock options.....	489,216	30,201
	15,068,254	930,201
Diluted net income per share	\$0.73	\$0.73

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Notes to Consolidated Financial Statements

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	2009	
	Class A Common Stock	Class B Common Stock
	(in thousands, except for share and per share amounts)	
Basic net income per share:		
<i>Numerator</i>		
Allocation of undistributed earnings.....	\$11,165	\$914
Amounts allocated to participating securities:		
Class A preferred stock.....	(1,434)	(118)
Exchangeable shares	(755)	(62)
Net income attributable to common stockholders.....	\$8,976	\$734
<i>Denominator</i>		
Weighted-average common shares outstanding.....	10,988,391	900,000
Basic net income per share	\$0.82	\$0.82
Diluted net income per share:		
<i>Numerator</i>		
Allocation of undistributed earnings for basic computation	\$8,976	\$734
Reallocation of undistributed earnings as a result of assumed conversion of:		
Class B common stock to Class A common stock.....	734	—
Class A preferred stock to Class A common stock	1,552	—
Exchangeable shares to Class A common stock	817	—
	\$12,079	\$734
<i>Denominator</i>		
Number of shares used in basic computation.....	10,988,391	900,000
Weighted-average effect of dilutive securities		
Add the conversion or exercise of:		
Class B common stock to Class A common stock.....	900,000	—
Class A preferred stock to Class A common stock	1,900,000	—
Exchangeable shares to Class A common stock	1,000,000	—
Employee stock options	694,145	42,245
	15,482,536	942,245
Diluted net income per share	\$0.78	\$0.78

Diluted net income per share excludes the impact of shares of common stock from the exercise of options to purchase 1,894,000, 877,000 and 522,000 shares for the years ended April 30, 2011, 2010, and 2009 respectively, as the effect would be antidilutive.

(11) Stock Compensation Plan

In May 1998, the board of directors approved the JTH Holding, Inc. Stock Option Plan (the Plan). Employees and outside directors are eligible to receive awards under the Plan, and a total of 6,100,000 shares of Class A common stock have been authorized for grant under the Plan. The Plan was readopted by the board of directors in May 2008. At April 30, 2011, 576,380 shares of Class A common stock are available for grant under the Plan. Stock options generally vest from six months to five years from the date of grant and generally expire five years from the vesting date.

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Notes to Consolidated Financial Statements

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The following table summarizes the information for options granted in the years ended April 30, 2011, 2010, and 2009:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Weighted average fair value of options granted	\$2.54	\$1.95	\$3.02
Dividend yield	0.0%	0.0%	0.0%
Expected volatility	14.6% - 15.7%	12.9% - 13.2%	13.8% - 14.5%
Expected terms.....	4 - 6 years	4 - 5 years	4 - 6 years
Risk-free interest rates	1.2% - 2.3%	1.5% - 2.5%	2.1% - 3.6%

Stock option activity during the years ended April 30, 2011, 2010, and 2009 is as follows:

	<u>Number of options</u>	<u>Weighted average exercise price</u>
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.....	1,970,720	11.61
Granted	1,048,800	15.03
Exercised	(460,162)	8.27
Canceled	(98,020)	10.08
Outstanding at April 30, 2011.....	<u>2,461,338</u>	13.77

Stock options were granted to employees of the Company except for options granted to nonemployee directors of 80,000, 50,000, and 80,000 stock options during the years ended April 30, 2011, 2010, and 2009, respectively.

The total intrinsic value of options exercised was approximately \$3,100,000, \$3,600,000, and \$4,300,000 during the years ended April 30, 2011, 2010, and 2009 respectively.

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Nonvested stock option (options which did not vest in the period in which granted) activity during the years ended April 30, 2011, 2010, and 2009 is as follows:

	Nonvested options	Weighted average exercise price
Outstanding at April 30, 2008.....	196,666	\$11.17
Granted	270,000	15.00
Vested	(126,666)	12.78
Canceled	<u>(65,000)</u>	12.40
Outstanding at April 30, 2009.....	275,000	13.90
Granted	40,000	15.00
Vested	(107,500)	12.76
Canceled	<u>(30,000)</u>	15.00
Outstanding at April 30, 2010.....	177,500	14.65
Granted	702,500	15.00
Vested	(275,000)	14.78
Canceled	<u>—</u>	—
Outstanding at April 30, 2011.....	<u><u>605,000</u></u>	15.00

At April 30, 2011, unrecognized compensation costs related to nonvested stock options are \$1,709,000. These costs are expected to be recognized between 2012 and 2015.

The following table summarizes information about stock options outstanding and exercisable at April 30, 2011:

Number of shares outstanding at April 30, 2011	Range of exercise prices	Weighted average exercise price	Weighted average remaining contractual life	Number of shares exercisable at April 30, 2011	Weighted average exercise price
100,000	\$ 5.50 - 6.25	\$5.65	1.4 years	100,000	\$5.65
26,664	7.00	7.00	1.0 years	26,664	7.00
49,804	8.50 - 9.00	8.63	1.5 years	49,804	8.63
370,820	10.50 - 11.55	10.52	2.1 years	370,820	10.52
1,914,050	15.00 - 16.50	15.02	4.5 years	<u>1,309,050</u>	15.02
				<u><u>1,856,338</u></u>	

(12) Fair Value of Financial Instruments

The Company uses the following methods and assumptions to estimate the fair value of financial instruments.

Cash equivalents, receivables, other current assets, accounts payable and accrued expenses, and due to area developers:

The carrying amounts approximate fair value because of the short maturity of these instruments. At April 30, 2011 and 2010, the Company had cash equivalents of \$970,000 and \$54,000, respectively, invested in money market accounts.

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 individuals/entities with comparable credit risk.

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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.

Concentrations of credit risks: 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 of the franchisee, value of the franchises, as well as the personal guarantee of the individual franchisees. At April 30, 2011 and 2010, 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.

The consolidated financial statements include various estimated fair value information at April 30, 2011 and 2010.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial assets and liabilities subject to fair value measurements on a recurring basis are classified according to a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value.

- Level 1 — quoted prices for identical assets and liabilities in active markets.
- Level 2 — quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, and model-based valuations in which all significant inputs are observable in the market.
- Level 3 — unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

At April 30, 2011 and 2010, the following tables present, for each of the fair value hierarchy levels, the assets and liabilities that are measured at fair value on a recurring and nonrecurring basis (in thousands):

	April 30, 2011			
	Total	Fair value measurements using		
		Level 1	Level 2	Level 3
Assets:				
Recurring:				
Cash equivalents	\$970	\$970	\$ —	\$ —
Nonrecurring:				
Impaired accounts and notes receivable.....	\$7,090	\$ —	\$ —	\$7,090
Impaired customer lists	348	—	—	348
	<u>\$7,438</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$7,438</u>
Liabilities:				
Recurring:				
Interest rate swap agreements	\$1,134	\$ —	\$1,134	\$ —
	<u>\$1,134</u>	<u>\$ —</u>	<u>\$1,134</u>	<u>\$ —</u>

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	April 30, 2010			
	Total	Fair value measurements using		
		Level 1	Level 2	Level 3
Assets:				
Recurring:				
Cash equivalents	\$54	\$54	\$ —	\$ —
Nonrecurring:				
Impaired accounts and notes receivable.....	\$6,736	\$ —	\$ —	\$6,736
Impaired customer lists	526	—	—	526
	<u>\$7,262</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$7,262</u>
Liabilities:				
Recurring:				
Interest rate swap agreements	\$821	\$ —	\$821	\$ —

(13) Related Party Transactions

The Company considers directors, their affiliated companies and executive officers to be related parties.

For the years ended April 30, 2011, 2010, and 2009, the Company repurchased common and Class A preferred stock from related parties as follows:

	2011	2010	2009
Common stock:			
Shares repurchased	224,625	297,730	146,100
Amount	\$3,369,000	\$4,466,000	\$2,192,000
Preferred stock:			
Shares repurchased	18,146	—	—
Amount	\$2,722,000	\$ —	\$ —

For the years ended April 30, 2011, 2010, and 2009, the Company issued and sold common stock to related parties as follows:

	2011	2010	2009
Shares sold	—	—	424,376
Proceeds from sale of stock	\$ —	\$ —	\$7,087,000

At April 30, 2011 and 2010, notes receivable from related parties are as follows:

	2011	2010
Notes receivable.....	\$950,000	\$700,000
Principal repayments during the year	—	50,000
Interest payments during the year	51,000	17,000

Interest rates on these notes approximate prevailing market rates at the time of their issuance.

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(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 salary. Total compensation expense related to these contributions was \$305,000, \$295,000, and \$263,000 for the years ended April 30, 2011, 2010, and 2009, 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 at April 30, 2011.

During the year ended April 30, 2009, following a 2008 trial, a judgment was entered against the Company and for the State of California related to advertising in that state. An amount of approximately \$1,300,000 was accrued and included in other expense in the consolidated statement of income for the year ended April 30, 2009.

(16) Subsequent Events

On June 3, 2011, the Company authorized the grant of 343,670 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 four to five-year period after the vesting date.

As previously discussed in Note 10, on July 14, 2011, the Company amended its Certificate of Incorporation to change the par value of all classes of stock from \$1 per share to \$.01 per share. Management has made this change to allow a potential increase in the number of shares authorized. The effects of the par value change have been recorded retroactively in the consolidated financial statements.