HNI Corporation (HNI)

Updated May 3rd, 2018 by Josh Arnold

Key Metrics

Current Price:	$34	**5 Year CAGR Estimate:**	15.6%	**Quality Percentile:**	N/A
Fair Value Price:	$45	**5 Year Growth Estimate:**	6.3%	**Momentum Percentile:**	N/A
% Fair Value:	76%	**5 Year Valuation Multiple Estimate:**	5.8%	**Total Return Percentile:**	N/A
Dividend Yield:	3.5%	**5 Year Price Target**	$61	**Valuation Percentile:**	N/A

Overview & Current Events

HNI Corporation was founded in 1944 as an office furniture manufacturer. The company continues to be a leader in that space as it has expanded its portfolio of brands and also added a full array of hearth products including fireplaces, inserts and stoves. HNI has a market cap of $1.5B and should do $2.2B in revenue this year.

Q1 is typically a weak quarter for HNI and this year's Q1 report was particularly uninspiring. Revenue was up 6% as both the Office Furniture and Hearth Products segments saw similar growth. However, gross margins fell while freight and distribution costs soared, more than offsetting the small gain in SG&A leverage. As a result, operating margins fell on an adjusted basis from 3.8% in last year's Q1 to just 1.2% this year. HNI is in an extremely cyclical industry so swings in revenue and profitability are expected; results like Q1 are something one has to tolerate when owning this stock.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.46	$0.56	$0.87	$1.05	$1.12	$1.43	$1.97	$2.58	$2.62	$1.97	***$2.50***	***$3.40***
DPS	$0.86	$0.86	$0.86	$0.92	$0.95	$0.96	$0.99	$1.05	$1.09	$1.14	***$1.20***	***$1.50***

Because of HNI's extreme cyclicality, EPS has been all over the place in the past decade. Importantly, the trend has remained firmly to the upside but growth has been anything but linear. Revenue growth has averaged -1% in the past decade but if we exclude the Great Recession, that number moves materially higher to 4% annually. That's roughly congruent with guidance for this year so we see a low single digit level of revenue growth annually moving forward. The problem is that margins are still under pressure from input cost inflation, unfavorable mix and higher freight costs. Freight has been a problem for many businesses of late as there simply aren't enough trucks to move products and HNI is suffering for it; the cost of moving its goods continues to rise. Its SG&A costs are moving down relative to revenue so that is helping to offset some of this burden, but it thus far hasn't been enough. HNI's buyback was good for 2.9% of the float in the past four quarters, something we see continuing. We are therefore forecasting total EPS growth of 6.3% annually, consisting of low single digit revenue growth, a small headwind from margins and a low single digit tailwind from the buyback. Keep in mind that these results won't come in a linear fashion but HNI looks setup for further growth.

We see the dividend continuing to rise as well. We are forecasting dividends per share of $1.50 or so in five years.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	15.5	33.8	31.5	24.3	23.7	25.0	19.7	18.7	16.7	21.1	***13.6***	***18.0***
Avg. Yld.	3.8%	4.5%	3.1%	3.6%	3.6%	2.7%	2.5%	2.2%	2.5%	2.7%	***3.5%***	***2.5%***

HNI's P/E multiple has moved around a lot, which is something you'd expect for a cyclical stock. Of late, however, it has moved well below its historical average and thus, looks like it is trading well below fair value. Even if we assume a modest P/E multiple of 18, the stock's current PE multiple of 13.6 is very enticing. We therefore see a meaningful 5.8% tailwind going forward from a sizable increase in the valuation.

Due to a rising stock price and the dividend increasing at relatively low rates, we see the high 3.5% current yield dwindling to a more normalized 2.5% yield. Today, HNI offers a combination of a cheap valuation and high yield that we do not believe will last.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	33.4%	34.0%	34.7%	34.9%	34.4%	34.7%	35.3%	36.8%	37.9%	36.0%	***35.0%***	***34.0%***
Debt/A	61%	58%	59%	60%	61%	62%	67%	62%	62%	63%	***63%***	***60%***
Int. Cov.	5.5	0.8	5.1	7.2	8.8	11.5	14.3	25.2	28.0	12.7	***15.0***	***20.0***
Payout	59%	154%	111%	86%	84%	66%	49%	40%	41%	56%%	***48%***	***44%***
Std. Dev.	65.4%	65.8%	40.7%	47.5%	26.1%	22.3%	32.4%	24.4%	49.6%	29.1%	***32.0%***	***40.0%***

HNI's quality metrics have been somewhat volatile during the past decade but again, its results are expected to be as such. Its balance sheet has looked very much the same in terms of leverage at around 60% debt financing and excluding 2009, its interest coverage has been more than sufficient. The payout ratio has also been quite low and we see it moving slightly lower over time as EPS growth outpaces dividend growth by a small margin; this also allows for increased safety of the dividend during the next downturn. The somewhat troubling trend stems from gross margins, which have been weakening since 2016. HNI's level of EPS very much depends upon whether or not it can stabilize its gross margins, which we see as continuing to drift lower over time. It has other levers to pull to grow, but it is worth watching.

HNI's competitive advantage is its scale in the office furniture business as well as its long operating history and track record with customers. HNI has some of the most recognizable brands in the sector but that doesn't save it from recessions; the next time a recession hits there will almost undoubtedly be a sizable downswing in HNI's earnings.

Final Thoughts & Recommendation

Overall, HNI is a compelling buy at current prices. The stock is at a trough valuation and the yield has commensurately moved to very high levels. We see total annual returns of 15.6%, consisting of the 3.5% current yield, 6.3% EPS growth and a 5.8% tailwind from the valuation moving higher. That makes HNI suitable for an investor that wants a higher yield that is reasonably safe as well as those seeking growth at a reasonable price. HNI is not a stock that will weather downturns but if that's something that one can move past, HNI looks attractive here for growth, value and yield.

Total Return Breakdown by Year