HNI Corporation (HNI)

Updated October 23rd, 2018 by Josh Arnold

Key Metrics

Current Price:	$39	**5 Year CAGR Estimate:**	12.1%	**Volatility Percentile:**	93.3%
Fair Value Price:	$44	**5 Year Growth Estimate:**	6.5%	**Momentum Percentile:**	32.3%
% Fair Value:	88%	**5 Year Valuation Multiple Estimate:**	2.6%	**Growth Percentile:**	58.6%
Dividend Yield:	3.0%	**5 Year Price Target**	$60	**Valuation Percentile:**	69.0%
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Total Return Percentile:**	69.4%

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 added a full array of hearth products including fireplaces, inserts and stoves. HNI has a market capitalization of $1.7 billion and should generate $2.3 billion in revenue this year.

HNI reported Q3 earnings on 10/22/18 and results were decent. Revenue grew 2% as the company produced a 4.6% gain in organic revenue, but that was partially offset by the closing of the small office furniture business. Gross margins rose 130bps as the company saw better price realization, as well as productivity and input cost gains from its ongoing efficiency efforts. These profitability gains were offset by a 110bps increase in SG&A costs, driven mostly by higher compensation expenses. HNI's tax rate fell from 33% to 22% year-over-year, which helped it produce a 10% gain in diluted earnings-per-share. We've maintained our estimate of $2.45 for this year after a largely in-line Q3 report.

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	***$2.45***	***$3.35***
DPS	$0.86	$0.86	$0.86	$0.92	$0.95	$0.96	$0.99	$1.05	$1.09	$1.14	***$1.18***	***$1.50***
Shares	44	45	45	45	45	45	44	44	44	43	***43***	***41***

Because of HNI's extreme cyclicality, earnings-per-share have been volatile over the past decade. Importantly, the trend has been up, 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 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. Margins improved slightly once again in Q3, a meaningful step forward for HNI. SG&A costs are a source of concern still, but management is focused on reducing that line item moving forward. HNI's buyback was good for ~3% of the float in the past four quarters, something we see continuing. We are therefore forecasting total earnings-per-share growth of 6.5% annually, consisting of low single digit revenue growth, roughly flat margins and a low single digit tailwind from the buyback. Keep in mind that these results will not come in a linear fashion, but HNI looks setup for further growth. Margins should also improve moving into next year as the closing of the small office furniture business is lapped, although the impact should be relatively small.

We see the dividend continuing to rise as well, given HNI's track record of returning excess cash to shareholders. 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	***15.8***	***18.0***
Avg. Yld.	3.8%	4.5%	3.1%	3.6%	3.6%	2.7%	2.5%	2.2%	2.5%	2.7%	***3.0%***	***2.5%***

HNI's price-to-earnings multiple has moved around a lot, which is something you'd expect for a cyclical stock. The recent selloff in the shares has it trading well below our fair value estimate of 18 times earnings. We are therefore forecasting a 2.6% tailwind to annual total returns from a rising valuation over time. The falling share price has caused the yield to move higher again, as it now sits at 3%. We expect the share price to grow more quickly than the dividend payment in the coming years, and the yield to fall back to 2.5% as a result.

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%***	***45%***
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%***

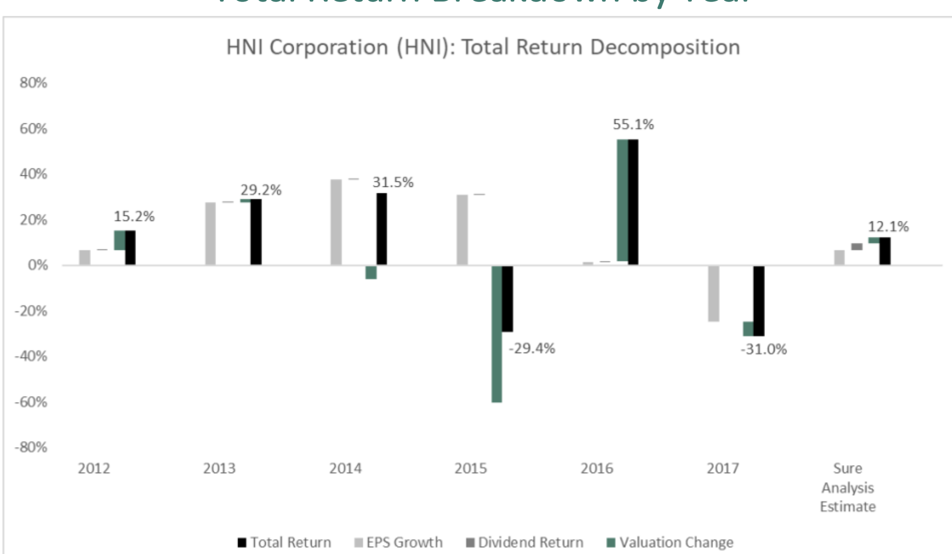
HNI's quality metrics have been somewhat volatile during the past decade but again, its results are expected to be as such. Its balance sheet has looked very much the same in terms of leverage at around 60% debt financing and excluding 2009, its interest coverage has been more than sufficient. The payout ratio has also been relatively low, and we see it moving slightly lower over time as earnings 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. Efficiency efforts and the closing of the small office furniture business should help. However, it certainly bears watching in the coming quarters for any signs of weakness.

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

After the recent selloff, HNI is once again undervalued, trading for just 88% of our fair value estimate. We now see total annual returns of 12.1%, consisting of the 3.0% current yield, 6.5% earnings-per-share growth and a 2.6% tailwind from the valuation. HNI's 3% yield is certainly a potential draw for investors and we also think the long-term growth outlook for the company is still very much intact. Adding in that the stock is trading once again below fair value, we rate HNI a buy. It offers investors a reasonable valuation, strong growth potential and a 3% yield.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	2478	1623.3	1686.7	1833.5	2004.0	2060.0	2222.7	2304.4	2203.5	2175.9
Gross Profit	828.6	562.8	585.6	639.1	689.2	715.3	784.2	847.4	835.0	784.0
Gross Margin	33.4%	34.7%	34.7%	34.9%	34.4%	34.7%	35.3%	36.8%	37.9%	36.0%
SG&A Exp.	717.9	513.8	518.3	554.3	599.7	606.5	649.1	672.1	667.7	671.8
D&A Exp.	70.2	74.9	58.6	46.3	43.4	46.6	56.7	57.6	68.9	72.9
Operating Profit	110.7	49.0	67.4	84.7	89.6	108.8	135.1	175.3	167.3	112.2
Operating Margin	4.5%	3.0%	4.0%	4.6%	4.5%	5.3%	6.1%	7.6%	7.6%	5.2%
Net Profit	45.5	-6.4	26.9	46.0	49.0	63.7	61.5	105.4	85.6	89.8
Net Margin	1.8%	-0.4%	1.6%	2.5%	2.4%	3.1%	2.8%	4.6%	3.9%	4.1%
Free Cash Flow	102.9	175.7	67.7	103.1	84.5	86.1	55.1	58.4	103.8	5.8
Income Tax	23.6	-1.5	16.8	24.4	29.3	33.3	43.8	51.8	43.3	-19.3

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	1166	994.3	997.9	1051.7	1077.1	1134.7	1239.3	1263.9	1330.2	1391.6
Cash & Equivalents	39.5	87.4	99.1	72.8	41.8	65.0	34.1	28.5	36.3	23.3
Accounts Receivable	N/A	N/A	190.1	204.0	213.5	228.7	240.1	243.4	229.4	258.6
Inventories	84.3	65.1	69.0	101.9	93.5	89.5	121.8	125.2	118.4	155.7
Goodwill & Int. Ass.	268.4	261.1	313.9	334.8	375.2	381.3	279.3	430.7	511.4	490.9
Total Liabilities	716.6	574.7	589.4	632.4	656.4	698.3	824.8	786.6	829.2	877.0
Accounts Payable	96.8	114.4	123.6	159.3	189.4	199.9	224.0	424.4	201.8	235.6
Long-Term Debt	321.8	200.0	200.3	180.8	155.1	153.9	201.3	196.5	218.4	279.6
Shareholder's Equity	448.8	419.3	408.0	419.1	420.4	436.3	414.6	477.0	500.6	514.1
D/E Ratio	0.72	0.48	0.49	0.43	0.37	0.35	0.49	0.41	0.44	0.54

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	3.8%	-0.6%	2.7%	4.5%	4.6%	5.8%	5.2%	8.4%	6.6%	6.6%
Return on Equity	10.0%	-1.5%	6.5%	11.1%	11.7%	14.9%	14.4%	23.7%	17.5%	17.7%
ROIC	6.0%	-0.9%	4.4%	7.6%	8.3%	10.9%	10.2%	16.4%	12.3%	11.9%
Shares Out.	44	45	45	45	45	45	44	44	44	43
Revenue/Share	55.76	36.16	36.82	40.12	43.74	44.82	48.77	50.71	48.43	48.53
FCF/Share	2.32	3.91	1.48	2.26	1.84	1.87	1.21	1.28	2.28	0.13

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.