HNI Corporation (HNI)

Updated July 24th, 2018 by Josh Arnold

Key Metrics

Current Price:	$44	**5 Year CAGR Estimate:**	9.3%	**Volatility Percentile:**	92.9%
Fair Value Price:	$45	**5 Year Growth Estimate:**	6.5%	**Momentum Percentile:**	37.1%
% Fair Value:	99%	**5 Year Valuation Multiple Estimate:**	0.1%	**Valuation Percentile:**	66.0%
Dividend Yield:	2.7%	**5 Year Price Target**	$60	**Total Return Percentile:**	66.5%

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 capitalization of $1.5 billion and should generate $2.2 billion in revenue this year.

HNI reported second quarter earnings on 7/24/18 and results beat estimates for both revenue and profits. Total revenue was up almost 6% on a reported basis, but rose nearly 9% on an organic basis, with a ~3% headwind from the divestiture of the company's small office furniture business. Earnings-per-share rose 4.8% on an adjusted basis, the product of higher gross margins more than offsetting a small increase in SG&A costs. HNI also named a new CEO during the last few days of the second quarter, so investors will be keen to see what, if any, changes come about. Earnings-per-share guidance was reduced by 15 cents for the rest of the year and we've slightly reduced our estimates in sympathy.

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	***$1.20***	***$1.50***

Because of HNI's extreme cyclicality, earnings-per-share have been volatile over the past decade. Importantly, the trend has been up and to the right, 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 in Q2, a meaningful step forward for HNI. SG&A costs rose slightly in Q2 but not enough to warrant shifting estimates down. 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 won't come in a linear fashion, but HNI looks setup for further growth.

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	***17.9***	***18.0***
Avg. Yld.	3.8%	4.5%	3.1%	3.6%	3.6%	2.7%	2.5%	2.2%	2.5%	2.7%	***2.7%***	***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 rally in the shares has it trading right at our fair value estimate of 18 times earnings. Therefore, we don't see the valuation as having an impact on forecast total returns at this point.

Since our last report, HNI shares have moved nearly a third higher, causing the dividend yield to fall back to more normalized levels in the mid-2% range. We see this as continuing in the coming years as the dividend rises at roughly the same rate as earnings.

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.

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%%	***49%***	***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%***

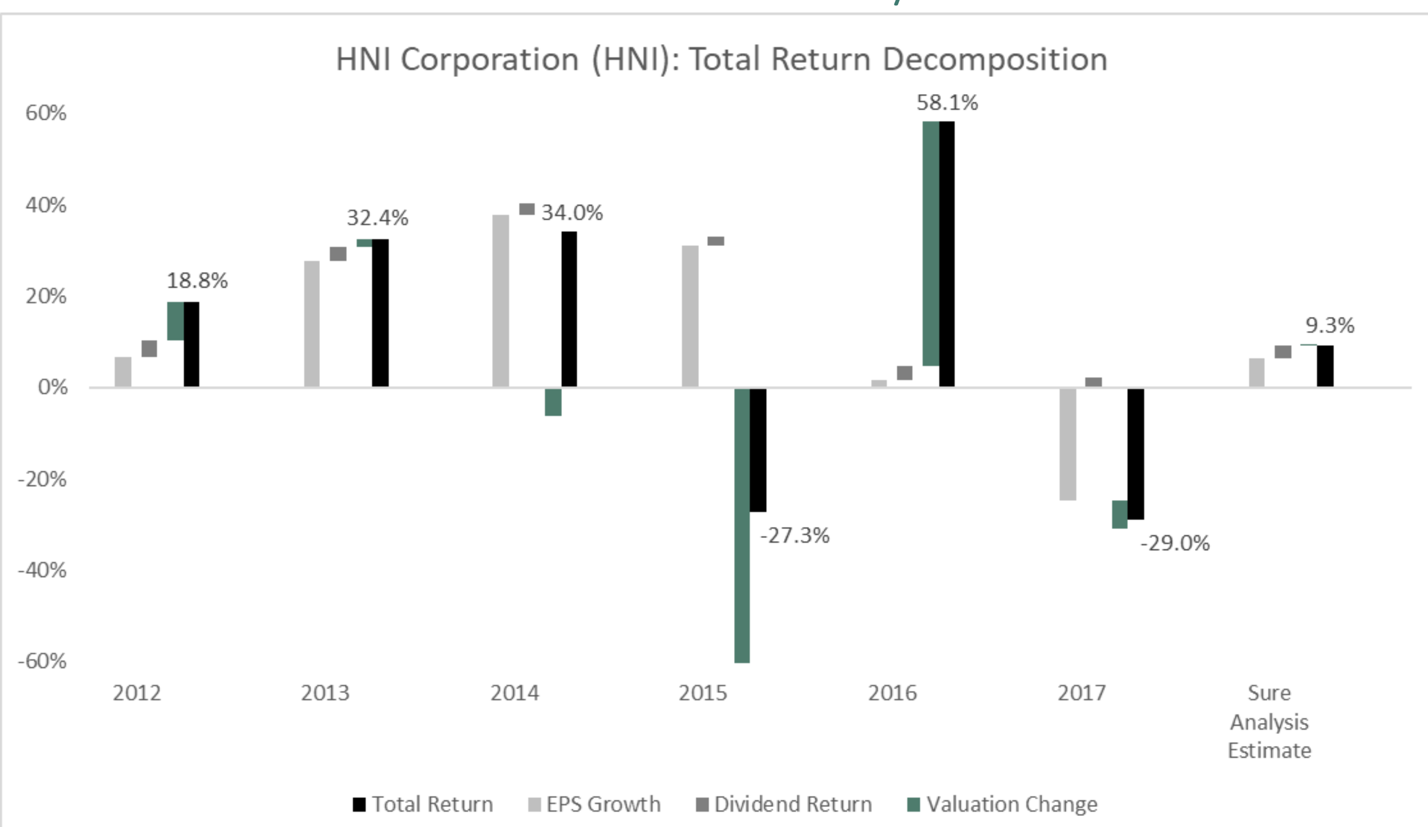
HNI's quality metrics have been somewhat volatile during the past decade but again, its results are expected to be as such. Its balance sheet has looked very much the same in terms of leverage at around 60% debt financing and excluding 2009, its interest coverage has been more than sufficient. The payout 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. Q2 was a bright spot on that metric, so we aren't as concerned as we were after the Q1 report. However, it certainly bears watching in the second half of this year 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

In our last report, we called HNI a compelling buy. However, the stock has rallied strongly, and it is now fairly valued. We now see total annual returns of 9.3%, consisting of the 2.7% current yield, 6.5% EPS growth and a 0.1% tailwind from the valuation. HNI is still an income stock, although the current yield is now much lower than it was during our last report. We think investors can wait for a better price on HNI given that it looks fully valued after the recent rally.

Total Return Breakdown by Year



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