HNI Corporation (HNI)

Updated February 27th, 2019 by Nathan Parsh

Key Metrics

Current Price:	$37	**5 Year CAGR Estimate:**	15.3%	**Volatility Percentile:**	91.8%
Fair Value Price:	$49	**5 Year Growth Estimate:**	6.5%	**Momentum Percentile:**	55.4%
% Fair Value:	76%	**5 Year Valuation Multiple Estimate:**	5.6%	**Growth Percentile:**	62.0%
Dividend Yield:	3.2%	**5 Year Price Target**	$67	**Valuation Percentile:**	87.6%
Dividend Risk Score:	C	**Retirement Suitability Score:**	B	**Total Return Percentile:**	86.4%

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 generates nearly $2.3 billion in annual revenues.

HNI reported fourth quarter and full-year financial results on 2/25/2019. Revenue increased 2.4% to $597.1 million in the quarter. Organic sales improved 5.4%. The company earned $0.97 per share, topping estimates by $0.01 and more than doubled the total from the previous year. A decline in the tax rate to 22% from 33% aided profitability. Gross margins were higher by 140 bps due improved price realization and productivity partially offset by an increase in input costs. SG&A expenses declined 220 bps because of lower restructuring costs and lower incentive-based compensation. For 2018, HNI's sales grew 3.8% to $2.26 billion. Earnings-per-share increased 22.3% to $2.41, though this was $0.04 below our estimate for the year. Net sales for office furniture improved 0.1% to $430 million in the fourth quarter. The divestiture of the company's small office furniture division caused a $17.1 million decrease in sales in the quarter. This segment had organic sales growth of 4.3% during the quarter and 6.4% for 2018. The Hearth Products segment experienced sales growth of 8.5% to $168.5 million in the quarter due to gains made in the new construction and retail businesses. Shares of HNI declined 11.5% following the release of results. This decline was likely due to management's forecast for a decline of 7% to 9% in total sales for the office furniture segment in the first quarter. Office furniture was responsible for 75% of total sales in 2018. HNI also stated that demand for products slowed late in the fourth quarter and early 2019. Growth is expected to return as the year progresses. HNI expects sales for 2019 to grow between 2% to 6% with organic sales growing 3% to 7%. The company expects earnings-per-share in the range of $2.50 to $2.90 for 2019 for the year.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$0.56	$0.87	$1.05	$1.12	$1.43	$1.97	$2.58	$2.62	$1.97	$2.41	***$2.70***	***$3.70***
DPS	$0.86	$0.86	$0.92	$0.95	$0.96	$0.99	$1.05	$1.09	$1.14	$1.18	***$1.18***	***$1.50***
Shares	45	45	45	45	45	44	44	44	45	44	***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. This annual average is in line with the company's guidance for 2019. Margins improved in the fourth quarter, but sustained a 20bps declined for the year. On the plus side, SG&A costs were reduced in the most recent quarter after increasing in the third quarter.

HNI's year-end share count was lower by 1.1% from 2017. We maintain our earnings-per-share growth estimate of 6.5% per year through 2024. This growth is made up of low single digit revenue growth, flat to slight increase in margins and share repurchases. Again, these results may not occur in a linear fashion, but if the company is able to see a reversal in slowing in the office furniture segment, then HNI looks setup for further growth. Margins should also improve in 2019 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.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	33.8	31.5	24.3	23.7	25.0	19.7	18.7	16.7	21.1	15.8	***13.7***	***18***
Avg. Yld.	4.5%	3.1%	3.6%	3.6%	2.7%	2.5%	2.2%	2.5%	2.7%	3.0%	***3.2%***	***2.2%***

HNI's price-to-earnings multiple has moved around a lot, which is something you'd expect for a cyclical stock. The selloff in the shares following fourth quarter results has it trading well below our fair value estimate of 18 times earnings. We are therefore forecasting a 5.6% 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 3.2%. We expect the share price to grow more quickly than the dividend payment in the coming years, and the yield to fall back to 2.2% as a result.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	154%	111%	86%	84%	66%	49%	40%	41%	56%%	49%	***42%***	***41%***

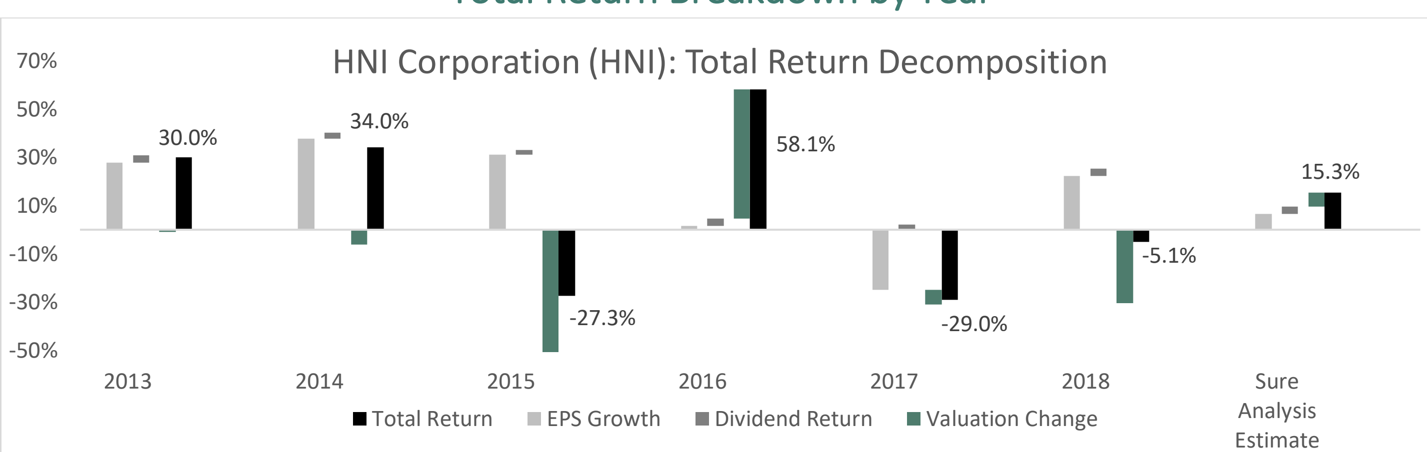
HNI's quality metrics have been somewhat volatile during the past decade but again, its results are expected to be as such. Its balance sheet has looked very much the same in terms of leverage at around 60% debt financing and excluding 2009, its interest coverage has been more than sufficient. The payout 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

Following the post-earnings release sell off, we find that HNI trades for 76% of our fair value estimate. We expect total annual returns of 15.3% through 2024, up from our previous estimate of 12.1%. While the slowing of sales for the company's largest segment is a concern, HNI expects to see solid sales growth for the current year. With a yield that is both well covered and in excess of the S&P 500, income investors could be attracted to the stock. We maintain our buy rating on the stock and have raised our 2024 price target to $7 to $67 due to higher expected earnings for 2019.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	1623	1687	1833	2004	2060	2223	2304	2203	2176	2258
Gross Profit	563	586	639	689	715	784	847	835	784	835
Gross Margin	34.7%	34.7%	34.9%	34.4%	34.7%	35.3%	36.8%	37.9%	36.0%	37.0%
SG&A Exp.	514	518	554	600	607	649	672	668	672	691
D&A Exp.	75	59	46	43	47	57	58	69	73	75
Operating Profit	49	67	85	90	109	135	175	167	112	144
Operating Margin	3.0%	4.0%	4.6%	4.5%	5.3%	6.1%	7.6%	7.6%	5.2%	6.4%
Net Profit	-6	27	46	49	64	61	105	86	90	93
Net Margin	-0.4%	1.6%	2.5%	2.4%	3.1%	2.8%	4.6%	3.9%	4.1%	4.1%
Free Cash Flow	176	68	103	85	86	55	58	104	6	123
Income Tax	-1	17	24	29	33	44	52	43	-19	25

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	994	998	1052	1077	1135	1239	1264	1330	1392	1402
Cash & Equivalents	87	99	73	42	65	34	29	36	23	77
Accounts Receivable	N/A	190	204	213	229	240	243	229	259	255
Inventories	65	69	102	94	90	122	125	118	156	157
Goodwill & Int. Ass.	261	314	335	375	381	279	431	511	491	463
Total Liabilities	575	589	632	656	698	825	787	829	877	839
Accounts Payable	114	124	159	189	200	224	424	202	236	221
Long-Term Debt	200	200	181	155	154	201	196	218	280	255
Shareholder's Equity	419	408	419	420	436	415	477	501	514	563
D/E Ratio	0.48	0.49	0.43	0.37	0.35	0.49	0.41	0.44	0.54	0.45

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	-0.6%	2.7%	4.5%	4.6%	5.8%	5.2%	8.4%	6.6%	6.6%	6.7%
Return on Equity	-1.5%	6.5%	11.1%	11.7%	14.9%	14.4%	23.7%	17.5%	17.7%	17.3%
ROIC	-0.9%	4.4%	7.6%	8.3%	10.9%	10.2%	16.4%	12.3%	11.9%	11.6%
Shares Out.	45	45	45	45	45	44	44	44	45	44
Revenue/Share	36.16	36.82	40.12	43.74	44.82	48.77	50.71	48.43	48.53	50.94
FCF/Share	3.91	1.48	2.26	1.84	1.87	1.21	1.28	2.28	0.13	2.77

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