



H&R Block Inc. (HRB)

Updated June 12th, 2019 by Samuel Smith

Key Metrics

Current Price:	\$28	5 Year CAGR Estimate:	8.9%	Volatility Percentile:	73.0%
Fair Value Price:	\$31	5 Year Growth Estimate:	3.3%	Momentum Percentile:	76.8%
% Fair Value:	91%	5 Year Valuation Multiple Estimate:	2.0%	Growth Percentile:	19.3%
Dividend Yield:	3.6%	5 Year Price Target	\$36	Valuation Percentile:	63.9%
Dividend Risk Score:	C	Retirement Suitability Score:	B	Total Return Percentile:	44.0%

Overview & Current Events

H&R Block, Inc. is a \$5.7 billion global consumer tax services provider. It offers comprehensive tax return preparation through approximately 12,000 company owned and franchised H&R Block locations around the world. H&R Block also offers tax software. The company generates annual revenue of more than \$3 billion, and prepared over 23 million tax returns in fiscal 2018.

HRB company announced financial results for the fiscal 2019 fourth quarter on June 11th, 2019. H&R Block reported revenue of \$2.33 billion for the quarter, down 2.52% year-over-year, along with a GAAP net profit of \$4.32 per share. Overall, the company achieved U.S. tax return growth, outpacing the industry for the second consecutive year while also reporting fiscal 2019 revenues and margins at the high end of the previously provided outlook. In addition, earnings per share were boosted by the fact that management repurchased approximately 7.9 million shares during the fiscal year and have now extended the share repurchase authorization for three more years to June 2022. The company also signed a definitive agreement to acquire Wave Financial Inc. in order to accelerate the company's strategy in the large and expanding small business market, providing the company with growth opportunities. Symbolizing their optimism about the future of the company, the board of directors raised the quarterly dividend by four percent to \$0.26 per share, equating to a \$1.02 payout in calendar year 2019 and in-line with our previous projections.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$1.35	\$1.25	\$1.69	\$1.81	\$1.75	\$1.53	\$1.96	\$2.98	\$2.40	\$2.40	\$2.40	\$2.82
DPS	\$0.60	\$0.70	\$0.80	\$0.80	\$0.80	\$0.80	\$0.84	\$0.92	\$0.98	\$1.00	\$1.02	\$1.20
Shares	305.4	292.1	272.6	274.2	275.3	220.5	207.2	209.3	207.0	207.0	207.0	207.0

By acquiring Wave Financial, H&R Block has added a boost to its otherwise murky growth outlook. Poor customer retention has prompted the company to engineer a turnaround. Broadly speaking, the operating environment for tax preparation is changing. While there will always be a need for tax preparation, the Trump administration has expressed a desire to greatly simplify the tax code. A much more simplified tax system could mean less demand for H&R Block's higher-margin services. In addition, earnings growth could be negatively impacted by the continued adoption of online or do-it-yourself tax software such as TurboTax. H&R Block has had to act on price and also invest in its own software services to meet the needs of a changing marketplace. These forces are expected to weigh on H&R Block's earnings growth, both this fiscal year and moving forward. That being said, Wave Financial will give them more opportunities to grow in the small business sector, an area less likely to be impacted by a simplified personal income tax code.

H&R Block management expects fiscal 2019 revenue of \$3.05 billion to \$3.1 billion. Earnings-per-share are expected to remain flat with fiscal 2018, based on the midpoint of 2019 guidance. As a result of the Wave Financial acquisition, we are slightly increasing our outlook to 3.3% annual earnings growth over the next five fiscal years. Dividends are expected to grow by 3.3% per year as well.

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Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	13.7	12.5	10.6	12.5	11.5	16.1	18.4	21.2	11.6	9.1	11.7	12.9
Avg. Yld.	2.8%	3.3%	4.2%	4.5%	4.1%	2.8%	2.5%	2.5%	3.7%	3.4%	3.6%	3.3%

In the past 10 years, H&R Block shares traded for an average price-to-earnings ratio of 13.7. However, this period includes an abnormally high valuation in 2015, when the company's earnings-per-share took a significant dive. Excluding this one year, H&R Block shares traded for an average price-to-earnings ratio of 12.9 in the past decade, which is a reasonable estimate of fair value. Based on this, the stock appears to be undervalued. Expansion of the price-to-earnings ratio is expected to add 2% to the annual returns for H&R Block if mean reversion were to occur over the next 5 years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2023
Payout	44.4%	56.0%	47.3%	44.2%	45.7%	52.3%	42.9%	30.9%	40.8%	41.7%	42.5%	42.6%

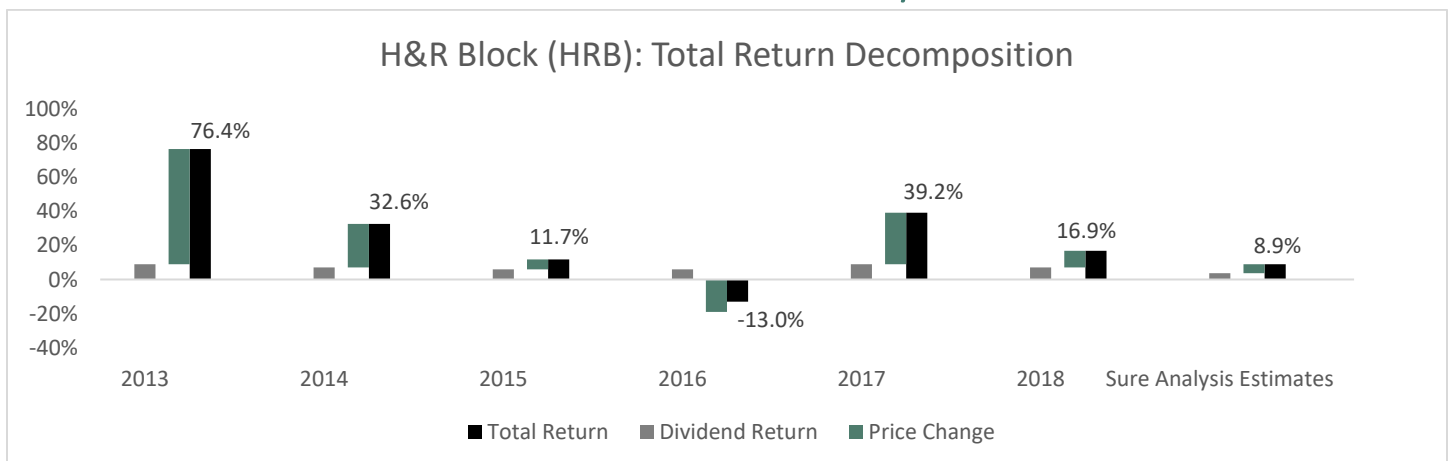
H&R Block scores fairly well when it comes to safety and quality metrics. The company has a large amount of debt, but also generates strong interest coverage. It also has a payout ratio well below 50%, which indicates the dividend is secure. H&R Block has paid quarterly dividends consecutively since the company went public in 1962.

H&R Block benefits from durable competitive advantages. It is the leading brand in the tax preparation industry, and provides a necessary service to taxpayers. H&R Block remained profitable each year during the Great Recession, and the company should be expected to remain profitable if and when another recession occurs in the United States.

Final Thoughts & Recommendation

H&R Block has a number of favorable qualities as a business. It has a leading brand in its industry, and has a highly profitable business model. This allows the company to return cash to shareholders through share repurchases and dividends. However, H&R Block is in the middle of a turnaround. It needs to invest significantly to adapt to a more challenging operating climate. This will inhibit the company's growth over the next five years. H&R Block has expected returns of 8.9% per year stemming from its 3.6% dividend yield, 2% expected annual multiple expansion, and 3.3% expected annual earnings-per-share growth rate. Given the share price surge since our last report, the ongoing uncertainty facing the industry, and the integration risk posed by the recent acquisition of Wave Financial, we downgrade the stock to a hold at current valuation levels.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	4084	3752	2945	2894	2906	3024	3079	3038	3036	3160
Gross Profit	1487	1284	1168	1192	1375	1452	1448	1353	1392	1420
Gross Margin	36.4%	34.2%	39.7%	41.2%	47.3%	48.0%	47.0%	44.5%	45.8%	44.9%
SG&A Exp.	648	631	529	599	587	611	606	719	676	668
D&A Exp.	124	127	122	104	92	116	160	174	182	183
Operating Profit	839	652	639	574	771	818	795	633	716	752
Operating Margin	20.5%	17.4%	21.7%	19.8%	26.5%	27.1%	25.8%	20.8%	23.6%	23.8%
Net Profit	486	479	406	266	434	475	474	374	409	613
Net Margin	11.9%	12.8%	13.8%	9.2%	14.9%	15.7%	15.4%	12.3%	13.5%	19.4%
Free Cash Flow	927	497	450	280	384	663	503	445	463	751
Income Tax	326	295	235	230	237	267	256	186	208	42

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	5360	5234	5208	4650	4538	4694	4515	2847	2694	3141
Cash & Equivalents	1655	1804	1678	1944	1748	2185	2007	897	1011	1545
Accounts Receivable	N/A	327	282	129	131	125	122	134	104	100
Goodwill & Int. Ass.	1236	1208	1214	704	719	792	874	905	901	882
Total Liabilities	3954	3794	3758	3324	3274	3137	2682	2824	2755	2747
Accounts Payable	706	757	618	567	524	222	231	260	217	252
Long-Term Debt	1141	1966	1930	1041	907	906	506	1492	1494	1496
Shareholder's Equity	1406	1441	1450	1326	1264	1557	1833	23	-61	394
D/E Ratio	0.81	1.36	1.33	0.78	0.72	0.58	0.28	64.59	-24.54	3.80

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	8.8%	9.0%	7.8%	5.4%	9.4%	10.3%	10.3%	10.2%	14.8%	21.0%
Return on Equity	40.6%	33.7%	28.1%	19.2%	33.5%	33.7%	27.9%	40.3%	N/A	368%
ROIC	17.7%	16.1%	12.0%	9.3%	19.1%	20.5%	19.7%	19.4%	27.7%	36.9%
Shares Out.	323.3	305.4	292.1	272.6	274.2	275.3	220.5	207.2	209.3	207.0
Revenue/Share	12.21	11.26	9.51	9.69	10.59	10.96	11.11	12.11	14.18	15.03
FCF/Share	2.77	1.49	1.45	0.94	1.40	2.40	1.82	1.77	2.16	3.57

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

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