



# H&R Block Inc. (HRB)

Updated January 10<sup>th</sup>, 2020 by Samuel Smith

## Key Metrics

<b>Current Price:</b>	\$24	<b>5 Year CAGR Estimate:</b>	7.2%	<b>Market Cap:</b>	\$4.6B
<b>Fair Value Price:</b>	\$25	<b>5 Year Growth Estimate:</b>	2.6%	<b>Ex-Dividend Date:</b>	3/6/20 <sup>1</sup>
<b>% Fair Value:</b>	97%	<b>5 Year Valuation Multiple Estimate:</b>	0.6%	<b>Dividend Payment Date:</b>	4/2/20 <sup>2</sup>
<b>Dividend Yield:</b>	4.4%	<b>5 Year Price Target</b>	\$28	<b>Years Of Dividend Growth:</b>	5
<b>Dividend Risk Score:</b>	C	<b>Retirement Suitability Score:</b>	B	<b>Last Dividend Increase:</b>	4%

## Overview & Current Events

H&R Block, Inc. is a \$4.6 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 second quarter on December 4<sup>th</sup>, 2019. Revenues grew by 8% year-over-year thanks to the Wave acquisition and improved tax return volumes. However, the expected loss per share increased considerably from \$0.10 to \$0.93. Despite the loss, the company returned quite a bit of cash to shareholders by repurchasing 5.7 million shares at an average price of \$23.94 per share. Management highlighted how their efforts to digitally enable all facets of their business were making good headway and they expect these efforts to combine with the Wave acquisition to deliver growth over the long term.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	\$1.25	\$1.69	\$1.81	\$1.75	\$1.53	\$1.96	\$2.98	\$2.40	\$2.40	\$2.40	<b>\$2.48</b>	<b>\$2.82</b>
<b>DPS</b>	\$0.70	\$0.80	\$0.80	\$0.80	\$0.80	\$0.84	\$0.92	\$0.98	\$1.00	\$1.02	<b>\$1.06</b>	<b>\$1.20</b>
<b>Shares<sup>3</sup></b>	292.1	272.6	274.2	275.3	220.5	207.2	209.3	207.0	207.0	207.0	<b>198.1</b>	<b>170.0</b>

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 the company more opportunities to grow in the small business sector, an area less likely to be impacted by a simplified personal income tax code. As a result of the Wave Financial acquisition, we expect 2.6% annual earnings growth over the next five fiscal years.

## Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
<b>Avg. P/E</b>	13.7	12.5	10.6	12.5	11.5	16.1	18.4	21.2	11.6	9.1	<b>9.7</b>	<b>10.0</b>
<b>Avg. Yld.</b>	2.8%	3.3%	4.2%	4.5%	4.1%	2.8%	2.5%	2.5%	3.7%	3.4%	<b>4.4%</b>	<b>4.3%</b>

<sup>1</sup> Estimate

<sup>2</sup> Estimate

<sup>3</sup> In millions

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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. However, given the recent simplification of the tax code and the growth of competing online services, H&R Block's moat has weakened considerably. As a result, we believe that a multiple of 10 is fair. Based on this, the stock appears to be undervalued. Expansion of the price-to-earnings ratio is expected to add a slight tailwind 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	56.0%	47.3%	44.2%	45.7%	52.3%	42.9%	30.9%	40.8%	41.7%	42.5%	42.5%	42.6%

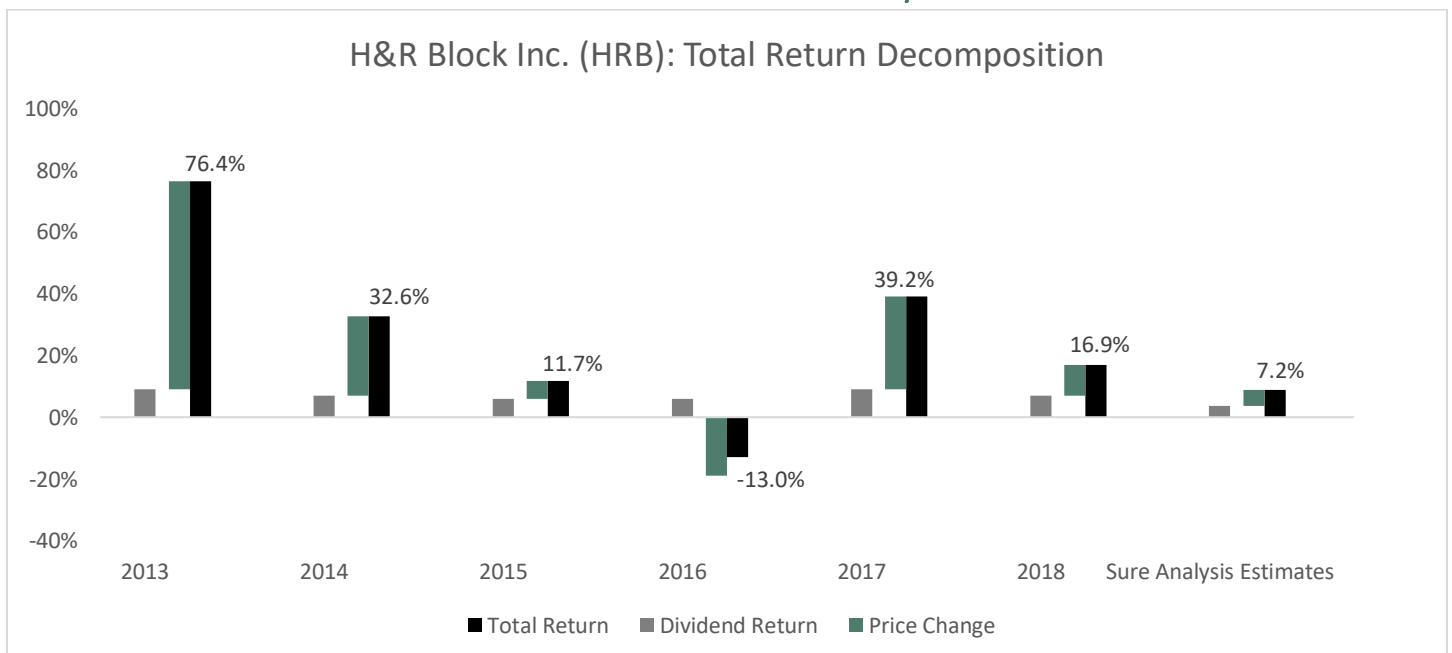
H&R Block scores fairly well when it comes to safety and quality metrics. The company has a large amount of debt, but also generates strong interest coverage. It also has a payout ratio well below 50%, which indicates the dividend is secure. H&R Block has paid quarterly dividends consecutively since 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 7.2% per year stemming from its 4.4% dividend yield, slight expected annual multiple expansion, and 2.6% expected annual earnings-per-share growth rate. Given these factors, we view the stock as a hold right now.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Revenue</b>	3,752	2,945	2,894	2,906	3,024	3,079	3,038	3,036	3,160	3,095
<b>Gross Profit</b>	1,284	1,168	972	1,161	1,202	1,210	1,353	1,392	1,420	1,338
<b>Gross Margin</b>	34.2%	39.7%	33.6%	40.0%	39.7%	39.3%	44.5%	45.8%	44.9%	43.2%
<b>SG&amp;A Exp.</b>	631	529	378	373	361	367	719	676	668	722
<b>D&amp;A Exp.</b>	127	122	104	92	116	160	174	182	183	167
<b>Operating Profit</b>	652	639	574	771	818	795	633	716	752	616
<b>Operating Margin</b>	17.4%	21.7%	19.8%	26.5%	27.1%	25.8%	20.8%	23.6%	23.8%	19.9%
<b>Net Profit</b>	479	406	266	434	475	474	374	409	613	423
<b>Net Margin</b>	12.8%	13.8%	9.2%	14.9%	15.7%	15.4%	12.3%	13.5%	19.4%	13.7%
<b>Free Cash Flow</b>	497	450	280	384	663	503	445	463	751	511
<b>Income Tax</b>	295	235	230	237	267	256	186	208	42	100

## Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Total Assets</b>	5,234	5,208	4,650	4,538	4,694	4,515	2,847	2,694	3,141	3,300
<b>Cash &amp; Equivalents</b>	1,804	1,678	1,944	1,748	2,185	2,007	897	1,011	1,545	1,572
<b>Accounts Receivable</b>	327	282	129	131	125	122	109	88	16	21
<b>Goodwill &amp; Int. Ass.</b>	1,208	1,214	704	719	792	874	905	901	882	862
<b>Total Liabilities</b>	3,794	3,758	3,324	3,274	3,137	2,682	2,824	2,755	2,747	2,758
<b>Accounts Payable</b>	757	618	567	524	222	231	260	217	252	250
<b>Long-Term Debt</b>	1,966	1,930	1,041	907	906	506	1,492	1,494	1,496	1,493
<b>Shareholder's Equity</b>	1,441	1,450	1,326	1,264	1,557	1,833	23	(61)	394	542
<b>D/E Ratio</b>	1.36	1.33	0.78	0.72	0.58	0.28	64.59	(24.54)	3.80	2.76

## Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<b>Return on Assets</b>	9.0%	7.8%	5.4%	9.4%	10.3%	10.3%	10.2%	14.8%	21.0%	13.1%
<b>Return on Equity</b>	33.7%	28.1%	19.2%	33.5%	33.7%	27.9%	40.3%		368.4%	90.4%
<b>ROIC</b>	16.1%	12.0%	9.3%	19.1%	20.5%	19.7%	19.4%	27.7%	36.9%	21.5%
<b>Shares Out.</b>	292.1	272.6	274.2	275.3	220.5	207.2	209.3	207.0	207.0	207.0
<b>Revenue/Share</b>	11.26	9.51	9.69	10.59	10.96	11.11	12.11	14.18	15.03	14.97
<b>FCF/Share</b>	1.49	1.45	0.94	1.40	2.40	1.82	1.77	2.16	3.57	2.47

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

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