HNI Corporation (HNI)

Updated April 25th, 2020 by Nathan Parsh

Key Metrics

Current Price:	$22	**5 Year CAGR Estimate:**	16.2%	**Market Cap:**	$969 million
Fair Value Price:	$30	**5 Year Growth Estimate:**	5.5%	**Ex-Dividend Date:**	5/15/2020[1]
% Fair Value:	72%	**5 Year Valuation Multiple Estimate:**	6.7%	**Dividend Payment Date:**	6/2/2020[2]
Dividend Yield:	5.5%	**5 Year Price Target**	$40	**Years Of Dividend Growth:**	9
Dividend Risk Score:	B	**Retirement Suitability Score:**	B	**Last Dividend Increase:**	3.4%

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 generates about $2 billion in annual revenues.

On 4/22/2020, HNI reported first quarter earnings results. The company earned $0.21 per share during the quarter compared to $0.02 in the previous year. This was $0.27 above estimates. Revenue declined 2.2% to $469 million, which was $8 million lower than expected.

Organic sales for the quarter declined 2.5%. Office furniture net sales were down 4.3%. This segment realized higher prices and productivity, but this wasn't enough to overcome lower volumes and higher tariff expense. Sales for Hearth Products increased 3.5% due to higher prices and volumes, and was only partially offset by increased tariff expenses. An acquisition added $1.1 million to sales for this segment.

Gross profit margins for Q1 improved 220 basis points to 37.6% due to higher prices and productivity. Lower volumes and increased tariff expense partially offset these gains. HNI had one-time charges of $37.7 million related to the COVID-19 pandemic. A one-time $5 million charge related to COVID-19 resulted in a 100-basis point expansion of S&GA expenses. The company reduced salaries, furloughed employees and reduced capital expenditures in response to the ongoing crisis. HNI did suspend its share repurchases, but said that free cash flow should be at least equal to the company's dividend. HNI is now expected to earn $2.17 per share in 2020, down from $2.75 previously.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$0.87	$1.05	$1.12	$1.43	$1.97	$2.58	$2.62	$1.97	$2.41	$2.59	***$2.17***	***$2.84***
DPS	$0.86	$0.92	$0.95	$0.96	$0.99	$1.05	$1.09	$1.14	$1.18	$1.22	***$1.22***	***$1.50***
Shares[3]	45	45	45	45	44	44	44	45	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.

We maintain our earnings-per-share growth estimate of to 5.5% per year through 2025. Our growth estimate is made up of low-single-digit revenue growth, flat to slightly higher 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, HNI looks setup for further growth. Margins should also improve in 2020 as the closing of the small office furniture business is lapped, but the impact will be relatively small.

We see the dividend continuing to rise as well, given HNI's track record of returning excess cash to shareholders. HNI increased its dividend by 3.4% for the 6/3/2019 payment. We forecast dividends per share of $1.50 or so in five years.

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[1] Estimated date

[2] Estimated dividend payment date

[3] In millions of shares

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	31.5	24.3	23.7	25.0	19.7	18.7	16.7	21.1	15.8	14.5	***10.1***	***14.0***
Avg. Yld.	3.1%	3.6%	3.6%	2.7%	2.5%	2.2%	2.5%	2.7%	3.0%	3.3%	***5.5%***	***3.8%***

HNI's price-to-earnings multiple has moved around a lot, which is something you'd expect for a cyclical stock. We are lowering our 2025 target price-to-earnings ratio to 14 from 16 due to lower EPS estimates for the year. The share price is down $19, or 46% since our 2/20/2020 report. Based on the current price and earnings estimates for 2020, HNI trades with a P/E ratio of 10.1. We are therefore forecasting a 6.7% tailwind to annual total returns from a rising valuation over time. Shares offer a current yield of 5.5%. We expect the share price to grow more quickly than the dividend payment in the coming years, and the yield to fall back to 3.8% as a result.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	111%	86%	84%	66%	49%	40%	41%	56%%	49%	47%	***56%***	***53%***

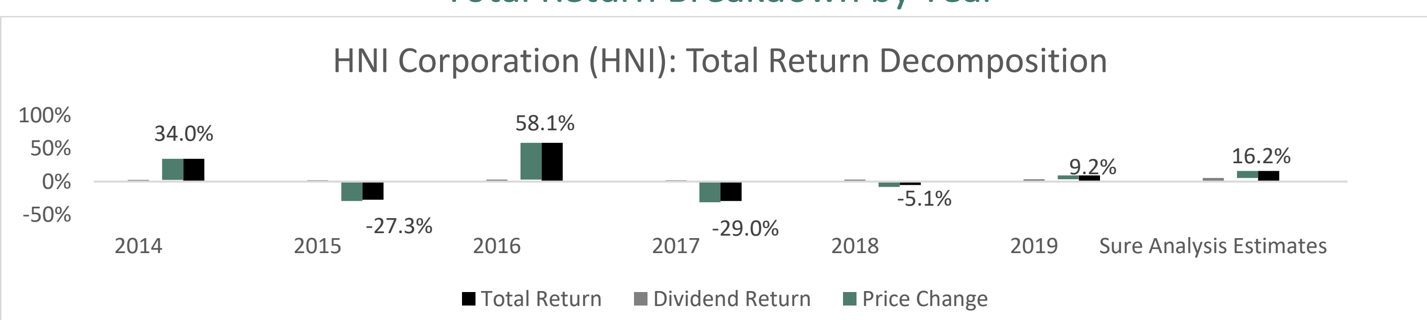
HNI's quality metrics have been somewhat volatile during the past decade but again, its results are expected to be as such. Its balance sheet has looked very much the same in terms of leverage at around 60% debt financing and excluding 2009, its interest coverage has been more than sufficient. The payout 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 reviewing first quarter results, HNI Corporation is now expected to offer a 16.2% annual return through 2025, up from our previous estimate of 9.5%. The company faced some headwinds due to the COVID-19 crisis, but has taken steps to help mitigate the impact of the virus. HNI's Hearth Products performed well in the quarter, though this wasn't enough to offset the performance of the Office Furniture segment. We have lowered our 2025 price target $18 to $40 due to lower earnings estimates and decrease in target valuation, but maintain our buy rating on the stock. We stress that only investors with a higher risk tolerance should consider buying HNI Corporation as the company is highly sensitive to the health of the overall economy.

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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	1,687	1,833	2,004	2,060	2,223	2,304	2,203	2,176	2,258	2,247
Gross Profit	586	639	689	715	784	847	835	784	835	834
Gross Margin	34.7%	34.9%	34.4%	34.7%	35.3%	36.8%	37.9%	36.0%	37.0%	37.1%
SG&A Exp.	518	554	600	607	649	672	668	672	691	680
D&A Exp.	59	46	43	47	57	58	69	73	75	77
Operating Profit	67	85	90	109	135	175	167	112	144	154
Operating Margin	4.0%	4.6%	4.5%	5.3%	6.1%	7.6%	7.6%	5.2%	6.4%	6.8%
Net Profit	27	46	49	64	61	105	86	90	93	111
Net Margin	1.6%	2.5%	2.4%	3.1%	2.8%	4.6%	3.9%	4.1%	4.1%	4.9%
Free Cash Flow	68	103	85	86	55	58	104	6	123	152
Income Tax	17	24	29	33	44	52	43	(19)	25	32

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	998	1,052	1,077	1,135	1,239	1,264	1,330	1,392	1,402	1,453
Cash & Equivalents	99	73	42	65	34	29	36	23	77	52
Accounts Receivable	190	204	213	229	240	243	229	259	255	275
Inventories	69	102	94	90	122	125	118	156	157	163
Goodwill & Int. Ass.	314	335	375	381	279	431	511	491	463	446
Total Liabilities	589	632	656	698	825	787	829	877	839	868
Accounts Payable	124	159	189	200	224		202	236	221	
Long-Term Debt	200	181	155	151	198	190	214	277	250	175
Shareholder's Equity	408	419	420	436	415	477	501	514	563	584
D/E Ratio	0.49	0.43	0.37	0.35	0.48	0.40	0.43	0.54	0.44	0.30

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.7%	4.5%	4.6%	5.8%	5.2%	8.4%	6.6%	6.6%	6.7%	7.7%
Return on Equity	6.5%	11.1%	11.7%	14.9%	14.4%	23.7%	17.5%	17.7%	17.3%	19.3%
ROIC	4.4%	7.6%	8.3%	11.0%	10.3%	16.5%	12.4%	11.9%	11.6%	14.1%
Shares Out.	45	45	45	45	44	44	44	45	44	43
Revenue/Share	36.82	40.12	43.74	44.82	48.77	50.71	48.43	48.53	50.94	51.66
FCF/Share	1.48	2.26	1.84	1.87	1.21	1.28	2.28	0.13	2.77	3.51

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