



H&R Block Inc. (HRB)

Updated April 16th, 2020 by Samuel Smith

Key Metrics

Current Price:	\$14	5 Year CAGR Estimate:	10.9%	Market Cap:	\$2.6B
Fair Value Price:	\$9	5 Year Growth Estimate:	14.9%	Ex-Dividend Date:	6/6/20 ¹
% Fair Value:	156%	5 Year Valuation Multiple Estimate:	-8.5%	Dividend Payment Date:	7/2/20 ²
Dividend Yield:	7.6%	5 Year Price Target	\$18	Years Of Dividend Growth:	5
Dividend Risk Score:	C	Retirement Suitability Score:	A	Last Dividend Increase:	4%

Overview & Current Events

H&R Block, Inc. is a \$2.6 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 third quarter on March 5th, 2020. Revenues grew by 11% year-over-year thanks to the Wave acquisition and improved tax return volumes. However, the expected loss per share increased considerably from \$0.52 to \$0.59 due to 11% growth in operating expenses such as the Wave acquisition, the timing of marketing expense recognition, increased compensation related to higher Assisted tax return volumes, and planned investments in technology.

Management was recently forced to pull guidance for the final quarter of the fiscal year after U.S. Treasury Secretary Mnuchin pushed back the tax filing deadline by 90 days.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$1.25	\$1.69	\$1.81	\$1.75	\$1.53	\$1.96	\$2.98	\$2.40	\$2.40	\$2.40	\$1.00	\$2.00
DPS	\$0.70	\$0.80	\$0.80	\$0.80	\$0.80	\$0.84	\$0.92	\$0.98	\$1.00	\$1.02	\$1.06	\$1.12
Shares³	292.1	272.6	274.2	275.3	220.5	207.2	209.3	207.0	207.0	207.0	198.1	170.0

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 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 and share buybacks, we expect low-single-digit annual earnings growth between fiscal 2019 levels and fiscal 2025 levels. 2020 numbers will be significantly suppressed due to the tax deadline delay.

¹ Estimate

² Estimate

³ In millions

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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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	13.7	12.5	10.6	12.5	11.5	16.1	18.4	21.2	11.6	9.1	14.0	9.0
Avg. Yld.	2.8%	3.3%	4.2%	4.5%	4.1%	2.8%	2.5%	2.5%	3.7%	3.4%	7.6%	6.2%

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 9 is fair. Based on this, the stock appears to be overvalued. Compression of the price-to-earnings ratio is expected to add a headwind 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%	106%	56%

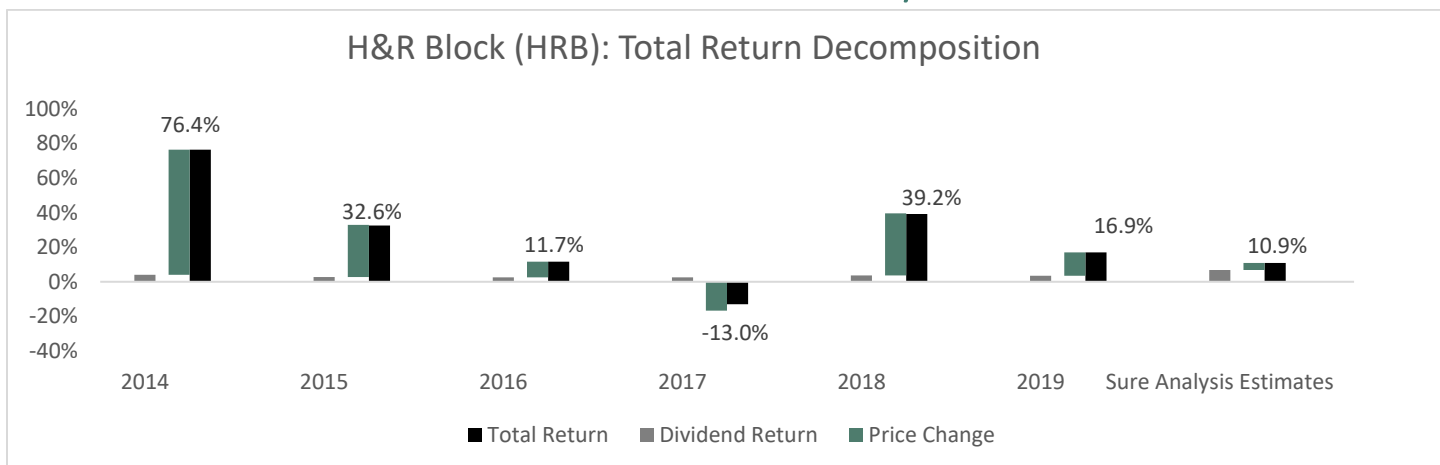
H&R Block scores fairly well when it comes to safety and quality metrics. The company has a large amount of debt, but also generates strong interest coverage. It also has a normalized payout ratio below 50%, which indicates the dividend is secure. H&R Block has paid quarterly dividends consecutively 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 10.9% per year largely stemming from its 7.6% dividend yield. Given these factors, we view the stock as a speculative buy 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
Revenue	3,752	2,945	2,894	2,906	3,024	3,079	3,038	3,036	3,160	3,095
Gross Profit	1,284	1,168	972	1,161	1,202	1,210	1,353	1,392	1,420	1,338
Gross Margin	34.2%	39.7%	33.6%	40.0%	39.7%	39.3%	44.5%	45.8%	44.9%	43.2%
SG&A Exp.	631	529	378	373	361	367	719	676	668	722
D&A Exp.	127	122	104	92	116	160	174	182	183	167
Operating Profit	652	639	574	771	818	795	633	716	752	616
Operating Margin	17.4%	21.7%	19.8%	26.5%	27.1%	25.8%	20.8%	23.6%	23.8%	19.9%
Net Profit	479	406	266	434	475	474	374	409	613	423
Net Margin	12.8%	13.8%	9.2%	14.9%	15.7%	15.4%	12.3%	13.5%	19.4%	13.7%
Free Cash Flow	497	450	280	384	663	503	445	463	751	511
Income Tax	295	235	230	237	267	256	186	208	42	100

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	5,234	5,208	4,650	4,538	4,694	4,515	2,847	2,694	3,141	3,300
Cash & Equivalents	1,804	1,678	1,944	1,748	2,185	2,007	897	1,011	1,545	1,572
Accounts Receivable	327	282	129	131	125	122	109	88	16	21
Goodwill & Int. Ass.	1,208	1,214	704	719	792	874	905	901	882	862
Total Liabilities	3,794	3,758	3,324	3,274	3,137	2,682	2,824	2,755	2,747	2,758
Accounts Payable	757	618	567	524	222	231	260	217	252	250
Long-Term Debt	1,966	1,930	1,041	907	906	506	1,492	1,494	1,496	1,493
Shareholder's Equity	1,441	1,450	1,326	1,264	1,557	1,833	23	(61)	394	542
D/E Ratio	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
Return on Assets	9.0%	7.8%	5.4%	9.4%	10.3%	10.3%	10.2%	14.8%	21.0%	13.1%
Return on Equity	33.7%	28.1%	19.2%	33.5%	33.7%	27.9%	40.3%		368%	90.4%
ROIC	16.1%	12.0%	9.3%	19.1%	20.5%	19.7%	19.4%	27.7%	36.9%	21.5%
Shares Out.	292.1	272.6	274.2	275.3	220.5	207.2	209.3	207.0	207.0	207.0
Revenue/Share	11.26	9.51	9.69	10.59	10.96	11.11	12.11	14.18	15.03	14.97
FCF/Share	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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