



H&R Block Inc. (HRB)

Updated December 21st, 2020 by Samuel Smith

Key Metrics

Current Price:	\$15.1	5 Year CAGR Estimate:	12.7%	Market Cap:	\$2.8B
Fair Value Price:	\$17.6	5 Year Growth Estimate:	4.6%	Ex-Dividend Date:	3/4/21 ¹
% Fair Value:	86%	5 Year Valuation Multiple Estimate:	3.1%	Dividend Payment Date:	4/4/21 ²
Dividend Yield:	6.9%	5 Year Price Target:	\$22	Years Of Dividend Growth:	6
Dividend Risk Score:	B	Retirement Suitability Score:	A	Last Dividend Increase:	2.0%

Overview & Current Events

H&R Block, Inc. is a \$2.8 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 \$3.5 billion and prepares over 20 million tax returns annually.

H&R Block announced financial results for the fiscal 2021 Q2 on December 8th, 2020. Adjusted earnings-per-share came in at \$1.09, up from \$0.85 per share in the year-ago period. \$177 million in revenue for Q2 FY2021 was higher than the \$163.8 million analyst consensus estimate and increased 10% from \$161 million year-over-year. EBITDA for this quarter was at \$168 million, down from \$197 million in the year-ago period. Operating expense of \$382 million was down by 5% year-over-year due to decreased travel, client claims and refunds, consulting, and depreciation and amortization. Pretax loss improved \$24 million to \$237 million. The company's GAAP loss per share from continuing operations increased \$0.24 to \$(1.17) and adjusted non-GAAP loss per share also increased \$0.24 to \$(1.09).

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$1.69	\$1.81	\$1.75	\$1.53	\$1.96	\$2.98	\$2.40	\$2.40	\$2.39	\$0.84	\$3.29	\$2.75
DPS	\$0.80	\$0.80	\$0.80	\$0.80	\$0.84	\$0.92	\$0.98	\$1.00	\$1.02	\$1.04	\$1.04	\$1.12
Shares³	272.6	274.2	275.3	220.5	207.2	209.3	207.0	207.0	207.0	198.1	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. The Trump administration was unable to simplify the tax code, but that remains a risk for the company moving forward, regardless of who is in power.

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. Fiscal 2020 earnings-per-share were artificially suppressed due to the extension of the tax filing deadline to further after the end of the fiscal year end. As a result, 2021 earnings-per-share will be artificially inflated. As a result, we are basing our fair value estimate and other valuation metrics off an estimated earnings power of \$2.20 for fiscal 2021, as we expect the company to be unable to replicate its 2021 actual earnings.

¹ Estimated

² Estimated

³ In millions

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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	12.5	10.6	12.5	11.5	16.1	18.4	21.2	11.6	9.1	7.0	6.9	8.0
Avg. Yld.	3.3%	4.2%	4.5%	4.1%	2.8%	2.5%	2.5%	3.7%	3.4%	5.0%	6.9%	5.1%

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 8 is fair. Based on this, the stock still appears to be slightly undervalued. Expansion of the price-to-earnings ratio is expected to add a modest tailwind to H&R Block's total returns if mean reversion were to occur over the next 5 years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	47.3%	44.2%	45.7%	52.3%	42.9%	30.9%	40.8%	41.7%	42.5%	52.0%	31.6%	40.7%

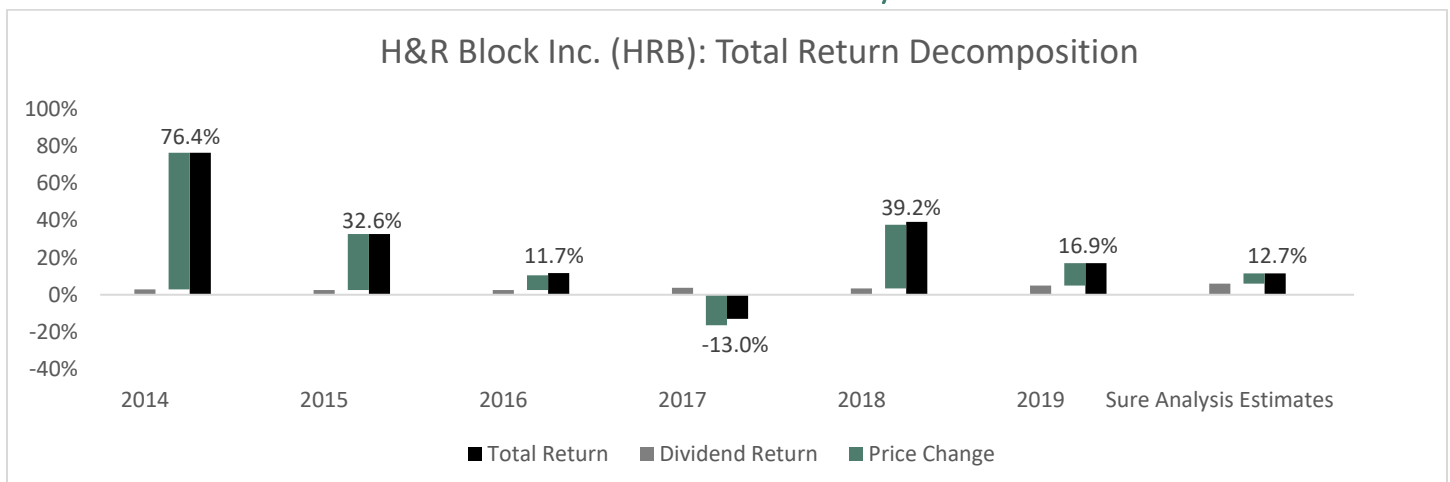
H&R Block scores fairly well when it comes to safety and quality metrics. The company has a large amount of debt, but also generates strong interest coverage. It also has a normalized payout ratio below 50%, which indicates the dividend is secure. H&R Block has paid quarterly dividends consecutively 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 several favorable qualities as a business. It has a leading brand in its industry and has a highly profitable capital light 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 annualized total returns of 12.7% per year largely stemming from its dividend yield and expected per share earnings growth. Given these factors, we view the stock as a buy.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	2,945	2,894	2,906	3,024	3,079	3,038	3,036	3,160	3,095	2,640
Gross Profit	1,168	972	1,161	1,202	1,210	1,353	1,392	1,420	1,338	927
Gross Margin	39.7%	33.6%	40.0%	39.7%	39.3%	44.5%	45.8%	44.9%	43.2%	35.1%
SG&A Exp.	529	378	373	361	367	719	676	668	722	744
D&A Exp.	122	104	92	116	160	174	182	183	167	170
Operating Profit	639	574	771	818	795	633	716	752	616	183
Operating Margin	21.7%	19.8%	26.5%	27.1%	25.8%	20.8%	23.6%	23.8%	19.9%	6.9%
Net Profit	406	266	434	475	474	374	409	613	423	(8)
Net Margin	13.8%	9.2%	14.9%	15.7%	15.4%	12.3%	13.5%	19.4%	13.7%	-0.3%
Free Cash Flow	450	280	384	663	503	445	463	751	511	27
Income Tax	235	230	237	267	256	186	208	42	100	(10)

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	5,208	4,650	4,538	4,694	4,515	2,847	2,694	3,141	3,300	5,112
Cash & Equivalents	1,678	1,944	1,748	2,185	2,007	897	1,011	1,545	1,572	2,662
Accounts Receivable	282	129	131	125	122	109	88	16	56	64
Goodwill & Int. Ass.	1,214	704	719	792	874	905	901	882	862	1,127
Total Liabilities	3,758	3,324	3,274	3,137	2,682	2,824	2,755	2,747	2,758	5,041
Accounts Payable	618	567	524	222	231	260	217	252	250	203
Long-Term Debt	1,930	1,041	907	906	506	1,492	1,494	1,496	1,493	3,495
Shareholder's Equity	1,450	1,326	1,264	1,557	1,833	23	(61)	394	542	71
D/E Ratio	1.33	0.78	0.72	0.58	0.28	64.59	(24.5)	3.80	2.76	49.20

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	7.8%	5.4%	9.4%	10.3%	10.3%	10.2%	14.8%	21.0%	13.1%	-0.2%
Return on Equity	28.1%	19.2%	33.5%	33.7%	27.9%	40.3%		368%	90.4%	-2.5%
ROIC	12.0%	9.3%	19.1%	20.5%	19.7%	19.4%	27.7%	36.9%	21.5%	-0.3%
Shares Out.	272.6	274.2	275.3	220.5	207.2	209.3	207.0	207.0	207.0	198.1
Revenue/Share	9.51	9.69	10.59	10.96	11.11	12.11	14.18	15.03	14.97	13.32
FCF/Share	1.45	0.94	1.40	2.40	1.82	1.77	2.16	3.57	2.47	0.14

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

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