

H&R BLOCK

H&R Block Inc. (NYSE: HRB)

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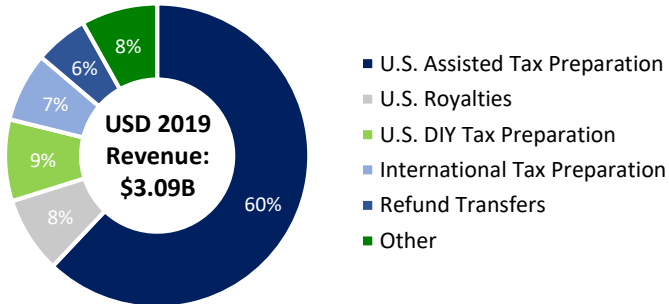
Recommendation

Company Overview

Business Description

- H&R Block Inc. (NYSE: HRB) is one of the largest global tax preparation companies, focusing on both assisted and do-it-yourself (DIY) preparation services
- The American company primarily operates in the United States, Canada, Australia and India; they also provide digital offerings
- Founded in 1955 and headquartered in Kansas City, H&R is a leader in the Tax Preparation industry with 18% of U.S. market share
- HRB currently employs 2,700 full-time and 90,700 part-time and seasonal workers across nearly 10,000 offices

2019 Segmented Revenue



Management Team

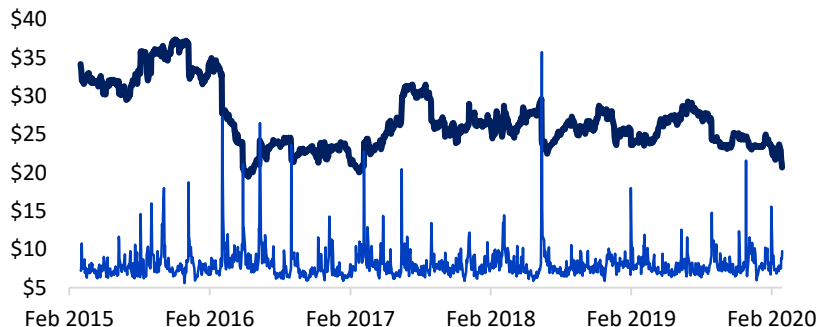
Name		Jeffrey J. Jones II	Tony Bowen	Jamil Khan	Vinoo Vijay
Position		President & CEO	CFO	CSO	CMO
Years of Exp.		28	23	21	20
Background		Previously President of Uber Technologies Inc.	Previously VP of Finance for U.S. Tax Services	Previously SVP of Strategy for Cengage	Previously CMO of TD Bank

Office Locations



Company Overview

Price-Volume Analysis



Market Data

52 Week Range	\$20.14 – \$29.62
<i>% of high</i>	72.5%
Levered Beta	0.694
P/E (LTM)	10.4x
EV/EBITDA (LTM)	7.9x
EV/Revenue (LTM)	1.9x

Primary Business Lines



Assisted Tax Filing

Assisted tax filings utilize a taxation specialist to tailor tax return sets to each individual customer based on their specific exceptions and needs



DIY Tax Filing

H&R is digitalizing their platform to enable customers to fill out their tax forms themselves with the support of a tax advisor



Wave Financial

The recent acquisition of Wave Financial gives H&R Block a new business line focused on office support for small Canadian businesses

Industry Overview

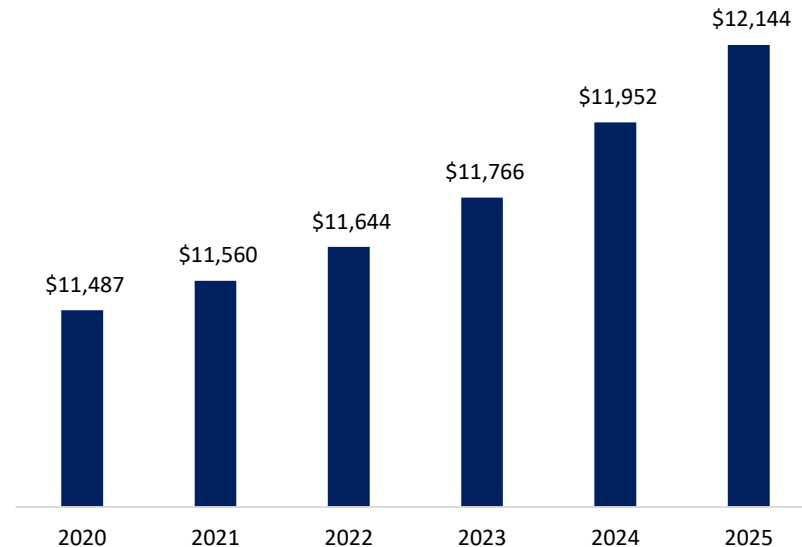
Emerging Trends

- Consumers are increasingly using online services due to stronger internet penetration and changing consumer trends
 - As a result, businesses are now focusing on the integration of both online and offline services
- Regulators have become tougher on the provision of Refund Anticipation Loans (RAL) over the past five years
 - However, major players in the industry are still experimenting with them as a new revenue segment
- Key drivers of revenue include volume and speed of turnaround

Industry Characteristics

- The Tax Preparation industry thrives during peak tax season, occurring from February to April, and accounting for a substantial amount of annual revenue
- The tax industry does not require large amounts of capital; rather, it is very labour-intensive
 - Wages accounted for about 33.3% of industry costs in 2019
- Exposure to government policy and disruptive technologies are the greatest industry risks

Revenue Growth 2020-2025 (\$in Millions)



As a mature industry, Tax Preparation is expected to grow at a compound annual growth rate (CAGR) of 1.12% from 2020 to 2025, reaching \$12.14B after the 5 years



Accelerated Expansion Within Small Business Markets

Acquisition of Wave Financial



- H&R Block recently acquired Wave Financial through an all-stock deal for \$405 million
- Wave provides accounting, invoicing, payroll, and payment software solutions for small businesses
- Wave currently has around 400,000 monthly users across 200 countries

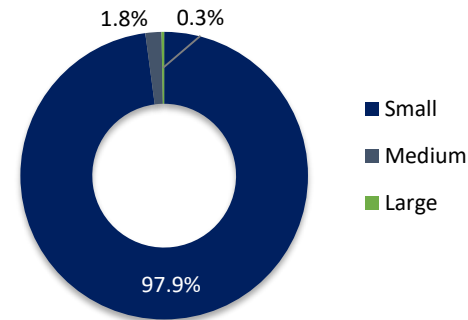
Strategic Alignment & Complimentary Service Synergies

- This acquisition aligns with H&R's strategy to pursue new growth opportunities and to grow within the small business market
- Bookkeeping and cash flow management are significant pain points for small business owners and essential to successful annual tax preparation
- Both companies can leverage each other's services, as well as customer base to further widen their client offerings

Additional Revenue Stream Widens H&R's Moat

- Wave Financial combats revenue intake irregularities by providing essential services year-round – creating a consistent revenue stream
- Almost 98% of Canadian businesses are classified as small businesses (<100 employees), leaving an enormous amount of untapped market share in Canada alone

2019 Canadian Business Size

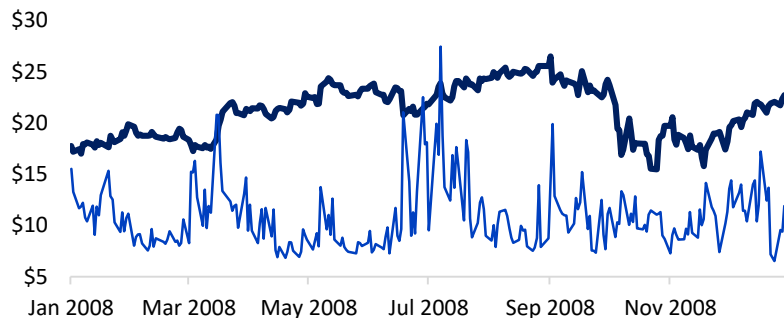


Recession-Resistant Business Model

Business Security Fueled by Need

- Expert tax preparation services are needed more than ever during a recession due to reduced income
- The marginal benefit of increased income through expert tax service is increasingly attractive during uncertain and underperforming economies
- Polarizing political tax positions are likely to cause tax reform and trigger the need for expert tax preparation

2008 Stock Performance



Industry Growth 2003-2014 (\$in Millions)

Year	Revenue \$ million	Growth %
2003	7,489.3	0.0
2004	7,711.8	3.0
2005	7,773.4	0.8
2006	7,931.2	2.0
2007	8,365.5	5.5
2008	8,650.7	3.4
2009	8,850.3	2.3
2010	8,891.3	0.5
2011	8,936.9	0.5
2012	8,842.8	-1.1
2013	9,204.4	4.1
2014	9,597.4	4.3

Historical Success

- The Tax Preparation industry has excelled during past recessions
- Between 2007-2009, revenue grew by 11.2% overall despite global economic decline
- During 2008, H&R block's stock rose 24.64% from \$18.08 per share in January to \$22.51 per share by the end of the year



Digitalization Drives Margin Expansion & FCF Generation

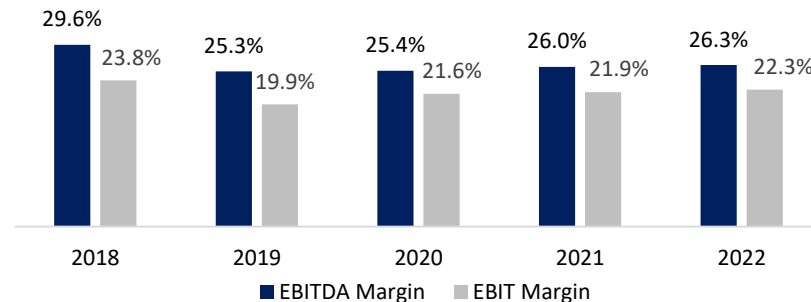
Digitalization of Tax Offerings

- Investment in digital technology is a major focus in their multiyear transformation plan
- HRB recently rolled out WorkCenter – platform that allows for more effective communication between Tax advisors and clients
 - WorkCenter consolidates and simplifies the process for Tax advisors, allowing for more efficient processing
- MyBlock – digital hub for HRB products – includes recently added features and increases customer visibility

Increased Customer Acquisition

- Market-leading digital tax platform lowers switching costs for DIY customers to transition to HRB services
- Positioned to utilize operating leverage – via large investments in digital infrastructure – to lower customer acquisition costs (CAC) over the long-term
- Management has thoughtfully allocated capital to fortify their inherent competitive advantages in the tax sector
 - Creates a strong runway for top-line growth with minimal additional capital expenditure

Margin Expansion



Unprecedented Customer Transparency

- Transition to digital platforms drives transparent, upfront pricing
- Customers can now view a pricing sheet and know the exact cost based on number of forms and the level of service
- First major player in the industry to offer full pricing transparency
 - Early results have been extremely positive – reduced customer churn with higher satisfaction ratings and increased customer acquisition without additional capital expenditure



Catalyst & Risks

Catalysts

Seasonal Tax Preparation Activities

- According to the Internal Revenue Service (IRS), there is an increase in tax preparation activities from February to April
- Short-term revenue growth can drive stock appreciation during the next reporting period

Integration of Wave Financial

- The effective integration of Wave Financial will allow H&R Block to realize synergies
- Wave paves the path for cost reductions and margin expansion due to its scalability

Risks

Weak Earnings Report

- The firm failed to meet Q3 expectations during this period last year
- On March 5, H&R Block may report Q3 2020 earnings that are weaker than expected

Acceleration of Digital Technology

- H&R Block is exposed to several sources of technological disruption
- These industry disruptors could shift demand away from traditional Tax Preparation firms



Comparables Analysis

Company Name	Equity Value (\$MM)	Enterprise Value (\$MM)	Margins		Enterprise Value / Revenue		Enterprise Value / EBITDA		P / E Multiple	
			Gross Profit	EBITDA	LTM	2020E	LTM	2020E	LTM	2020E
Intuit Inc.	\$69,251.1	\$67,739.1	83.1%	30.4%	9.5x	9.0x	32.0x	25.4x	43.5x	36.4x
Avalara Inc.	6,520.8	6,129.9	69.9%	N/A	15.7x	13.0x	N/A	N/A	N/A	N/A
Blucora Inc.	1,071.9	1,329.9	49.5%	16.8%	1.6x	1.6x	24.9x	20.0x	17.9x	7.6x
CBIZ Inc.	1,425.1	1,690.5	13.2%	10.8%	1.8x	1.7x	14.0x	13.0x	20.3x	18.4x
Maximum	\$69,251.1	\$67,739.1	83.1%	30.4%	15.7x	13.0x	32.0x	25.4x	43.5x	36.4x
Median	3,973.0	3,910.2	59.7%	16.8%	5.7x	5.4x	24.9x	20.0x	20.3x	18.4x
Minimum	1,071.9	1,329.9	13.2%	10.8%	1.6x	1.6x	14.0x	13.0x	17.9x	7.6x
H&R Block Inc.	\$4,035.7	\$5,909.0	43.2%	25.3%	1.9x	1.9x	7.9x	7.4x	10.4x	8.1x

Comparables Analysis Commentary

- H&R Block currently trades as at discount compared to its peers within the Tax Preparation industry on an EV/Revenue, EV/EBITDA and P/E basis
- HRB sports a superior EBITDA margin and will likely reap larger margins as business model shifts towards digitalization and DIY services
- However, the comparables analysis ultimately receives zero weight in the overall valuation because of significant differences in size and consumer segments

Discounted Cash Flows

DCF Unlevered Cash Flow Summary

(US\$ millions)	Historical					Forecast					
	2015A	2016A	2017A	2018A	2019A	2020E	2021E	2022E	2023E	2024E	2025E
Revenue	3,079	3,038	3,036	3,160	3,095	3,141	3,174	3,208	3,233	3,256	3,277
Operating expenses, excld. D&A	(2,124)	(2,231)	(2,138)	(2,225)	(2,312)	(2,343)	(2,366)	(2,383)	(2,394)	(2,403)	(2,410)
EBITDA	954	807	898	935	782	798	808	824	839	853	867
D&A	(160)	(174)	(182)	(183)	(167)	(112)	(118)	(124)	(130)	(136)	(141)
EBIT	795	633	716	752	616	686	690	700	709	717	725
Income tax expense	(237)	(165)	(164)	(8)	(133)	(43)	(145)	(147)	(149)	(151)	(152)
EBIAT	558	468	552	744	483	643	545	553	560	567	573
Add: D&A	160	174	182	183	167	112	118	124	130	136	141
Less: CapEx	(123)	(100)	(89)	(99)	(96)	(94)	(103)	(96)	(81)	(90)	(98)
Less: Change in Net Working Capital	(126)	(126)	(158)	(79)	(41)	(41)	40	29	(8)	(0)	(17)
Unlevered Free Cash Flows	469	416	488	749	513	620	600	611	601	613	599

- Revenue is forecasted under the assumption that the new business segment, Wave, will continue to expand and capture switching consumers while the regular taxation business grows in line with population growth
- Mild CapEx increases are forecasted in 2021 and 2022 to represent investment in new technologies and Wave expansion projects
 - This falls back in line with historic CapEx in 2023



Discounted Cash Flows

DCF Valuation Results

	Forecast					
	2020E	2021E	2022E	2023E	2024E	2025E
EBIAT	638	545	553	560	567	573
Add: Depreciation & Amortization	112	118	124	130	136	141
Less: CapEx	(94)	(103)	(96)	(81)	(90)	(98)
Less: Change in Net Working Capital	(40)	39	29	(8)	(0)	(17)
Unlevered Free Cash Flows	616	599	611	601	613	599
Discount Period	0.3	1.3	2.3	3.3	4.3	5.3
WACC	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Discount Factor	0.98	0.91	0.84	0.78	0.72	0.67
PV of Unlevered Free Cash Flows	604	544	513	468	441	400

DCF Valuation Results

Terminal Multiple Method		WACC Analysis	
Cumulative PV of Free Cash Flow	2,975	10-Year U.S. Treasury	1.6%
% of Enterprise Value	39.1%	Market Risk Premium	8.4%
Terminal Value		Beta	0.694
Terminal Year EBITDA	867	Company Risk	2.0%
EBITDA Multiple	8.0x	Cost of Equity	9.4%
Terminal Value	6,935	Cost of Debt	4.8%
PV of Terminal Value	4,624	Tax Rate	21.0%
% of Enterprise Value	60.9%	After-Tax Cost of Debt	3.8%
Enterprise Value	7,598	Target Debt/Capitalization	25.0%
Less: Net Debt	(1,873)	WACC	8.0%
Equity Value	5,725		
Fully Diluted Shares Outstanding	198		
Implied Share Price	\$28.97		
Current Share Price	\$21.46		
Implied Margin of Safety	35.0%		

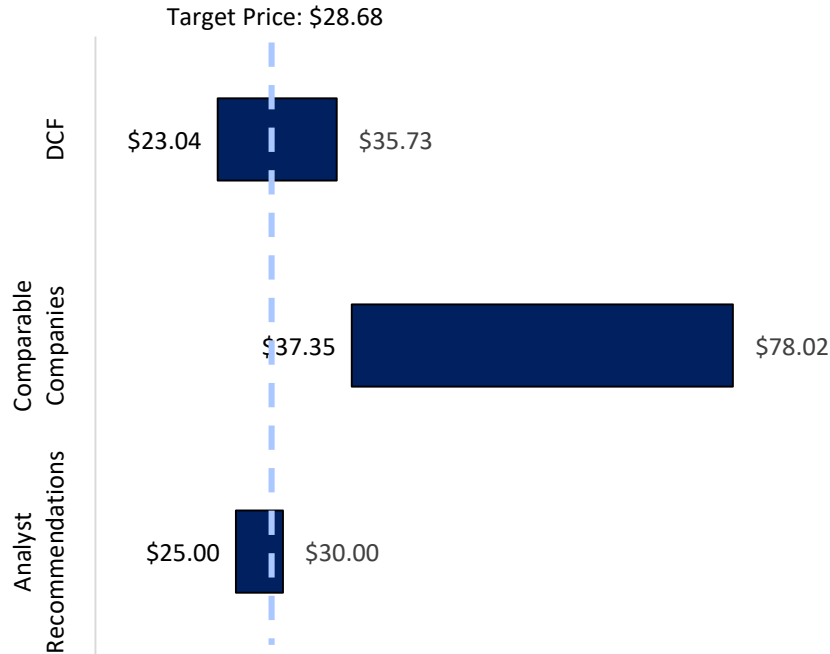
Exit Multiple	WACC					
	7.0%	7.5%	8.0%	8.5%	9.0%	
7.0x	27.8%	24.6%	21.4%	18.3%	15.3%	
7.5x	20.7%	17.6%	14.6%	11.6%	8.8%	
8.0x	42.1%	38.5%	35.0%	31.6%	28.3%	
8.5x	49.3%	45.5%	41.8%	38.2%	34.8%	
9.0x	63.6%	59.5%	55.5%	51.5%	47.7%	

- DCF valuation results in a target price of \$28.97 per share, representing an upside of 35.0%



Recommendation: BUY

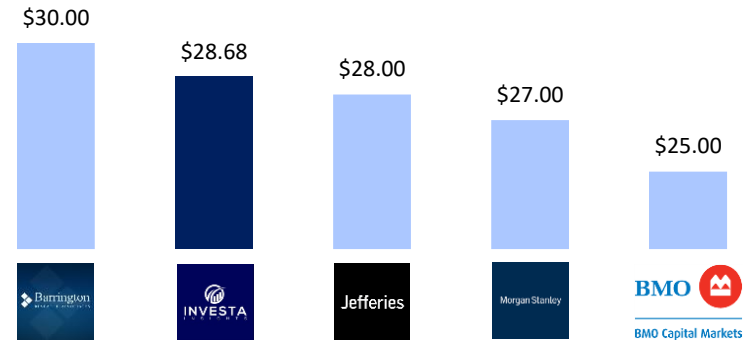
Valuation



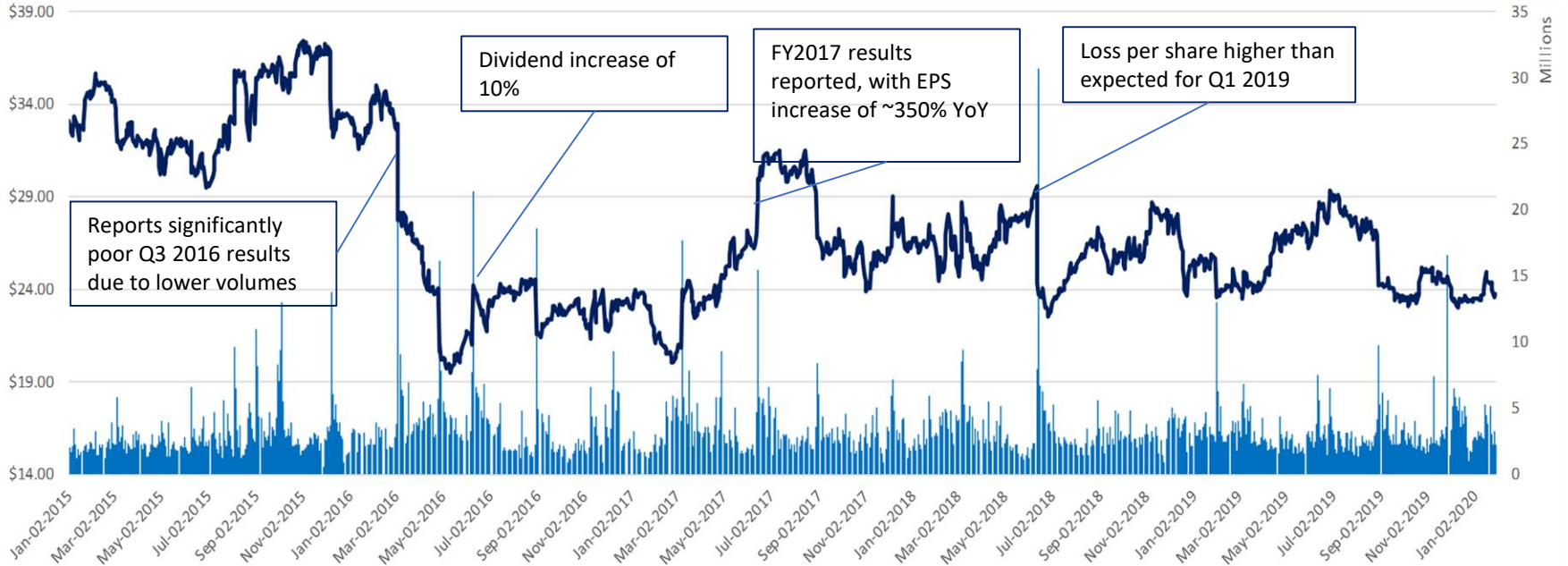
Price Target

Analysis	Price	Weights
DCF	\$ 28.97	80%
Comparables Analysis	\$ 60.57	0%
Analyst Targets	\$ 27.50	20%
Target Price	\$ 28.68	100%
Current Price	\$ 21.46	
Implied Return	33.6%	

Selected Brokerage Summary



Annotated Stock Chart



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