



Mossberg's Investor Digest

Idea Profile

H&R Block (NYSE: HRB)

DESCRIPTION:

Through its network of 13,000 company-owned and franchised offices, H&R block is the largest provider of income tax return preparation services in the United States. The company generates approximately 70% of its revenue from income tax return preparation and related services. An additional 20% of revenue is generated from the company's Business Services segment, which provides accounting, tax and business consulting services for middle-market companies under the RSM McGladrey name. The remaining 10% of revenue comes from retail banking at H&R Bank. Founded in 1955, H&R Block is headquartered in Kansas City, Missouri.

KEY INVESTMENT CONSIDERATIONS:

Restructuring plan is proceeding as planned – Over the past two years, the company has disposed of its sub-prime mortgage business (Option One) and divested its brokerage business. These divestitures increase HRB's focus on its core tax preparation business, reduces risk and improves liquidity.

Jackson/Hewlett and other competitors have limited financing to fund RALs (Refund Anticipation Loans) – Refund anticipation loans are a very important and profitable piece of H&R block's business. The loans allow customers to receive tax refunds immediately or within a few days, instead of having to wait the several weeks for the U.S. government to process the return and send out the check. The fees H&R block receives for these loans, around \$100 for a \$3,000 loan, are highly profitable. So much so, that while RAL's have generated just 4% and 5% of revenue over the past two years, they have generated a much larger portion of profitability...14% and 24% of pretax income, respectively. Considering the loan is only outstanding for a couple of weeks, the annualized return can be higher than 80%. H&R block has a long-term agreement with HSBC, in which HSBC is obligated to fund \$3 billion in funding for RAL through June of 2011. Other competitors have had difficulties securing financing to offer these types of loans, which gives H&R Block significant advantage and the ability to take market share.

Ability to buy back stock begins in February, 2009 – The board has authorized management to buy back up to \$2 billion in stock over the next four years.

KEY RISK:

Mortgage exposure declining, but still there – The company stopped originating mortgage loans in January 2008 and has sold its mortgage servicing arm earlier this year. However, the company still owns approximately \$800 million in mortgages in its bank subsidiary portfolio. These loans are geographically concentrated with approximately 50% for properties in Florida, California, and New York. In addition, the majority of these mortgages are non-conforming, which means there is greater exposure to loss with respect to default.

VALUATION:

Management has recently re-affirmed EPS guidance of \$1.60 to \$1.70 for fiscal 2009, which equals a 13x multiple at the midpoint. Given the company's 5-year ROE above 30%, these shares should easily command higher multiples. In addition, management's focus on its core tax business, gives the company clear direction, making it easier for investors to understand the merits and risks...which often leads to higher valuation multiples. It's also important to note that the company pays a regular dividend, which is currently almost a 3% yield. In a bear market, dividend paying stocks tend to fair better because dividends signal a high quality of earnings and yields can provide downside support.

(NYSE: HRB)

Investment Data (as of 12/24/08)

Recent Price	\$21.91
52-Week Range	15.00 - 27.97
Fiscal Year End	April
Dividend	\$0.60
Yield	2.7%
Shares Outstanding	339 MM
Average Trading Volume (3 mos)	2.8 MM
Market Capitalization	7.5 B
Cash	0.7 B
Long Term Debt	1.85 B
Enterprise Value (EV)	8.6
LT Debt/ Equity	2.2
BV/ Share	2.46
TTM Revenue	4.4
P/ Revenue	1.7x
TTM EPS (non-GAAP)	0.69
P/ EPS	31.8x
TTM EBITDA	971 MM
EV/ TTM EBITDA	8.9x

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