



HNI Corporation

First Quarter Fiscal 2022 Earnings Conference Call

April 28, 2022

C O R P O R A T E P A R T I C I P A N T S

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C O N F E R E N C E C A L L P A R T I C I P A N T S

Budd Bugatch, *Water Tower Research*

Reuben Garner, *The Benchmark Company*

Gregory Burns, *Sidoti & Company*

Kathryn Thompson, *Thompson Research Group*

P R E S E N T A T I O N

Operator

Welcome, everyone, to the HNI Corporation First Quarter Fiscal 2022 Earnings Conference Call.

It is now my pleasure to turn today's call over to Mr. Jack Herring. Please go ahead, sir.

Jack Herring

Good morning. My name is Jack Herring. I am Vice President, Corporate Finance and Treasurer for HNI Corporation. Thank you for joining us to discuss our First Quarter Fiscal 2022 results. With me today are Jeff Lorenger, Chairman, President and CEO, and Marshall Bridges, Senior Vice President and CFO.

Copies of our financial news release and non-GAAP reconciliations are posted on our website. Statements made during this call that are not strictly historical facts are forward-looking statements, which are subject to known and unknown risk. Actual results could differ materially. Financial news release posted on our website includes additional factors that could affect actual results. The corporation assumes no obligation to update any forward-looking statements made during the call.

I'm now pleased to turn the call over to Mr. Jeff Lorenger.

Jeff Lorenger

Good morning, and thank you for joining us.

Our members delivered solid results in the first quarter despite record levels of inflation in a dynamic environment. Today, I will cover three key points around why we are optimistic about 2022 and beyond: first, our actions to drive profit improvement and address last year's headwinds are on track and delivering results; second, top line growth and market demand in Residential Building Products remains strong; and third, we are generating strong growth in Workplace Furnishings and the demand environment is improving.

I will cover these points. Marshall will then go through our 2022 outlook, which is unchanged from what we presented in February. I will then conclude with some general comments. Finally, we will open up the call to your questions.

Moving to our first key point. Our initiatives to improve long-term profitability are on track in delivering results. In February, on our fourth quarter call, we discussed two sources of pressure on our margins in 2021: first, price costs negatively impacted profitability due to rapid input cost inflation; and second, constraints around labor availability and supply chain capacity shifted revenue out of 2021.

We also discussed the actions we were taking to address these issues, including multiple pricing actions across our brands, the opening of a new seating facility in Mexico, moving multiple production lines to HNI facilities with better labor dynamics and operational changes aimed at making our existing labor force more productive. These actions are all on track to deliver their expected benefits for 2022 and beyond. Specifically, price cost turned positive in the first quarter, driving sequential gross margin improvement from the fourth quarter.

While inflationary pressures have recently intensified, we have quickly responded with additional pricing actions. We expect these actions to offset the additional inflation, keeping price cost on track to deliver significant profit improvement in 2022. Our actions to add labor capacity are also ramping up. Our new facility in Mexico is currently up and running. The new capacity, along with the production line and operational layout changes we are making, will support strong second half volume growth and long-term margin expansion.

I will now move on to my second key point. Top line growth and market demand in Residential Building Products remains strong. Segment revenue grew 13% organically with comparable strength in both the new construction and remodel/retrofit channels. Incoming orders showed no indications of slowing with first quarter orders in the segment up 25% organically versus the year ago period. Our strong order rates and elevated backlog point to continued strength this year.

Rising mortgage rates and decreasing affordability are concerns. However, our positive outlook is still supported by our growth initiatives, demographic trends, historically low housing inventories and elevated builder backlogs. Finally, we expect acquisitions closed over the past 12 months to complement our robust organic growth in 2022. Our unique, vertically integrated business model has unmatched product and channel reach with a regional distribution infrastructure that offers unparalleled customer service.

I will finish with my third key point. We are generating strong growth in Workplace Furnishings and the demand environment is improving. First quarter Workplace Furnishings' revenue adjusted for recent restructuring activity increased nearly 25% versus the prior year period. Order activity continued to be strong with small to midsize customers. While contract customers, particularly those in larger cities, have been slower to ramp up, our second half contract funnel has strengthened in recent weeks and is now back above pre-pandemic levels.

We ended the first quarter with a backlog up more than 50% from the same period last year. Our strong dealer network, unmatched price point breadth and multiple strategic growth initiatives have put us in a strong position to capitalize on the improving environment. As a result, in addition to margin expansion, we expect strong top line growth in Workplace Furnishings during 2022. Now I'll turn the call over to Marshall to discuss our outlook.

Marshall Bridges

As Jeff previously mentioned, our revenue and margin enhancement initiatives are on track. As a result, the 2022 outlook we shared with you on our last call is unchanged. We still expect benefits from pricing actions and added capacity will drive strong revenue growth and profit improvement as the year progresses. In Workplace Furnishings, we expect pricing benefits, backlog normalization and assumed market improvements will drive revenue growth rates in the high teens to the low 20s for the year.

In Residential Building Products, pricing benefits, revenue from acquisitions and multiple growth initiatives are expected to fuel growth rates in the high teens. Our view on consolidated margins remains the same. We continue to expect improving price cost and volume growth will drive operating margin expansion in the second half of the year and for the full year. We expect to recapture much of last year's price cost gap, with price cost driving a net benefit to operating profit of \$45 million to \$55 million.

Our thoughts on seasonality are also unchanged. As a reminder, we historically generate approximately 70% of our full year profit in the second half of the year. We expect 2022 profit to be more weighted to the second half driven by the timing of price cost improvement, capacity additions and first quarter COVID impacts. Also, recall our second half comps are less challenging than those in the first half. For the second quarter specifically, we expect profit to be near the levels generated in the first quarter of 2022.

On a sequential basis, the benefits from additional Workplace Furnishings volume is expected to be offset by the seasonal step down in Residential Building Product sales. Finally, some brief comments on our financial position. We expect to maintain a strong balance sheet throughout 2022, our modest increase in debt from the fourth quarter is consistent with our normal seasonal use of working capital. We expect to generate strong free cash flow this year, which will provide capacity for continued investment, M&A, dividend payments and share buyback activity. I'll now turn the call back over to Jeff.

Jeff Lorenger

Thanks, Marshall.

You will notice a consistent theme across our comments this morning. Our initiatives and outlook remain on track despite inflationary pressures in a dynamic environment, and we are staying focused on our two primary objectives: improving the long-term profitability of our Workplace Furnishings segment by focusing on margin expansion and driving strong top line growth in Residential Building Products by leveraging our differentiated business model. We will now open up the call to your questions.

Operator

Your first question is from the line of Budd Bugatch with Water Tower Research. Your line is open.

Budd Bugatch

Good morning. This is a very, very nice and heartening report. Congratulations on the quarter. I know it's not been an easy time. So just a couple of questions, if I could.

In Workplace Furnishings, you mentioned, I think, the larger customers slower to ramp up, but yet the funnel seem to be increasing. Can you give us a little bit more color on that, Jeff?

Jeff Lorenger

Yes, Budd, we're above pre-COVID levels. And across the board, the trends we look at are continuously improving day over day, week over week. I would tell you, the bid activity is nearly double. Our bid pricing activity is nearly double fourth quarter levels. We got continued strong activity in the small business. I know you didn't ask about that, but—and across the geographies, we're seeing improvement across

pretty much every region of the country. Dealers are reporting they're having trouble keeping up with requests, design requests and pricing exercises. Leasing activity's up, it just continues to build. So we're confident that it's coming.

Budd Bugatch

The order growth in RBP is consistent with what we have thought you would start to see. Can you talk about that in relationship to the market? Up 25% is a notable number. I know that you also mentioned that some affordability and mortgage issues might be dampening some of that demand further on. I was curious of how you're seeing the hearth business relationship to the overall market and whether you're seeing the primary demand in hearth starting to show some signs of growing.

Jeff Lorenger

Budd, look, the affordability question is out there, and it's well known, and we're clearly keeping a really close eye on that as it's concerned. I would tell you, on a macro basis, we still like the demographics and the inventory stock being low. But we also have high visibility to our backlog right now. So we have a really large backlog in that business. And remodel, there's strength kind of across the board in the remodel. The LIRA index is up mid- to high teens.

We continue to see momentum in our growth initiatives, many of which are focused on the remodel market. The electric category, which if you think about its customers, who sometimes are not necessarily gas buyers, continue to grow. It's up 44%. Our website traffic's up. Our gas insert program, which is focused on existing homes, is up. Category awareness issues are going well. We're really starting to reach customers. And as customers think about maybe not moving up, there is—we are really bullish on the remodel side of our business. So it's a great question. We're going to stay focused on the new home construction, but we're still seeing growth there, and we've got big backlogs.

Budd Bugatch

Okay. I guess every question in the last couple of quarters has started almost with price cost and you started there saying that it turned positively. Marshall, can you quantify for us what the positive was? And if I could be so bold, just to maybe talk about that? You said you had another pricing action, I think, in the quarter, so maybe you could quantify some of that for us.

Marshall Bridges

Yes, Budd.

For the first quarter, price cost was positive \$2 million. That reflects \$62 million of incremental price versus the prior year and about \$60 million of incremental input costs versus the prior year period. As we look forward, we said in our prepared remarks that we expect price cost to be positive \$45 million to \$55 million. So it's happened over the last 60, 90 days is that we have seen an increase in input costs. So we're expecting that to run in the \$240 million \$250 million range versus last year.

But we've also offset that with price. So we're expecting to have about \$285 million to \$305 million of incremental price. So both those have gone up. In fact, our price cost outlook is slightly improved, they're certainly in the range of what we had before.

Budd Bugatch

How does that split between the sets?

Marshall Bridges

If you look at the midpoint of that \$45 million to \$55 million range, you made—approximately \$35 million of it would hit Workplace Furnishings, with the balance sitting Residential Building Products.

Budd Bugatch

That's very helpful. And you still have great margins in RBP. So that's still very helpful. And last for me, you talked a little bit about that you did increase debt a little bit in the quarter, and working capital was a usage. So where do we see that? Do we see that debt coming back down at the end of the year and just a normal pattern?

Marshall Bridges

Yes. I think we have a pretty normal pattern. As you know, we typically use cash in the first quarter and the first half and then generate quite a bit of cash in the back half, and we don't expect that to change this year.

Budd Bugatch

Okay, great. A very heartening report. Thank you very much, and good luck for the second quarter and balance of the year.

Marshall Bridges

Thanks, Budd.

Operator

Your next question comes from the line of Reuben Garner with The Benchmark Company. Your line is open.

Reuben Garner

So maybe a follow-up to the price cost question. I think you guys got back to price cost positive maybe a little bit earlier than you were expecting last time we spoke. Can you talk about when maybe you expect to be able to kind of recover the margin that you lost over the last year or so? And maybe if you can do it by segment, that would be helpful.

Marshall Bridges

Yes, Reuben, we're more or less on track to what we said. We said we'd be roughly neutral in price cost in the first half, and we were positive \$2 million, so that's encouraging, but in the range of what we expected. We do expect very positive price cost in the second half of the year, roughly \$30 million to \$35 million in the third quarter and \$15 million to \$20 million in the fourth quarter.

That's going to drive margin expansion, pretty considerable margin expansion. I'm not sure we get all the margin back, but we're looking at some healthy op margin increases during those quarters. It will be more in Workplace Furnishings than Residential Building Products because of just the margin differences between those businesses.

Reuben Garner

Okay. Then maybe on the Residential Building Products side, a lot of good commentary on kind of the drivers there and R&R and your internal initiatives. There's been a lot of talk about the impact of rising interest rates and gas prices and everything else on the consumer. Can you just talk about what you guys saw more recently and maybe in March and April? Have trends held up? Your order rate for the first

quarter was obviously very strong. Has it remained so? Or did you guys already kind of see an impact from the consumer from an affordability standpoint?

Marshall Bridges

I mean, so far, it's staying pretty solid, Reuben. So maybe a little bit description behind that, that 25% growth rate that we had, some of that's being driven by the trade partners ordering for delivery later in the year. So what it's doing is giving us a lot of visibility, more than we normally would have to the growth rates we're going to see. So basically, what we see, we're very confident in what we've laid out here.

Reuben Garner

Okay. Great. And last one for me. Workplace Furnishings, the funnel versus the order commentary, can you—is there any way to kind of give us an idea of just how—I mean, you said the funnel was back above pre-pandemic levels, I think you said. Can you just—what kind of growth rates does that point to from an order perspective as we move through the year? I know a lot can change between now and then. But does it directly (inaudible) are we going to see an acceleration, a pretty big acceleration in your order growth as the year progresses? And is that mostly driven by the contract piece coming back? Or is it across the board?

Marshall Bridges

No, Reuben, it's driven by the contract improving. The SMB business has shown some pretty steady growth, which we expect to continue. But what we've seen throughout 2022 is that the contract side of Workplace Furnishings started pretty slow. And here recently the order rates have converged, and we expect contract continue to accelerate partly just due to the lower comps, but partly due to the increasing activity you see in the major metros. So we're pretty excited about the growth prospects in the contract as we enter the rest of the year.

Jeff Lorenger

Reuben, we see the SMB business probably hanging in there. It's typically—now this isn't a typical cycle. But typically, those are early market indicators. And we see those hanging in through the year and the contract kind of, like Marshall said, merging and increasing above those rates as we go throughout the year.

Reuben Garner

Great. Thanks, guys.

Operator

Your next question is from the line of Greg Burns with Sidoti. Your line is open.

Gregory Burns

Good morning. So in the Residential Building Products, it was a lot stronger this quarter than I was expecting, I think historically, you would see like kind of a sequential decline into the first quarter from the fourth quarter, and obviously that wasn't the case here. So was there any degree of pull forward, or anything unique there to call out that would not be sustainable like going forward? I'm just trying to figure out how we can model all for the first quarter.

Marshall Bridges

Yes, Greg, we did see a more seasonally strong pattern in Residential Building Products for the first quarter. I think we're up roughly 5% versus the fourth quarter. That's a little bit above what we normally see, where we'd see a little bit of a decline. I think this just reflects the strong backlog we had and the fact that we were hitting some capacity constraints in the fourth quarter. So that volume moved to the first quarter. We don't see that as a pull forward. We absolutely are seeing some good growth in that segment and expect it to continue through the year.

Gregory Burns

Okay. Then with energy prices going up, are you seeing increased demand in woodstoves, pellet side of that business? And can you just remind us maybe how big that business is currently for you and maybe where it peaked out at the last kind of time oil increased to this degree?

Marshall Bridges

Yes. Pellet's doing well. It is—along with all of our stove businesses, we're seeing really big backlogs, longer lead times there. The growth is somewhat constrained by our capacity there. We're certainly at those levels. So we're excited about it. I think what it does is it gives us confidence in that remodel/retrofit, which pellet's included in that, is going to do well this year, and it is consistent with the growth outlook that we said. It's not going to be the major growth driver that we saw five, seven years ago. It is a growth driver, though.

Jeff Lorenger

Yes. Well, as far as we know, it's not. I mean, the overall category, Greg, is up just because the remodel side is strong, and all types of units are up. And as Marshall said, our lead times are stretched out there. Now the recent spike in gas and fuel, oil and other things, we probably haven't seen if there is going to be a bump off that. But you're right. Historically, there is some bump, but it's too early to tell if that's going to add to the already strong category going forward.

Gregory Burns

Okay. Then lastly, sticking with the Residential Building Products. In terms of the new home construction, I know you've been doing a lot of category awareness, kind of trying to grow—like kind of grow the category initiatives. So have you seen any change there where attach rates are increasing, where maybe even if we do see a slowdown because of affordability you're making it up because you're getting higher attach rates? What are your thoughts there?

Jeff Lorenger

Yes, Greg, I think intuitively, we are. We're definitely seeing it in the remodel side of the business. We put this—the website traffic's up 67%. It continues to grow. We did some awareness on HDTV, they've got a program called *Rock the Block*, and we're driving a lot of awareness through that. So these things take time to filter through, and some of it is a little hard to track, but we believe that, that's going to start to take hold in the new home side as well. We have a strong A&D program that we've tipped up that's driving additional specification with some of the builders.

All those efforts are, I think, probably somewhat embedded in our growth rates and more to come.

Gregory Burns

Great. Thanks.

Jeff Lorenger

Yes.

Operator

Your next question is from the line of Kathryn Thompson with the Thompson Research Group. Your line is open.

Kathryn Thompson

Hi, thank you for taking my question today.

One, just focusing on Mexico and the prevailing theme that we're seeing with so many companies, public and private, is just deglobalization and shifting operations, greater operations to the Americas, North America, with Mexico being one of the biggest beneficiaries. So against that backdrop, what is the longer-term impact of how this facility feeds HNI demand? And also strategically, how are you rethinking the global supply chain as you plan your business over the next three to five years?

Jeff Lorenger

Yes. That's a great question. I think in the short term, as we've said, Mexico was a pure capacity play for us relative to labor availability with what's happened in the last couple of years. Now, as time goes on, you are correct that the supply chain shorten up, the ability to control shipping shortens up. And we believe that's all going to be a positive. On the inventory side, look, we were kind of rotating through bringing stuff closer to home even before the pandemic hit.

I think what that has done is accelerate that. Now it's not—you don't do that overnight. But as you look out three to five years, I think you're going to—we're going to have shorter supply chains. Where we don't, we're going to probably carry some more inventory, which we are already, just to keep our lead times in check and make sure that we can service our customers, and we see that as a good trade on both fronts.

Kathryn Thompson

Okay. More on the quarter and margin improvement, it's good to see that. Can you give us more of a breakdown though, just in terms of segments? How much is mix versus pricing actions? And how do we think about that trend as the year progresses for margins?

Marshall Bridges

Yes. Kathryn, I mean, the big drivers in both segments are for the year and for the quarter are volume and pricing—price cost. Certainly, the sequential margin improvement we saw had a lot to do with price costs. Mix is not a big play there. Then we've got the timing of SG&A. So I think the story to look for this year is the progression of price cost, as we laid out, it's second half weighted, and it's similar for volume. As we bring that capacity online, as that Mexican facility ramps up, as our other initiatives get traction, we will get more output and volume will increase sequentially and drive profit improvement.

Kathryn Thompson

Okay. Helpful. In terms of backlogs, really looking more at the pace of orders and how our shipment levels versus—anticipated versus the second half of '21. And part of this, too, with the pace of orders we've seen in a couple of different industries, some choppiness, but some now we're seeing as an acceleration and some and not as much. What are you seeing in terms of your backlogs, and in particular, the pace of orders?

Marshall Bridges

I would say that we are seeing choppiness. If you look at Workplace Furnishings, our backlog is elevated. It's up about 50% over the same period last year. But that's down about 25%, 30% from its peak. It goes to the really rapid order growth that we had in the third quarter of last year, followed by a little bit slower order growth in the fourth and first quarter. It's picking back up again. So I think that reflects what's going on there.

In Residential Building Products, similar story, the backlog is almost double what it was last year. I think that goes to what we talked about earlier in that we've seen some of the trade partners were a little bit earlier than they normally would and also reflects just the underlying strength in those markets.

Kathryn Thompson

Okay, great. Thank you for taking my questions today.

Jeff Lorenger

Thank you.

Operator

There are no further questions at this time. I will now turn the call back over to Mr. Jeff Lorenger.

Jeff Lorenger

Okay. Thanks, everybody, for joining us today, and have a great day and the rest of the week. Thanks.

Operator

Ladies and gentlemen, thank you for your participation. This concludes today's conference call.