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HNI Corp. (HNI)

Q1 2017 Earnings Call

CORPORATE PARTICIPANTS

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Chief Financial Officer & Vice President, HNI Corp.

Stanley A. Askren
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OTHER PARTICIPANTS

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Analyst, Raymond James & Associates, Inc.

Kathryn Ingram Thompson
Analyst, Thompson Research Group LLC

Matt McCall
Analyst, Seaport Global Securities LLC

Greg J. Burns
Analyst, Sidoti & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, my name is Kayla, and I will be your conference operator today. I would like to welcome everyone to the HNI Corporation First Quarter 2017 Fiscal Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] As a reminder, today's conference call is being recorded. Thank you.

Mr. Jack Herring, you may begin, sir.

Jack D. Herring
Treasurer, Director of Finance and Investor Relations, HNI Corp.

Thank you. Good morning. I am Jack Herring, Treasurer and Director of Investor Relations for HNI Corporation. Thank you for joining us to discuss our first quarter fiscal 2017 results. Here with me are Stan Askren, Chairman, President and CEO; and Marshall Bridges, Vice President and Chief Financial Officer.

Copies of our financial news release, earnings presentation, 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 risks. Actual results could differ materially.

The earnings presentation 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 am pleased to turn the call over to Mr. Stan Askren.

Stanley A. Askren
Chairman, President & Chief Executive Officer, HNI Corp.

Good morning, everyone. As usual, Marshall and I will share the assessment of the first quarter 2017 and then provide some thoughts on the outlook for the second quarter and then full year, then we'll open up to questions.

Results were slightly better than we expected. Now, we have a bunch of information to share with you. I would say we have lots of numbers, maybe too much numbers, but we'll roll this through and then see where the questions are.

Our businesses continue to compete well and generated sales at the high end of our anticipated range. As expected, the demand environment started slowly, then improved throughout the quarter. We're pleased with the positive customer response to recent investments in new products and selling capabilities.

We delivered another quarter of strong operational performance providing further margin improvement. This now marks a long string of year-over-year increases in non-GAAP gross profit margin. Our margin improvement is a result of a very deliberate process. We're focusing our businesses on areas that drive the most value. The strategic streamlining makes our organization stronger and more capable to aggressively pursue profitable growth and serve our very important customers.

In addition, we continue to significantly invest across our businesses. Increased capabilities, business process simplification and manufacturing process efficiencies, all contribute to our position as the best cost producer. This allows us to deliver greater value to our customers, driving both growth and future profitability.

We are a stronger company due to these efforts. We're well positioned with a strong platform to grow the business. We continue to remain focused on the long term and are confident in our ability to double our earnings every three to five years.

I'll now turn the call over to Marshall for some specifics on the quarter, and he'll roll through a bunch of numbers for you.

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

Thanks, Stan. For the first quarter, non-GAAP net income per diluted share was \$0.26 compared to \$0.31 in the first quarter of 2016. Consolidated net sales decreased 2.9% organically and decreased 4.7% in total when including the impacts of acquisitions and divestitures.

In the office furniture segment, sales decreased 4.9% organically and declined 7.1% in total. Within our office furniture segment, sales in our supplies-driven business decreased approximately 6% organically or minus 7% including the impacts of acquisitions and divestitures.

Sales in our North American contract business decreased 1% organically or minus 4% in total and sales in our international business decreased 20%.

Looking at our hearth segment, sales increased 3.5%. Within the hearth segment, new construction sales increased 3%. Sales of retail wood and gas products increased 2%, while sales of pellet appliances increased \$2 million or approximately 26%.

HNI non-GAAP consolidated gross profit margin increased 60 basis points to 38%. Labor and material productivity gains and the favorable impact of divestitures were partially offset by lower volume.

Stan?

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

We're seeing improvement in our markets, although conditions remain choppy. In the second quarter, we are forecasting solid organic growth led by our contract business, which we expect to increase 12% to 15%. Activity levels, project funnel and in-house orders provide confidence in our sales projections.

In our supplies-driven business, we're expecting organic sales to be up 1% to 4%. Total organic office furniture sales are expected to be up 5% to 8%. Within our hearth business, we expect sales growth of 1% to 4%.

New construction sales are expected to be up 3% to 6% as growth in single family starts continue. Sales in our retail wood and gas business are projected to be down 2% to 5% due to seasonal timing and mix. Sales in our pellet appliance businesses are forecasted to be up more than 40% or \$1 million to \$2 million.

In total, we expect HNI consolidated organic sales to be up 4% to 7% for the second quarter. Marshall?

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

I'll give some additional information on our second quarter outlook. The growth rates Stan just referred to were all organic. When including the impacts of acquisitions and divestitures, we expect total consolidated sales growth to be flat to plus 3% in the second quarter. We also expect total sales for the office furniture segment in the second quarter to be flat to up 3%.

Non-GAAP gross profit margin is expected to be similar to the prior year when it was 39.9%. Non-GAAP SG&A as a percentage of net sales is also expected to be similar to the prior year when it was 30.6%. Our estimate of non-GAAP earnings per diluted share for the second quarter is in the range of \$0.65 to \$0.72.

For the full year of 2017, our outlook for net sales remains unchanged. We expect consolidated organic sales to grow 3% to 6%. Office furniture organic sales are forecasted to be up 3% to 6%. Sales in our hearth business are expected to be up 2% to 5%. Including the impacts of acquisitions and divestitures, total consolidated sales are forecasted in the range of minus 1% to plus 2%. Total office furniture sales are expected to be relatively flat to the prior year.

Our current best estimate of non-GAAP earnings per diluted share for the full-year 2017 is now in the range of \$2.80 to \$3.10. Stan?

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

Okay. Let me wrap this up then. Simply, our strategies are working, and we remain focused on creating long-term shareholder value. We're well-positioned to deliver profitable growth and enhance our already strong market position.

So with those comments complete for Marshall and myself, we'll now open it up to questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from the line of Budd Bugatch from Raymond James.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Good morning, Stan. Good morning, Marshall. And good morning, Jack. And thank you for taking my question. I guess you said – in office, you said that business improved during the quarter, I believe. And then, you've given some pretty hefty improvement particularly in the contract side. Can you talk a little about the project funnel? Can you maybe give us a little characterization of where this is coming from, what do these projects look like, how sticky are they beyond Q2?

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

Yeah. So I'll start and Marshall can fill in anything I miss or any additional color, but – yeah, we are coming off a period of strategic pruning here and you're right, contract is showing some significant growth forecasted for the second quarter. I think I said 12% to 15%.

Now, you know Budd, we don't get too high when there's big numbers and we don't get too low when there's not big numbers. This is such a choppy business in contract world due to timing of large projects, due to all sorts of factors. It does feel to us like things are improving. We are coming off of a more subdued demand environment. We do have several significant projects for us anyway, significant projects that are coming in. And we think the second half is going to continue to be strong for contract. I don't know, Marshall, is there anything else you want to comment?

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

A

No, I'd say, Budd, we're seeing pretty good activity on the project side and particularly architecture walls is a benefit for the quarter and we're feeling pretty good about the funnel in the back half on the project side.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

And the average project size is what? Can you give us a characterization? We've heard it go from very large projects now down to much smaller projects. So, in your case, what are these projects looking like?

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

Yeah. I don't know if we can characterize it. I would say this, Budd, our large projects are smaller than the other big contract guys' large projects. So, our large is their mid probably is how – just to give you a relative comparison. We don't – due to where we come from and how we're positioned, we don't do the monster projects. We do large, and I think there are several million dollars is what we would characterize as large, I think.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. And in hearth, again the – and these numbers are much smaller, but the notable percentage changes is going on in the pellet side, particularly the appliance side. Is energy cost and what's – well I'll let you characterize, what's causing that?

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

Yeah. I mean at hearth, that pellet appliance growth number is big, but it's a very small base now. As you know, we've been through multiple years of decline in pellet due to energy prices. And I think we're just basically signaling that we are now at the bottom and what you're seeing is it always overshoots both ways, Budd, in this.

Because it's a dealer – the dealer business which typically there's inventory, so when it's good, they over order; and when it goes down, it tend to get stuck with inventory. And so, I think what we're signaling is, it's reached bottom and they're simply purchasing product to fill the pipeline, and some of that's inventory. How much? I don't know.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

And even that segment at that pricing has been pretty profitable for you, right? And still the same way you would characterize it that way?

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

Yeah. Exactly. It is profitable business for us. We're the industry leader in this as well. I mean, we have significant share in pellet appliances. We've got good know-how. We have great intellectual property, and we have very efficient operations. It fits into our other core part business, and so we're able to sort of accordion that up and down as needed and maintain our cost structure and keep it profitable regardless of what the volume is.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. Just a couple more, these are more housekeepings, or – well, first one is not. Costs, what are you seeing in the cost environment right now? Raw materials, how are they behaving or misbehaving?

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

A

Yeah. Budd, we're seeing about 4% to 5% input cost inflation for the year led by steel.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

And did you have much of that in the first quarter?

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

A

No. We didn't have a lot in the first quarter. Inflation was about \$2 million in the first quarter.

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

And as you recall, Budd, we index steel so that it tends to lag going up and tends to lag going down. And so, we are – it's bounced up. Steel has bounced up significantly. Now, you also know that steel is much less of an input cost as it used to be, so – or as it used to be, but we tend to lag and that's why it was not as much first quarter as you might think.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Yes. That's why I was asking. I know about the lag. And my last question is you've given us the organic and you've given us the non-GAAP. What about – what restructurings are left in the book in the second, third and fourth quarter? How does the – how do the charges look so that we can probably do a GAAP and get the cash flows where we are comfortable with them?

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

A

Yeah. Budd, we still have some charges yet to come. In the second quarter, we're looking at about little over \$9 million of non-GAAP adjustments.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Pre-tax or after, Marshall?

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

A

That's pre-tax.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. Yeah.

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

A

And then in the third and the fourth quarter, we have a little over \$8 million in the third and between \$3 million and \$4 million in the fourth.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Perfect. Thank you very much.

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

A

And that has accelerated depreciation, and that's a typical stuff.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Is there any non-restructuring in there like move costs or any of that in that as well?

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

A

Yeah. There's quite a bit of transition costs in there.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. All right. Thank you.

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

Thank you, Budd.

Operator: Our next question comes from the line of Matt McCall from Seaport Global.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Thank you. Good morning, guys. So, Stan, a couple of things that you hit on. You talked about recent investments in, I think, you mentioned new products and selling capability.

Can you get more specific on some of the things that you're doing, maybe some of the products that are showing promise or showing results and maybe quantify what amount of help you got in Q1 and what you're assuming from some of these initiatives in the Q2 and 2017 guidance?

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

Yeah. Well, I think, Matt, as you know, we're so broadly-based diversified basically is investments in virtually all of our companies, all of our brands, all of our segments, all of our product categories, it's selling investments, product investments, et cetera. And it's significant sort of benefit in driving our results, our sales growth, profitability growth for the year. We have not broken out specifically how much of those improvements coming from those investments.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Well, maybe I'll ask it the opposite way. If you think about the 12% to 15% in contract in Q2, and I think you're back in around a 10% in the back half, what kind of market assumption do you have in those periods? I mean, I assume there's a level of outperformance from those items. Are you assuming some mid-single-digit type growth for the industry?

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

Yeah. It's the same as you're seeing and not a bit much, et cetera. And again, I'll just sort of rephrase what I said to Budd. We don't – it's really nice growth, and I'm excited about it. But we're not pounding our chest that we're like outperforming everybody.

I think this – anybody that's tracked contract business world for any timeframe should know that claiming share gain is a canard and claiming share loss or praying about share loss in the short term and midterm is a waste of time. And you know that's kind of how I think about this.

So, we have nice performance. A lot of it has to do with where you're positioned and what's going on, et cetera. So it's not a whole lot more than I think, just timing and mix and where we're positioned, et cetera. Some of that's coming from new products, but it's a lot of just day-to-day grinded out company by company stuff.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. All right. And one thing, just to clarify, sometimes, you've given contracts and sometimes you've given contracts and other, I think, which includes international. What is the 12% to 15%? Is that just contract in North America?

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

A

Yeah. It's – when we talk about contract in the outlook, it's contract in the business of international and North America.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. Okay. Just want to make sure, speaking the same language. One other thing, Stan, you talked about strategic pruning. You're exiting a period of strategic pruning. Can you talk about that a little bit more and have you quantified the impact in recent quarters from some of those pruning efforts?

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

We have not quantified that, Matt, because again it's typical of our sort of overall continuous improvement sort of mentality. So...

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Right.

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

...it goes all the way from very finite pruning product lines, even options on product lines to pruning categories, to consolidating, to some cases, pruning customers. And then the big one that we talked about last time was we pruned some businesses out of the whole system as well. So, it's very broad based. It's consistent with our sort of daily improvement, rapid, continuous improvement sort of culture and way of thinking.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. All right. Last one, I think you might have partly answered this a second ago, Marshall. But when I look at the full year, I think the high-end of the guidance range ticked a little bit lower. What was the real driver? Well, I think you mentioned inflation to Budd's question, but was there anything else?

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

A

Yeah. No, Matt, the reason we've lowered the top end of the range a nickel had to do with inflation coming in at the top end of our expected range and we're also seeing a greater opportunity to invest in the business. And as a result, we're seeing less upside for 2017.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. And is that inflationary environment supporting pricing in a bigger way, Stan?

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

It's a good question, Matt. It's harder to get pricing these days, I think, right now. So the answer is not really supporting this specifically. If it is, it'd be more like 2018 before we would see that. The inflation isn't crazy. It's just – I think, it's modest inflation. And so because of that, it's harder to get price, I think, to cover that.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. Thank you, guys.

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

Thanks, Matt.

Operator: Our next question comes from Kathryn Thompson from Thompson Research Group.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Hi. Thanks for taking my questions today. You had said last quarter that you had expected sales to improve throughout the year. We certainly saw that in Q1. Was that improvement choppy or was it consistent throughout the quarter? And did you see this trend in both office and hearth?

And then finally, with this improvement, to what degree is this really more company-specific efforts that you're yielding profits from, or is it more post-election animal spirits feedback?

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

Yeah. Those are great questions, Kathryn, as usual. I think the improvement we're seeing is relatively consistent, and it's driven, in part, I think, significantly by the overall market and just the overall sentiment post election. And then, I think, also that we are performing well within that improving market. So, I don't see any, quote, animal spirits. I just think it's an overall improvement and not sort of tracking maybe slightly because of where we're positioned ahead of that improvement. It's about what we thought both in office furniture and in hearth.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Okay. Helpful. And one of the things that we are starting to hear from our – this is more on the contractor base is that you're seeing more bids that are bigger and their backlogs. And this is something that's really started to change over the past, say, four to six months. And what visibility do you have with your business to either support or debunk that observation from large national contractors?

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

And we're talking about building products, Kathryn?

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

No. We're talking about guys that are building football stadiums, to office buildings, to hospitals and schools.

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

Yeah. I would say, we are – because of where we compete, we tend to be really more in the small type of bids and the medium type of bids and not as tuned in maybe to the mega bid sort of stuff. That said, right now, we're in a period of seeing some good large- to medium-size project business. But I wouldn't say that we would support or deny that premise that you stated there.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Okay. Of the asset that you announced divesting last quarter, you're able to distinguish on the top line the impacts. But what was the profitability or maybe margin impact of taking that asset out of the picture.

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

A

So, Kathryn, there's more than just one asset that we have divested.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Yeah.

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

A

But the one being a big one. So for the year, our divestitures were lower top line by approximately \$100 million, and we'll increase EBIT by approximately \$3 million. So it's definitely accretive.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Perfect.

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

So the other divestitures, Kathryn, that Marshall is referring to would be periodically we will free up or we will divest contract dealers that we brought in-house to help, and then we, typically, will help straighten those up, and then typically we'll sell those back to the local entrepreneurial talent. And so that's part of what Marshall is referring to, in addition to this other big business we divested.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Okay. Perfect. Thanks very much for your time.

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

Thanks, Kathryn.

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

A

Thank you.

Operator: Our final question comes from the line of Greg Burns from Sidoti & Company.

Greg J. Burns

Analyst, Sidoti & Co. LLC

Q

Good morning. What would you say is driving the underperformance internationally, and what do you think needs to be done, particularly in China, to drive growth in those markets?

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

Well, yeah, your definition of underperformance is always in a shackle bag and say, Greg, these businesses are choppy, volatile. International for us is 5% of the total HNI sales. Based on where you're positioned, et cetera, you're going to see different orders.

So, a significant portion of our business is Mexico and the Mideast, which has been rather volatile. And then China and India moves around, depending on what projects we win and what's going on there. So what makes it better? Well, it's just day to day grinding it out and hitting the right mix and timing of the business.

Greg J. Burns

Analyst, Sidoti & Co. LLC

Q

Okay. Maybe more specifically around China and how you're positioned in that market? I mean, are you more regional there, and do you need to expand your footprint? What kind of investments do you see needing to be made in China to establish your position there?

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

Well, we're one of the leaders in China. China is very much a regional business, and it's about investing and selling capabilities and product. There's no big silver bullet here, it's just driving the business forward. We like what's going on in China. We like how we're positioned in China. China is an important business for us and it's just day-to-day management, keep the ball rolling, so to speak.

Marshall H. Bridges

Chief Financial Officer & Vice President, HNI Corp.

A

Hey, Greg. Just to know we are expecting some acceleration there in the second half. Some – kind of 15% to 20% growth rates international for the back half of the year.

Greg J. Burns

Analyst, Sidoti & Co. LLC

Q

Okay. Thanks. And in terms of the supplies market, it seems like the sentiment indicators for small businesses have been improving since the election or have improved since the election. Looks like the second quarter guide's implying a little bit of a pick-up but not as much as contract. But can you just talk about what you're seeing in the supplies market and what the small business sentiment out there?

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

A

Yeah. I think your comments are right on, small business sentiment is improving, it's not improving as much as contract. It's a very – as you know, we are the market leader in that segment, it's a very volatile segment due to sort of the changing supplies nature. We have several large customers that sometimes the results get moved around based on how they inventory and stock. I think there's a lot more to play out there. We are well positioned. We're broadly diversified, and I think we've got a – it's a significant profit generator for us and will be in the future. So, again, it's more of invest wisely in product and the selling capabilities and serve those customers as efficiently as effect as we can. And as that market improves, we will improve likewise.

Greg J. Burns

Analyst, Sidoti & Co. LLC

Q

Thank you.

Operator: There are currently no more questions in queue. I hand the call back over to the presenters.

Stanley A. Askren

Chairman, President & Chief Executive Officer, HNI Corp.

Well, thank you very much for tuning in to the HNI first quarter earnings call. We look forward to talking to you all in the future and have a great day.

Operator: This is the end of today's call. You may now disconnect. Have a great day.

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