

22-Apr-2016

# HNI Corp. (HNI)

Q1 2016 Earnings Call

## CORPORATE PARTICIPANTS

Jack D. Herring  
*Investor Relations Manager, HNI Corp.*

Kurt Tjaden  
*Senior Vice President and Chief Financial Officer*

Stanley A. Askren  
*Chairman, President & Chief Executive Officer*

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## OTHER PARTICIPANTS

Matthew Scott McCall  
*BB&T Capital Markets*

Kathryn Ingram Thompson  
*Thompson Research Group LLC*

Beryl Bugatch  
*Raymond James & Associates, Inc.*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning. My name is Melissa, and I will be your conference operator today. At this time, I would like to welcome everyone to the HNI Corporation First Quarter 2016 Fiscal Results Conference Call. [Operator Instructions] 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. Herring, you may begin your conference.

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Jack D. Herring  
*Investor Relations Manager, HNI Corp.*

Thank you. Good morning. I am Jack Herring, Manager of Investor Relations for HNI Corporation. Thank you for joining us to discuss our first quarter fiscal 2016 results. Here with me are Stan Askren, Chairman, President and CEO; and Kurt Tjaden, Senior Vice President and CFO. 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 risk. 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 Stan Askren.

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Stanley A. Askren  
*Chairman, President & Chief Executive Officer*

Good morning, everyone. We'll share our assessment of the first quarter 2016, we'll provide some thoughts on our outlook for second quarter and full-year 2016 and then, as usual, we'll open the call up for questions.

Non-GAAP earnings per share increased 48% on a sales decrease of 4%. It was a great start to the year with profits exceeding our expectations. We managed the business well, and we delivered another quarter of strong operational performance, driven by productivity improvements, structural cost takeout and strong returns from previous investments.

And I'd like to make a point here. This is not profit performance just from short-term cost cutting. This is about managing the business for the long-term through a focus on productivity and working to facilitate flow through our businesses and investing in projects that we think are going to drive long-term growth and long-term profitability improvement.

Operating margins increased in both our office furniture and hearth segments, while we continue to invest for long-term profitable growth. Sales results for the quarter were as expected. Office furniture sales were down 5%. On an organic basis, office furniture sales were down 6% against very strong prior-year comparison, of 14% growth in the first quarter of 2015.

Sales of supplies-driven channel were down 6% or down 8% on an organic basis. Sales in our other office furniture businesses were down 4%. Hearth sales decreased 2%. Strong momentum continued in new construction with sales increasing 10%. Warm weather and the low-energy cost continued to negatively impact sales of [ph] home (O3:18) appliances, which declined 35%.

During the quarter, we also met a significant milestone in our Business Systems Transformation. We had a successful transition of one of our small office furniture companies to our new enterprise system. We're projecting – excuse me. I wanted to remind you that this Business Systems Transformation is a broad-based transformation on how we work. It's a national extension of our rapid, continuous improvement culture with substantial process simplifications already occurred that eliminates waste from our combined total business. While we're only in the middle innings of our implementation timeline, we are in fact seeing the financial benefits of BST, this Business Systems Transformation across our businesses.

Overall, I'm very pleased with our first quarter results.

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## Kurt Tjaden

*Senior Vice President and Chief Financial Officer*

Thank you, Stan. So a couple of additional highlights for the first quarter include: Non-GAAP consolidated gross margin improved 190 basis points versus the prior year to 37.4%. These results were driven by strong operational and material productivity and better price realization, which were partially offset by lower volume.

Non-GAAP selling and administrative expenses were down versus the prior year due to broad-based cost reductions, partially offset by strategic investments and incentive-based compensation. During the quarter, we completed the acquisition of a small office furniture business. This acquisition will contribute approximately \$30 million of sales and \$2 million of profit in 2016.

So as we look to the second quarter 2016, we anticipate consolidated sales to be down 4% to 7%. Office furniture sales are expected to be down 4% to 8%. Supplies-driven office furniture sales are projected to be up 2% to down 2% or down 1% to 5% organically. Sales in our remaining office furniture businesses are forecasted to be down 9% to 13% against very strong prior-year comparisons and a challenged China market.

Hearth sales are expected to be flat to down 4%. New construction channel sales are expected to be strong, again, up 10% to 14%. And we are projecting retail pellet sales to be down 26% to 30% and retail non-pellet sales to be down 10% to 14%.

Non-GAAP gross profit margin is expected to increase significantly over the prior year, consistent with our recent quarterly improvements.

Non-GAAP SG&A is expected to be comparable to the second quarter 2015 amount of \$167 million, and our estimated non-GAAP earnings per diluted share for the second quarter is in the range of \$0.54 to \$0.59.

So, let me shift to the full year 2016. For the full year, we expect consolidated sales to be down 2% to 4%. We are forecasting office furniture sales to be down 2% to 5%, and sales in our hearth business are expected to be flat to down 3%. We are narrowing and increasing our estimated range of our full year earnings per share guidance. Our current best estimate of non-GAAP earnings per diluted share for the full year is now in the range of \$2.40 to \$2.70.

Stan?

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

All right. Thank you, Kurt. So, I'll summarize. Our businesses are strong, agile and well positioned for the future. Our brands are competing well in their respective markets. Despite this uncertain economic environment, I'm confident in our ability to continue to drive long-term profitable growth. So, with those comments complete from Kurt and myself, we'll now open it up to questions.

## QUESTION AND ANSWER SECTION

**Operator:** [Operator Instructions] Your first question comes from Matt McCall with BB&T Capital Markets. Your line is open.

Matthew Scott McCall

*BB&T Capital Markets*

Thanks. Good morning, guys.

Q

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

Good morning.

A

Matthew Scott McCall

*BB&T Capital Markets*

So, let's see. I guess, talk about the commentary in the release. You're seeing some modest – saw some signs of modest market improvement. I assume you're talking about in – well, I'll just leave – which markets are you seeing signs of improvement? It looks like the outlook is still for down-ish top lines. But what led to that comment?

Q

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

Well, I think, Matt, as we look out and talk to our dealers and talk to our dealer sales folks and we look at pipeline activity and to sort of gauge overall sentiment, I am feeling more optimistic about the second half than I was the last time we talked to you. If you look at our outlook, in fact, we're showing the second half is going to be up slightly. And so, we're feeling better. It's early though. I think there's lots of choppiness in our markets still, and we're seeing the upturn and, I'd say, my sentiment is improving in both the supplies-driven side, as well as the contract side.

Matthew Scott McCall

*BB&T Capital Markets*

Q

And so that's just – that's from feedback from sales people, feedback from dealers, feed – just that – any change in order patterns or anything like that?

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

Well, the answer is, it's early – probably too early to really comment on the order pattern uptick. So it's more about sentiment. Just being in the market, our executive group in the market talking to people we think are the closest to the customers and feeling more positive.

Matthew Scott McCall

*BB&T Capital Markets*

Q

Okay. So in our model, we had noted that you were going to see most of the savings from some of the cost initiatives in Q4. I think we had [indiscernible] (09:44) of savings beginning to show up in Q4. Was the margin improvement this quarter related to something else, or did you just get the savings sooner than you expected?

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

Related to something else is the answer. Those structural cost savings are still out there, as we projected earlier. We – as I indicated pretty emphatically in my opening comments, we're seeing broad-based productivity improvement. The operations and the distribution in the front-end are executing very well.

We're seeing the savings that in its – in lots of places from our Business Systems Transformation initiative. So as you recall, that BST is not just an Oracle implementation. It's really understand, simplify, standardize then flow. And so we have 100 people to 150 people working full-time on that, and we're seeing the benefits in the business even before we roll to the – do an Oracle implementation.

And then, the final point is, as you have noted in the past, we've invested significant capital back into the business that we've indicated has a relatively quick, like, 12 months to 24 months payback and we are seeing those results flow through to the operation. So I'll go back. We're really seeing a broad-based productivity improvements across the business, and the structural stuff is still out there. This improvement is not due to that. That's yet to come.

Matthew Scott McCall

*BB&T Capital Markets*

Q

Okay. Let's see. A couple more. The acquisition, I understand, is small, about \$30 million. What did you buy and what do they bring to the suite of products that you already had?

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

We bought a small company that is more of a catalogue-based, click-to-buy business, heavily focused [ph] in sheathing (11:49). It was a nice little acquisition that came on our stream. It's called OFM. They fit in nicely, tucks in. It's not a huge deal for us, but it's a nice little profit contributor to the overall corporation.

Matthew Scott McCall

*BB&T Capital Markets*

Q

Okay, okay. Thank you. And then last one, you gave the outlook for the full year. Can you talk about your expectations for new construction overall, the hearth channel growth overall for the year you've given? But if I talk about just the new part, I think you said new – next quarter up 10% to 14%. What about the full-year view? Is that consistent with your full-year view?

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

Yeah, it's pretty much and it's just around it. And we – as we've indicated to you before, we look at permits – and permits, I don't have it in front of me, it seems like last month, we're up 20%, 21%; the previous month, we're up 18%. So we're pretty – we continue to be pretty bullish on new construction, and I would say that our outlook is – based on these recent two months, is improving. I don't think we're moving our numbers big, yet. We want to see ongoing improvement, but I would say – again, if I [ph] tell (13:02) how I'm feeling, I feel better about them than I have in the past.

Matthew Scott McCall

*BB&T Capital Markets*

Q

That are relative to that 10% to 14%, you mean – so, you're actually seeing trends that are better than that, but you're not ready to make that change yet?

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

That's correct.

Matthew Scott McCall

*BB&T Capital Markets*

Q

Got it. All right. Perfect. Thank you, guys.

**Operator:** Your next question comes from Budd Bugatch with Raymond James. Your line is open.

Beryl Bugatch

*Raymond James & Associates, Inc.*

Q

Good morning. Congratulations on the operating performance, Stan, Kurt and Jack, and to your team. Question for you. As I look at, I think, on page five of the slide for office, it says organic sale is down 6.1%, supply is down 5.9%, and all other down 4%. All other being North American contract and international contract? Is that the way to read that? And how do you parse that?

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

That is the way to read that, Budd. You have that correct.

Beryl Bugatch

*Raymond James & Associates, Inc.*

Q

And so difference between North America and China, how does that factor in?

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

Well, China is down – it's going to be down significantly more than North American contract. But as you recall, that business is still relatively, the North American contract, smaller. So, the mix would be China will be down more, but it's not – it's a much smaller part of the mix.

Beryl Bugatch

*Raymond James & Associates, Inc.*

Q

And North America, well just – well, then, let's take it the other way, how much was North American contract down?

Kurt Tjaden

*Senior Vice President and Chief Financial Officer*

A

It would have been close to that, Budd. North American contract – hang on for a second...

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

A little bit less.

Kurt Tjaden

*Senior Vice President and Chief Financial Officer*

A

A little bit less.

Beryl Bugatch

*Raymond James & Associates, Inc.*

Q

[ph] That's certainly the way (14:46) the math works.

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

Yeah, that's right.

Beryl Bugatch

*Raymond James & Associates, Inc.*

Q

The pellet – let's go to pellets and the comparisons as the year progresses. And I understand the reason for the pellet comparisons, when do they start to ease, do we have to wait for fourth quarter or is that where we are?

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

Yeah, it starts to ease a bit in the third quarter, but really it's fourth quarter when everything kind of anniversaries and settles down. Still, you're just going to see where pellet ends up. It may go down a bit more in fourth quarter depending on this weather and alternative fuel cost. I think the one thing I always have to mention, Budd, I'll use your question the platform; this is still a profitable business for us. We have a significant market share. It's just facing a huge headwind on fuel cost and on weather.

Beryl Bugatch

*Raymond James & Associates, Inc.*

Q

And as you look at it, which is more important? Or do you know or maybe you don't know, whether it's just weather or – whether it's weather or cost?

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

Yeah. Again, it comes back to the homeowner and how they're – how hard they're getting kicked in the head on their bill. So the core is the more they're running their furnace and higher the alternative is, [indiscernible] (16:13) or fuel oil, the worse. So it's a combination thereof, but it depends on which has spiked and which has not. I would guess, if had to answer your question, that cost of the fuel is probably the biggest issue and weather will be second.

Beryl Bugatch

*Raymond James & Associates, Inc.*

Q

Okay. Let me go back to North American contracts. As I think about that, for the next several quarters, you said you had heavy and strong comparisons, when do those comparisons ease, Kurt? When do we see a positive and specified in your planning horizon?

Kurt Tjaden

*Senior Vice President and Chief Financial Officer*

A

So I'll echo Stan's earlier comments, Budd. If you look at second half of the year, you'd start to see those comps turn modestly positive. So based on where we sit today, third quarter, we'd start to see that turn.

Beryl Bugatch

*Raymond James & Associates, Inc.*

Q

And shouldn't we see that in the order book already? Wouldn't we start to see some backlog growth?

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

Pretty early yet, Budd, is what I would respond there. And as far as our sales for second quarter, that's – we're still – we're delivering that which was ordered in the softer period. So it's still relatively early on the order book, and I would say it's really more about how I'm feeling about the sentiment.

As you know, and I know you know this, it's really – for us, it's a very choppy sort of environment out there around size of orders, around geographic sort of movement, around wall versus other stuff. And so lots of moving complex pieces.

Beryl Bugatch

*Raymond James & Associates, Inc.*

Q

Okay. Thank you very much. Good luck on the balance of the year and the second quarter.

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

Thanks, Budd.

**Operator:** Your next question comes from Kathryn Thompson with Thompson Research. Your line is open.

Kathryn Ingram Thompson

*Thompson Research Group LLC*

Q

Hi. Thanks for taking my questions today. Within the office unit, you cited price realization in the quarter. Is this driven more by supplies? Or to your office segment, if you could just in general give a little bit more color around pricing improvement in the quarter.

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

Yeah. Kathryn, it would be in both segments, and it's a relatively small number, 2% to 3% price increase.

Kathryn Ingram Thompson

*Thompson Research Group LLC*

Q

And more color – and what has enabled you to gain pricing now versus maybe not as typically in magnitude in the prior quarter?

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

It's really just an annual – it's an annual cycle of price increases to offset cost, people cost, et cetera. So there is – it's actually a much smaller number than we've historically been able to gather over the years.

Kathryn Ingram Thompson

*Thompson Research Group LLC*

Q

Okay. You had talked earlier in your prepared comments and in the Q&A about modest market improvements. But I was going to see if you could talk in a little bit more detail how that relates to project size and also if you could focus on end market, be it geographic or literal end type of market like office, healthcare, et cetera, in order to understand more the color behind this modest market improvement that you're seeing.

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

Yeah. And for us, we're broadly diversified between these different segments and these different companies and these different product categories in different geography. I would say it's broad-based. Certainly, we're feeling the down stroke from energy. The other segments we're not broken out as much. I would say the large projects are probably less. Smaller business would be relatively more stable than the large projects. I don't know. Kurt, anything else?

Kurt Tjaden

*Senior Vice President and Chief Financial Officer*

A

I think you got it.

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

Okay.

Kathryn Ingram Thompson

*Thompson Research Group LLC*

Q

All right. And in terms of your fiscal 2016 guidance, if you got to put into the buckets the greater driver of that raised guidance, how much of it is your operational improvement going better than expected versus modestly improving market?

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

I would say, at this stage, Kathryn, our call is more around productivity improvement, operational improvement than it is market. Our comment – the comment in that press release was meant to really signal that the sentiment – my personal sentiment and our collective sentiment as the senior management team is improving, but we have not factored those numbers into our outlook in a significant way or any way really is what I would say.

Kathryn Ingram Thompson

*Thompson Research Group LLC*

Q

Okay, okay. That's helpful. And then, finally, we've spent a lot of time talking about the market. And then, also about what you're doing from an operational standpoint. But maybe switch gears and focus more on new products. What percentage of your sales either mostly for office, but maybe perhaps even hearth or new products? And how much your new product introduction is going to help to drive that improvement this year? And how is that any different if at all versus the prior two years?

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

Yeah. That's a great question. New products, we classify new products as significant new SKUs introduced in the last, let's say, three to – three years, I guess. That level is running about 25%. That's higher than we have run in the previous decade, but it is consistent with what we've been running in the last several years. And so, it's a very important part of our story going forward. We continue to find lots of new opportunities for new products. And as you know, Kathryn, each of our operating companies run in different segments. And so, if you walk through – look at each of the companies, they are all working significant new product launches. And so, I think the pipeline is strong or stronger than ever, and I think it's a very important contributor to our ongoing profitable growth initiatives.

Kathryn Ingram Thompson

*Thompson Research Group LLC*

Q

Okay. Great. Thank you very much. Good luck.

Stanley A. Askren

*Chairman, President & Chief Executive Officer*

A

All right. Thanks, Kathryn.

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**Operator:** There are no further questions in queue at this time. I will turn the call back to Mr. Askren for any closing comments.

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**Stanley A. Askren**

*Chairman, President & Chief Executive Officer*

Yeah. One thing, we understand it's Matt McCall's birthday today, and we want to wish Matt a Happy Birthday. And with that, we appreciate your interest in HNI, and we appreciate your focus on trying to understand our business, and we look forward to speaking with you in the future. We hope everybody has a great day. Take care. Bye-bye.

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**Operator:** Ladies and gentlemen, this concludes today's conference call. You may now disconnect.

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