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HNI Corporation

Fourth Quarter and Year-End Fiscal 2021 Results Conference Call

February 28, 2022

CORPORATE PARTICIPANTS

Jeff Lorenger, *Chairman, President, Chief Executive Officer*

Marshall Bridges, *Senior Vice President, Chief Financial Officer*

Matt McCall, *Vice President, Investor Relations and Corporate Development*

CONFERENCE CALL PARTICIPANTS

Reuben Garner, *The Benchmark Company*

Budd Bugatch, *Water Tower Research*

Greg Burns, *Sidoti & Company*

Steven Ramsey, *Thompson Research Group*

PRESENTATION

Operator

At this time, I'd like to welcome everyone to the HNI Corporation Fourth Quarter and Fiscal Year 2021 Conference Call.

Thank you. Mr. McCall, you may begin your conference.

Matt McCall

Good morning. My name is Matt McCall. I'm Vice President Investor Relations and Corporate Development for HNI Corporation. Thank you for joining us to discuss our fourth quarter Fiscal 2021 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, 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'm now pleased to turn the call over to Jeff Lorenger. Jeff?

Jeff Lorenger

Thanks, Matt. Good morning and thank you for joining us.

pressures, supply chain constraints, and labor shortages while taking multiple steps to improve our long-term profitability, including additional pricing actions, strategies to address our labor constraints, restructuring initiatives to simplify our business, and the completion of two acquisitions. These actions, along with our ongoing strategies to create long-term growth, make us optimistic about 2022 and beyond.

Our two differentiated business segments are well positioned to benefit from secular trends and numerous HNI specific growth initiatives. I will cover three key points today: first, we continue to take actions to improve profitability and workplace furnishings; second, our performance in residential building products remain strong; third, we are focused on deploying cash to improve shareholder returns.

I will cover these points. Marshall will then go through our 2022 outlook. I will conclude with some general comments. Finally, we will open up the call to your questions.

Moving to our first key point. We are taking actions to improve profitability in workplace furnishings. Our 2021 workplace furnishings margins were severely impacted by two main factors: first, price cost was negative due to rapid and substantial input cost inflation; second, constraints around labor availability, supply chain capacity, and COVID outbreaks shifted revenue out of 2021. Combined, these negative impacts reduced 2021 segment profit by over \$80 million and lowered segment operating margin by approximately 550 basis points.

We have taken action to address both issues and expect to increase profitability as a result.

To address price cost, we have implemented multiple price increases across our brands. We expect price cost to be approximately neutral in the first quarter and to drive significant profit improvement in the second half of 2022. We have also taken multiple steps to address our labor shortage. I'll remind you of three of the more significant actions we have taken.

First, we opened a new seating facility in Mexico. This facility provides access to a new labor pool. Production at the plant has already started and will ramp up through the first half of this year. We anticipate being at full capacity in the third quarter.

Second, we are moving multiple production lines to HNI facilities with better labor dynamics.

Third, we are making our existing labor more productive. This includes improving operational flow through layout changes, additional automation, and creating arrangements to ensure our labor can be deployed where it is most needed. In total, we expect these initiatives will enable us to increase workplace furnishings production by 10% to 15% in 2022. Labor will remain a challenge, but we will be in a better position to manage it effectively.

We also made two strategic moves in the fourth quarter to simplify our business and improve our long-term profitability. We announced plans to exit a small workplace furnishings brand. This will allow us to streamline our offering and focus our capacity on our most important and highest profit brands. We also made the decision to restructure one of our e-commerce businesses, exiting the low margin portion of that business.

Our workplace furnishings businesses have unmatched price point breadth, channel access, and market reach. We are investing in multiple strategic initiatives aimed at driving continued profitable growth. We have a unique ability to serve fast growing segments of the market, including education, home office, and with small to mid-sized customers.

Our investments, along with our existing competitive differentiators, position us well to benefit from office re-entry, work from home, and adoption of hybrid work. While large urban markets have been slower to reopen, they remain an area of opportunity for us. These markets are now showing signs of increasing activity.

The breadth of our offering and investments in new products, technology, and partnerships position us well to participate in that rebound.

I will now move on to the residential building product segment and cover my second key point. Our performance in this segment remains strong with high margins and multiple opportunities for growth, both in our core business and in new addressable markets. For the full year 2021, residential building products revenue grew over 27% and operating profit increased 30% to \$142 million.

We expect another strong year in 2022 driven by a positive outlook for new home construction and remodel retrofit activity, optimism surrounding our HNI specific growth initiatives, elevated backlog levels entering 2022 for our business and for home builders, and trends around nesting outdoor living and de-urbanization, which continue to provide secular support for this segment.

To take full advantage of these growth opportunities, we are addressing price cost and our labor and supply chain constraints, both of which negatively impacted fourth quarter results. In addition to driving organic growth, we are also expanding our residential building products business through acquisitions.

In December, we acquired The Outdoor GreatRoom Company, a leading manufacturer and marketer of premium outdoor living products, primarily fire tables and fire pits. The acquisition, which generated approximately \$25 million in revenue during 2021, provides us a platform in the fast growing outdoor living market. It enhances our ability to take advantage of trends around nesting de-urbanization and increasing interest in creating flexible outdoor living spaces.

We also acquired Trinity Hearth and Home, a large Dallas hearth appliance and installing distributor. As we discussed in our last call, Trinity will act as a hub to better serve the rapidly growing Southwest region. This addition to our fireside hearth and home distribution network bolsters our competitive advantage, allowing us to control the content and experience throughout the customer journey. We're excited to welcome The Outdoor GreatRoom and Trinity teams to the HNI family.

We have strong competitive positions in both the new residential construction and remodel retrofit markets. Our unique vertically integrated business model, unmatched product depth and pricing breadth, strong builder relationships, and regional distribution infrastructure all provide differentiation for this business. Our scale positions us to benefit from our efforts to grow the category.

We have multiple initiatives underway to influence and assist home buyers and homeowners during their purchase and remodeling journeys. These initiatives include driving category awareness, reimagining the fireplace, and growing the electric category. In addition, we are able to deliver digital tools and capabilities to engage customers online, improving their experience in ways that are difficult for our competitors to match.

I will now shift to my third key point. We are focused on deploying cash to improve shareholder returns. In 2021, we paid \$54 million in dividends. We have now paid a dividend continuously for the last 67 years. We also ramped up our share buyback activity in the fourth quarter, re-purchasing more than \$40 million worth of our shares outstanding, taking the total repurchases for the year to nearly \$60 million. We have approximately \$100 million of repurchase authorization remaining.

As previously mentioned, we have invested \$45 million in acquisitions, primarily The Outdoor GreatRoom and Trinity. As we look forward, we expect our balance sheet and cashflow will continue to support elevated cash deployment.

Now, I'll turn the call over to Marshall to discuss our 2022 outlook.

Marshall Bridges

growth and profit improvement as the year progresses. In workplace furnishings, we expect pricing benefits, backlog normalization, and assumed market improvements to drive revenue growth rates in the high teens to low 20's for the year. I would also like to point out that we started 2022 with an elevated workplace furnishings backlog that will support solid growth. Segment backlog at the end of 2021 was approximately \$120 million above normal levels.

In residential building products, pricing benefits and organic revenue from acquisitions and multiple growth initiatives are expected to fuel growth rates in the high teens. That's on top of the 25% organic growth generated in the segment during 2021. Let's look at consolidated margins.

We expect improving price cost and volume growth to drive operating margin expansion in the second half of the year. We expect to recapture much of 2021's price cost gap during the year.

Some thoughts on seasonality. Historically, we 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. I would also point out that we'll be comparing it against reasonably strong prior year results in the first half.

Despite pressures from the pandemic, non-GAAP EPS in the first half of last year was among the highest levels we generated over the prior 15 years, surpassed only by 2016 and 2017. The second half comps are less challenging.

For the first quarter specifically, we expect profit to be below levels generated in the first quarter of 2021. Comparing the first quarter sequentially to fourth quarter 2021, benefits from reduced price cost pressure are expected to be more than offset by three main drivers: first, impacts from COVID on the supply chain and labor availability worsened in the early part of the quarter as the Omicron variant surged; second, our e-commerce international workplace furnishings businesses are experiencing their typical seasonal softness as they move from the historically strong fourth quarter to the typically slower first quarter; and third, the actions we're taking to address labor availability require investment in the first half. As a result, we expect first quarter EPS will be below prior year levels and near the results of the first quarter of 2020. Although we expect to start slowly, we do anticipate strong profit growth for the full year 2022.

I'll now turn the call back over to Jeff.

Jeff Lorenger

Thanks, Marshall. Before we take your questions, I would like to highlight an important milestone for HNI. This year, we are celebrating our 75th anniversary. In 1947, the Home-O-Nize Company was founded as an idea to launch a manufacturing enterprise to employ American veterans returning from World War II. That company, which later became HON Industries and then HNI Corporation, began as an idea to start a company where everyone would be treated equally and respectfully.

These founding principles, along with our shared belief of relentlessly focusing on our customers, have allowed HNI to grow into a leading global family of brands across two industries. As we enter our next 75 years, our focus on our members and our customers will remain as will our desire for HNI to be a good corporate citizen supportive of our communities and the environment.

We are addressing the challenges in front of us with aggressive actions, which will drive long-term profit growth, increase shareholder value, and allow us to continue to positively impact our members, our communities, and our planet.

To our members, I would like to express my sincere gratitude for your dedication and commitment to operating each day in a manner consistent with the same core beliefs our Company was founded on 75 years ago. It takes a big team to contribute to our ongoing success.

Operator

Thank you. Our first question is from Reuben Garner with The Benchmark Company. Your line is open.

Reuben Garner

Thank you. Good morning, everybody.

Jeff Lorenger

Morning.

Reuben Garner

I guess let's start with the order rates in workplace, if we could. Maybe, and if you said this in your prepared remark, sorry, I had some difficulties at the beginning of the call, but can you talk about the trend through the quarter and maybe how that's looked more recently in light of the Omicron cases fading away over the last month or so?

Jeff Lorenger

Yes, Reuben, I think the trend as we exited the year or in the fourth quarter and entered the year, we had some pull ahead. We had a lot of price that we passed and pulled some orders ahead and created some softness as we exited the year. Then Omicron hit in January and that kind of slowed some stuff down.

What I would tell you though—well, first of all, first quarters typically are slow, the slowest time of the year, but secondarily, we're starting to see the recovery. Again, it's led by SMB customers. Quarter-to-date, if you exclude e-com, which we took some actions in, orders are up 10% year-over-year. We've got an elevated backlog that's encouraging and we're optimistic.

I would tell you what, the pre-order activity is increasing. The North American contract, the funnel's growing. Actually, dealer design, design requests are at 2019 levels. We monitor that as a forward-looking indicator. That's kind of what we saw. We saw kind of a dip and then now we're seeing a lot of forward-looking indicators that are double-digit positive.

Reuben Garner

Okay, great, and then the price cost again in workplace, so Marshall, I think the neutral comments are maybe on a sequential basis. Can you help us understand what kind of year-over-year price cost pressure still remains in the first part of the year, and then maybe how much of a tailwind that becomes as we move through the year, especially if we continue to see steel drift lower and as you're realizing your pricing actions?

Marshall Bridges

Reuben, we're expecting, for the Corporation, price cost to be roughly neutral in the first quarter and in the second quarter as well. In the back half of the year, we expect to recover the majority of that \$66 million negative price cost GAAP we had in 2021, so maybe \$40 million to \$50 million of benefit spread pretty evenly across the third and fourth quarters of 2022.

Reuben Garner

the backlog being at unprecedented levels, at least relative to your history. What kind of visibility do you have in hearth? There's some concern that rising rates are going to lead to a slowdown in starts. You guys have a lot going on internally. What kind of comfort do you have that you can grow at those strong levels on top of what was a very strong 2021?

Jeff Lorenger

That's a great question, Reuben. I would say, look, I mean, we still have an elevated backlog entering the year for that business segment and our orders year-to-date are up 20%. Clearly housing indicators are mixed, but we're positive in our position and in our efforts.

Our HNI specific growth initiatives give us some confidence. We've been talking about those for a bit now. The category awareness efforts, we're continuing to see traction there. For instance, our awareness, consideration and purchase visits on our websites are up 26% year-to-date. Our gas insert initiative has been rolled out now. It had 10 dealers on that program last year. We have a hundred dealers on it now. It was up 30% last year and year-to-date, it's up 60%. We're pushing in the electric category quite a bit. Although it's a small piece of the business, it's growing at a nice rate. It was up 79% last year. Then we talk about the new expansion into the outdoor area. We're bullish on that as well. That's our view. We think it's an exciting time for growth in that portion of our business.

Reuben Garner

Great, and then I'm going to sneak one more in if I can. On that outdoor living note, very interesting acquisition. Can you talk about maybe where you guys could see this business going? Is there a lot of runway in those sort of hearth or fire related components, or could you see yourself getting outside of the fireplace business in outdoor living moving forward via acquisition or organically?

Jeff Lorenger

That's an interesting question, Reuben. First of all, in their core business, we see a lot of headroom for growth. It's a pretty fragmented market and we think we can bring some capability expertise to that business and use it as a platform. Whether that leads to other product categories in the outdoor living space, it's too early to tell, but we'll obviously always evaluate those opportunities as we get closer to them.

Reuben Garner

Perfect. Congrats on the close to '21 and good luck this year again.

Jeff Lorenger

Thanks, Reuben.

Operator

Our next question is from Budd Bugatch with Water Tower Research. Your line is open.

Budd Bugatch

Yes, good morning and my congratulations to HNI for its history and for its future as well.

Jeff Lorenger

Thanks, Budd.

You're welcome. Question, Jeff. Make sure I understand what's going on in workplace furnishing versus SMB versus the contract channel. I kind of got confused a little bit with your comments about how the year ended and where you are now with Omicron and where it's going on with the various geographies.

Jeff Lorenger

Budd, that's a great question. I did kind of combine the overall workplace area. What I would say is the SMB business, the smaller market business has been stronger. I mean, if you think about it, they probably went back to work a little sooner and our SMB business, we're strongly positioned with our distribution network in those areas. That's been a positive. When I say the contract business as you would call it, or we would call it, in the urban markets, that's what I was saying, that's still been down. The Omicron really hit that piece of the business, but that's where this preorder activity, some of the rates I was quoting are up.

For instance, our back half funnel strength for that piece of the business is up 40% over prior year. It's still in the build phase, but we're pretty bullish on that piece of the business as well. That's kind of the two pieces. SMB is stronger with education and small markets right now and the contract business is building.

Budd Bugatch

Okay. That's helpful. Could you give us—by the way, on price cost, Marshall, maybe we can get a review of where we are. What is the composition of raw materials and how does price cost in labor and other factors fit into it? We throw in some numbers, but I'm trying to understand by segment and for overall, what's that composition, steel versus wood or plastics or fabric and labor.

Marshall Bridges

Yes Budd, the price cost number that I gave Reuben earlier includes all of that. Roughly speaking, as we look into 2022, we're expecting input costs to be up like \$220 million to \$240 million in that range. About 80, 85 plus percent of that is basically things that cost to get sold. The biggest four would be steel, the carryover from steel ramping up last year. We also have carryover from ocean freight, wages, and then there's just a broad set of commodities that we're seeing inflation in, none of which are large individually, but collectively, very impactful. We're seeing inflation also in wages outside of COGS, as well as just freight costs going up. Collectively, that gets you to about that \$220 million, \$240 million range, which we expect to offset with price in order to drive that \$40 million to \$50 million positive price cost for 2022.

Budd Bugatch

The price then is somewhere in the \$270 million to \$300 million kind of number, is the price realization?

Marshall Bridges

Yes. I think it's \$260 million to \$290 million, I think gets you there, right?

Budd Bugatch

Yes, okay. All right, and when you talked about investment in wages, or investment in labor, I think in the first quarter, if I remember right, your language, is that in increased wages that'll be sticky for—then that'll never go back down. So that investment is a continuing investment?

Marshall Bridges

right, we're seeing that. I think what we're also explaining is that in the first half, the cost of adding this extra capacity, which kind of Jeff walked through, the New Mexico facility and moving some of our production lines to other facilities with better labor dynamics, that has a bit of an investment cost in the first half, so we're looking at a temporary one-time sort of hit there of approximately \$10 million on the year to get that capacity online.

Budd Bugatch

So those are training costs and those are one-time costs, kind of additional issues like that. Does that understand that variable?

Marshall Bridges

Yes. It's the inefficiency of starting those (inaudible) up and moving them. Not so much training, but you get the idea.

Budd Bugatch

Yes. Okay. Sure. I got it, and the backlog, you talked about an elevated backlog in workplace. I think there was \$120 million delta. Did you give the number in workplace? I mean, in residential and hearth?

Marshall Bridges

We didn't. The backlog there is elevated. We do believe that will support an extra \$30 million of growth this year. If demand were to come in, we have \$30 million of backlog that we can normalize there.

Budd Bugatch

That's an organic? I mean, that's outside of The Outdoor GreatRoom, right? That's not in...

Marshall Bridges

Correct. That's a core business.

Budd Bugatch

Okay. Thank you very much. Congratulations again and best of luck on 2022 and beyond.

Jeff Lorenger

Thanks, Budd.

Operator

The next question is from Greg Burns with Sidoti & Company. Your line is open.

Greg Burns

Morning. With the restructuring on the online channel, was that with OFM or DPG, and what was the impetus there? Were those channels underperforming? Why did you take a look at restructuring that side of the business?

Jeff Lorenger

exiting is really opening price points sold through retailers, and the profit pool there is no longer, in our judgment, attractive for our business.

Many new entrants have come into that over the last couple of years, and so we wanted to pivot and get our focus on—we have a nice portion of that business in the gaming space and believe the macro environment for gaming is going to continue. We're going to put our efforts behind that.

Greg Burns

Okay, and then we look at the profitability initiatives on the workplace side of the business. I guess, where do you see the operating margins of that business getting to over the next couple of years? I guess you mentioned, I think it was \$80 million of operating profit lost to some of these headwinds. How much of that do you expect to get back in 2022?

Marshall Bridges

We will not get all that \$80 million of pressure back. We talked about the price cost in 2021, it was negative \$66 million. I talked about getting back \$40 million to \$50 million of that in 2022, but Greg, we fully anticipate getting that back over time, so we would get that.

Likewise, we may not completely normalize our backlog and workplace furnishings during 2022. There's that volume growth to go after. The two examples we gave of exiting one of our smaller businesses and then the restructuring around e-commerce are sort of indicative of the type of action we're going to be taking over the next few years to drive margins forward. So, we certainly expect to recover some margin in 2022, but there'll be more to come after that.

Greg Burns

Okay, great. Thank you.

Operator

The next question is from Steven Ramsey with Thompson Research Group. Your line is open.

Steven Ramsey

Hey, good morning. I wanted to continue with the backlog topic for a second. You said workplace, probably not normalize this year, but what about the residential segment, and how much of this depends on the Company specific initiatives on labor and capacity, and how much of this depends on incoming orders throughout the year?

Marshall Bridges

I think the way to think of it, Steven, is that if orders are strong in both segments, we will not completely normalize the backlog. As we sit right now, we expect to normalize the backlog in the residential building product segment. Then we expect to have a significant amount of tailwind from normalizing the backlog in workplace furnishings, but we are expecting a pretty strong year, as Jeff mentioned, in the back half of the year. Our ability to lower that backlog depends on the equation of how much capacity we can add and what the incoming orders are. I'm not sure we have complete visibility to either of those yet.

Steven Ramsey

these in the release. Is there a way to rank the contribution of the various drivers to the workplace sales guidance, and maybe what is the key factor that moves you from the low side or to the high side?

Marshall Bridges

For workplace furnishings, just to recap, we had given an outlook for revenue growth in the high teens to low 20's. The thing to remember there is that price cost that we're going to close is driving a lot of price realization. Maybe 13% to 14% points of that outlook has come from price realization. Then the rest of it, 4% to 5% points or so is really net organic, non-price growth, and I think that depends on how strong the incoming orders are from this building activity that we talked about as well as how much capacity we can add.

Steven Ramsey

Okay. Helpful, and then last one for me on the hearth business, thinking about the new construction side potential benefit from the wave of new starts, but the bigger opportunity seems to be penetration for you guys. Is this happening at a slower pace than maybe you would hope for given builders are working through so many other operational issues, or do you feel like you're able to make a strong push still on the penetration side this year?

Jeff Lorenger

Yes Steven, this is Jeff. We still feel we can penetrate. I mean, look, there is clearly building delays and the system is gummed up a little bit, but penetration comes in multiple forms. Awareness and our operational model, the categories, those are all—we see the benefits.

Timing, just like Marshall said, timing of all this stuff is still a bit foggy given the constraints we're dealing with, but we think we can penetrate at a rate that is acceptable for our investment level.

Steven Ramsey

Okay. Helpful. Thank you.

Operator

We have no further questions at this time. I'll turn the call over to Mr. Lorenger for any closing remarks.

Jeff Lorenger

Great. Thank you so much. Thanks for your interest in HNI, and thank you for joining us today on the call. Have a great day.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect. Thank you.