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HNI Corp. (HNI)

Q4 2018 Earnings Call

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Matt McCall
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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Holly and I'll be your conference operator today. At this time, I'd like to welcome everyone to the HNI Corporation Fourth Quarter Fiscal 2018 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. Herring, you may begin your conference.

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

Good morning. I am Jack Herring, Treasurer and Director of Investor Relations for HNI Corporation. Thank you for joining us to discuss our fourth quarter fiscal 2018 results. Here with me are Jeff Lorenger, 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 pleased to turn the call over to Jeff Lorenger.

Jeffrey Lorenger
President, Chief Executive Officer & Director, HNI Corp.

Good morning, everyone. We will share our assessment of the fourth quarter and provide some thoughts on our outlook for 2019. We'll then open up the call for questions. Our teams performed well in the fourth quarter. We

drove significant earnings growth and margin expansion while continuing to manage through multiple challenges. Inflationary pressures remain high and the market environment was choppy. Despite these challenges, we grew organic sales by more than 5% and improved our overall performance across the board.

As I look back on the full year, we completed multiple strategic actions to build our long-term foundation. We successfully launched our Business Systems Transformation initiative, or BST as we refer to it. BST will be crucial to our future, providing a foundation to more effortlessly serve our customers, adapt to changing market needs, and enable greater operational efficiency.

We finalized multi-year transformations of our operational network, lowering costs, and improving our responsiveness in both office furniture and hearth. We made significant progress strengthening our supplies-driven office furniture business. We improved our capabilities and created a stable platform to drive that business forward. We continue to build out our e-commerce capabilities. This is a rapidly growing segment with great opportunity for us.

We also completed our long-planned leadership transition. After 26 years with the company, including the last 14 years as Chairman, President, and CEO, Stan Askren retired at the end of 2018. I was honored to be appointed by our Board of Directors to lead our teams, and I look forward to working with our new Independent Chairman, Larry Porcellato.

In addition to these accomplishments, we also drove financial improvement. All of our businesses delivered solid growth. We grew organic sales 6.6% led by strong growth in our supplies-driven business and our hearth business. Our non-GAAP earnings per share improved 22%. Productivity and cost savings improvements, stronger volume, and a lower tax rate more than offset costs associated with our successful BST launch. We improved our profit while making key investments, including investments in launching new products, continuing to build our quick ship fulfillment capability, and adding selling capability in our rapidly growing e-commerce and international markets.

We further solidified our strong balance sheet. During 2018, we generated \$147 million of free cash flow. We ended the year with \$250 million of debt and our debt to EBITDA ratio was 1.1 times. We are financially strong and have significant access to capital to continue to grow our business and drive greater returns for our shareholders. I feel good about our businesses, brands and the teams we have in place. I am pleased with the progress we have made and I'm excited about the opportunities in front of us.

I'll now turn the call over to Marshall to review some financial details in the fourth quarter. Marshall?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

Thanks, Jeff. Fourth quarter consolidated organic sales grew 5.4% versus the prior year. In the office furniture segment, sales increased 4.3% organically. Within the office furniture segment, sales in our supplies-driven business increased 4%. Sales in our contract business were up 5% organically. Hearth segment sales increased 8.5%, new construction sales grew 3% and sales of retail products increased 14%.

Non-GAAP net income per diluted share was \$0.97 compared to \$0.47 in the fourth quarter of 2017. We experienced higher input costs, but we're able to overcome them with productivity gains, cost savings, SG&A efficiency, and improved price realization. Jeff?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Thanks, Marshall. For the full year 2019, we expect to grow profit while navigating several challenges including a volatile demand environment, inflationary pressures and negative tariff impacts. We expect demand to start slowly and improve as we progress throughout the year. Market activity slowed in the fourth quarter and the weakness extended into the early part of this year. The decline coincided with general concerns around the economy, slowing new home construction, the drop in key confidence metrics, potential trade issues and the government shutdown. As a result, we expect low first quarter volume which will challenge our first quarter profitability.

Activity levels are recently recovering. We are assuming the positive trend will continue but expect conditions will be choppy and dynamic. For the full year 2019, we're expecting low-single-digit growth in demand. Including additional price realization necessary to offset higher input costs, we expect consolidated organic sales will grow 3% to 7%.

Continuing improvements in productivity and cost savings are key drivers of our 2019 profit growth. These initiatives are gaining momentum now that we are through the initial BST learning curve and have stability in our operational footprint. We expect productivity and cost savings, net of our investments, will drive \$10 million to \$15 million of financial benefit during the year. We are continuing to make long-term growth investments in areas such as digital and data analytics, go-to-market capability, new products and operational capability.

Based on a combination of strong productivity and cost savings, modest volume growth and investments for long-term growth, we are currently forecasting our diluted earnings per share in the range of \$2.50 to \$2.90 for the full year. Consistent with our focus on long-term profitable growth, we have made the decision to change our guidance practices. Going forward, we will no longer issue quarterly guidance. As a transition, we will provide our outlook for the first quarter but will not provide a quarterly outlook in subsequent earnings calls or press releases. We will continue to update our annual outlook each quarter.

I will now turn it back over to Marshall to provide some additional financial details.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

Thanks, Jeff. As Jeff noted, we are expecting full year consolidated organic sales to be up 3% to 7%. We're expecting each of our businesses, supplies-driven office, contract office and hearth to have similar growth rates, with each up approximately 3% to 7% for the year.

Our 2019 gross profit margin is expected to increase modestly from the levels we realized in 2018. We expect SG&A including freight and distribution expense will increase 3% to 5% driven by inflation and investments in growth initiatives. For the full year, we are forecasting a tax rate of 22.5%. This results in forecasted net income per diluted share of \$2.50 to \$2.90 for the full year, primarily driven by improved productivity and cost savings. Not having the negative impact of our 2018 BST launch costs and modest volume growth, we expect free cash flow will be in the range of \$130 million to \$140 million, including \$65 million to \$75 million of capital expenditures.

Okay, let's shift to the first quarter. As Jeff noted, demand activity slowed late in the fourth quarter and in the early part of this year. As a result, we expect consolidated first quarter organic sales to be down 2% to down 4% or down 3% to 5% when including the effects of divestitures. Office furniture sales are expected to be down 3% to 5% organically or down 5% to 7% in total.

Sales in our supplies-driven business are projected to be down 3% to 5%. We are forecasting sales in our contract office furniture business to be down 3% to 5% organically or down 7% to 9% in total. We expect hearth sales to be flat to up 3% with new construction sales down 2% to up 1%, and sales of retail hearth products up 3% to 6%.

Gross profit margin for the first quarter is expected to be approximately 35%. SG&A, which includes freight and distribution expense, for the first quarter is expected to be \$165 million to \$170 million. Our estimate of net income per diluted share for the first quarter is in the range of minus \$0.02 to plus \$0.04.

Jeff?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Thanks, Marshall. We remain confident about our markets and our prospects for growth. Our teams are highly capable and engaged. Our strategy to deliver best value to customers through a convenient buying experience is ramping up. We remain focused on the long-term and have strong market positions, the right products, the tuned operating platform, and dedicated members to drive significant profit improvement.

With those comments complete, I'll open it up for questions.

QUESTION AND ANSWER SECTION

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

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Good morning.

Q

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Good morning, Budd.

A

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

You used some interesting terms in the release calling the – I think calling it a dynamic environment and talking about it slowing. Can you give us maybe a little bit more color as to where it slowed? You were in several different market segments between hearth and office, so maybe a little color on that would be helpful.

Q

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Yeah, Budd. Appreciate the question. Beginning in kind of November, we saw a pretty noticeable slowdown primarily in the supplies-driven business and in the hearth business. That's – we believe it's broad-based concerns on the economy we're kind of hitting at that time, slowing new home construction, some trade issues, the government shutdown, et cetera, et cetera. But it was primarily in the supplies business and the hearth business.

A

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

So not in the contract office, so contract got stayed reasonably...

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah, that stayed reasonably. In the contract space, as you recall, we said in the third quarter we had some project push into the fourth, and we saw that hit and deliver in the fourth. Overall, I'd say the contract activity is pretty solid, continue to see new projects come into the funnel. So that was not as noticeable; maybe slightly ticked, but that was not as noticeable as the supplies and the hearth.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

And so does that variance with what you're planning for the first quarter then? Tell me about – connect those dots, if you would.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah. I think, look, the contract business is – like I said, we're seeing good funnel activity there, we're seeing good activity overall. We are comping at 13% up last first quarter in the contract space. So that's probably...

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

[ph] Right (00:13:12).

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

That's a little bit more what's going on that we – our comp on the supplies business is more like plus 6%.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. So just talk a little bit about backlog in the contract business with – just give us a little flavor. Is it up year-over-year, is it up quarter-to-quarter? How has that funnel translated into backlog?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah. Budd, our pre-order activity and order rates reflect our outlook for the year. We have good funnel activity supporting that 3% to 7% growth rate that we're expecting for 2019. The backlog is growing. It's up over prior year. So, feeling pretty confident about the longer selling cycle contract business.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. And in supplies, we've had structural issues there that impacted us two years ago. Are there any structural issues again impacting supplies or no?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

I think, Budd, it's a good question. I think for the most part that was macroeconomic driven, there's a little bit of noise in the channel with some of the dynamics but not like you experienced two years ago by any means. And I think whatever that noise is they'll probably unwind here in the next couple of months anyway.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. And Marshall, you talked a little bit about inflation persisting. I mean, we are seeing some rollover in steel and some other commodities. Talk to me about what you expect in cost versus price either in the first quarter or the year. What's the – how do we quantify that?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah. For the first quarter and the year, we expect price – net price to roughly equal our inflation and the negative impact of the tariff. So we expected zero price/cost gap for the year and for the first quarter. The tariff is a bit of a wildcard. So the amount of price we'll realize will fluctuate with whatever happens to the tariff.

But on the inflation side, we're expecting \$55 million to \$65 million of total inflation for the year which reflect...

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

And offset by price.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah, which will be offset by price exactly. And we do expect to see the benefit of steel mainly in the back half. If you remember, our contracts on steel lag the spot price by six months. So we'll still see some inflation in the early part of the year.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

So, now you confuse me because I thought you said in the first quarter it's going to be roughly balanced between price and cost.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

That's correct. I was just giving you some color on the steel, I think that was one of your questions.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

So steel is one – so the other commodities that are abating, so that should get you net zero.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

We are going to see some inflation, Budd, steel will be part of that and we're going to offset that with price realization to be net zero.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. And if tariffs went away like I think there's a reasonable likelihood they will, what would happen?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah. If tariffs went away, let's say, at the end of March, we would have seen about \$5 million of impact from the tariff. So you'd add that \$5 million to the \$55 million to \$65 million of inflation we already have and we would see a total impact of \$60 million to \$70 million which we...

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

\$5 million a quarter then, right?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah. Yeah. Add 10%.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. All right. That's good. Last question for me is as I look at the segments, explain to me what happened in corporate in the fourth quarter?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Well, if you look at the segment results, that includes some of the charges we carved out for non-GAAP. So last year, the biggest thing there was we had a \$10 million impairment on a long lived asset and we had a \$2 million, roughly \$2 million recovery of an allowance to be taken. So, there's a \$12 million swing in the fourth quarter there that accounts for majority of the \$22 million decrease you saw. So most – a little more than half comes from those non-recurring items. The other half is really driven by the roll-off of BST support costs that we were expensing in the fourth quarter of last year but didn't have those this year, lower incentive comp and lower insurance costs.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

So cut to the chase, what's corporate running? That's usually pretty close to a fixed cost per quarter on a period basis. What should the corporate run on a quarterly basis or an annual basis? How do we think about that?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah. There's about a \$12 million worth of noise in the fourth quarter. So we're expecting it to be around \$60 million for the year. So we're roughly saying \$60 million – \$15 million a quarter.

Beryl Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Makes sense. Okay. All right. Thank you. I'll let others ask questions. Thank you for taking mine.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Thanks, Budd.

Operator: Our next question will come from the line of Matt McCall, Seaport Global.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Thanks. Good morning, everybody.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Good morning, Matt.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

So you gave some good detail around the guidance both Q1 and the full year. Can you go into price versus volume versus any mix impact? Just more top line details what I'm looking for across the different segments and then sub-segments.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Are you talking about the fourth quarter, Matt? I didn't hear the first part of your question.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

No. I'm sorry. For the – in your guidance, what's assumed in the guidance, you said full year I think up 3% to 7%. I'm just trying to figure out across the different segments and sub-segments, what the volume or price is expected to look like as specific as you're willing to get.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah. Yeah. So the total organic growth we expect to be 3% to 7% across supplies, contract and hearth. There's a decent amount of price realization in there. As I mentioned earlier, depending what happens with tariffs, we could – need to realize up to \$90 million to \$100 million in price, which should be roughly 4%, 5% of that growth. So we have pretty modest non-price growth assumptions but we are assuming growth excluding price for the year in all of our businesses.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. So should I just use that 4% to 5% across the two segments and equally across the businesses or I think there's some mix kind of skewed toward, say, supplies rather than contract, but how should I think about the 4% to 5% across the different businesses?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah, you're right. There's a little bit more in the supplies-driven business due to the exposure to the tariff. Now, if the tariff goes away, there probably won't be much difference, Matt. So it really depends on what this tariff does, but it could be a couple of points higher price realization in the supplies business if the tariff goes to 25%.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. Okay. And then so the 3% to 7%, there's 4% to 5% price. So you said there's still some volume in there. Maybe I'm having trouble with the math there. It seems like the midpoint should be [ph] above all (00:20:31) price. So what's the volume assumption that you're using?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah. So let's maybe unpack this a little bit. So we have to kind of settle on what the tariff assumption is. If the tariff is 25% for rest of the year, we have that 4% to 5% of price.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

So we'd be maybe above the midpoint in that case. If the tariff stays at 10%, we probably have more like 3.5% of price, and if it goes to 0%, it'll be closer to 3%.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. Okay. And then I guess just one more time, the volume across the different businesses. You said you're assuming some volume growth. Can you give me specifics around the assumption for the different segments?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

More detail beyond that 3% to 7%, Matt?

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Yeah, yeah, segment. So what are you assuming for furniture and for contract and supplies and new? Do you just have any volume details there is what I'm trying to get to?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

You're saying excluding price, I think is you're getting after. So, the...

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Correct, volume. Yeah.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah. It's low-single digit growth basically for all our markets.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

All right. Can you talk about the retail strength a little bit more? So, I think you said the hearth retail up 14%. What's behind that? You're only assuming low-single digits for the year. So did that imply that that moderates? Or just give me more detail around retail.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah, Matt. This is Jeff. Yeah. I think it moderates. That's what we're seeing. We're coming off a couple of good years in that business. We still think it's going to grow in the 5% to 9% range. So, it's good growth but we're going to see it moderate just a bit.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

So what it is that drove the 14%, Jeff, or what's been behind some of that stronger growth?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

The pellet business, Matt, which is only 10% of hearth, so a pretty small part of HNI, showed some pretty strong growth. We are up close to 28% in the fourth quarter. We're also up in non-pellet retail business. But we're not expecting our pellet business to continue the same growth that we saw here in the fourth quarter through 2019.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. And then I guess – I think maybe Budd asked some of this. But when you're talking about this revenue recovery and you said things seem to be getting better, can you go into more detail in both furniture and hearth about what you see and what gives you comfort that you're going to see this kind of recovery post Q1?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah, Matt. This is Jeff. I think overall the economic, the labor market, as you well know, has remained tight. The people are still in – businesses are still investing in offices, continue to invest in their people and new working environment. So, we feel that's good. We think it was a little bit of a short-term issue that kind of went across our businesses in the fourth quarter but the outlook is strong for furniture, same with new home construction in the hearth business. That business continues, we think it's going to project stronger in the back half. And so that gives us confidence for these revenue numbers.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. Thanks, guys.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Thanks, Matt.

Operator: Our next question will come from the line of Kathryn Thompson, Thompson Research.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Hi. Thank you for taking my questions today. First, focusing on just the transportation and logistics has been a challenge throughout 2018 but feedback we are getting from the wide variety of our industry contacts is that we've seen an improvement in trends in terms of availability, while pricing may not necessarily has improved or the cost structure. What are you seeing in your business and how should we think about this in 2019?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Hi, Kathryn. This is Marshall. We're not really seeing a dramatic change in that environment. It's not much different we've seen all year. So, I don't know if we can really give a lot of color on that subject.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Okay. I know that you in the Q&A and prepared commentary gave a little bit more color in terms of the pricing and how tariff impacts your guidance but maybe put differently, there's a lower postpone tariff putting you at the high-end of the EPS range or does it just shift the range upward?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

In regards to the EPS, we're not expecting the presence of the tariff or the lack of tariff to have any material impact. We're expecting to offset that tariff with price realizations. So if the tariff goes away, we won't realize more price but we won't have the cost to go along with it. So, we're expecting a net neutral there in basically all the scenarios.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Okay. And I know that the hearth and supplies business as you noted is more sensitive to the swings in sentiment and economic change. But between the two historically, which has been more sensitive? And based from historic trends, how is that similar or different given what you're seeing right now between hearth versus the supplies business? And what does that speak to overall future trends?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Well, Kathryn, this is Jeff. Let me – if I understand your question, I think I would say the supplies business is a little more sensitive to overall economic trends. I mean, it's a lot of small business customers, it's a short-cycle business. And so, it reacts fairly quickly both up and down than housing which, as you know, operates a little bit more, for lack of a better term, like contract market where it's a longer selling cycle. And so, I'm not sure [ph] I respond (00:27:01) to your question directly but I think that's what you asked.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Yeah. And so – go ahead.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

But the new home construction element responds very directly to that macroeconomic factor but maybe not as much to others.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Okay. Perfect. All right. That's helpful. Thank you very much.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Thank you.

Operator: Our next question will come from the line of Greg Burns, Sidoti & Company.

Gregory J. Burns

Analyst, Sidoti & Co. LLC

Q

Good morning.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Good morning, Greg.

Gregory J. Burns

Analyst, Sidoti & Co. LLC

Q

You might have mentioned this, but what was the \$13 million goodwill impairment related to?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah. It wasn't \$13 million. We had approximately \$13 million of impairments. We did have about \$12 million goodwill impairment related to a small office furniture company.

Gregory J. Burns

Analyst, Sidoti & Co. LLC

Q

Okay. Okay. And then in terms of the gross margins for the fourth quarter came in a little bit lower than expected, I think what you were kind of aiming for at the beginning of the year also the gross margin didn't expand as much as expected. But you completed a lot of your cost savings projects and passed along some price increases. So I just wanted to kind of understand the divergence in your view earlier this year where you thought you had gross margin to, to where you ended up and kind of what you're guiding to for next year. What are the offsets to some of the positives you're still hoping to drive? Thanks.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah. There's probably three factors going on on the gross profit line. So the first is the price/cost, right. So, we talked earlier about how we expect to have zero price/cost in 2019. In the fourth quarter, we actually had positive price/cost when you account all of those factors. So we had about \$20 million of total inflation including the tariff and we realized about \$20 million of list price. So we were basically zero.

But then we also benefited about \$7 million from business mix which lowered discounts. We had about a \$7 million positive price cost cap which actually was a little better than we expected to be. But that was offset by lower volume which caused some deleverage and also the volume challenged our productivity initiatives. So we did not realize the productivity that we expected to in the fourth quarter.

As we look into next year, we feel pretty good about where we are from a productivity run rate. The \$10 million to \$15 million of productivity in cost savings, net of investments, that Jeff mentioned earlier is in line with the run rate we achieved in the second half. So I think that our 2019 guidance is reflective of where we are and we're feeling pretty solid about it.

Gregory J. Burns

Analyst, Sidoti & Co. LLC

Q

Okay. Thank you.

Operator: At this time, we have no further questions in the queue. I'd now like to turn the conference over to Mr. Lorenger for closing comments.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Yes. Thank you for your time today and for your interest in HNI Corporation. Have a great day. Thanks.

Operator: Once again, we'd like to thank you for participating on today's conference call. You may now disconnect.

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