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HNI Corp. (HNI)

Q1 2019 Earnings Call

CORPORATE PARTICIPANTS

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

Marshall H. Bridges
Senior Vice President & Chief Financial Officer, HNI Corp.

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

OTHER PARTICIPANTS

Budd Bugatch
Analyst, Raymond James & Associates, Inc.

Brian Biros
Analyst, Thompson Research Group

Matt McCall
Analyst, Seaport Global Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Julie, and I will be your conference operator today.

I would like to welcome everyone to the HNI Corporation first quarter fiscal year 2019 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.

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 2019 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 am pleased to turn the call over to Mr. Jeff Lorenger.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Good morning, everyone. We will share our assessment of the first quarter and provide some thoughts on our outlook for the rest of the year. We'll then open up the call for questions.

I would like to start with a couple of opening comments. First, not much has changed since our last earnings release. The first quarter played out as we generally expected and our profit improvement outlook for the year is unchanged. I would also like to note that I continue to be impressed by our dedicated members. We are making progress on our initiatives and our teams have done a nice job improving our businesses in the face of dynamic conditions.

I'll now cover the first quarter. As anticipated, demand conditions generally improved throughout the quarter after a slow start. We were able to offset much of the impact from lower volume with better cost. Our markets continue to be dynamic with pockets of uncertainty, but I feel good about our momentum and the opportunities in front of us.

Let me give some color on how each of our main businesses performed in the first quarter, starting with the supplies-driven office furniture business, which was down nearly 8%. The decline in supplies was driven by the transactional portion of that business, which is typically a small order that processes on a quick cycle. Transactional orders started the year very slow and generally improved through the quarter. The other parts of the supplies-driven business are positive with good growth in e-commerce and small to mid-sized projects. We are encouraged by the recent order trend in supplies overall, but the transactional portion does remain soft and conditions continue to be dynamic.

Overall, we expect that supplies-driven business will continue to improve. The transactional business responds to macroeconomic factors quickly. As confidence in sentiment improves with items such as tariff resolution, we should see the transactional portion of the supplies business strengthen.

Shifting to our contract office furniture business; we continue to see solid performance. While organic sales were down 2% during the quarter, this was on top of a strong prior-year comparison. On a two-year basis, our compounded growth rate was plus 6% for the first quarter. We have been on a good run in the contract business and our orders and activity levels give us confidence that we have more growth ahead of us.

In hearth, we grew sales and profits despite difficult demand conditions. The new construction market continued to slow in the first quarter consistent with declining single family housing permits. Our retail business started slowly but improved through the quarter. We have a strong market position and continue to see signals that demand will improve as we progress through the year, particularly in the back half.

With that, I will turn it over to Marshall for some additional financial details on the first quarter. Marshall?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

Thanks, Jeff. First quarter consolidated organic sales were down 3.4% versus the prior year. Including the impacts of closures and divestitures, sales were down 5.1%. In the office furniture segment, sales decreased 5.1% organically.

Within office furniture, sales in our supplies-driven business decreased 8% and sales in our contract business were down 2% organically.

Hearth segment sales increased 1.4%. Within hearth, new construction sales grew 1% and sales of retail products increased 2%.

Non-GAAP net income per diluted share was \$0.02 compared to \$0.10 in the first quarter of 2018. Compared to last year, non-GAAP EBIT was down \$2.5 million, lower volume combined with increased input costs drove an estimated \$30 million headwind to our bottom line. We were able to offset most of that through price realization, productivity improvements, cost savings and the benefits of not repeating our BST go live. Jeff?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Thanks, Marshall. For the full year, we continue to expect to drive profit growth and our profit outlook remains unchanged. The primary driver of our profit improvement will be realizing \$10 million to \$15 million of productivity, net of investments. We are on track to deliver that goal. Overall, we expect to see a bit less top line for the full year due to two factors: First, we have adjusted our assumptions around tariffs; and second, we are expecting modestly lower growth in our hearth new construction business.

Breaking down our demand picture, not much in our office furniture outlook has changed since the beginning of the year. While uncertainty persists particularly in the transactional part of the supplies-driven business, many indicators suggest the market environment continues to go in the right direction.

The macro factors supporting the demand for office furniture remain relatively strong, employment markets are tight and the war for talent continues to be aggressive. Employers are finding that the need to invest in their office spaces, to attract and retain the best and brightest. We believe these factors will drive improved demand as we progress through the year.

In our hearth business, we also see signs of a stronger second half. Our full-year result in hearth has tempered slightly as single family housing permits have been softer than expected so far this year. It is our belief however that the market will improve in the second half as the long-term demographics and supply of housing continues to support new home construction growth.

I would like to point out that we expect to generate all of our annual profit improvement in the back half of the year consistent with last year. This is being driven by a combination of improving demand, cost savings and investment timing, along with lower inflation levels in the second half. I'm confident in our strategies and our ability to grow profit for the year.

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

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

Okay. Let's first cover some of the details around our full-year outlook. Our full-year forecasted net income per diluted share remains in the range of \$2.50 to \$2.90. We now expect consolidated organic sales to be up 2% to 6%, or up 1% to 5%, when including the impacts of closures and divestitures.

As Jeff mentioned, our reduced sales outlook is driven by tariff assumptions and modestly lower growth in our hearth new construction business. I would like to note the change in tariff assumptions has no meaningful impact on our bottom-line. We also expect the lower volume in hearth will be offset by lower costs.

We're expecting sales in our supplies-driven business will be up 2% to 6%. In our contract office furniture business, we continue to expect organic sales will be up 3% to 7%. When including the impacts of closures and divestitures, sales in contract are expected to be flat to up 4%. In hearth, we now expect sales will grow 1% to 5%.

Okay. Let's shift to our sales outlook for the second quarter. We expect second quarter organic sales will be up 2% to 4% driven by price realization required to offset higher input costs. The impact to divestitures will reduce sales by approximately \$5 million. Second quarter sales in office furniture are expected to be up low to mid-single digits, and we are forecasting sales in our hearth business to be flat to down low-single digits. Jeff?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Thanks, Marshall. I'm excited about the opportunities in front of us to grow the business, increase profits, and drive greater value for our shareholders.

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

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Your first question comes from Budd Bugatch with Raymond James. Please go ahead. Your line is open.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Good morning and thank you for taking my question.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Hey, Budd.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Jeff, I want to make sure I understood the profit outlook. Did you say all of the profit gain will be in the second half of the year? Is that what [indiscernible] (00:09:58)?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Yes. That's what I said. That's correct, Budd.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

So, last year second quarter, you earned \$0.44 as I see adjusted, so you're looking for a lower earnings in the second quarter than \$0.44 or is that...?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Well, let me give some color on the second quarter, Budd. We're not giving formal guidance, but we can maybe give you some color on what we're seeing. In general, what we're seeing is that most of the profit drivers are flat-to-slightly negative. We talked about 2% to 4% organic growth which is mostly price-driven, so non-price volume is roughly flat-to-slightly negative to prior year. We're still ramping up on our productivity and expect that to be offset with investments in the quarter versus prior year, and the other profit drivers more or less are flat.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

So, when you say you're ramping up in productivity, do you have any nodes that you're closing in the system that's in accounting for that right now, or is it just BST familiarity?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah. I think it's a couple of things, Budd. Productivity, it's not real big node closures, it's really productivity and cost savings net of investments. And I think second quarter is a little higher on the investment load than the rest of the year. And then the second big piece is the lower BST cost and disruption that's starting to get untangled, continue to get untangled and gets streamlined, and that ramps in the back half a lot more in the second.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

And what was price cost realization in Q1? How did that...?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah, we had about \$21 million of price realization in the first quarter against approximately \$15 million of total inflation, which includes the impact of the tariffs.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

So, \$6 million to the good. And what do you think it will be for the year? How do you – what's your crystal ball say today?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah. For the year, we do expect it to be positive. Our outlook for price realization is a little bit lower than it was, mainly due to the tariff as we mentioned in our call comments, but we are expecting \$75 million to \$85 million of price realization against \$60 million to \$70 million of total cost inflation.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. Has that happened pretty much ratably through the year?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah, it does. It's pretty consistent through the year. Although, it's actually less in the fourth quarter as we start to anniversary some of our tariff-driven price increases.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. And is there any notable change in – you have some nice growth, I guess there's some growth in office and even – sorry, in the contract side and the supplies-driven side. Where do we get the comfort that we can make those kinds of looks right now? What's the backlog, what's the incoming order flow, how do we see that?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah. Budd, I think, look, I mean the – I'll say a couple of things. One in the supply side, we've seen the business get stronger through the quarter. We started slow and it's starting to get stronger as the quarter has built and into this quarter. On the contract side, same thing, we're seeing activity levels, backlog funnel order rates support the growth we're projecting. On the hearth side, the demand indicator is still with customers, channel partners, sales teams are pointing to a stronger back half. So, we're feeling like all – and in the retail, I should comment on the retail side, the store traffic, website visits et cetera on the hearth retail side of things are ramping up. So, kind of across the board, it feels like that that's what we're banking on. We need the demand to continue to improve and it's generally heading in the right way.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. All right. Thank you very much. Good luck on the rest of the year. Good luck on the second quarter.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Thank you, Budd.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Thank you, Budd.

Operator: Your next question comes from Matt McCall with Seaport Global. Please go ahead your line is open.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Thank you. 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, the price cost, it sounds like that's going to be \$15 million to the good if I just took the midpoint of the pricing cost you just gave, Marshall. Jeff, you also talked about productivity, you talked about cost savings, you talked about no-BST, can you remind us what the benefits from each of those are expected to be for the full year, and how they're going to be recognized as you progress through the year?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

So, the first is – the big driver for the year, Matt, is the net productivity less investments that we talked about being \$10 million to \$15 million of benefits for the year...

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

...that will occur in the back half.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

...which is, so. And that includes what Jeff is alluding to, using BST to drive productivity and things like that.

As it relates to price cost, we did have some benefit in the first quarter. We expect a smaller benefit in the second quarter, somewhere between \$0 million and \$2 million. And the third quarter would be the balance of it and then roughly flat in the fourth quarter, based on what we know now.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Flat, flat meaning price is equal to cost in Q4?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yes.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. So, whatever. So, you had – looking – so you had \$6 million benefit, \$0 million to \$2 million, and then the remainder of that \$15 million will show up in Q3. And is there – you said productivity and cost savings, is the \$10 million to \$15 million a combination of those two buckets?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yes.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yes, it's basically the net of productivity cost savings less investments that we put in place to sort of drive these things.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. And last [indiscernible] (00:16:31) – and then, the no-BST, what was the BST, I probably have got in my notes somewhere, I don't have it in my brain, so what's the BST hit last year?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah, we expect BST to be an \$8 million improvement for the full year. A majority of that was in the first quarter.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. Obscure metric, but I noticed that the assets in office furniture moved higher and I'm just trying to understand what that is, given that you divested that – and maybe that has nothing to do with it, but given that you're focused on productivity and cost savings and these things, can you help me understand what that is and maybe it's tied to the investments that you're talking about that are netting out some of the benefit of productivity and cost savings?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

I don't think there's a material impact from the investments on the office furniture assets. I think what you're probably picking up there Matt is the change in the accounting rules related to leases...

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

...and so there's more assets queued in general for that.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay, okay. Well, maybe talk about the investments a little bit and specifically what are you doing, what's the impact, how does it flow through the next three quarters?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah, Matt, the investments are pretty broad based. I mean our classic operational investments to improve flow and quality and just general labor productivity is what we're doing. There's no single big item there. And we do expect that to peak in the second quarter and then kind of ramp down as we get into the back half of the year.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

I'd say the other thing Matt is we are continuing to invest in kind of digital and analytics to better connect to our customers and streamline connectivity to the marketplace. So, it's our traditional operational investments, but we've also ramped up the digital and the analytics investments as well.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Is that an area, Jeff, where you're behind, or you feel like you're behind from a digital analytics perspective you're trying to catch up, or is it more of a leadership effort?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah. I would – that's a tough question, leadership or behind, Matt. I think we're right where we want to be for our business.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

And the timing is right and the marketplace is receptive to these and customers' buying behaviors and patterns are such that we're meeting them in the marketplace and how they want to be met at the right time. So, I feel we're kind of right on trend there, Matt.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. And last question I had, I think Budd may have asked this, but I just wanted to hear it again, I guess that your housing outlook and your improved feelings about the back half of this year, are you hearing commentary

from your builder customers, or is it more you're looking at the macro, you're looking at the same things we are from a supply and demand perspective? What is it that's giving you that confidence? I'm specifically curious about your conversations with some of your bigger customers.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Well, yeah, Matt, it's good question. I think it's both if I step way back. I mean we look at all the macro drivers that you probably look at, but we also talk to customers and channel partners and sales teams that are maybe more discrete and in certain geographic regions, and that dialogue has remained consistent since the beginning of the year.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Consistent in the second half supposed to be...

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

...show some acceleration?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yes, correct.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. All right. Thank you all.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yes.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Thank you.

Operator: Your next question comes from Steven Ramsey with Thompson Research Group. Please go ahead, your line is open.

Brian Biros

Analyst, Thompson Research Group

Q

Hey, good morning. This is actually Brian Biros on for Steven. Thank you for taking my questions. I want to start with the new construction channel and [indiscernible] (20:54) you could dig in a little deeper into how that played out in Q1 given the environment that was in Q4 and Q1, and also kind of the outlook for the rest of the year for new construction specifically.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah, we really showed some growth, just a tad over 1% in new construction hearth business in the first quarter, Brian. We are seeing that market slow. I mean the slowing housing activity, the permits, the starts will have an impact on our business. We're expecting that to be more of a headwind in the second quarter than in the first, as Jeff mentioned on the previous question from Matt, that we do expect that to rebound in the second half.

Brian Biros

Analyst, Thompson Research Group

Q

Got it. Thank you. And just one more for the – in Q1, you mentioned, demand was growing each month, kind of compounding. If you just kind of provide, maybe some more details on the level; if there was kind of a steady demand or if there was a big jump from month to month, any insight into how that played out throughout the quarter would be appreciated.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah. We had said on our last call that demand started very slowly in the first quarter. So, January was very slow, and it was a carryover from slow activity we saw that it was sort of late in middle of the fourth quarter of last year. And we did see a rebound sequentially, as we moved through the quarter from those levels. So, it's not really been a step-up, a rapid change, been pretty steady build.

Brian Biros

Analyst, Thompson Research Group

Q

Understood. Thank you.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Thank you.

Operator: I will now turn the call back over to Mr. Lorenger for closing remarks.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Yes. Thank you, everyone. As always, we thank you for taking time to talk with us and your continued interest in HNI Corporation. Have a great day. Thanks.

Operator: This concludes today's conference call. Thank you for your participation and you may now disconnect.

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