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HNI Corp. (HNI)

Q3 2015 Earnings Call

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Vice President and Chief Financial Officer

Stanley A. Askren
Chairman, President & Chief Executive Officer

OTHER PARTICIPANTS

Matthew Scott McCall
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Kathryn Ingram Thompson
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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Lori and I will be your conference operator today. I would like to welcome everyone to the HNI Corporation First (sic) [Third] (:10) Quarter Fiscal 2015 Results Conference Call. [Operator Instructions]. Mr. McGough, you may begin your conference.

Matthew D. McGough
VP-Corporate Finance & Head-Investor Relations

Good morning. Thank you for joining us to discuss our third quarter fiscal 2015 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 this call. I'm pleased to turn the call over to Stan Askren.

Stanley A. Askren
Chairman, President & Chief Executive Officer

Good morning. We delivered strong double digit earnings growth in the third quarter despite modest declines in both office furniture and our organic sales in a slowing economic environment. The markets where we compete were impacted by slower economic momentum in the third quarter. We experienced softening orders in mid-August which has since stabilized. I'm pleased our office furniture business has delivered double digit operating margins despite a 3% sales decline, our supplies driven business sales were down 4% while sales in our other contract furniture businesses were flat. We continue to believe our office furniture business are competing well in their respective markets. We have a very strong and profitable hearth business. Sales in our hearth business increased 11% including Vermont Castings. Organic sales increased 11% in the new construction channel which

makes up approximately 40% of the overall hearth business. As expected, organic sales in the remodel retrofit portion of the business decreased 13% driven by declining biomass specifically pellet fuel stoves.

Overall I'm pleased with our strong third quarter profit performance and our ability to adjust to a slower economic environment. Kurt?

Kurt A. Tjaden

Vice President and Chief Financial Officer

Thank you, Stan for the third quarter of 2015 specific financial highlights include consolidated net sales increased 0.2% to \$616 million, net sales declined 2.8% on an organic basis. Non-GAAP net income per diluted share excluding restructuring and transition costs improved 15% to \$0.93 per share. Non-GAAP consolidated gross margin improved at 38% compared to 36.4% in the prior year. Strong operating performance, lower material costs and increased price realization were partially offset by lower volume and an unfavorable product mix. Selling and administrative expenses as a percentage of sales increased 70 basis points due to higher freight costs, strategic investments and acquisition impact partially offset by strong cost management. Stan?

Stanley A. Askren

Chairman, President & Chief Executive Officer

Okay. Thank you, Kurt. We entered the fourth quarter focused on delivering our profitability commitment despite a softening economy. We are taking calculated actions to reset our cost structure for a range of slowing economic scenarios. Our management team has been through these types of business cycles before with proven results. For the full year 2015 we continue to project more than a 25% profit improvement on approximately 4% sales growth. We remain committed to long term, we believe there continues to be significant investment opportunities for long term value creation in our core businesses both office furniture and hearth products. We're using this opportunity to continue to tighten our business and product portfolios, we're configuring our operations to support new products, build new capabilities and improve our operational efficiencies. We remain focused as always on eliminating waste to improve profitability and better serve our customers.

As we look forward to 2016, we're preparing for multiple scenarios. Our current best view projects overall sales to be up slightly to down slightly for 2016, we expect our supplies driven business to be flat to down modestly due to a muted small business spending environment. We're projecting our North America office furniture contract business to be up slightly to flat compared to last year. Overall our international business is forecast to be down modestly led by the economic challenges in China and for our hearth business we expect that to be up slightly, we project continued growth in the new construction channel, remodel retrofit channel sales are expected to be flat to down slightly again led by continued declines in the biomass portion of that business.

Overall I remain confident in our investments and the capabilities we are building to strengthen our market positions and deliver long term profitable growth. We expect to increase profits in 2016 despite the overall challenging economic outlook. Kurt?

Kurt A. Tjaden

Vice President and Chief Financial Officer

So, financial outlook for the fourth quarter 2015, we anticipate overall sales to be down 4% to 8%, office furniture sales are expected to be down 3% to 7%. The supplies driven office furniture sales are projected to be down 5% to 9% while sales in our remaining office furniture businesses are forecasted to be down 2% to 6%. Hearth sales are expected to be down 6% to 10%, sales in our new construction channel are forecasted to be up 8% to 12% and we expect the remodel retrofit channel sales to be down 15% to 19% again led by biomass.

Non-GAAP gross profit margin is expected to be similar to the third quarter 2015 results of 38%, non-GAAP SG&A as a percentage of sales is expected to be similar to the third quarter 2015 results of 27.7%. The effective tax rate is projected to be approximately 34% for the full year. And for the full year 2015 we project non-GAAP earnings per diluted share to be in the range of \$2.55 to \$2.60. So the financial outlook for 2016, we believe we owe shareholders our best current view of the business, even in this uncertain economic environment. We expect 2016 full year consolidated sales to be in the range of up low single digits to down low single digits. In our initial 2016 non-GAAP earnings per diluted share guidance range is \$2.60 to \$2.85 per share. Stan?

Stanley A. Askren

Chairman, President & Chief Executive Officer

All right, thank you, Kurt. I'll wrap it up here. Our businesses are strong and well positioned for the future. Our brands are competing well in their markets, I remain confident in our strategies and investments for long term profitable growth and we'll continue to aggressively manage structural costs and we expect to increase profits in 2016. So with those comments complete by Kurt and myself, we'll now open it up to questions.

QUESTION AND ANSWER SECTION

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

Matthew Scott McCall

BB&T Capital Markets

Q

Thank you, good morning everybody. Can you hear me?

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Yeah, go ahead, Matt.

Matthew Scott McCall

BB&T Capital Markets

Q

Oh, okay, sorry. Where to start. So first you said I understand the softer economic environment comments I guess but you said orders stabilized since the weak August, I'm just talking about, I think that was in furniture in general. So what is it that you're seeing specifically that's causing this much I guess adjustment to the outlook or is it an adjustment to the outlook, do we just had it wrong?

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Well there's several questions in there, Matt, so let me see if I can wade in here and help you sort it out. I think that's all good stuff for us to thrash around here a bit. Certainly the year started off very strong and our activities were very strong, orders were strong, continued through, we saw a significant sort of step down in orders in early August. So I want to say that we saw it across the board, Matt. So I will remind you as you know we play all the way from the very top to the very quick to buy value segment of the market and we saw that sort of deceleration across the board, completely across the board. So you say okay, so is that you or is that the market, is the question that you'll probably ask and we believe it's the market.

If you look at what's happened in the economy, we believe that the economy has stepped down just due to the global economic uncertainty and that everybody begin to put the brakes on. The challenge here is there's been mixed signals though, because if we talk to our resellers, our dealers, they say they're busier than ever. If you look at our activity pipeline it looked good but simply what was not happening is it was not converting to orders. And so that led to lots of mixed signals. And so we went back and asked the question, I think pretty rigorously across the board is it us or the market. We believe it's the market, we believe that the overall economy has stepped down and office furniture is a non-revenue producing asset that the brakes get put on.

The other thing I will remind you is we're the shortest cycle player in the industry, in other words we tend to deal with smaller projects, smaller business. And that historically is the stuff that puts the brakes on first. We saw that in the longer cycle businesses where there is a project underway, there is a hole in the ground, there is a new building coming up or there is a merger and there is consolidation, it takes longer for that stuff to sort of come off, it also takes longer for to come on and so we've even seen that sort of phenomenon. So we still have some long cycle projects going on but we simply are saying based on the uncertainty of this environment, based on what we've seen across the board with all of our businesses, we believe office furniture is stepping down.

Now we're also prepared for multiple scenarios. As you recall, Matt, we done this a few times and so we're prepared if it's better than that we know how to ramp up, and we're also prepared that if it's worse on how to get after structural cost along with day to day cost and just good old fashioned wringing it out. So that's a long response to a general question. I will let you probe wherever you'd like here.

Matthew Scott McCall

BB&T Capital Markets

Q

Yes, but going back to the comment about stabilization. So it sounds like in August, you saw things slower, you saw good pipeline activity, a lot going on just wasn't translating into orders. But you said since August you've seen a stabilization. Does that mean you've seen some of that activity turning to more orders? And it seems like you're dragging the trend in August out into next year and not necessarily the more recent trend or did I misunderstand.

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

I think you misunderstood. It has stabilized at a lower level. So we in fact are projecting, as Kurt gave you the guidance there, potentially it's slightly up to slightly down for 2016 and actually he gave you more specific guidance for the remainder of 2015. So yes stabilized or level, projecting that forward unless we see some catalyst that would change that. And I don't know, you're a smart guy that pays attention to economy. We're not seeing anything really that says it's going to get worse or it's going to get better. Now we're scanning daily, weekly, looking for that and if that happens as I said we're prepared for whatever scenario comes our way.

Matthew Scott McCall

BB&T Capital Markets

Q

Okay. And, there was, so the topline guidance for next year were basically flat if you take the mid-point it sounds like. You're talking about flat to up maybe \$0.15, if I will take the high end of 2015 guidance, you're talking about flat to up topline EPS, so you referenced some cost takeout in the release and you talked about focusing on efficiencies. Can you give more detail into what it is that you're doing? Are you pulling back on any investments or is it just an efficiency improvement effort?

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Matt, you followed us for lots of years. And so you know how I'm going to answer this I think; which is, one of things we're really good at, that we always are working, good times or bad times, is structural cost. And what does that mean? It means we're always thinking about, how do we realign our manufacturing, logistics physical distribution network. As product categories shift, as we launch new products we're always thinking about where do we invest to drive factory productivity. We're always thinking about where do we invest around information systems and productivity there, we consistently move, redeploy people around on the front end to kind of skate where the market's hot and where it's not. And so it's just a lot of that. As you recall we have some 10-some businesses, 16 plus, you know dozen and half operating facilities and we have dozens and dozens of manufacturing lines and we have millions and millions of products and so it's just part of our HNI member owner culture to get after that all at the same time and so it's that sort of thing that we're talking about.

We're are not talking about backing off, long term value creation investments. I think it's just that through the last global recession that we know how to sort take cost out but also continue to invest in the long term and that continues to be our emphasis is investing for the long term while we attack the ways to find a better way of doing what we're doing today to drive value for our customers, drive value for our shareholders and drive value for our member owners.

Matthew Scott McCall

BB&T Capital Markets

Q

Okay. But it did seem like there was maybe an increased emphasis on, I know that's the way you operate and you guys are very efficient and you're right, I know it's a day to day thing but I guess it seemed like there was maybe a bigger effort tied to this softer economic environment and if so is there any way to breakout the expected cost, the expected savings, the timing of those savings. You know how much is assumed in the \$2.60 to \$2.85 those types of things.

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Yeah, I think, Matt, why we don't we break it out because the big question you should be asking or our shareholders should be asking, more importantly, is how do we beat earnings on a sales miss? Well we got on it early. We saw this thing coming down. We made the call, we begin to tighten up, we accelerated some – took some priorities off the table, accelerated some structural cost and that's how we got on this sort of beating earnings when sales are softer than anticipated. And, so we wanted to make sure we emphasized that point in this press release and this goes back to sort of this environment. We actually do pretty well in this type of environment with our split and focused model, with our member owner culture, with our rapid continuous improvement sort of set of tools. I'm not going to break out what specific projects and what the return is, I don't think that's important for our shareholders. Quite frankly what's important is our forecast for what we think sales are going to be and our EPS and as you know there are many ways to get there, we simply are saying look we've got this target in front of us, we're responding to multiple possible scenarios. We have the experience, we have the tools in place and we're going to get after there and we're going to get after there with all sorts of different ways and we would spend hours trying to describe specifically what those are and how we're going to go get them. You'll just have to wait and see as we release our earnings, our results on whether we're able to do that or not in the long term.

Matthew Scott McCall

BB&T Capital Markets

Q

Okay, okay I understand. Let me squeeze one more in, you talked about reallocating assets on the front end toward markets that are hot and away from markets that are not. Can you talk about what areas of the business are the hottest right now, whether it be geographies or end markets or product categories? Anything that you can point out as being kind of a leading market.

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Yes so as you know, Matt, I'm going to give you a general response, we are so broadly diversified between our company and the segments that we play in and our selling models and geography, we generally are tracking the overall economy. So some of this is strategic competitive as well, so we're identifying markets that we think we should you know are more likely to grow and where we have a competitive advantage and where we don't and so a lot of this is specific competitive strategic sort of diagnosis and so I'm going to defer on answering any of that specifically.

Matthew Scott McCall

BB&T Capital Markets

Q

Okay, all right. Thank you, Stan.

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

You bet, Matt. Thanks.

Operator: Your next question is from Kathryn Thompson of Thompson Research Group. Your line is open.

Kathryn Ingram Thompson

Thompson Research Group LLC

Q

Hi, thank you for taking my questions today. The first is on hearth, I know that you've given guidance for the upcoming quarter and for next year with your hearth business, but realistically how should we think about the biomass business on a go forward basis? Not only for the balance of this year but as we go into next year, taking into account comps and other fundamentals. Second part of that, how much of a down draft will you apply on biomass specifically to the quarter? And then finally do you have any clarity on what percentage improvement you saw from the new construction business which has been improving and I know you talk about tracking overall economy, but all indications are that housing starts have been healthy and should be benefiting this business. Thank you.

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Okay thanks, Kathryn, those are very thoughtful questions. So, let me see if I can answer some of those. And, I don't write fast so I didn't get those so I may need Kurt to clarify. So, let me talk about new construction first off. That of our hearth businesses right now is 40% of that business likely to be more. We are very, very strong in that business. We're very well aligned with, in those markets. We have an excellent share market, we have the best brands with builders, we have, I think the best products, the best management team, the best distribution, etcetera, and we should continue to benefit disproportionately as new single family new constructions starts continue to grow. And we see this single family continuing to grow back towards you know – you look at these numbers, back towards historic trends for single family which means, there is lots of runway there. We also continue to work aggressively to help try to promote more fireplaces per home, etcetera. So not only do we want to sort of track with the market because of our position, we want to exceed the market and then we also want to help

grow the category, is part of the initiative. So the other side, biomass is then is currently 16% of the business which retail gas as we call it is basically half that...

Kurt A. Tjaden
Vice President and Chief Financial Officer

A

Yep.

Stanley A. Askren
Chairman, President & Chief Executive Officer

A

...and then pellet stoves and cordwood would be the other part of, excuse me, I did that wrong. Remodel retrofit would be half retail gas and then half biomass, of the biomass we have cordwood, wood burning stoves and then we have pellet stoves. So what's really going up and down is the biomass largely driven by the pellet stoves. The big driver of that is that is a decision around efficiency and economic sort of decision around the cost of liquid propane and the cost of fuel oil out of the [ph] Northeast (22:54). It's also impacted heavily by cold weather. So as oil has come down, as LP prices have come down, that order activity has come down in a big way. In 2014 that business went up 47% and this year it's down roughly 30% and so how do we think about that going forward. We really think you need to take a multi-year sort of look at that and kind of average that out over high fuel prices, low fuel prices and somewhere in the middle and so I would guess next year we're going to continue to see moderate decline less because I think it's started to reach the bottom, and then we'll reset based on somewhere between the peak and the trough there. The thing I would say to you, Kathryn, is that we have an excellent share position in that, again we make money on those products, up cycle and down cycle. We're constantly thinking about where do we set our cost structure to make sure that that continues to happen as we go forward. Kurt, what did I miss?

Kurt A. Tjaden
Vice President and Chief Financial Officer

A

You got it.

Stanley A. Askren
Chairman, President & Chief Executive Officer

A

Okay. Anything else Kathryn?

Kathryn Ingram Thompson
Thompson Research Group LLC

Q

That's helpful in the hearth business. I have a few follow-up questions on office.

Stanley A. Askren
Chairman, President & Chief Executive Officer

A

Go ahead.

Kathryn Ingram Thompson
Thompson Research Group LLC

Q

In the office segment did you see any changes in mix that impacted trends in the quarter and then I will wait for a follow-up for another office question.

Stanley A. Askren
Chairman, President & Chief Executive Officer

A

Nothing notable to report, nothing out of the ordinary.

Kurt A. Tjaden
Vice President and Chief Financial Officer

A

Again because we play in virtually all of the categories, all of the segment it's the normal sort of stuff.

Kathryn Ingram Thompson
Thompson Research Group LLC

Q

Okay. And I guess follow up, I know that you said earlier when answering Matt's questions that you're tracking the overall economy, but we over here at TRG look at the entire value chain of construction process from bonding and contractors to distributors to office furniture retailers. My question to you is I guess two part with that, first what were some of the greater differentiations within contract because seeing a greater weakness in that would be more troublesome than the day to day. So what were contract sales trending in the first half to now [indiscernible] (25:19) the quarter you just reported and based on your prior experience, you were talking about just not seeing your pipeline converting to orders. How does what you're seeing now compared to what you've seen in prior cycles? And, is it better or less or in line with what you've seen.

Stanley A. Askren
Chairman, President & Chief Executive Officer

A

I think first off, Kathryn, the thing I would say to you is you really have to, look new construction is not necessarily the primary driver of office furniture events. It certainly has an impact but there is a, there is not a direct sort of correlation there. Office furniture events, obviously can come from consolidation as well. It really, what drives it is, CEO confidence, small business confidence lead to furniture events and so the result of that then as well is that to your broader contract, contract came off, it came off slower and is much more volatile than small business. Why? Because big project – isn't it interesting, and in fact I find that sometimes – I don't think it's terribly helpful that this industry actually looks at quarterly sales data and you find some of the competitors talking about whether they won a project or didn't win a project in the previous quarter. And, so it's very lumpy by nature in the contract and so you have to kind of watch looking at one competitor versus the other on a quarter. You'll find if you track us a bit, you'll never find me pounding my chest when we do better on a quarter, likewise I don't get terribly concerned if we don't do as well on a quarter because it's so dang lumpy when you look at that data.

So back to your point. We're seeing similar sort of trend. Now, this is not the global recession. This is not like the last cycle, it's not as dramatic but every time we see a softening in the economy, office furniture events tend to lag. So you'll see there's projects that are started, there's decisions that are made and typically our dealers are far down the line. None of them, the train is stopping, you start to hear the cars crashing into next one and office furniture is way down the line. And so, the pipeline tends to kind of look good, look good, look good, and the economy is so closely connected, if it takes a dip it takes a while for it to show up in the pipeline. And, so you've got good bid activity, you've got good selling activity, you've got good showroom business – all that sort of stuff and it doesn't convert. And, we saw similar the last time at a smaller scale, that same thing happen where people are looking at all the activity and saying it's good. But then the orders don't come and they get delayed and they get deferred and then they get pushed out and then they get descaled, down-scoped whatever and then you have a softer sort of order period than you were anticipating.

Kathryn Ingram Thompson
Thompson Research Group LLC

Q

Okay. Final question, on the supplies driven sales, down 4% in the quarter but did you see a stabilization in that segment of the business too once you got into September and October?

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

Yes it's kind of running about that same rate, the answer is yes.

Kathryn Ingram Thompson

Thompson Research Group LLC

Q

Okay. Thank you very much.

Stanley A. Askren

Chairman, President & Chief Executive Officer

A

You bet, Kathryn.

Operator: You have no further questions at this time. I will turn the call back over to Mr. Askren.

Stanley A. Askren

Chairman, President & Chief Executive Officer

Yes, well thank you so much for tuning in and your interest in HNI and we look forward to speaking to you in the future and we hope you all have a great day. Thank you.

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

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