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HNI Corp. (HNI)

Q2 2015 Earnings Call

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Vice President and Chief Financial Officer

Stanley A. Askren
Chairman of the Board, Chief Executive Officer, President, Director

OTHER PARTICIPANTS

Josh A. Borstein
Longbow Research LLC

Beryl Bugatch
Raymond James & Associates, Inc.

Matthew S. McCall
BB&T Capital Markets

Kathryn Ingram Thompson
Thompson Research Group LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen. My name is Ryan, and I will be your conference operator today. I would like to welcome everyone to the HNI Corporation First (sic) [Second] Quarter Fiscal 2015 Results Conference Call. [Operator Instructions] As a reminder, today's conference is being recorded. Thank you.

Mr. McGough, you may begin your conference call.

Matthew D. McGough
Vice President-Corporate Finance

Good morning. Thank you for joining us for the HNI Corporation conference call to discuss second quarter fiscal 2015 results announced yesterday after market close. Copies of our financial news release, earnings presentation and non-GAAP reconciliations have been posted to our website, www.hnicorp.com. Joining me today from HNI Corporation are Stan Askren, Chairman, President and CEO; and Kurt Tjaden, Senior Vice President and CFO.

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 from expected results. The earnings presentation posted on the HNI Corporation 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 Stan Askren.

Stanley A. Askren
Chairman of the Board, Chief Executive Officer, President, Director

Good morning, everyone. We'll share our thoughts regarding second quarter 2015; provide additional thoughts on our outlook for third quarter and for the full year 2015. We'll then open it up [indiscernible] (01:52). In summary,

it was another strong quarter. We delivered 36% non-GAAP earnings improvement a 12% top line growth, while continuing to invest for the long-term.

Our Office Furniture business has performed well, 6% sales growth and significant profit improvement. Sales in our supplies driven business were up 2%. Sales in the remaining Office Furniture businesses increased 11%, led by 13% growth in our North American contract business. Our Hearth business sales increased 8% on an organic basis or 37%, when we include the Vermont Castings acquisition. Momentum continued in our new construction business with organic sales up 9%. Our remodel/retrofit business performed well with organic sales growth of 6%. Within that business, retail gas sales were up 15%, while our biofuel product sales were down 8%, due to lower oil prices. Overall, I'm very pleased with our strong results in the second quarter.

I'll now turn it over to Kurt.

Kurt A. Tjaden

Vice President and Chief Financial Officer

Thank you, Stan. Additional financial highlights for the second quarter include, non-GAAP consolidated gross margin, excluding restructuring and transition cost, improved to 36.5% compared to 36.3% in the prior-year quarter. Higher volume, increased price realization and strong operational performance were partially offset by unfavorable product mix. Non-GAAP SG&A as a percent of sales, excluding restructuring, impairment and gain on sale of assets decreased 110 basis points. The benefit of higher sales volume was partially offset by strategic investments, higher incentive-based compensation, and the impact of the Vermont Castings acquisition. We recognized \$800,000 of restructuring and transition cost in the quarter, in connection with previously announced closures, acquisition integration and structural alignment. Stan?

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

Thank you, Kurt. Let me recap the first half of 2015 and our outlook for the remainder of the year. I feel very good about our first half performance. Non-GAAP earnings improved 45% on 14% sales growth. Our outlook for the balance of the year remains positive. We expect our earnings performance to be very strong, as we see the benefit of our long-term strategic investments. Our businesses are performing well, and we expect to continue to outperform the markets. In the second half of 2015, we expect strong growth in our Office Furniture businesses, but at a lower rate than experienced in the first half of the year. In our Hearth business, we anticipate second half growth comparable to first half growth rates. In summary, we're well-positioned across our markets to continue to deliver strong results for the remainder of 2015. Kurt?

Kurt A. Tjaden

Vice President and Chief Financial Officer

So financial outlook for the third quarter and the full year 2015. For the third quarter 2015, we anticipate overall sales growth to be 5% to 9% or 1% to 5% on an organic basis. Office furniture sales are expected to increase 1% to 5%. Sales in the supplies-driven channel are forecasted to be flat to up 4%. And sales in the rest of our Office Furniture businesses are projected to increase 4% to 8%. Hearth sales are expected to be up 20% to 24%, or flat to up 4% on an organic basis.

Sales in the new construction channel are forecasted to be up 22% to 26%. And within the remodel/retrofit channel, retail gas sales are projected to be up 8% to 12%, while biomass sales are expected to be down 28% to 32%. Gross profit margin, excluding restructuring and transition costs, is forecasted to modestly improve versus third quarter 2014 when it was 36.4%. Non-GAAP SG&A as a percent of sales, excluding restructuring charges is

expected to slightly increase from the third quarter 2014 when it was 27%. The effective tax rate is projected to be approximately 35% for the full year. Capital expenditures for the full year are forecasted to be \$110 million to \$115 million.

Our estimated range for non-GAAP earnings per diluted share for the third quarter is \$0.84 to \$0.89. And for the full year we're raising the low-end of our guidance by \$0.05. Our new estimated range for non-GAAP earnings per diluted share is \$2.55 to \$2.65. So therefore, as you look at the fourth quarter, we're forecasting overall sales growth to be flat to up 4% and an estimated range for non-GAAP earnings per diluted share to be \$0.97 to \$1.02. You'll note this is a shift versus our historical trend between third quarter and fourth quarter profitability. The change primarily is driven by the timing of strategic investments and returns, favorable business mix and improved operational performance. Stan?

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

Okay. Thank you, Kurt. I'll summarize here, Office Furniture and Hearth businesses are performing well. We remain on track to grow sales and significantly increase profits.

With those comments complete, we'll now open it up to questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Josh Borstein from Longbow Research. Your line is open.

Josh A. Borstein

Longbow Research LLC

Q

Hey good morning Stan, Kurt and Matt. Congrats on a great quarter there. Just a few questions. Some of your peers over the past quarter, Knoll and Steelcase, in particular, mentioned in their last call a trend towards larger projects with extended shipping dates that they attributed to whole buildings and campus projects versus the smaller renovation projects that they were seeing previously. Is that something you guys have seen in your contract business as well?

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

So Josh, is the question about shipping or the project size?

Josh A. Borstein

Longbow Research LLC

Q

It was the project size and extended shipping dates, and they attributed that just larger whole building projects as opposed to just kind of one floor renovations that they had been seeing previously.

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

Yeah. I think our mix of large, medium and small is probably the same. I don't think there is anything really to distinguish the difference. We are seeing a bit of a slowdown just in the ability of the trades, the dealers, architects

and designers, the dealers, et cetera, to process this thing, this stuff through. I would say the channels and the network is plenty full right now. And so people are just really busy working that step through, and that's leading to some delays and some extended push-outs I guess. It's not a big factor, but it is a factor.

Josh A. Borstein

Longbow Research LLC

Q

Okay. So the push-out is coming from the A&D community actually having too much work right now?

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

No. I don't want to narrow it down that narrow. I think it's a combination. I think it's the A&D firms, I think it's the construction firms, and I think it's even the dealers that are having to plan and execute and all that stuff. So it's a combination of kind of from A to Z, I think.

Josh A. Borstein

Longbow Research LLC

Q

Okay. Great. And then in the contract side of the business, you guys put up a fourth straight quarter of double-digit growth. And looking at the first half of the year, you guys are outpacing Vista by nearly double, outpacing your peers. I know one quarter doesn't make a trend, but four quarters seem to. So Stan, I know in the past you said the games have been broad-based, but if you had to put your finger on just one or two things that are really making a difference in the business right now, what do you think they would be?

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

Josh, I'm going to come back to that same sort of line. It's broad-based, it's products, it's selling, it's execution, it's multiple companies within our contract as well. So you can't really nail it down to one thing. It's just positive momentum kind of putting all the factors together to get ahead in the right direction. We're feeling good. We're proud about sort of the – proud isn't the right word, we're pleased with the performance we've seen last year in contract and this year in contract. And I continue to be positive about the outlook.

Josh A. Borstein

Longbow Research LLC

Q

Okay. Great. And just one more from me, I'll hop back in the queue. Stan, last quarter you mentioned you were more positive on the business than you were the three months prior. Do you still feel that way here after 2Q?

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

Yes, I do Josh. If you look at the fundamentals across as the macroeconomic factors are positive. You look at non-res construction spending, office spending, I haven't looked at it real recently, but it's up like over 25%. If you look at employment gains, it's up; [ph] CEO (11:26) confidence and small business confidence are kind of bouncing around, but I don't think there is enough to change the mind there. What is interesting a little bit is this noise that we just talked about. The first question you asked around sort of the ability for the channels to absorb it. The net of all this is, it's going to continue to be that term that we are getting tired of around here, choppy, lumpy, whatever. But I still feel like the economy is solid, we're well positioned; I think the industry is in on an uptick and it should continue.

Josh A. Borstein

Longbow Research LLC

Great. Thanks for the color. Good luck on the balance of the year.

Q

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

Thanks Josh.

A

Operator: Your next question comes from the line of Matt McCall from BB&T Capital Market. Your line is open.

Matthew S. McCall

BB&T Capital Markets

Thanks. Good morning guys. Kurt, back to the seasonality shift that you referenced earlier. Just want to understand, I think you mentioned timing of strategic investments, product mix, and I think I wrote improved operational performance. Can you give us a little more detail there, is the anticipated margin benefit it's going to help Q4 going to come more gross margin, going to come SG&A, where we're going to see the big difference there?

Q

Kurt A. Tjaden

Vice President and Chief Financial Officer

So let me step back a bit here, Matt, and set the context. So for the full year, as we said in opening comments, we've improved our outlook. And Stan just talked, feels like, we believe we're continuing to outperform in our markets. Our profit margins for the full year is significantly improving, while we're investing. Office Furniture margins, we'd expect to be up 150 basis points to 200 basis points on the year. Hearth margins total, including Vermont Castings, up 20 basis points to 40 basis points. So recall, we are integrating, bringing that business into it. What we're really talking is a third quarter to fourth quarter timing shift. And the big piece of it, Matt, comes back to strategic investment timing. So timing of when we're making those investments and when we see the returns of those investments.

A

And think about the things that we've talked about on prior calls. So Vermont Castings, we're coming up on a one-year anniversary of significant transformative benefits that we start to see in the fourth quarter. Benefits of two Office Furniture facilities that we closed last year that we see the benefits of. Stan talked about portfolio and what we're seeing in terms of product. And investments we've made in operations around capability and in different core processes. All of those things flowing into the fourth quarter. So that's the big mix part of it. The second part is, we've got some business mix that moves around between the quarters. And while it's a headwind in the second quarter or the third quarter, it actually is neutral in the fourth quarter, and that can be size of projects year-on-year, that can be day-to-day versus project, that can within product. But that flips between third quarter and fourth quarter.

And then the last item, if you recall in the fourth quarter last year, we had some significant challenges from a cost perspective around West Coast Port disruption and carrier capacity. And you'll recall that we have a significant volume lift in the fourth quarter that we struggled operationally to be able to service efficiently and effectively. We've rolled through those, so that's not a repeat. The big piece is the strategic investment piece of it, that's probably more than half and the other is the other comments that I talked about.

Matthew S. McCall

BB&T Capital Markets

Q

Okay. So if I think about it maybe and look at from a full year perspective, and I think about the investments that you made this year, I know Stan, those are going to be ongoing. But is there any way, I know – as you layered in Vermont Casting that impacted your incremental margin. I mean, it's some of these things that have impacted the results this year. As we start to think about how to model next year in the context of what you just talked about, how much of the Q4 margin picture is going to – how closely is the 2016 margin picture going to look like to Q4 margin picture, or we going to get back to kind of that full year trend, is that the better guide?

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

Yes. I think, Matt, the answer is, I don't know, geez. We haven't planned out next year lap. But the part we've said consistently is that we're expect to deliver this leverage, 25% to 30%. And so that's really what you ought to plan for, is top line with this 25% to 30% leverage over a year, we will move around by quarter, but I don't think you should jump all over the fourth quarter and just extrapolate that because Kurt said, there is a lot of noise in there that moves around. And we have so many different moving pieces that I tend to take a longer-term view on this rather than take one quarter and extrapolate it forward, if I was you.

Matthew S. McCall

BB&T Capital Markets

Q

Okay. And then maybe just a follow-up on the contract space a little bit. The second half outlook is that growth is going to slow. I just want to make sure I understood that that was basically just because of some of these delays and the pipeline filling, and issues that come with that that you referenced, when Josh asked the question. Those are the issues, it's not necessarily a cyclical slowdown.

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

Well, again, I'll go back and say, it's all pretty choppy. Now, last year third quarter of 2014 we were up 12%, fourth quarter 2014 we were up 21%, first quarter we were up 15%, second quarter we were up 13%, and that's going – we start to lap those high growth rates. And so there's some of what Josh and I talked about, but some of that is we're just running into some comparables that just are not sustainable, I don't think, as you start to anniversary those.

Matthew S. McCall

BB&T Capital Markets

Q

Okay. All right. Thank you guys.

Operator: Your next question comes from the line of Budd Bugatch from Raymond James. Your line is open.

Beryl Bugatch

Raymond James & Associates, Inc.

Q

Good morning. I understand, Stan, that lumpy and bumpy, can it make you grumpy.

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

That is a fact. This is what I'm talking to the analysts, Budd.

Beryl Bugatch

Raymond James & Associates, Inc.

Q

I resemble that remark for sure.

Kurt A. Tjaden
Vice President and Chief Financial Officer

A

I know you do.

Beryl Bugatch
Raymond James & Associates, Inc.

Q

I am trying to understand in office, your expectation when we had the first quarter call was for office to be up 8% to 12% in the second quarter, I think we were up 6.4% overall. What changed, what surprised you during the quarter? Was it in supplies, or was it in contract, or was it in both?

Stanley A. Askren
Chairman of the Board, Chief Executive Officer, President, Director

A

It was more supplies, Budd, I would say.

Beryl Bugatch
Raymond James & Associates, Inc.

Q

So supplies were flat you said and that surprised you?

Stanley A. Askren
Chairman of the Board, Chief Executive Officer, President, Director

A

Well, supplies were not as strong, which was coming out. Now, supplies we had some forward sort of inventory build and deploying to some customers. Our large customers take inventory and they place in. So it's a little bit more tricky to forecast kind of what sell-through, et cetera. But I would say, small business confidence was down a little bit. Transaction type of day-to-day went down a little bit, and there is always noise there. So it was not as strong as we anticipated.

Kurt A. Tjaden
Vice President and Chief Financial Officer

A

But I think, Budd, important for the full year, as you think about supplies, we've said since the beginning of the year we expect low single-digit growth, and that still holds true for the full year.

Beryl Bugatch
Raymond James & Associates, Inc.

Q

In supply, even though there is some turmoil in that sector, right, and we do have production changes afoot?

Kurt A. Tjaden
Vice President and Chief Financial Officer

A

Right. So even with those changes, we're still expecting supplies channel to be low single-digits for the year.

Stanley A. Askren
Chairman of the Board, Chief Executive Officer, President, Director

A

We're back to that lumpy and grumpy thing.

Beryl Bugatch

Raymond James & Associates, Inc.

Q

Well, that particular area should be less lumpy and we should be less grumpy, because of that. That's a less bumpy area, less grumpy area. Okay. Tell me then if you would, what the mix today between supplies and contract is. It used to be 50-50, where does it run today?

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

I've used that, I continue to use that number, Budd.

Beryl Bugatch

Raymond James & Associates, Inc.

Q

If we grow the two segments at different rates, at some point of time that's got to change, Stan, doesn't it?

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

That is a mathematical fact.

Beryl Bugatch

Raymond James & Associates, Inc.

Q

Even at my age, I think I got that one right.

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

Mine too.

Beryl Bugatch

Raymond James & Associates, Inc.

Q

Can you quantify for us the investment spending in the third quarter then, Kurt? What's the delta in spending either in SG&A or efficiency that you're going to see in that quarter? And maybe if we can quantify a little bit what the return comes into fourth quarter, how do we think about that?

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

Yeah. So I think in the third quarter, Budd, that investment spending between operations are up in cost of goods and SG&A is probably \$5 million to \$10 million. And it's blended between the two. As you look above into the fourth quarter, that investment spend continues. But if you kind of try and normalize between fourth quarter, what you might have called and what we're seeing, I'd say, half of that is really the returns that we start to see. So if you want to say, hey, you're at \$0.80 and we're at \$1 as a midpoint \$0.10 or – you're talking \$7 million to \$8 million of type of return. And again recall, we've talked about those big structural cost transformations start to roll in and see full run rate. And as Stan has talked on prior calls, great investment opportunities across the business front-end and back-end that we start to see the payoff of.

Beryl Bugatch

Raymond James & Associates, Inc.

Q

No, you guys do a fabulous job of running that. So I'm trying to figure out that return. How does that factor out between seg? I mean, is it much of it because of the VC lapping and you're getting the benefit of some cost reductions or efficiencies that we've been able to bring to that, or is it in domestic – ?

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

Yes, it's split between the two, Budd. Sorry, go ahead, finish your question, Budd.

Beryl Bugatch

Raymond James & Associates, Inc.

Q

Say again, I missed it, Kurt.

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

No, I'm sorry I interrupted you, midstream there maybe. It's split between the two segments. I mean, clearly Vermont Castings provides the benefit on the Hearth side. I would tell you, they are also continuing to have strong core operational performance and execution with similar investments. So the way I think about it, come back, I talked about full year profit improvement within the segments, that should help you as you model that in for the balance of the year to get to where that benefit flows through.

Beryl Bugatch

Raymond James & Associates, Inc.

Q

Okay. And those benefits would continue to flow, at least some of them through the first three quarters of next year?

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

Yeah, Budd. This is Stan. So you're absolutely correct. And the other thing, and you and I've had this conversation over the years, we're never done. We are working the next level of what those transformational cost opportunities are and should be. And I would tell you, there is a nice lift that we're actively working and taking action on now. So that's really what's driving this operational leverage that we talk about of 25% to 30%. And the reason it's not exactly linear by quarters because these big investments happen, and it takes – there's different timing for the returns, et cetera. But as Kurt and I have said, we feel confident that we can drive this leverage not only this year, but we're confident we're going to drive it next year. We should be able to drive it into the future, all else equal, unless the pricing environment goes to heck or raw materials go to heck in the short-term, but you're on it.

Beryl Bugatch

Raymond James & Associates, Inc.

Q

Okay. And two other areas for me, the biomass or that area, we've expected that to be weaker because of the price of energy and also because of the time of the year, how are you thinking about that now, given the energy cost, energy prices have had some stickiness down here, and what are you thinking really the longer term?

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

Yeah. We think longer term it will normalize kind of at a manageable positive sort of mean. Now, last year we saw extraordinary growth. So we saw in third quarter and fourth quarter in that category 40% to 50% growth in that

category. This year seeing third quarter and fourth quarter, we see decline somewhere between 25% and 35%. Still positive sort of growth, if you kind of cut the top off that and smooth that out, we have a significant sort of position in that. There's still other compelling reasons as to why one would want to use the biomass appliance. We continue to invest in that. But it's really very volatile due to energy cost, and the second thing would be just temperature, weather patterns. Severe winter helps, a warm winter doesn't help.

Beryl Bugatch

Raymond James & Associates, Inc.

Q

Okay. And the final area for me is just corporate overhead. Given the good results, are there any lumpiness coming in the corporate overhead, incentive accruals that might pop up to be heavier than normal? What do we have in that area?

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

I think as you look at the back half of the year, Budd, I'd expect it to be relatively close to what we saw in the second half of 2014.

Beryl Bugatch

Raymond James & Associates, Inc.

Q

So you would model that as flat year-over-year, no inflation growth, nothing in that?

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

We do get pluses and minuses in there, but nothing of significance.

Beryl Bugatch

Raymond James & Associates, Inc.

Q

All right. Well, congratulations on just the good performance. And thank you very much for taking my questions.

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

Yeah. Thanks for your questions, Budd. Appreciate it.

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

Kathryn Ingram Thompson

Thompson Research Group LLC

Q

Hi. Thanks for taking my questions today. First of all, I want to focus a bit on Hearth. Just with some of the primary research we do on the more residential products, we're finding that there is a difference in terms of the demand momentum for higher price products versus lower price points. So pulling the string on your Hearth business, are you seeing a greater volume increase for different price products within what you're selling, and how has that changed over the past 12 months?

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

Yeah. It's a very good question, a complex question to answer. So we are working diligently to help the builders differentiate their product with Hearth appliances. Hearth appliance is in the top three for desired amenities. If one is not careful, if a builder doesn't really understand that they'll spec a low end, and that makes the homeowner unhappy. So we're working hard, Kathryn, with the builders to show them how to give an upscale, up-priced product, but also help them engineer sort of the total install, so they actually have lower cost and more margin. So we're seeing nice unit dollar average growth on a same-for-same type of situation. What makes it hard for us to track is just as you know, is the mix of housing because entry-level housing versus custom housing will see different movement there, but working hard to move people up is probably the operative term here.

Kathryn Ingram Thompson

Thompson Research Group LLC

Q

Okay. Maybe another way to think about that question is, how much did price versus volume contribute to overall results at least in the quarter for Hearth?

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

We don't break that out.

Kathryn Ingram Thompson

Thompson Research Group LLC

Q

Okay. Understood. On the office side – so understanding that construction cycle right now, we're only starting to see some real volume growth [indiscernible] (29:28) earlier cycle building materials, for instance, aggregates and steel studs you're seeing high single-digit volume growth in the current market. Based on your experience in prior cycles, what has been the timing lag between increased demand for these earlier type of basic building products versus demand for your office products and really be more on the contract side. And what is other than some of the bottlenecks that we're seeing with labor and backlogs there, what is tagging along with that? Is there anything in the current cycle that would change that timing? Thank you.

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

Again, great questions Kathryn. Certainly, non-res new construction office is a very positive factor for us. It's hard for us to track that timing because it depends on a lot of factors. Is it sold new construction, or is it going to be leased, and then there is a whole domino effect that happens as well. So new construction is built for somebody or somebody is going to occupy it. When they leave their old space, that becomes available, somebody moves there, which then somebody moves there, which somebody moves there. And so if you think about Office Furniture events, is how we think about it, they come from lots of different things. They come from sort of real estate strategies, it's come from facility management strategies, it's come from business drivers. And most of Office Furniture is for existing workers, about 10% is for new workers. So there is so many different dynamics, Kathryn, we have not been able to track the timing exactly. There's a good correlation here, but lagging at it and leaving it, we have not been able to sort it through. I like a lot when the economy is building new office buildings, and I like it a lot when the economy is adding jobs because those are the most positive furniture events that the industry can have.

Kathryn Ingram Thompson

Thompson Research Group LLC

Q

Okay, great. Then my final question was just a cleanup question regarding your guidance, and this maybe because I'm a little bit newer with coverage. But I know that you talked about investments that are going to be hitting in Q3, and you touched on them too in the Q&A. But could you maybe just give a little bit more clarity, a little bit more at least confidence for me as newer coverage, in better understanding that. What gives you confidence, those investments made in Q3 will yield – what types of investments in Q3 will yield results once you get into Q4 and beyond?

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

I mean if you go back, we've been talking about these types of moves in these investments for years. So what gives us confidence is past performances results. And because we're a split and focus company, we're a company that plays in many different segments with many different brands. It's a very broad-based picture. We're investing in product, we're investing in distribution, we're investing in sales capacity, we're investing in manufacturing capacity, we're investing in people, we're investing in IT platforms, and so we are focused on volume growth. We're a company that's very tuned into sort of cost efficiencies. And so we invest a lot to drive cost efficiencies as well.

And they go all the way from large facility transformations to a couple of more feet on the street to sell education product. It goes from large brands like HON Company to smaller brands like Maxon. And we run it kind of as a portfolio strategy. So big stuff, little stuff. And so as we look at it, we just kind of sort of lay it in and see when it's going to come as we're plan with the operating companies. Now, I'll be honest with you, Kathryn, not all of our investments generate a return, but we have a pretty good track record of making good investments that generate nice returns. That goes back to this sort of leverage that Kurt and I talk about. We feel like we're outperforming the market on the top line, that's the volume growth both Hearth and in Office Furniture. Second, we said over time we should be driving 25% to 30% operating leverage on incremental dollars. And so we're driving volume growth and we're also expanding margins, and then we're driving capital efficiency. And the reason why we think it's going to happen is because that's what we've been doing, and that's what we plan to continue to do.

Kathryn Ingram Thompson

Thompson Research Group LLC

Q

All right. Thanks for taking my questions today.

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

A

Thank you Kathryn.

Operator: Your next question comes from the line of Josh Borstein from Longbow Research.

Josh A. Borstein

Longbow Research LLC

Q

Hi. Just one more from me, Kurt. It looks like you guys paid down some debt on the quarter. Just wanted to know if you can update us on the balance sheet?

Kurt A. Tjaden

Vice President and Chief Financial Officer

A

No pay down on debt in the quarter, Josh. If you see a movement between short-term and long-term, it all has to do with maturity on our long-term private placement debt which comes up in early next year and we just have a reclass between the two, between short-term and long-terms of accounting. Yes, purely the accounting of it, nothing from a debt perspective.

Josh A. Borstein

Longbow Research LLC

Q

Okay. Great. Thanks for the clarification.

Operator: We have no further questions in the queue.

Stanley A. Askren

Chairman of the Board, Chief Executive Officer, President, Director

All right. Well, thank you very much for the excellent questions. Thank you for your interest in HNI. We look forward to speaking with you in the future. Have a great day.

Operator: This concludes today's conference call. You may now disconnect.

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