Herman Miller, Inc.
Second Quarter Fiscal 2017
Investor Conference Call
December 22, 2016

The following document is a replication of the notes used in Herman Miller, Inc.'s Second Quarter Fiscal 2017 conference call presentation. Brian Walker, President and CEO; Jeff Stutz, Executive Vice President and CFO; and Kevin Veltman, Vice President – Investor Relations and Treasurer, hosted the call. These notes represent an abridged version of the conference call and do not include the Q & A portion. Those wishing to hear the associated Q & A segment can do so by listening to the archived webcast version of the call on the investor relations page at www.hermanmiller.com.

This presentation will include forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. These risks and uncertainties include those risk factors discussed in the Company's reports on forms 10-K and 10-Q and other reports filed with the Securities and Exchange Commission.

Also, the financial amounts and references to internal measures mentioned today are unaudited.

OPENING – BRIAN WALKER, PRESIDENT AND CEO

Good morning everyone, and thank you for joining us today.

Yesterday, we announced our financial results for the second quarter of fiscal 2017. Our consolidated sales and orders for the quarter were $578 million and $576 million, respectively, and GAAP earnings per share were $0.53. Sales for the quarter were lower than we expected. The softness was primarily in our North America contract furnishings segment as ELA, Specialty and Consumer each delivered mid- to high-single digit growth for the quarter. In the face of challenging comparisons to the prior year and an uncertain near-term business environment, consolidated orders posted a modest decline this quarter, particularly in the North America and Specialty segments, both of which experienced double-digit organic order growth last year. Adjusted earnings per share of $0.54 for the quarter met our expectations as the organization did a good job delivering manufacturing efficiencies and adjusting spending to the demand levels across the business.

Before Jeff and Kevin provide a more detailed breakdown of the results for the quarter, I'd like to share my perspective on the economic backdrop, as well as the overall direction of our business.

Despite the impact of low energy costs and interest rates, growth and productivity in the U.S. and abroad remain tepid. The contentious political environment in

Europe and the recent US election have combined to increase volatility over the past several months. The contract furniture industry in North America has echoed this mixed environment – with choppy order levels and lower architectural billings activity at odds with supportive service sector employment and non-residential construction activity.

Our North America business has reflected this cautious environment. Sales and order rates within our North America segment did not meet our expectations this quarter. On an organic basis, net sales decreased 5% and new orders were down 3% compared to the year ago period. This quarter's results were challenged by a particularly difficult prior year comparison and a competitive pricing environment. Looking at the data on a 2-year stack basis, order growth for the second quarter was approximately 3%. This exceeds the growth within the broader North American contract industry, which over that time averaged closer to 1%. This data reflects the project nature of our business and the broader uneven demand patterns. Pricing is also impacting top-line metrics. We estimate that 200 basis points of the year-over-year decline in sales for this segment was due to increased discounting. And, we know this reflects a broader trend toward value engineered solutions.

Looking forward, our sales teams remain optimistic and continue to report an increase in qualified projects in our funnel. This is further supported by an increase in contract activations and customer visits. With that said, the conversion of this activity into orders has been muted in recent months. We anticipate the next couple of quarters will remain choppy, but we should see business confidence begin to mirror the increasing optimism in equity markets as a result of the new administration's plan to lower taxes, reduce regulation, and ramp-up infrastructure spending.

The competitive pricing environment, requires a constant focus on value engineering our solutions and finding ways to reduce the cost of manufacturing. With the industry bringing new products to market faster than ever before, the recent changes we've made to our new product commercialization process will drive even greater throughput. And we have a robust development pipeline and strong lineup of recently launched products, including the remastered Aeron chair with meaningful material and technology innovations that will extend the life of this powerful franchise.

Moving to our other segments, on the consumer front, the high end of the housing market has been soft, but overall existing home sales and new housing starts have generally shown gains the past few months, aided by rising household incomes and relatively low interest rates. While interest rate changes will impact the housing market, the upper end consumer should be buoyed by the lower tax rates that are being bantered.

Our Consumer business generated high single-digit sales and order growth during the quarter. We're especially pleased with the topline acceleration as we began to overcome the challenges our team experienced in the second half of last year. At first blush, the top line improvement appears to have not translated into improved profitability as compared to last year. Because we're opening new studios at a faster rate than in previous quarters, we have increased pre-opening costs. And, there's a drag on profitability as the sales levels build towards maturity over the first twelve to eighteen months of operation. We estimate the unfavorable impact from these new studios operating at less than full efficiency, combined with incremental pre-opening expenses, was approximately $2 million this quarter at the operating income level. So, looking through this impact we believe operating profit is improving. Having said that, we are focused on increasing the profitability of this segment through growth, product development and operational improvements. We believe there is a significant opportunity to reduce our logistics costs and further integrate the consumer operations of Herman Miller and Design Within Reach.

We continue to execute against our strategy to expand our real estate footprint. In addition to the Paramus studio that opened during the second quarter, we have another five studios under contract to open by the end of the fiscal year. This past quarter we also opened the first Herman Miller retail store in North America, located inside our New York City flagship. Having a branded retail space in a prime metropolitan area marks a significant milestone in our efforts to further connect the Herman Miller brand to consumers.

While the Specialty business delivered broad-based sales growth totaling 5% this quarter, new orders were down 11% relative to last year. Project timing played a large part in this, as the business experienced very strong order growth in the first quarter of this fiscal year. Additionally, last year's second quarter posed a challenging comparison, as order growth in that period was up 16%. Overall, this segment is well positioned to remain a growth and profit engine for our business, particularly as industry trends continue to embrace the application of ancillary furnishings in their office designs.

The ELA business delivered strong sales results this quarter, led by double-digit growth in Asia-Pacific and Latin America. Orders in the second quarter were 3% below last year's level on an organic basis, largely reflecting the uncertainty in the U.K. and oil-producing regions and, to some degree, the project-based nature of the Contract business. These declines were offset by broad-based growth in Latin America as well as gains in mainland Europe and Japan. I would note that customer activity remains robust as there was a sizable increase in new opportunities during the quarter when compared to last year. Overall, the team is performing very well given the macro-economic and geopolitical headwinds and is gearing up for a number of new product launches for both the Herman Miller and POSH brands.

Considering the various dynamics within our businesses right now, we are focusing on the following steps as we move forward:

- While we've always believed the key to profitability is growth, one of our core initiatives in the coming year is to look for places to drive efficiency and leverage as well as eliminate waste across our global business. This is especially important given the current environment and our firm commitment to grow operating profit and continue to provide cash flow to investors. We are developing the details of this work and will have more to report as the year progresses. This will also help us to mitigate industry price competitiveness and free up resources to maintain appropriate levels of investment in support of our long-term growth initiatives.

- We are also focused on improving the profitability of the Consumer business by continuing to expand our real estate footprint through Design Within Reach studio openings, increasing the mix of exclusive product offerings, and growing our contract, catalog and digital channels.

- Finally, because evolving customer needs are affecting the industry in terms of what's being sold, we believe that fully activating our ancillary furnishings channel is a key area of opportunity. We've significantly expanded our portfolio of products, and believe there is un-tapped potential to gain share of our dealer and customer wallets. To that end, we recently established dedicated resources to best position the Herman Miller Collection, Geiger, Design Within Reach, and naughtone brands for further growth in this space. As these capabilities are fully integrated, we'll be in a good place to go squarely after these broader opportunities and drive greater sales pull through.

Our strength has always been our ability to understand changes in society, design solutions to help our customers navigate these changes, and reinvent the way we do business. We end this calendar year being recognized once again by Contract Magazine as "the number one furniture brand that inspires." Guided by our hallmark excellence in design innovation, and grounded by our values as a purpose-driven organization, Herman Miller has been a pioneer in the industry every step of the way. Our significant investments in recent years to build a multi-channel business and powerful family of design brands is to ensure we maintain this leadership in the years to come.

Now I'll turn the call over to Jeff to provide more detail on the financial results for the quarter.

Q2 FINANCIAL REVIEW – JEFF STUTZ, CFO

Thanks, Brian and good morning everyone.

Consolidated net sales in the second quarter of $578 million were slightly below the same quarter last year. On an organic basis, which excludes the impact of foreign currency translation and a dealer divestiture, sales were 1% higher than the prior year. Orders in the period of $576 million were 4% lower than the prior year level. On an organic basis, orders decreased 3% from the second quarter of last year. I would also note that while our reported backlog was 6.5% lower than last year, the balance last year included approximately $20 million in orders related to the Australia dealer that we divested at the start of the fiscal year. Excluding this amount, backlog was 1% lower than the same quarter last year.

Within our North American segment, sales were $330 million in the second quarter, representing a decrease of 5% from the same quarter last year. New orders in this segment were $338 million in the quarter, reflecting a decrease of 3% from last year. Orders from project sizes above $1 million were up compared to last year, which was a contributing factor to discount levels during the quarter as larger projects generally carry higher volume discounts. Orders from project sizes below $1 million were down year-over-year. As expected in an uneven business environment, order activity by industry sector was mixed. We saw growth in business services, manufacturing and state and local government, while energy, as we have seen for the past few quarters, along with wholesale, healthcare and financial services were lower than the prior year. From a regional perspective, we saw modest order growth in the West and East regions, while order levels in the Central region were down significantly given its close ties to the energy sector. As a result of these declines linked to a challenging energy sector in the Central region, North America order levels were unfavorably impacted by approximately 300 basis points in the quarter.

Our ELA segment reported sales of $108 million in the second quarter, reflecting an increase of 7% compared to last year. New orders totaled $100 million, an amount 12% lower than the same quarter last year. On an organic basis, which excludes the impact of a dealer divestiture and foreign currency translation, segment sales were 17% above last year – led by growth in China, mainland Europe, India and Latin America. Organic orders were 3% lower than last year. This year-over-year order decline was primarily due to lower demand levels in the U.K. and Middle East tied to the uncertainty in these regions, as well as reduced year-over-year order levels in China related primarily to project timing. This was partially offset by strong demand across Latin America.

Sales in the second quarter within our Specialty segment were $61 million, an increase of 5% from the same quarter last year and reflected growth across each of our Specialty businesses. New orders in the quarter of $55 million were 11% lower than the year ago period. As Brian mentioned, the lower level of orders was primarily due to challenging prior year comparisons and the timing of order placement for the Geiger business, partially offset by order growth for the Herman Miller Collection.

The Consumer business reported sales in the quarter of $80 million, an increase of 8% compared to last year. New orders for the quarter of $83 million were 7% ahead of the same quarter last year. On a comparable brand basis, revenues for the quarter were up by nearly 9%. While the comparable brand sales growth was partially related to softer sales a year ago during the ERP implementation at the start of the quarter, our marketing investments, particularly in the areas of catalog and digital, have gained significant traction.

Consolidated gross margin in the second quarter was 37.7%, which was 100 basis points lower than the second quarter last year. As Brian mentioned earlier, on a year-over-year basis we felt the impact of comparatively deeper discounting. As we noted in our outlook last quarter, the recent increase in steel prices had an unfavorable impact on us compared to the same quarter last year. As a reminder, we are planning a price increase at the beginning of February to help address these commodity pressures. These factors were partially offset by continued operational improvements and lower incentive-based compensation.

I'll now cover operating expenses and earnings in the period.

In total, operating expenses in the second quarter were $167 million compared to $169 million in the same quarter a year ago. The prior year included approximately $2 million in operating expenses related to the dealer in Australia that was divested at the start of this fiscal year. After adjusting for those expenses, operating expenses were flat compared to last year as lower incentive based compensation and medical costs were offset by spending on new product development and marketing initiatives, as well as higher occupancy costs and incremental pre-opening costs related to new DWR studios.

Additionally, during the second quarter we announced restructuring actions involving certain workforce reductions. These actions resulted in the recognition of severance and outplacement expenses totaling approximately $1 million.

On a GAAP basis, including restructuring expenses, we reported operating earnings of $50 million this quarter. Excluding these charges, adjusted operating earnings this quarter were $51 million, or 8.8% of sales, compared to $55 million, or 9.6% of sales, in the prior year period.

The effective tax rate in the second quarter was 32.0%.This compares to an effective tax rate of 33.0% reported last year.

Finally, net earnings in the second quarter totaled $32 million, or $0.53 per share on a diluted basis. Excluding the impact of restructuring expenses, adjusted diluted earnings per share this quarter totaled $0.54. This compares to earnings of $0.57 per share in the second quarter of last year.

With that, I'll now turn the call over to Kevin to give us an update on our cash flow and balance sheet.

KEVIN VELTMAN, VICE PRESIDENT – INVESTOR RELATIONS & TREASURER

Thanks, Jeff.

We ended the quarter with total cash and cash equivalents of $68 million, which reflected an increase of nearly $3 million from last quarter. Cash flows from operations in the period were $60 million compared to $40 million in the same quarter of last year. The increase in cash flows from operations was primarily due to higher cash inflows from working capital resulting from higher accrued liabilities, offset by increased accounts receivable and inventory levels.

Capital expenditures were $25 million in the quarter and $47 million year-to-date. We anticipate capital expenditures of $85 million to $95 million for the full fiscal year. Cash dividends paid in the quarter were $10 million and we repurchased approximately $5 million of shares during the quarter.

We remain in compliance with all debt covenants and as of quarter-end our gross-debt to EBITDA ratio was approximately 0.8 to 1. The available capacity on our bank credit facility stood at $372 million at the end of the quarter. Given our current cash balance, ongoing cash flows from operations, and our total borrowing capacity, we believe we continue to be well-positioned to meet the financing needs of the business moving forward.

With that, I'll now turn the call back over to Jeff to cover our sales and earnings guidance for the third quarter of fiscal 2017.

OUTLOOK – JEFF STUTZ

Thanks Kevin….

With respect to the forecast, we anticipate sales in the third quarter to range between $520 million and $540 million. We estimate the year-over-year unfavorable impact of foreign exchange on sales for the quarter to be approximately $2 million. On an organic basis, adjusted for the dealer divestiture and the impact of foreign exchange translation, this forecast implies flat revenue compared to last year at the mid-point of the range. On a two-year stacked basis, this reflects organic sales growth of approximately 3%.

Consolidated gross margin in the third quarter is expected to range between 37% and 38%. This assumes the relative seasonal slowdown in factory production that we normally experience around the holiday period and in the month of January. It also assumes the expected impact of higher year-over-year costs for key commodity inputs, offset by continued productivity gains and improved channel mix.

Operating expenses in the third quarter are expected to range between $164 million and $168 million.

We anticipate earnings per share to be between $0.31 and $0.35 for the period. This assumes an effective tax rate of 31% to 33%.

With that, I'll now turn the call back over to the operator for your questions.

[Q&A]

CLOSING – BRIAN WALKER

Thanks for joining us on the call today. We appreciate your continued interest in Herman Miller and look forward to updating you next quarter. On behalf of all of us at Herman Miller, I want to wish you and your families a wonderful holiday season. Have a great day.