Herman Miller, Inc.
Second Quarter Fiscal 2018
Investor Conference Call
December 21, 2017

The following document is a replication of the notes used in Herman Miller, Inc.'s Second Quarter Fiscal 2018 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 at the end of this presentation and 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. Thanks for joining us today.

I'll start with a brief overview of our quarterly results, followed by highlights of our progress on the strategic priorities for the business. I'll close with perspective on the current economic backdrop before turning it over to Jeff and Kevin for more information on the financial results.

We saw a second straight quarter of better than expected demand patterns, with consolidated orders up 9% over last year on a reported basis, and up 10% organically. In fact, the $629 million in order entry this past quarter reflects an all-time record level for Herman Miller. We were particularly pleased to see this order growth come from all segments of the Company – helping to boost our ending backlog by double-digits from this time last fiscal year, putting us in a good starting position as we enter the second half of fiscal 2018.

Sales of $605 million were consistent with our expectations at the start of the quarter, driven by growth from our North America, ELA and Consumer segments. Although we did feel some negative pressures at the gross margin level, the organization again did an excellent job of managing operating expenses during the quarter and delivered adjusted earnings per share of $0.57, an increase of 6% over adjusted earnings per share of $0.54 in the same quarter last year.

To sum up by business: Our North American and International segments both delivered solid results this quarter, highlighted by impressive order growth and double-digit operating margins. The Consumer segment once again posted a strong quarter of top-line growth, which spanned its multi-channel footprint. Operating profitability in this segment was again muted by the impact of several recently opened studio locations that are still in the early phase of maturity. However, demand patterns for this business are very encouraging, and we have growing confidence the operating performance will begin to improve as we move through the second half of the fiscal year.

The Specialty segment is really two stories—two groups doing well; two groups not meeting our goals. Geiger and the Herman Miller Collection are performing to our expectations, with strong order growth and profitability. Maharam continues to be an important contributor to profitability for the segment, although through the first half of the year has not delivered the top-line growth we had expected. In response, the Maharam team has mobilized around a range of growth initiatives that we believe will drive improvement – including multiple new product launches planned for the coming months, as well as improving the depth and market coverage of its sales team. To be frank, the fourth business within the Specialty group – Nemschoff – has fallen short of the growth and profit targets we set for the first six months of this year. We have put new leadership in place who are energizing the product pipeline and improving quality and operational reliability. This team is clear on the goals, and while we are confident we have the right pieces in place, it will take some time for these changes to be fully implemented and realized.

Now, with that overview of the quarter, I'd like to update our progress on the five key priorities we are focused on across Herman Miller. As a reminder, these five priorities are:

- Scaling our Consumer business
- Realizing the next generation of our Living Office proposition
- Leveraging our dealer eco-system
- Delivering on our cost and profit improvement goals and
- The continued commitment to product and service innovation

While we continue to make progress across each of these priorities, let me provide some highlights from this quarter.

We are scaling our Consumer business by expanding the real estate footprint of Design Within Reach studios, increasing the mix of higher margin, exclusive product designs, and growing the catalog, contract, and digital channels. We are encouraged by the progress as our Consumer business delivered its sixth straight quarter of comparable brand growth, as our efforts to accelerate revenue growth for this business are paying off.

In addition, we are continuing the work we discussed last quarter with an outside partner. This effort is ultimately aimed at driving operational excellence across our Consumer business in ways that will both improve the overall customer experience and optimize our value proposition in key areas.

We are currently implementing detailed plans for this work and expect to realize benefits beginning in the fourth quarter. Specifically, we are targeting price optimization strategies across our product assortment, strategic sourcing initiatives, logistics enhancements and improved studio effectiveness. As a specific example on the logistics front, we are enhancing our shipping program to be more competitive in the market, increase repeat business through an improved customer buying experience, and lower overall operating costs. Some of these changes pressured our Consumer gross margins this past quarter. Going forward, however, we expect to begin realizing savings from increased shipping consolidation, re-negotiated logistics costs and lower customer return levels. Early results from this work have helped drive improvement in our net promoter scores from around 50 at this time last year to nearly 60 today – a meaningful move towards the ambitious target that our Consumer team has established in their "Drive for 65" campaign.

In addition to our core strategy to scale the Consumer business, these actions to improve operational excellence will play an important part in reaching our goal to increase operating margins for the Consumer segment above 8% by Fiscal 2020. We expect this operational excellence work will ultimately contribute benefits of $10 million to $20 million towards achieving that goal.

In realizing the next generation of the Living Office framework, we have been launching new technology solutions and using research to quantify the positive impact to organizations from applying Living Office concepts. Still in the early days of development, our Live OS digital architecture provides real-time data insights for individuals and organizations to help improve work space performance and achieve wellness goals. We have five pilot installations with key customers currently in place and are building a strong sales pipeline of Fortune 1000 companies as we ready for the full launch.

We are continuing to make progress on our cost savings initiative targeting gross annual savings of $25 million to $35 million by FY20. Our annual savings run rate sits at $18 million for the second quarter and the teams continue to work on a number of initiatives designed to meet our overall target. As a reminder, our rationale here is three-fold: 1) to help offset potential inflation 2) to free up operating headroom to fund growth initiatives and 3) support our goal of increasing consolidated operating margins at or above 10% by fiscal 2020. Despite the progress we are making in this area, our consolidated operating margin backed up a little compared to the second quarter last year. This was mainly due to the gross margin pressures that we felt this past quarter. With that said, we remain confident in achieving this operating margin target, aided by the range of cost savings initiatives that are still to be implemented, as well as the margin expansion opportunity in our Consumer business that I discussed earlier.

Finally, we are also working to fully leverage our dealer eco-system. We have a great team working to increase our share of dealer wallet in the ancillary product category of the market, an area with great potential based on current workspace planning trends. We group our brands and products that serve this category under the name "Herman Miller Elements." The team is concentrating its initial efforts on building awareness of the breadth of our products across all of our brands and providing a range of digital tools to aid ordering, specifying and visualizing of our entire offering**.** Products across the Herman Miller group of brands that fall under the "Elements" umbrella have contributed meaningfully to the growth we've experienced in recent quarters; and our strategy moving forward is aimed at protecting the leadership we've developed in this category.

More broadly, we are continuing to drive our leadership in the seating category in partnership with our dealers through a number of product launches in the past year, including the remastered Aeron, Verus and Taper task chairs. In addition, our product development pipeline includes a number of exciting additions in this space which are scheduled for introduction over the next two years.

Before Jeff reviews the financial results for our business segments, let me provide some context on the current economic backdrop

While industry sales and order levels in North America have bounced around in the near-term, better than expected GDP growth, strong confidence measures, and positive trends in service sector employment and architectural billings activity provide a supportive economic environment.

With Congress and the White House moving toward a new tax bill, reform has the potential to be an industry tailwind through higher employment levels and investment spending. Within our own operations, it offers the potential for improved cash access and generation through repatriation and lower rates

On the North America consumer front, high consumer confidence, low unemployment, strong equity markets, and historically low interest rates combine to provide a generally positive backdrop for consumer furnishings in North America.

While the international picture is stable overall and global economic growth continues, pockets of disruption persist in some key areas. The U.K. still faces uncertainty tied to Brexit; economic and political pressures in oil-producing regions including the Middle East contribute to ongoing uncertainty there; and the current geo-political problem of North Korea represents an obvious threat.

Closer to home at Herman Miller, we were once again named #1 “Brand that Inspires” by Contract Magazine, and for 11 straight years we have earned a perfect score from the Corporate Equality Index. Such awards are not the only measures of progress, but they are evidence that our culture of design, innovation, and inclusiveness is strong.

Encouraged by the strong demand levels the past two quarters, the energies of our global, multi-channel business remain laser-focused on our mission to deliver “inspiring designs to help people do great things.”

With that overview, I’ll turn the call over to Jeff to provide more detail on the financial results for the quarter.

FINANCIAL REVIEW – JEFF STUTZ, CFO

Thanks, Brian and good morning everyone.

Consolidated net sales in the second quarter of $605 million were 5% above the same quarter last year. On an organic basis, which excludes the impact of foreign currency movement and dealer divestitures, consolidated net sales were 6% higher than last year’s level. Orders in the period of $629 million were 9% above the same quarter last year and up 10% organically.

Our backlog last year included approximately $9 million in orders related to dealers that have subsequently been divested. Excluding the impact from those divestitures, the ending backlog for the quarter was 15% higher than last year’s level and gives us a nice tailwind as we enter Q3.

Within our North American segment, sales were $331 million in the second quarter, representing an increase of 5% from the same quarter last year. New orders were $341 million in the quarter, reflecting an increase of 6% from last year. On an organic basis, we posted year-over-year revenue growth of nearly 9%, while orders were 8% higher than the same quarter a year ago. Higher order levels were led by large project activity during the quarter, although we saw increases across all size categories. Sector results showed fairly broad-based growth, led by Financials, Communications and Manufacturing sectors.

Our ELA segment reported sales of $113 million in the second quarter – an increase of 5% compared to last year on a GAAP basis, and up 3% organically. New orders totaled $118 million which is 18% higher than last year on a reported basis, and up 16% organically. The year-over-year organic order growth was broad-based across all regions – with particular strength in Europe, China, Mexico and the Middle East.

Sales in the second quarter within our Specialty segment were $74 million, a decrease of 3% from the same quarter last year. New orders in the quarter of $77 million were 9% higher than the year ago period. The increase in orders was driven by strong project activity for Geiger and the Herman Miller Collection, partially offset by lower demand levels for Nemschoff and Maharam. While there was some carryover impact from the supplier quality issue at Nemschoff discussed last quarter, segment profitability during the quarter was also impacted by higher than normal warranty levels for Nemschoff and close-out activity at Maharam related to certain discontinued textile lines.

The Consumer business reported sales in the quarter of $87 million, an increase of 9% compared to last year driven by strong growth across our studio, catalog, eCommerce and Contract channels. New orders for the quarter of $93 million were 12% ahead of the same quarter last year.

While operating earnings for this segment remain constrained in the near-term by the roll-out of new studio locations that take time to fully mature, along with other investments that we believe are necessary to support our longer-term growth potential, we see a path to operating margins near double digits for this business over the long term. During the current quarter, we estimate the unfavorable impact to operating earnings related to the "drag" from new studios that have not reached full maturity was approximately $2 million.

Consolidated gross margin in the second quarter was 36.7%, which was 100 basis points below the same quarter last year. In addition to labor and outsourcing expenses tied to the capacity challenges we mentioned last quarter for certain high demand products, we also experienced higher levels of discounting, partially tied to a greater mix of larger projects, unfavorable product mix and, to a lesser degree, higher steel costs during the quarter. I would note that the year-over-year impact of steel costs was lower than past quarters and is expected to be minimal in the third quarter of fiscal 2018.

Operating expenses in the second quarter were $170 million compared to $167 million in the same quarter a year ago. The increase was driven primarily by higher variable selling costs and incentive compensation levels. As Brian noted, we also made good progress on our cost savings initiative. A portion of these savings were earmarked to help fund growth investments, such as the increased occupancy and staffing costs related to new DWR studios and new product development and marketing. As I've stated before, the walk toward our ultimate goals for profitability won't be an even one, as required investments for growth are not necessarily linear with our cost reduction plans. However, we feel very good about the progress our teams are making related to this priority.

Restructuring actions involving certain workforce reductions that were announced in the second quarter resulted in the recognition of severance and outplacement expenses during the quarter. We also recognized other charges related to the consulting fees associated with our profitability improvement initiative for our Consumer business. Combined, these amounts totaled approximately $2 million for the quarter.

On a GAAP basis, we reported operating earnings of $50 million this quarter. Excluding restructuring and other charges, adjusted operating earnings this quarter were $52 million, or 8.6% of sales. By comparison, we reported adjusted operating income of $51 million, or 8.8% of sales, in the second quarter of last year.

The effective tax rate in the second quarter was 30.5%. This compares to an effective tax rate of 32.0% reported in the same quarter last year. The tax rate for the quarter was at the low end of our expected range due to a favorable mix of earnings.

Finally, net earnings in the second quarter totaled $34 million, or $0.55 per share on a diluted basis. Excluding the impact of restructuring expenses and other charges, adjusted diluted earnings per share this quarter totaled $0.57 compared to adjusted earnings of $0.54 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 $115 million, which reflected an increase of $35 million from last quarter. Cash flows from operations in the period of $63 million were comparable to the $64 million generated in the same quarter of last year.

Capital expenditures were $15 million in the quarter and $40 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 $11 million and we repurchased $6 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 $392 million at the end of the quarter, which includes $150 million set aside to repay the private placement notes that are due in January 2018. Given our current cash balance, ongoing cash flows from operations, and our total borrowing capacity, 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 2018.

OUTLOOK – JEFF STUTZ

Thanks Kevin….

We anticipate sales in the third quarter to range between $565 million and $585 million. We estimate the year-over-year favorable impact of foreign exchange on sales for the quarter to be approximately $5 million. On an organic basis, adjusted for dealer divestitures and the impact of foreign exchange translation, this forecast implies a revenue increase of 9% compared to last year at the mid-point of the range.

We expect consolidated gross margin in the third quarter to range between 36.5% and 37.5%. Given our strong order pacing in Q2, we anticipate less of the relative seasonal slowdown in factory production that we normally experience around the holiday period and in the month of January.

Operating expenses in the third quarter are expected to range between $166 million and $170 million.

As we outlined in our press release last night, our earnings per share estimate for the third quarter is based on existing U.S. tax regulations and an assumed effective tax rate of between 29.5% to 31.5%. On this basis, we anticipate earnings per share to be between $0.46 and $0.50 for the period.

With that said, assuming the tax bill passed by Congress earlier this week is ultimately signed into law, the impact would be meaningful to our effective tax rate for the upcoming quarter and future periods. While we have a profitable and growing international business, the fact is we still derive more than 75% of our revenue from businesses in the United States. Accordingly, the proposed rate change will have a significant impact on these earnings. We currently estimate the law change would reduce our full year effective tax rate for fiscal 2018 to between 26% and 28%. To be clear, this represents a blend of both "old" and "new" tax rates and excludes the impact of one-time adjustments that would be recorded in the third quarter related to the adoption of the new law. This would include factors such as re-valuation of net deferred tax liabilities and recognition of taxes associated with un-repatriated foreign earnings. Given the complexity of these items, our team is currently in the process of working through these estimates, and while we believe our longer-term effective tax rate will be lower still… more time is needed to work through the details.

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.

Risk Factors

This presentation contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act, as amended, that are based on management's beliefs, assumptions, current expectations, estimates, and projections about the office furniture industry, the economy, and the Company itself. Words like "anticipates," "believes," "confident," "estimates," "expects," "forecasts," "likely," "plans," "projects," and "should," variations of such words, and similar expressions identify such forward-looking statements. These statements do not guarantee future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict with regard to timing, extent, likelihood, and degree of occurrence. These risks include, without limitation, the success of our growth strategy, our success in initiatives aimed at achieving long-term cost saving goals, employment and general economic conditions, the pace of economic recovery in the U.S., and in our International markets, the increase in white-collar employment, the willingness of customers to undertake capital expenditures, the types of products purchased by customers, competitive-pricing pressures, the availability and pricing of raw materials, our reliance on a limited number of suppliers, our ability to expand globally given the risks associated with regulatory and legal compliance challenges and accompanying currency fluctuations, the ability to increase prices to absorb the additional costs of raw materials, the financial strength of our dealers and the financial strength of our customers, our ability to locate new DWR studios, negotiate favorable lease terms for new and existing locations and implement our studio portfolio transformation, our ability to attract and retain key executives and other qualified employees, our ability to continue to make product innovations, the success of newly-introduced products, our ability to serve all of our markets, possible acquisitions, divestitures or alliances, the pace and level of government procurement, the outcome of pending litigation or governmental audits or investigations, political risk in the markets we serve, and other risks identified in our filings with the Securities and Exchange Commission. Therefore, actual results and outcomes may materially differ from what we express or forecast. Furthermore, Herman Miller, Inc., undertakes no obligation to update, amend or clarify forward-looking statements.