Herman Miller, Inc.
Second Quarter Fiscal 2019
Investor Conference Call
December 20, 2018

The following document is a replication of the notes used in Herman Miller, Inc.'s Second Quarter Fiscal 2019 conference call presentation. Andi Owen, 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.

OPERATOR

Good morning and welcome to the Herman Miller second quarter earnings conference call. As a reminder, this conference call is being recorded. I would now like to introduce your host for today's conference, Kevin Veltman, Vice President of Investor Relations & Treasurer.

KEVIN VELTMAN, VICE PRESIDENT – INVESTOR RELATIONS & TREASURER

Good morning everyone. Joining me today on our second quarter earnings call are Andi Owen, our President and Chief Executive Officer, and Jeff Stutz, our Executive Vice President and Chief Financial Officer.

We have posted today's press release on our investor relations website at hermanmiller.com. Some of the figures that we'll cover today are presented on a non-GAAP basis. We've reconciled the comparable GAAP and non-GAAP amounts in a supplemental file that can also be accessed on the website.

Before we begin our prepared remarks, I will remind everyone that this call will include forward-looking statements. For information on factors that could cause actual results to differ materially from these forward-looking statements, please refer to the earnings press release we issued last night as well as our annual and quarterly SEC filings.

At the conclusion of our prepared remarks, we will have a Q&A session. We will limit today's call to 60 minutes and ask that callers limit their questions to no more than three to allow time for all to participate.

With that, I'll now turn the call over to Andi.

ANDI OWEN, PRESIDENT AND CEO

Good morning and thank you for joining us today. With this quarter being my first full quarter with Herman Miller, I thought it appropriate to open with a few comments describing how I've spent my first 100 days in the role. As I'm sure you can imagine it's been a whirlwind schedule, but I've thoroughly enjoyed engaging with stakeholders across all of our businesses and around the globe. My travels have taken me to each of our primary office and manufacturing locations around the world and have given me an opportunity to meet and speak with our diverse and talented employees. I've had the opportunity to engage with customers, dealer partners, and investors; tour retail studios; and spend quality time with each of our executive leaders focusing on ways to amplify our progress. In many ways this first 100 days has been about actively listening and building an understanding of what is going well and where there may be opportunities ahead that we can capitalize on. It's been an amazing experience overall, and I'm encouraged and energized by the opportunities I see for our company. My team and I are focused on accelerating our path to these opportunities, and I look forward to sharing more about our strategy in the months ahead. In the meantime, I'd like to share a few thoughts on our results for the second quarter and progress on several key initiatives. After that I'll turn the call over to Jeff and Kevin to share the details of the financials.

Let me start with the global macro-economic picture. While volatile equity markets and uncertainties around U.S./China trade policy and Brexit persist, underlying economic indicators are generally positive. We were encouraged to see the recent postponement of higher tariff rates to allow for further negotiations between the U.S. and China. And, while not reflected in our current quarter results, lower market prices for U.S. steel during the quarter were a positive development that will begin to layer into our gross margins in the third quarter.

This supportive demand environment was reflected in our results for the quarter. We were very encouraged by the magnitude and broad-based nature of our sales and order growth this quarter, both of which achieved record levels for our business. Consolidated sales of $653 million were up 7% organically over the same quarter last year. New orders in the quarter totaled $703 million, representing an organic increase of 10%. This order growth is particularly notable as it was on top of the 10% organic increase that we delivered in the second quarter of last year.

Our focus on profit optimization is helping to stabilize our performance at the gross margin level and our teams remained diligent in managing operating expenses. Combined with sales growth, these factors helped drive operating margin expansion over the same quarter last year. We reported EPS on a GAAP basis of $0.66 during the quarter. On an adjusted basis, which excludes certain restructuring and other charges, we reported EPS of $0.75 in the second quarter, which reflected an increase of 32% over the same quarter last year.

We continue to make great progress on our current strategic priorities – let me share a few highlights from the quarter.

Our innovation pipeline has been very active. The Cosm performance task seating chair was launched late last quarter and is pacing well ahead of its business plan. Its sophisticated ergonomic design that brings instant comfort is generating critical acclaim as Cosm has won a number of awards, including the Fast Company Innovation by Design Award and the Orgatec Innovation Award.

Towards the end of this quarter, we also launched two exciting new products. The first is Canvas Vista, a desking system that trims the size of a workspace to free up space for more people or more diverse settings. By using every square inch of space smartly, it provides compression without compromise.

The second product launched was Overlay, which is a system of freestanding, movable walls used to help define space. Designed to create visual clarity in open-plan offices, Overlay gives organizations the agility to evolve and adapt quickly. As we look ahead, our research-based Living Office framework will continue to shape our innovation agenda and help our customers create high-performing work spaces that meet their unique needs.

As you know, our focus on the dealer ecosystem centers on being as easy to do business with as we can be. This effort has been led by the development of technology tools that make interactions more seamless for our dealers. We've developed new digital search and access tools that help sellers understand the full offering across all our brands. The ecosystem effort has also included targeted product launches that aid our dealers in winning new business every day.

In August, we finalized our investment in Maars Living Walls, a global leader in architectural glass walls. This transaction provides an important addition to our dealer eco-system both here in North America, and elsewhere around the world. During the second quarter, our teams and dealer partners made good progress in their onboarding and market strategy development process. This early integration work has also included incorporating Maars award winning products into our Herman Miller showrooms. We are already seeing project wins with this new capability and have growing confidence in the long-term potential of this business.

On the Consumer front, we've seen further progress in scaling this business with another strong quarter of revenue growth. With the investment we made this past June, our teams are well underway launching the HAY brand in North America.

The HAY North America website went live at the start of November, and we are in the initial stages of marketing investments to drive traffic to the new site. We also opened our first two dedicated HAY studios in Portland, Oregon and Costa Mesa, California at the end of November. At the same time, we have made HAY products more widely available throughout our Design Within Reach retail studios. We're pleased by the remarkable job by our HAY teams to meet aggressive timelines and deliver fabulous initial results. HAY's combination of influential design and democratic pricing creates a tremendous opportunity to leverage our multi-channel platform across commercial and consumer audiences.

Finally, as we have unpacked our profit optimization initiative in detail the past two quarters, let me reiterate that we are successfully executing on this initiative and remain confident that we are on track to achieve our savings targets. This goal plays a critical role in helping fund growth initiatives, offsetting inflationary pressures, and driving operating leverage as we move forward.

In the near-term, this goal plays a critical role helping to offset tariff pressures. With the recent deferral of the potential 25% tariff rate on goods imported by Herman Miller and its suppliers from China, near-term tariff pressures have lessened. While uncertainty remains how trade tensions will ultimately conclude, we continue to believe that our profit optimization work and January price increase will fully offset these pressures, and we will continue to evaluate additional contingency plans to help navigate this situation in the longer term.

With that brief introduction and 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 Andi and good morning everyone.

Consolidated net sales in the second quarter of $653 million were 8% above the same quarter last year on a GAAP basis, and up 7% organically – which adjusts for the impact of year-over-year changes in foreign currency rates and the impacts of adopting new revenue recognition rules earlier this fiscal year. New orders in the period were 12% above last year on a GAAP basis, and up 10% organically.

Within our North American segment, sales were $353 million in the second quarter, representing an increase of 7% from last year. New orders were $371 million in the quarter were up 9% on a reported basis and increased 7% organically over last year. The order growth in North America this quarter was led by small and medium size projects, with the strongest geographic increases coming from the central and western regions of the U.S.

Our ELA segment reported sales of $119 million in the second quarter – an increase of 5% compared to last year. New orders totaled $137 million, representing growth of approximately 16% over last year's second quarter. The strong year-over-year order performance was led by growth in Asia-Pacific, Mexico, and the Middle East.

Sales in the second quarter within our Specialty segment were $82 million, an increase of 10% from the same quarter last year. New orders in the quarter of $87 million were 13% higher than the prior year. Encouragingly, the increase in orders this quarter reflected higher demand levels across all four businesses that comprise the Specialty segment.

Our Consumer business segment reported sales in the quarter of $99 million, an increase of 15% from the same quarter last year. These results were driven by strong growth across our studio, catalog, eCommerce and wholesale channels. New orders for the quarter of $108 million were 16% ahead of the same quarter last year. Design Within Reach comparable brand sales for the period were 5% higher than last year, reflecting eleven straight quarters of comparable brand sales growth for DWR.

From a currency translation perspective, the general strengthening of the U.S. dollar relative to year-ago levels was a head-wind to sales growth this quarter. We estimate the translation impact from year-over-year changes in currency rates had an unfavorable impact on consolidated net sales of $4 million in the period.

Consolidated gross margin in the second quarter was 36.1%, which was 60 basis points below the same quarter last year. This decrease was driven by the impact of adopting new revenue recognition rules at the start of our current fiscal year. As we noted last quarter, under the new guidance, we are now recording certain dealer payments as expenses within cost of goods sold that were previously classified as a reduction to net sales. While this classification has zero impact on reported gross profit dollars, it reduced our gross margin percentage compared to last year.

Operating expenses in the second quarter were approximately $182 million compared to $170 million in the same quarter a year ago. This amount includes $6 million in special charges primarily associated with consulting fees supporting our profit enhancement initiatives and CEO transition costs. The remaining year-over-year increase of $6.5 million was driven mainly by higher variable selling expenses, as well as occupancy, marketing and staffing costs related to new retail studios and eCommerce platforms, including the launch of the HAY brand in North America.

Restructuring charges recorded in the second quarter of $300,000 related to previously announced facility consolidation projects in both the U.K. and China. These projects are progressing on-schedule and we expect to begin realizing the benefits from improved efficiency and lower costs as we move through the back half of this fiscal year and into the first half of fiscal 2020.

On a GAAP basis, we reported operating earnings of $53 million this quarter, compared to operating earnings of $50 million in the year ago period. Excluding restructuring and other special charges, adjusted operating earnings this quarter were $59 million, or 9.1% of sales. By comparison, we reported adjusted operating income of $52 million, or 8.6% of sales, in the second quarter of last year.

The effective tax rate in the second quarter was 22.6%. The rate in the current quarter included an adjustment related to recently clarified guidance regarding the adoption of the U.S. Tax Cuts and Jobs Act. Excluding this adjustment, the effective rate in the period was 21.0%. This compares to a rate of 30.5% in Q2 of last fiscal year.

Finally, net earnings in the second quarter totaled $39 million, or $0.66 per share on a diluted basis, compared to $34 million, or $0.55 per share in the same quarter last year. Excluding the impact of restructuring and other charges, adjusted diluted earnings per share this quarter totaled $0.75 compared to adjusted 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 $114 million, an increase of $12 million from last quarter. Cash flows from operations in the second quarter were $59 million compared to $63 million generated in the same quarter of last year.

Capital expenditures were $19 million in the quarter and $41 million year-to-date. For fiscal 2019, we anticipate capital expenditures of $90 million to $100 million for the full year. Cash dividends paid in the quarter were $12 million and we repurchased $17 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 1.1 to 1. The available capacity on our bank credit facility stood at $164 million at the end of the quarter. Given our current cash balance, ongoing cash flow from operations, and total borrowing capacity, we remain 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 2019.

OUTLOOK – JEFF STUTZ

Thanks Kevin.

With respect to the forecast, we anticipate sales in the third quarter of fiscal 2019 to range between $615 million and $630 million. The mid-point of this range implies an organic revenue increase of 7% compared to the same quarter last fiscal year.

We expect consolidated gross margin in the second quarter to range between 35.75% and 36.75%. This estimate of course includes the impact of adopting the new revenue recognition standard in fiscal 2019, which – as I described earlier – impacts year-over-year comparability by approximately 60 basis points. Adjusted for this change, this mid-point gross margin forecast is approximately 125 basis points higher than the third quarter of last fiscal year. This forecast reflects the latest view for sequentially lower steel costs next quarter and a full quarter impact of tariffs on Chinese imports at the 10% level.

Operating expenses in the third quarter are expected to range between $177 million and $182 million.

We anticipate earnings per share to be between $0.59 and $0.63 for the period, and our assumed effective tax rate is between 20% to 22%.

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

[Q&A]

CLOSING – ANDI OWEN

Thanks for joining us on the call today. We appreciate your continued interest in Herman Miller and look forward to updating you again 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 and be well.

Forward Looking Statements

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 profit optimization 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, changes in future tax legislation or interpretation of current tax legislation, the ability to increase prices to absorb the additional costs of raw materials, changes in global tariff regulations, the financial strength of our dealers and the financial strength of our customers, our ability to locate new retail 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, our ability to integrate and benefit from acquisitions and investments, 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.