Herman Miller, Inc.
Third Quarter Fiscal 2017
Investor Conference Call
March 23, 2017

The following document is a replication of the notes used in Herman Miller, Inc.'s Third 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. I'd like to begin with an overview of our recent performance and key strategic initiatives, then hand the call over to Jeff and Kevin to review the financials in greater detail.

Yesterday, we announced our financial results for the third quarter of fiscal 2017. Consolidated sales and orders for the quarter were $525 million and $543 million, respectively, and GAAP earnings per share were $0.37. Revenue was within the range we expected and adjusted EPS of $0.39 exceeded our expectations due to well-managed operating expenses, in part as we began implementing a portion of the cost savings we alluded to last quarter.

While organic sales growth was flat compared to the same quarter last year, we were encouraged by the acceleration in consolidated order pacing throughout the quarter, which in total came in 5% above last year on an organic basis. When we look broadly at our business, the project-nature of the industry was reflected in order levels by segment. Strong order growth in the North America contract business was partially offset by lower demand levels in our Specialty and International businesses. The focused effort within our Consumer business to accelerate growth across digital, physical and wholesale channels continues to gain traction, and that business again delivered solid sales and order increases relative to last year.

Earlier in the quarter, we announced several changes to our organizational structure aimed at better positioning us to execute against our growth strategy. I'd like to highlight a few key aspects of this realignment. First, as we continue to increase our market opportunity through geographic and customer segment expansion, we're being deliberate in our efforts to identify and capitalize on the natural synergies between business segments. This will enable greater leverage of resources in our vertical segments, while continuing to allow us to bolster the strength of our individual brands. The realigned structure also increases our agility by placing more decision-making autonomy into the business units. We believe these changes will aid us in our cost structure – we know we need new investment in certain areas, and eliminating redundancies will help us fund those investments. With these objectives in mind, we made the following changes to our executive leadership team:

- Greg Bylsma was appointed President, North America Contract which brings together responsibility for the work, healthcare and education businesses.
- Ben Watson was appointed Chief Creative Officer, adding Research and Development to his existing responsibilities as Executive Creative Director.
- Steve Gane was appointed President, Specialty Brands, to lead the combined efforts of the Geiger, Herman Miller Collection, and Maharam businesses.
- And Jeremy Hocking, was named Executive Vice President of Strategy and Business Development, combining his existing responsibilities for strategic planning, M&A and channel development with Information Technology and Dealer Distribution.

Now, I'd like to share my perspective on the macro-environment and the performance of our individual business segments. The contract furniture industry in North America is mixed – industry data for sales and orders remains choppy, but macro indicators including service sector employment, architectural billings, and non-residential construction activity continue to be generally supportive and sentiment measures have moved positively since the U.S. election. The new administration's plans for lower taxes, cash repatriation, and capital investment incentives have the potential to drive employment and related investment spending over the longer term.

While revenue levels within our North America contract segment reflected the cautious atmosphere we saw throughout the first half of this fiscal year, the level and pace of new orders improved consistently throughout the quarter, and we ended the period up nearly 7% on an organic basis from the third quarter of last year. We are always cautious to reach conclusions on the basis of one quarter of activity, however this improvement does square with the project activity and contract activation levels we had been tracking earlier in the year. These same measures remained strong throughout the third quarter, which gives us some confidence that the improvement in order levels can be sustained in the near-

term. To be sure, the competitive pricing environment remains challenging, and we again felt the impact of higher price discounting on our sales and margins this quarter. This only highlights the need for us to remain diligent around driving productivity and efficiency improvements across the organization. This is something we've proven we have the ability to do well, and as I'll describe shortly, we are re-doubling our efforts here.

The Specialty segment reported organic sales and orders that were 2% and 4% lower, respectively, than the same quarter last year, as the project nature of the business impacted results. Order growth for the Herman Miller Collection and Maharam was offset by lower demand for Geiger, partially tied to a large project last year that created a challenging comparison. As we look to the future, we believe this segment is well positioned to serve as a growth and profit engine for our business, particularly as industry trends continue to embrace the inclusion of collaborative spaces in office design and a strong slate of product launches across each of the Specialty Brands, including the recently launched Maharam leather line.

The ELA business posted organic sales and orders that were slightly below last year. Lower demand in Asia-Pacific, Latin America and the Middle East was partially offset by solid growth from mainland Europe. While the weakening of the British Pound has had an unfavorable foreign currency translation impact on reported sales for the segment, demand in mainland Europe has benefitted from a relative cost advantage tied to our U.K. manufacturing operation where costs are largely Pound denominated. Despite persistent macro-economic and geopolitical headwinds, particularly from the lingering uncertainty in the U.K. and oil-producing regions such as the Middle East, the team is performing incredibly well. We continue to see higher long-term growth potential in Asia-Pacific, and we are poised for several new product launches for both the Herman Miller and POSH brands across the region. This includes expanding to new price points and product categories, including a broader assortment of collaborative furnishings such as those we have access to through our partnership with naughtone.

Moving on to our Consumer segment, while mortgage rates are beginning to rise, existing home sales and new housing starts are showing year-over-year improvement and the possibility of lower tax rates should benefit this sector as well. Our Consumer business mirrored this upswing, with sales and orders up 4% and 13% over last year, respectively. Order levels were concentrated toward the end of the quarter, as the initial week of the Design Within Reach Semi-Annual sale fell in the last week of the quarter. By comparison, last fiscal year this same event began in the first week of our fiscal fourth quarter. Admittedly, this shift in timing had a positive impact on the order comparison to last year. Normalizing for this change, the growth in orders over last year was closer to 10%.

Several factors are contributing to the improved demand picture within our Consumer business. First, we have greatly improved the efficiency of our direct-

to-consumer catalog program. Second, we've launched over 100 new proprietary products designed for DWR and Herman Miller this fiscal year, significantly enhancing our total offering with these higher margin designs. We also continue to expand the volume of DWR proprietary products sold through our contract dealer channel.

The expansion of our DWR real estate footprint continues to be a growth driver for the Consumer business as well. This quarter, we opened new studios in Portland, Oregon and Westport, Connecticut and have a larger, repositioned Atlanta studio under contract to open by the end of the fiscal year. Because we're opening new studios at a faster rate than in previous years, there is a drag on profitability from pre-opening costs and the ramp up it takes for new studios to build towards full productivity over the first twelve to eighteen months. This unfavorable impact to the Consumer business was approximately $2 million during the quarter. In addition, we have also been deliberate in putting in place the organizational structure and capability to realize the longer-term potential we see for growth across our Consumer channels. These are the right decisions for the business longer-term, but to be frank the tradeoff has been lower profitability in the short run. This is particularly acute during periods of relatively low sales volume, such as the third quarter. That being said, we continue to believe the value drivers to increase operating margins remain in place as we scale the Consumer business. We also believe there is an opportunity to reduce operational costs as we further integrate the consumer operations within the Herman Miller Group of Companies.

Before I turn the call over to Jeff to review the results in detail, I want to take a few minutes to highlight what our leadership team sees as the primary areas of focus for the business going forward:

- As I described, we've made targeted investments aimed at positioning our Consumer business for long-term profitable growth. This represents one of our top priorities, and we remain confident in our strategy of scaling the business by expanding our real estate footprint of Design Within Reach studios, increasing the mix of exclusive product offerings, and growing our contract, catalog and digital channels.

- Second, we are building on our Living Office solutions-based approach with a range of new products and services that address the entire floor plate, with emphasis on expanding our leadership in seating and increasing our offer for collaborative spaces. We also believe there is untapped potential to integrate a layer of technology to improve user experiences by delivering a comprehensive solution of furnishings and technology tools. We've partnered with several leading technology providers, A.V. integrators, and software developers to help our dealers deliver on this capability to customers. We are currently piloting programs in four markets, with plans to be fully operational by the end of FY18.

- Next, we are focused on the integration of our businesses to ensure optimal leverage of our dealer ecosystem and gain further share of the dealer wallet. Our goal is to reduce the friction that exists for our dealers so they can broadly access our growing product and brand portfolio in its entirety. Specifically, we're enhancing our order fulfillment technology within a universal digital environment that will enable dealers to view, specify, and order any product across the Herman Miller Group of Companies.

- As we mentioned last quarter, we are working on several cost savings initiatives. Our rationale is threefold:
    - We appear to be headed into an inflationary environment for both materials and wages, given recent increases in commodities and proposed tax reforms, and we want to get ahead of that.
    - While our long-term revenue outlook for mid-single digit organic growth has remained largely unchanged, we want to position the business to drive improved leverage during periods when sales growth falls below this level.
    - Third - we need to free up the operating headroom to fund our long-term growth initiatives without driving significant incremental cost into the business.

  We're developing a range of initiatives – some will have a near-term impact while others will be more structural in nature. While plans are still preliminary, we believe there is a $25 million to $35 million opportunity that will phase in over the next three years. As I said, some of these savings will offset inflationary pressures and fund needed investments, but we do expect to realize improved profitability as a result. Net – we believe these initiatives will help us deliver consolidated operating margins above 10% within the next three years.

- Finally, as we've aligned our creative direction and new product commercialization under common leadership, we'll expand our innovation agenda by reducing our time to market and ensure that development is focused on the customer's most critical needs, while at the same time fueling synergies between these activities.
    - With our industry leading R&D investment and capabilities in key regions across the world, we have been developing a robust product development pipeline to meet the increasingly varied demands of the market. The remastered Aeron chair headlines a slate of recent and upcoming product launches worldwide, including Keyn Chair Group, Layout Studio 2.0, and Ubi Work Tools, which add functionality to any work station in the form of thoughtful storage, personal tools and power access. In addition, our International, Specialty and Consumer teams will launch a number of new products developed specifically for their markets.

Ultimately, what we've done is marry the most comprehensive product offer in the industry with an unrivaled multi-channel capability, which enables us to serve a broad and unique audience of A&D, dealers, consumers, and large contract customers. We back this up with a regional operating footprint that enables us to provide a fast and reliable service to our customers and dealers around the globe. We don't believe anyone else has our breadth of reach.

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

Q3 FINANCIAL REVIEW – JEFF STUTZ, CFO

Thanks, Brian and good morning everyone.

Consolidated net sales in the third quarter of $525 million were 2% below the same quarter last year. On an organic basis, which excludes the impact of foreign currency translation and dealer divestitures, sales were essentially flat with last year's level. Orders in the period of $543 million were 7% higher than the same quarter last year. As we outlined in our press release yesterday afternoon, we believe the timing of our most recent price increase had an impact on order pacing between our third and fourth quarters. At the beginning of February, we increased our general list prices an average of 2%. As a result, we estimate orders totaling approximately $21 million were pulled ahead into the third quarter that would have otherwise entered in Q4. On an organic basis, which includes adjusting for this pull-ahead impact, orders increased approximately 5% from the third quarter of last year.

This impact was also reflected in our reported backlog for the quarter – which was 6% higher than last year. The backlog last year included approximately $25 million in orders related to dealers that have been subsequently divested, including the sale of a dealer based in Australia at the start of this fiscal year, and the sale of a dealer based in Philadelphia earlier this quarter. Excluding the impacts from dealer divestitures and order pull ahead, backlog ended the third quarter more than 7% higher than last year, evidencing the strong order pacing during the back half of the quarter.

Within our North American segment, sales were $310 million in the third quarter, representing a decrease of 1% from the same quarter last year. New orders in this segment were $333 million in the quarter, reflecting an increase of 12% from last year. On an organic basis, adjusting for the Philadelphia dealer sale and foreign exchange translation, revenue was slightly below the same quarter last year, while orders were 7% higher. Orders from project sizes below $1 million were higher compared to last year, while projects above $1 million in size were slightly down year-on-year. Order growth during the quarter was led by business services, manufacturing and federal, state and local government, while there was lower demand in the computer hardware, chemical and pharmaceutical sectors.

Our ELA segment reported sales of $88 million in the third quarter, reflecting a decrease of 11% compared to last year. New orders totaled $86 million, an amount 10% 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 1% below last year, while on this same measure new orders decreased approximately 2%. This year-over-year order decline was primarily due to lower demand levels in the Middle East, where we are seeing fewer large project opportunities, and in Mexico and India, both of which we attribute simply to project timing. This was partially offset by strong demand in continental Europe and Japan.

Sales in the third quarter within our Specialty segment were $54 million, a decrease of 1% from the same quarter last year. New orders in the quarter of $52 million were 3% lower than the year ago period. Excluding the impact of the price increase on orders, organic order demand was 5% lower than last year. The decrease in orders was primarily due to challenging prior year comparisons and a general slowdown in activity for the Geiger business. This was partially offset by order growth for the Herman Miller Collection and Maharam businesses.

The Consumer business reported sales in the quarter of $73 million, an increase of 4% compared to last year. New orders for the quarter of $73 million were 13% ahead of the same quarter last year, although partially impacted by the timing of the promotional event that Brian described earlier. On a comparable brand basis, DWR revenues for the quarter were up by 3%.

Consolidated gross margin in the third quarter was 37.2%, which was 150 basis points lower than the third quarter last year. On a year-over-year basis we continue to feel the impact of comparatively deeper discounting and higher steel prices. The price increase at the beginning of February was targeted at products most impacted by commodity pressures. These factors were partially offset by lower incentive-based compensation.

Operating expenses in the third quarter were $158 million compared to $164 million in the same quarter a year ago. The prior year included approximately $3 million in expenses related to dealers divested this fiscal year. After adjusting for those expenses, operating expenses were $3 million below last year due to lower levels of incentive based compensation, a pretax gain of $700,000 recognized in conjunction with the divestiture of our Philadelphia dealership and the broader effort to begin realizing the cost savings opportunities that our teams have identified. These reductions were partially offset by higher occupancy and staffing costs related to new DWR studios.

Additionally, restructuring actions involving certain workforce reductions that were announced in the third quarter resulted in the recognition of severance and outplacement expenses totaling approximately $2.7 million.

On a GAAP basis, we reported operating earnings of $35 million this quarter. Excluding restructuring charges and the gain from the dealer divestiture, adjusted operating earnings this quarter were $37 million, or 7% of sales, compared to $44 million, or 8.3% of sales, in the prior year period.

The effective tax rate was 29.8% in the third quarter of both fiscal years.

Finally, net earnings in the third quarter totaled $23 million, or $0.37 per share on a diluted basis. Excluding the impact of restructuring expenses and the gain from the dealer divestiture, adjusted diluted earnings per share this quarter totaled $0.39. This compares to earnings of $0.46 per share in the third 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 $78 million, which reflected an increase of $7 million from last year. Cash flows from operations in the period were $28 million compared to $53 million in the same quarter of last year. Changes in working capital balances resulted in a net cash outflow of $17 million this quarter, driven primarily by lower accounts payable and accrued liabilities, along with higher inventory levels. By comparison, in the year ago period, changes in working capital drove a net cash inflow of approximately $5 million.

Capital expenditures were $24 million in the quarter and $70 million year-to-date. We anticipate capital expenditures of $90 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. Since November 2015, our share repurchase activity has been primarily aimed at offsetting dilution. However, we have recently increased our target for cash returns to investors, a metric which we measure by interest expense, dividend payments and share repurchases as a percent of trailing three year EBITDA. While investing in our business remains our number one priority, based on our strong cash flow generation and consistent with our goals of delivering improved shareholder value, we have increased our target for cash returns to investors from 20 to 25% of EBITDA to 30 to 35% of EBITDA. While we have an upcoming capital structure review with the Board to finalize the specifics of the approach we will take, we expect to achieve this target through a combination of higher dividends and share repurchase activity.

We remain in compliance with all debt covenants and as of quarter-end our gross-debt to EBITDA ratio was approximately 0.9 to 1. The available capacity on our bank credit facility stood at $357 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. As a reminder, we also entered into a forward starting interest rate swap in September 2016 with a notional amount of $150 million that will be effective in January 2018. While the swap does not impact our interest expense in fiscal 2017, it will fix our interest rate on that portion of our debt at 2.8% and reduce our annual interest expense run rate by approximately $5 million starting in January 2018. 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 fourth quarter of fiscal 2017.

OUTLOOK – JEFF STUTZ

Thanks Kevin….

With respect to the forecast, we anticipate sales in the fourth quarter to range between $575 million and $595 million. We estimate the year-over-year unfavorable 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 4% compared to last year at the mid-point of the range.

As mentioned earlier, we sold our Philadelphia contract dealership at the beginning of January. This transaction will impact year-over-year sales and order comparisons going forward. Net of intercompany eliminations, that dealer contributed approximately $6 million of revenue in Q4 of last year and $25 million of revenue on an annual basis.

Consolidated gross margin in the fourth quarter is expected to range between 37.0% and 38.0%, reflecting the sequential improvement in gross margin in the fourth quarter from production leverage on higher sales volumes.

Operating expenses in the fourth quarter are expected to range between $165 million and $169 million.

We anticipate earnings per share to be between $0.53 and $0.57 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. Have a great day.