Herman Miller, Inc.
Third Quarter Fiscal 2020
Investor Conference Call
March 18, 2020

The following document is a replication of the notes used in Herman Miller, Inc.'s Third Quarter Fiscal 2020 conference call presentation. Andi Owen, President and Chief Executive Officer; Jeff Stutz, Chief Financial Officer; Greg Bylsma, President – North America & Global Operations, 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 evening and welcome to Herman Miller's third quarter earnings conference call. As a reminder, this 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 evening everyone. Joining me today on our third quarter earnings call are Andi Owen, our President and Chief Executive Officer, Jeff Stutz, our Chief Financial Officer, and Greg Bylsma, our President of North America and Global Operations.

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 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 as well as our annual and quarterly SEC filings. Any forward-looking statements that we make today are based on assumptions as of this date and we undertake no obligation to update these statements as a result of new information or future events.

At the conclusion of our prepared remarks, we will have a Q&A session. Today's call is scheduled for 60 minutes. With that, I'll now turn the call over to Andi.

ANDI OWEN, PRESIDENT AND CEO

Good evening, everyone, and thank you for joining us. Since we spoke with you last quarter, uncertainty and associated market volatility have clearly accelerated as the coronavirus outbreak has spread across the globe. With that in mind, I'll begin our remarks today with our perspective on the current environment, followed by an overview of our financial results for the quarter and an update on our strategic progress. Before I turn it over to Jeff and Kevin for further information on our financial results, Greg Bylsma, who not only leads our North America Contract business, but also oversees our global manufacturing operations, will share more details on how we are managing the coronavirus situation.

Moving to our perspective on the current environment, first and foremost, our hearts go out to the individuals and families around the world that have thus far been directly impacted by coronavirus. Our top priority right now at Herman Miller is to keep our employees and communities safe and healthy and we are taking every precaution to do so.

As we manage our business through this fluid situation, we are focused on the factors that we can control. We are monitoring our global footprint around the clock and have developed detailed contingency plans. Given the outbreak began in China and our third quarter results were most impacted in Asia-Pacific, let me provide some background on our footprint there. The Asia-Pacific region, which is served by manufacturing operations in Dongguan, China and Bidadi, India, represents approximately 8% of consolidated sales. Across the globe, 10% to 11% of our cost of goods sold are sourced from China. As the number of new cases in this region of the world decline, our Dongguan manufacturing operations are nearing full capacity and our key suppliers in China are producing and shipping products for all regions of the world. At the same time, we are proactively leveraging our team's efforts in China and applying that learning to our efforts to mitigate our exposure in North America and Europe.

Against this backdrop, the demand picture was mixed during the quarter. Sales in the period were 8% higher than last year as the consolidation of the HAY and naughtone brands contributed to reported growth. On an organic basis, sales were slightly below the same quarter last year. Our North America and Retail businesses delivered modest organic sales growth, while shipments from our China facilities were unfavorably impacted by the broad-based government-mandated shutdown following the virus outbreak. Reported order levels this quarter were 6% higher than last year, while 1% lower than last year on an organic basis.

Despite the relative softness we experienced on the top-line, our teams did a great job managing costs and we were very encouraged by the overall level of profitability we generated in the quarter. We continued to drive year-over-year gross margin improvement in our business. Favorable price realization, lower commodity costs, and our profitability improvement efforts were the primary drivers of gross margin expansion over last year. As a result, we delivered another quarter of adjusted operating margin expansion, with an increase of 110 basis points over the same quarter last year. Earnings per share on a GAAP basis were $0.64, while adjusted EPS, which excluded the impact of restructuring and other special charges, totaled $0.74 in the quarter. This reflected an increase of 16% over the same quarter last year.

In addition to delivering on our earnings commitment for the quarter, we drove positive momentum toward our strategic priorities. Let me share some of the highlights.

First, on the innovation front, we've leveraged our leadership in high performance seating by establishing recent partnerships with the e-Sports organization *Complexity Gaming* and *Logitech*, an industry leader in gaming gear. While these partnerships are in the early days, they represent an opportunity to bring our ergonomics expertise to the e-Sports arena and highlight how our deep knowledge and research can be applied to new audiences in rapidly growing markets.

Creating digital solutions that are aimed at improving our customer experience is one of our top priorities. As part of that effort, we made significant progress on our journey to refresh our ecommerce platforms. New page designs for DWR.com have been completed as part of our plans to re-launch DWR.com in the first quarter of next year. We also launched a number of ecommerce improvements on our platforms in North America, including chat and video functionality to communicate with our customer care teams, and a next generation financing option which we've deployed on HermanMiller.com and HAY.com. These new designs and functionality upgrades will result in a much-improved customer experience, which we believe will translate to higher conversion rates.

More broadly across our Retail business, as we mentioned last quarter, Debbie Propst joined us in January to lead the business and she is hitting the ground running. As she initially spent a lot of time listening and learning, she and her team are already developing a number of work streams around areas like brand marketing and merchandising assortments that will drive top- and bottom-line growth for the Retail business. With her deep background in global retail brands, we're excited to have her on board and expect Debbie to join us on an upcoming call to share more about her progress. I would like to call out one highlight from the quarter. One of the pillars for accelerating profitable growth in our Retail business is joining with leading designers to launch higher margin exclusive designs. Through our partnership with Egg Collective – a firm led by three award-winning female designers – the Emmy sofa is already our top selling sofa line since its launch in the second quarter of this year.

And finally, I'm pleased to report that our North America profitability improvement initiative continues to deliver benefits to our bottom line. We finished the quarter at a run rate of $44 million of benefits this quarter, which means we exceeded our goal of $20 to $40 million savings that we established when we began this work two years ago. Our efforts around pricing analysis and strategic sourcing have been particularly meaningful to this effort, and we'll be leveraging our learnings and successes into other parts of our business.

While we remain confident in our plans for sustainable long-term growth for Herman Miller, given the rapidly changing environment surrounding coronavirus, we are not following our typical practice of providing quarterly guidance for the upcoming fourth quarter given the difficulties of estimating near-term demand. Navigating the coronavirus situation will require flexibility, resilience and an ability to balance our long-term objectives with the challenges we face today.

With that, let me turn the call over to Greg to provide an update on the impact of the coronavirus on our global operations.

GREG BYLSMA, PRESIDENT – NORTH AMERICA CONTRACT

Thanks, Andi. I would like to reiterate that our people and their safety and wellness are at the heart of our effort around coronavirus. We have a significant number of initiatives in place right now across the organization. Within operations, some of the actions we have taken include increasing the frequency and scope of our facility cleaning, staggering break periods and increasing the time between shifts for manufacturing teams and changing the structure of our work to allow for social distancing in work cells. Additionally, we are providing health guidance to help our employees stay well and understand the symptoms to look for, and, if they are not feeling well, encouraging them to stay home and removing barriers they may face in making that choice.

As Andi mentioned, we felt the initial impact of the coronavirus situation this past quarter in the Asia-Pacific region, driven by government-mandated delays returning from the Chinese New Year. Our factories in the Dongguan region were closed for an additional full week, which caused a delay in shipments which reduced net sales in the period by an estimated $6 million for the International business segment. As workers have been returning over the past few weeks, our manufacturing operations and those of our key suppliers in the region are nearing full capacity, and we are working to catch up on the missed production.

Our manufacturing facility in India has also been able to help meet a portion of customer demand in the region.

As coronavirus has spread across our global markets, we have put in place contingency plans to ensure we support our customers, maintain the supply of critical product lines, and address potential disruption at key suppliers. As this remains a fast-moving situation, we are meeting regularly to assess any new issues within our manufacturing or supply chains, as well as to ensure risk mitigation plans are fully implemented. With that background on our response, I'll now turn the call over to Jeff to cover the financial details from the third quarter.

FINANCIAL REVIEW – JEFF STUTZ, CFO

Thanks Greg and good evening everyone.

Consolidated net sales in the third quarter of $665.7 million were 8% above the same quarter last year on a reported basis and slightly below last year organically. Reported orders in the period of $652 million were 6% above last year on a reported basis and 1% below the prior year on an organic basis.

Within our North American Contract segment, sales were $413 million in the third quarter, representing an increase of 4% from last year on a GAAP basis and an organic increase of nearly 3%. New orders of $406 million in the quarter were 4% higher than last year on a reported basis and up 2% organically. Order patterns in this segment reflected growth in larger project sizes, while smaller and medium project activity were lower. From a sector standpoint, we saw order growth in the U.S. Federal Government, Healthcare and Energy sectors, partially offset by lower demand in Financial Services.

Our International Contract segment reported a 24% increase in sales to $156 million in the third quarter. New orders of $159 million were 26% above the same quarter last year. Reported sales and orders reflect the impact of our recent step acquisitions of HAY and naughtone. Collectively, the consolidation of these entities contributed approximately $50 million of net sales to our results in the quarter. On an organic basis, which excludes the impact of these acquisitions, net sales and orders in the International segment decreased 10% and 7%, respectively, from the third quarter of last year.

The unfavorable impact from the mandated factory shutdown at our facilities in Dongguan, China reduced the International growth rate by approximately five percentage points for the quarter. In addition to this pressure, the International business faced particularly challenging sales growth comparisons for the quarter. In the third quarter of last year, this segment of our business posted organic order growth of 24%. On a two-year basis, organic sales growth has averaged 8.5%. Given the difficult comparison, organic order declines were fairly broad-based, except for higher order levels in Japan and mainland Europe during the quarter.

Our Retail business segment reported sales in the quarter of $96 million, which were flat compared to the same quarter last year. New orders for the quarter of $86 million were down 9% on a year-over-year basis. It's important to clarify that this order comparison to last year was significantly impacted by a timing difference in our retail promotion calendar. Specifically, the timing of our *Herman Miller* product sale was shifted this year and as a result our third quarter included 6 fewer days than it did a year ago. Normalizing for this timing difference, we estimate orders this quarter would have been approximately 1% lower than the same quarter last year.

Consolidated gross margin in the third quarter was 36.5% and includes certain adjustments related to the initial purchase accounting for HAY. Excluding these items, adjusted gross margin of 36.8% was 110 basis points higher than last year. Favorable price realization, lower steel costs, and our ongoing profitability improvement efforts all contributed to gross margin expansion.

Operating expenses in the third quarter of $189 million compared to $173 million in the same quarter a year ago. The current quarter included $5 million of special charges primarily related to transaction expenses and purchase accounting adjustments associated with the HAY and naughtone investments. By comparison, we recorded special charges totaling $0.5 million in the third quarter of last fiscal year. Exclusive of these items, the year-over-year increase in operating expenses of $12 million resulted mainly from the impact of consolidating HAY and naughtone.

Restructuring charges recorded in the third quarter totaled $3.5 million and related to actions associated with our profit improvement initiatives.

On a GAAP basis, we reported operating earnings of $50 million this quarter, compared to operating earnings of $48 million in the year ago period. Excluding restructuring and other special charges, adjusted operating earnings this quarter were $60 million, or 9.0% of sales. By comparison, we reported adjusted operating income of $49 million, or 7.9% of sales, in the third quarter of last year.

The effective tax rate in the third quarter was 22.4%.

Finally, net earnings in the third quarter totaled $38 million, or $0.64 per share on a diluted basis, compared to $39 million, or $0.66 per share in the same quarter last year. On an adjusted basis, earnings per share this quarter totaled $0.74 compared to adjusted earnings of $0.64 per share last year.

With that, I'll 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 $111 million, which was $66 million lower than cash on hand last quarter, primarily related to the $79 million investment in HAY at the beginning of the quarter. Cash flows from operations in the third quarter were $49 million, reflecting an increase of 26% over the same quarter of last year. Lower working capital was the key driver of higher operating cash flows, primarily due to decreased inventory and prepaid expenses levels.

Capital expenditures were $18 million in the quarter. Cash dividends paid in the quarter were $12 million, while shares repurchased totaled $18 million for the quarter.

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 $266 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 weather the near-term market volatility and meet the financing needs of the business moving forward.

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

GUIDANCE COMMENTARY – JEFF STUTZ

Thanks, Kevin. As Andi mentioned, the rapidly changing situation surrounding global mitigation efforts around COVID-19 make it too difficult to estimate the near-term impact on our business. As such, we are not following our typical practice of offering sales and earnings guidance for the fourth quarter.

With that being said, there are a few data points that we can share.

To begin, we enter the fourth quarter with a consolidated backlog of $411 million, which is up approximately 3% from last year. As a general rule, our backlog typically represents approximately 6 weeks of shipments as we head into a new reporting period.

To provide a sense for current activity levels, through the first two weeks of the fourth quarter, our consolidated sales were up approximately 6% from last year, while new orders were *down* closer to 3%

To date, we have received minimal requests from customer and dealers to adjust the timing of scheduled shipments – both in the U.S. and abroad – though we would expect this to increase. However, we have not (to date) experienced any meaningful order cancellations and would expect to ship the majority of our backlog within the fourth quarter.

With that additional commentary, I'll now turn the call back over to the operator and we will take 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. In the meantime, please join us in helping our communities stay safe and healthy.

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, natural disasters, public health crises, disease outbreaks 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.