

HNI CORP  
Form 10-Q  
August 03, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended July 1, 2006

OR

/  TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-2648

HNI Corporation  
(Exact name of Registrant as specified in its charter)

Iowa  
(State or other jurisdiction of  
incorporation or organization)

42-0617510  
(I.R.S. Employer  
Identification Number)

P. O. Box 1109, 408 East Second Street  
Muscatine, Iowa 52761-0071  
(Address of principal executive offices)

52761-0071  
(Zip Code)

Registrant's telephone number, including area code: 563/272-7400

Indicate by check mark whether the registrant (1) has filed all required reports to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

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required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

| Class                        | Outstanding at July 1, 2006 |
|------------------------------|-----------------------------|
| Common Shares, \$1 Par Value | 50,091,315                  |

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HNI Corporation and SUBSIDIARIES

INDEX

PART I. FINANCIAL INFORMATION

|   | Page |
|---|------|
| Item 1. Financial Statements (Unaudited)  |      |
| Condensed Consolidated Balance Sheets July 1, 2006, and December 31, 2005                       | 3    |
| Condensed Consolidated Statements of Income Three Months Ended July 1, 2006, and July 2, 2005   | 5    |
| Condensed Consolidated Statements of Income Six Months Ended July 1, 2006, and July 2, 2005     | 6    |
| Condensed Consolidated Statements of Cash Flows Six Months Ended July 1, 2006, and July 2, 2005 | 7    |
| Notes to Condensed Consolidated Financial Statements  | 8    |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations   | 18   |
| Item 3. Quantitative and Qualitative Disclosure about Market Risk                               | 23   |
| Item 4. Controls and Procedures   | 23   |

PART II. OTHER INFORMATION

|                           |    |
|---------------------------|----|
| Item 1. Legal Proceedings | 24 |
|---------------------------|----|

|  |    |
|--|----|
| Item 1A. Risk Factors  | 24 |
| Item 2. Unregistered Sales of Securities and Use of Proceeds | 24 |
| Item 3. Defaults Upon Senior Securities - None               | -  |
| Item 4. Submission of Matters to a Vote of Security Holders  | 25 |
| Item 5. Other Information - None                             | -  |
| Item 6. Exhibits   | 25 |
| SIGNATURES   | 26 |
| EXHIBIT INDEX  | 27 |

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements (Unaudited)

HNI Corporation and SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

|  | Jul. 1,<br>2006<br>(Unaudited)<br>(In thousands) | Dec. 31,<br>2005 |
|--|--|------------------|
| <b>ASSETS</b>                                  |  |                  |
| <b>CURRENT ASSETS</b>                          |  |                  |
| Cash and cash equivalents                      | \$ 26,934  | \$ 75,707        |
| Short-term investments                         | 8,820  | 9,035            |
| Receivables                                    | 314,471  | 278,515          |
| Inventories (Note C)                           | 112,487  | 91,110           |
| Deferred income taxes                          | 16,413   | 15,831           |
| Prepaid expenses and other current assets      | <u>17,232</u>                                    | <u>16,400</u>    |
| Total Current Assets                           | 496,357  | 486,598          |
| <b>PROPERTY, PLANT, AND EQUIPMENT, at cost</b> |  |                  |
| Land and land improvements                     | 27,165   | 26,361           |
| Buildings                                      | 258,730  | 240,174          |
| Machinery and equipment                        | 535,693  | 523,240          |
| Construction in progress                       | <u>21,131</u>                                    | <u>23,976</u>    |
|  | 842,719  | 813,751          |
| Less accumulated depreciation                  | <u>529,175</u>                                   | <u>519,091</u>   |
| Net Property, Plant, and Equipment             | 313,544  | 294,660          |
| <b>GOODWILL</b>                                | 253,723  | 242,244          |
| <b>OTHER ASSETS</b>                            | <u>165,326</u>                                   | <u>116,769</u>   |

|              |                     |                     |
|--------------|---------------------|---------------------|
| Total Assets | <u>\$ 1,228,950</u> | <u>\$ 1,140,271</u> |
|--------------|---------------------|---------------------|

See accompanying Notes to Condensed Consolidated Financial Statements.

HNI Corporation and SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

|   | Jul. 1,<br>2006<br>(Unaudited)                        | Dec. 31,<br>2005    |
|---|---|---------------------|
| LIABILITIES AND SHAREHOLDERS' EQUITY  | (In thousands, except share and per share value data) |                     |
| <b>CURRENT LIABILITIES</b>  |   |                     |
| Accounts payable and accrued expenses   | \$ 312,682  | \$ 307,952          |
| Income taxes  | 8,297   | 1,270               |
| Note payable and current maturities of long-term debt   | 80,306  | 40,350              |
| Current maturities of other long-term obligations   | <u>3,605</u>  | <u>8,602</u>        |
| Total Current Liabilities   | 404,890   | 358,174             |
| <b>LONG-TERM DEBT</b>   | 205,550   | 103,050             |
| <b>CAPITAL LEASE OBLIGATIONS</b>  | 757   | 819                 |
| <b>OTHER LONG-TERM LIABILITIES</b>  | 49,845  | 48,671              |
| <b>DEFERRED INCOME TAXES</b>  | 26,870  | 35,473              |
| <b>MINORITY INTEREST IN SUBSIDIARY</b>  | 576   | 140                 |
| <b>SHAREHOLDERS' EQUITY</b>   |   |                     |
| Capital Stock:  |   |                     |
| Preferred, \$1 par value, authorized<br>2,000,000 shares, no shares outstanding   | -   | -                   |
| Common, \$1 par value, authorized<br>200,000,000 shares, outstanding -<br>2006 - 50,091,315 shares;<br>2005 - 51,848,591 shares | 50,091  | 51,849              |
| Paid-in capital   | 2,296   | 941                 |
| Retained earnings   | 488,689   | 540,822             |
| Accumulated other comprehensive income  | <u>(614)</u>  | <u>332</u>          |
| Total Shareholders' Equity  | <u>540,462</u>  | <u>593,944</u>      |
| Total Liabilities and Shareholders' Equity  | <u>\$ 1,228,950</u>                                   | <u>\$ 1,140,271</u> |

See accompanying Notes to Condensed Consolidated Financial Statements.

HNI Corporation and SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

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(Unaudited)

|  | Three Months Ended                                 |                 |
|--|--|-----------------|
|  | Jul. 1,<br>2006                                    | Jul. 2,<br>2005 |
|  | (In thousands, except share<br>and per share data) |                 |
| Net sales  | \$ 671,271   | \$ 594,168      |
| Cost of sales  | <u>436,758</u>                                     | <u>379,880</u>  |
| Gross profit   | 234,513  | 214,288         |
| Selling and administrative expenses                                    | 185,774  | 160,146         |
| Restructuring and impairment charges                                   | <u>228</u>   | <u>-</u>        |
| Operating income   | 48,511   | 54,142          |
| Interest income  | 192  | 441             |
| Interest expense   | <u>3,617</u>                                       | <u>343</u>      |
| Earnings before income taxes and minority interest                     | 45,086   | 54,240          |
| Income taxes   | <u>16,457</u>                                      | <u>19,255</u>   |
| Earnings before minority interest                                      | 28,629   | 34,985          |
| Minority interest in earnings of subsidiary                            | <u>(23)</u>  | <u>-</u>        |
| Net income   | \$ 28,652  | \$ 34,985       |
| Net income per common share - basic                                    | \$0.56   | \$0.63          |
| Average number of common shares outstanding - basic                    | 51,009,288   | 55,130,985      |
| Net income per common share - diluted                                  | \$0.56   | \$0.63          |
| Average number of common shares outstanding - diluted                  | 51,339,367   | 55,512,902      |
| Cash dividends per common share  | \$0.18   | \$0.155         |
| See accompanying Notes to Condensed Consolidated Financial Statements. |  |                 |

HNI Corporation and SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)

|  | Six Months Ended                                   |                 |
|--|--|-----------------|
|  | Jul. 1,<br>2006                                    | Jul. 2,<br>2005 |
|  | (In thousands, except share<br>and per share data) |                 |
| Net sales  | \$1,319,948  | \$1,156,429     |
| Cost of sales                                      | 855,825  | 746,296         |
| Gross profit                                       | 464,123  | 410,133         |
| Selling and administrative expenses                | 367,784  | 315,546         |
| Restructuring and impairment charges               | 1,947  | -               |
| Operating income                                   | 94,392   | 94,587          |
| Interest income                                    | 471  | 980             |
| Interest expense                                   | 5,004  | 827             |
| Earnings before income taxes and minority interest | 89,859   | 94,740          |
| Income taxes                                       | 32,799   | 33,633          |

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|   |            |            |
|---|------------|------------|
| Earnings before minority interest                     | \$ 57,060  | \$ 61,107  |
| Minority interest in earnings of subsidiary           | (62)       | -          |
| Net income  | \$ 57,122  | \$ 61,107  |
| Net income per common share - basic                   | \$1.11     | \$1.11     |
| Average number of common shares outstanding - basic   | 51,422,647 | 55,153,394 |
| Net income per common share - diluted                 | \$1.10     | \$1.10     |
| Average number of common shares outstanding - diluted | 51,781,098 | 55,502,312 |
| Cash dividends per common share                       | \$0.36     | \$0.31     |

See accompanying Notes to Condensed Consolidated Financial Statements.

HNI Corporation and SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

|  | Six Months Ended |                 |
|--|------------------|-----------------|
|  | Jul. 1, 2006     | Jul. 2, 2005    |
|  | (In thousands)   |                 |
| Net Cash Flows From (To) Operating Activities:                           |                  |                 |
| Net income   | \$ 57,122        | \$ 61,107       |
| Noncash items included in net income:                                    |                  |                 |
| Depreciation and amortization  | 34,857           | 33,385          |
| Other postretirement and post employment benefits                        | 1,055            | 1,001           |
| Excess tax benefits from stock compensation                              | (720)            | -               |
| Deferred income taxes  | (9,090)          | (7,553)         |
| Loss on sale, retirement and impairment of property, plant and equipment | 344              | 982             |
| Stock issued to retirement plan  | 7,948            | 6,199           |
| Other - net  | 3,934            | 706             |
| Net increase (decrease) in non-cash operating assets and liabilities     | (60,053)         | (37,868)        |
| Increase (decrease) in other liabilities                                 | (4,531)          | (1,687)         |
| Net cash flows from (to) operating activities                            | <u>30,866</u>    | <u>56,272</u>   |
| Net Cash Flows From (To) Investing Activities:                           |                  |                 |
| Capital expenditures   | (32,683)         | (15,333)        |
| Proceeds from sale of property, plant and equip.                         | 965              | 231             |
| Capitalized software   | (490)            | (2,162)         |
| Acquisition spending, net of cash acquired                               | (64,120)         | (10,093)        |
| Short-term investments - net   | 926              | 2,400           |
| Purchase of long-term investments  | (6,300)          | (28,177)        |
| Sales or maturities of long-term investments                             | 3,900            | 27,655          |
| Other-net  | -                | (255)           |
| Net cash flows from (to) investing activities                            | <u>(97,802)</u>  | <u>(25,734)</u> |

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|  |                 |                 |
|--|-----------------|-----------------|
| Net Cash Flows From (To) Financing Activities:                         |                 |                 |
| Proceeds from sales of HNI Corporation common stock                    | 2,908           | 11,933          |
| Purchase of HNI Corporation common stock                               | (107,858)       | (24,934)        |
| Excess tax benefits from stock compensation                            | 720             | -               |
| Proceeds from long-term debt   | 411,675         | 29,000          |
| Payments of note and long-term debt and other financing                | (270,728)       | (29,340)        |
| Dividends paid   | <u>(18,554)</u> | <u>(17,128)</u> |
| Net cash flows from (to) financing activities                          | 18,163          | (30,469)        |
|  |                 |                 |
| Net increase (decrease) in cash and cash equivalents                   | (48,773)        | 69              |
| Cash and cash equivalents at beginning of period                       | <u>75,707</u>   | <u>29,676</u>   |
|  |                 |                 |
| Cash and cash equivalents at end of period                             | \$ 26,934       | \$ 29,745       |
| See accompanying Notes to Condensed Consolidated Financial Statements. |                 |                 |

HNI Corporation and SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

July 1, 2006

Note A. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The December 31, 2005 consolidated balance sheet included in this Form 10-Q was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six-month period ended July 1, 2006 are not necessarily indicative of the results that may be expected for the year ending December 30, 2006. For further information, refer to the consolidated financial statements and footnotes included in HNI Corporation's (the "Corporation") annual report on Form 10-K for the year ended December 31, 2005.

Note B. Stock-Based Compensation

Under the Corporation's 1995 Stock-Based Compensation Plan (the "Plan"), as amended and restated effective November 10, 2000, the Corporation may award options to purchase shares of the Corporation's common stock and grant other stock awards to executives, managers, and key personnel. As of July 1, 2006 there are approximately 2.5 million shares available for future issuance under the Plan. The Plan is administered by the Human Resources and Compensation Committee of the Board of Directors. Restricted stock awarded under the Plan is expensed ratably over the vesting period of the awards. Stock options awarded to employees under the Plan must be at exercise prices equal to or exceeding the fair market value of the Corporation's common stock on the date of grant. Stock options are

generally subject to four-year cliff vesting and must be exercised within 10 years from the date of grant.

The Corporation also has a shareholder approved Members' Stock Purchase Plan (the "MSP Plan"). The price of the stock purchased under the MSP Plan is 85% of the closing price on the applicable purchase date. During the six months ended July 1, 2006, 53,194 shares of common stock were issued under the MSP Plan at an average price of \$43.64.

The Corporation adopted the provisions of Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" ("SFAS 123(R)"), beginning January 1, 2006, using the modified prospective transition method. This statement requires the Corporation to measure the cost of employee services in exchange for an award of equity instruments based on the grant-date fair value of the award and to recognize cost over the requisite service period. Under the modified prospective transition method, financial statements for periods prior to the date of adoption are not adjusted for the change in accounting.

Prior to January 1, 2006, the Corporation used the intrinsic value method to account for stock-based employee compensation under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and therefore did not recognize compensation expense in association with options granted at or above the market price of common stock at the date of grant.

As a result of adopting the new standard, earnings before income taxes for the three months ended July 1, 2006 decreased by \$0.8 million, and net earnings decreased by \$0.5 million, or \$.01 per basic share and \$.01 per diluted share. These results reflect stock compensation expense of \$0.8 million and tax benefits of \$0.3 million for the period. Earnings before income taxes for the six months ended July 1, 2006 decreased by \$1.6 million, and net earnings decreased by \$1.0 million, or \$.02 per basic share and \$.02 per diluted share. These results reflect stock compensation expense of \$1.6 million and tax benefits of \$0.6 million for the period.

Adoption of the new standard also affected the presentation of cash flows. The change is related to tax benefits associated with tax deductions that exceed the amount of compensation expense recognized in the financial statements. For the six months ended July 1, 2006, cash flow from operating activities was reduced by \$0.7 million and cash flow from financing activities was increased by \$0.7 million as a result of the new standard.

Concurrent with the adoption of the new statement, the Corporation began to use the non-substantive vesting period approach for attributing stock compensation to individual periods. The nominal vesting period approach was used in determining the stock compensation expense for the Corporation's pro forma net earnings disclosure for the three and six months ended July 2, 2005, as presented in the table that follows. The change in the attribution method will not affect the ultimate amount of stock compensation expense recognized, but it has accelerated the recognition of such expense for non-substantive vesting conditions, such as retirement eligibility provisions. Under both approaches, the Corporation elected to recognize stock compensation on a straight-line basis.

The following table presents a reconciliation of reported net earnings and per share information to pro forma net earnings and per share information that would have been reported if the fair value method had been used to account for stock-based employee compensation last year:

|  | Three Months<br>Ended<br><u>July 2, 2005</u> | Six Months<br>Ended<br><u>July 2, 2005</u> |
|--|--|--|
| (in thousands)   |  |  |
| Net income, as reported  | \$ 34,985                                    | \$ 61,107                                  |
| Deduct: Total stock-based employee<br>compensation expense determined under fair<br>value based method for all awards, net of<br>related tax effects | <u>(456)</u>                                 | <u>(890)</u>                               |



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|                       |           |           |
|-----------------------|-----------|-----------|
| Pro forma net income  | \$ 34,529 | \$ 60,217 |
| Earnings per share:   |           |           |
| Basic - as reported   | \$0.63    | \$1.11    |
| Basic - pro forma     | \$0.63    | \$1.09    |
| Diluted - as reported | \$0.63    | \$1.10    |
| Diluted - pro forma   | \$0.62    | \$1.08    |

The stock compensation expense for the six months ended July 1, 2006 and the stock compensation expense used in the preceding disclosure of pro forma net earnings for the six months ended July 2, 2005 was estimated on the date of grant using the Black-Scholes option-pricing model that used the following assumptions by grant year:

|                          | Six Months Ended<br><u>Jul. 1, 2006</u> | Year Ended<br><u>Dec. 31, 2005</u> |
|--------------------------|---|------------------------------------|
| Expected term            | 7 years                                 | 7 years                            |
| Expected volatility:     |   |                                    |
| Range used               | 29.75% - 31.23%                         | 33.49% - 31.77%                    |
| Weighted-average         | 31.21%                                  | 33.46%                             |
| Expected dividend yield: |   |                                    |
| Range used               | 1.24% - 1.43%                           | 1.17% - 1.45%                      |
| Weighted-average         | 1.24%                                   | 1.45%                              |
| Risk-free interest rate  |   |                                    |
| Range used               | 4.62% - 5.08%                           | 4.21% - 4.57%                      |

Expected volatilities are based on historical volatility due to the fact that the Corporation did not feel that future volatility over the expected term of the options is likely to differ from the past. The Corporation used a simple-average calculation method based on monthly frequency points for the prior seven years. The Corporation used the current dividend yield as there are no plans to substantially increase or decrease its dividends. The Corporation elected to use the simplified method as allowed by Staff Accounting Bulletin (the "SAB") No. 107 "Share Based Payment" to determine the expected term since the awards qualified as "plain vanilla" options as defined in the SAB. The risk-free interest rate was selected based on yields from U.S. Treasury zero-coupon issues with a remaining term equal to the expected term of the options being valued.

Changes in outstanding stock options for the six months ended July 1, 2006 were as follows:

|                              | <u>Number</u> | <u>Weighted-Average<br/>Exercise Price</u> |
|------------------------------|---------------|--|
| Balance at December 31, 2005 | 1,128,650     | \$31.84                                    |
| Options granted              | 135,946       | 58.06                                      |
| Options exercised            | (39,000)      | 22.91                                      |
| Options forfeited            | (22,480)      | 39.91                                      |
| Balance at July 1, 2006      | 1,203,116     | \$35.61                                    |

A summary of the Corporation's nonvested shares as of July 1, 2006 and changes during the six-month period are presented below:

|                                | <u>Shares</u>   | <u>Weighted-Average<br/>Grant-Date<br/>Fair Value</u> |
|--------------------------------|-----------------|---|
| Nonvested Shares               |                 |   |
| Nonvested at December 31, 2005 | 695,400         | \$14.07   |
| Granted                        | 135,946         | 21.39   |
| Vested                         | (142,900)       | 11.91   |
| Forfeited                      | <u>(22,480)</u> | <u>15.90</u>  |
| Nonvested at July 1, 2006      | 665,966         | \$15.97   |

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At July 1, 2006, there was \$5.4 million of unrecognized compensation cost related to nonvested awards, which the Corporation expects to recognize over a weighted-average period of 1.5 years.

Information about stock options that are vested or expected to vest and that are exercisable at July 1, 2006, follows:

| Options                    | <u>Number</u> | <u>Weighted-Average<br/>Exercise Price</u> | <u>Weighted-Average<br/>Remaining<br/>Life in Years</u> | <u>Aggregate<br/>Intrinsic<br/>Value<br/>(\$000s)</u> |
|----------------------------|---------------|--|---|---|
| Vested or expected to vest | 1,167,796     | \$34.62                                    | 5.8   | \$12,530  |
| Exercisable                | 537,150       | \$28.21                                    | 3.1   | \$ 9,207  |

The weighted-average grant-date fair value of options granted was \$21.39 for the six months ended July 1, 2006. Other information for the three and six-month periods follows:

| (In thousands)                                      | Three months ended      |                         | Six months ended        |                         |
|---|-------------------------|-------------------------|-------------------------|-------------------------|
|   | <u>Jul. 1,<br/>2006</u> | <u>Jul. 2,<br/>2005</u> | <u>Jul. 1,<br/>2006</u> | <u>Jul. 2,<br/>2005</u> |
| Total fair value of shares vested                   | \$ -                    | \$ -                    | \$1,702                 | \$ 875                  |
| Total intrinsic value of options exercised          | 459                     | 6,705                   | 1,301                   | 7,595                   |
| Cash received from exercise of stock options        | 266                     | 6,660                   | 893                     | 7,533                   |
| Tax benefit realized from exercise of stock options | 168                     | 2,380                   | 475                     | 2,696                   |

Note C. Inventories

The Corporation values its inventory at the lower of cost or market with approximately 85% valued by the last-in, first-out (LIFO) method.

| (In thousands)                | <u>Jul. 1, 2006<br/>(Unaudited)</u> | <u>Dec. 31, 2005</u> |
|-------------------------------|-------------------------------------|----------------------|
| Finished products             | \$ 75,941                           | \$ 61,027            |
| Materials and work in process | 52,456                              | 46,398               |
| LIFO allowance                | <u>(15,910)</u>                     | <u>(16,315)</u>      |
|                               | \$ 112,487                          | \$ 91,110            |

Note D. Comprehensive Income and Shareholders' Equity

The Corporation's comprehensive income for the first six months of 2006 consisted of additional minimum pension liability and foreign currency adjustments.

For the six months ended July 1, 2006, the Corporation repurchased 2,058,176 shares of its common stock at a cost of approximately \$107.9 million. As of July 1, 2006, \$35.6 million of the Board of Director's current repurchase authorization remained unspent.

## Note E. Earnings Per Share

The following table reconciles the numerators and denominators used in the calculation of basic and diluted earnings per share (EPS):

|  | <u>Three Months Ended</u> |              | <u>Six Months Ended</u> |              |
|--|---------------------------|--------------|-------------------------|--------------|
|  | Jul. 1, 2006              | Jul. 2, 2005 | Jul.1, 2006             | Jul. 2, 2005 |
| Numerators:                                |                           |              |                         |              |
| Numerator for both basic and diluted EPS   |                           |              |                         |              |
| net income (in thousands)                  | \$28,652                  | \$34,985     | \$57,122                | \$61,107     |
| Denominators:                              |                           |              |                         |              |
| Denominator for basic EPS                  |                           |              |                         |              |
| weighted-average common shares outstanding | 51,009,288                | 55,130,985   | 51,422,647              | 55,153,394   |
| Potentially dilutive shares                |                           |              |                         |              |
| from stock option plans                    | 330,079                   | 381,917      | 358,451                 | 348,918      |
| Denominator for diluted EPS                | 51,339,367                | 55,512,902   | 51,781,098              | 55,502,312   |
| Earnings per share - basic                 | \$0.56                    | \$0.63       | \$1.11                  | \$1.11       |
| Earnings per share - diluted               | \$0.56                    | \$0.63       | \$1.10                  | \$1.10       |

Certain exercisable and non-exercisable stock options were not included in the computation of diluted EPS at July 1, 2006, because their inclusion would have been anti-dilutive. There were no stock options outstanding, which met this criterion for the three and six months ended July 2, 2005. The number of stock options outstanding, which met this criterion for the three and six months ended July 1, 2006, was 135,566.

## Note F. Restructuring Reserve and Plant Shutdowns

As a result of the Corporation's business simplification and cost reduction strategies, the Corporation began the shutdown of two office furniture manufacturing facilities in the third quarter of 2005. In connection with those shutdowns, the Corporation incurred \$0.2 million of current period charges during the quarter ended July 1, 2006. The closures and consolidations are virtually complete with the exception of the sale of the facility. The following is a summary of changes in restructuring accruals during the second quarter of 2006:

| (In thousands)              | <u>Severance</u> | Facility Exit |              | <u>Total</u> |
|-----------------------------|------------------|---------------|--------------|--------------|
|                             |                  | Costs &       | <u>Other</u> |              |
| Balance as of April 1, 2006 | \$ -             | \$ 537        |              | \$ 537       |
| Restructuring charges       | -                | 191           |              | 191          |
| Cash payments               | -                | (635)         |              | (635)        |
| Balance as of July 1, 2006  | \$ -             | \$ 93         |              | \$ 93        |

## Note G. Business Combinations

The Corporation completed the acquisition of Lamex, a privately held Chinese manufacturer and marketer of office furniture, as well as a small office furniture services company and a small manufacturer of fireplace facings during the first quarter ending April 1, 2006. The combined purchase price for these acquisitions less cash acquired totaled approximately \$77.8 million, of which \$64.1 million was paid in cash and the remaining is due over the remainder of the year. The Corporation did increase its borrowings under its revolving credit facility to help fund the acquisitions.

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The Corporation is in the process of finalizing the allocation of the purchase price, primarily with respect to deferred taxes and pension plans. There are approximately \$51.7 million of intangibles associated with these acquisitions. Of these acquired intangible assets, \$14 million was assigned to a trade name that is not subject to amortization. The remaining \$37.7 million have estimated useful lives ranging from two to fifteen years. There is approximately \$10.1 million of goodwill associated with these acquisitions, of which \$7.3 million was assigned to the furniture segment and \$2.8 was assigned to the hearth segment. Approximately \$7.1 million of the goodwill is not deductible for income tax purposes.

Note H. Goodwill and Other Intangible Assets

The table below summarizes amortizable definite-lived intangible assets as of July 1, 2006 and December 31, 2005, which are reflected in Other Assets in the Corporation's condensed consolidated balance sheets:

| (In thousands)                   | <u>Jul. 1, 2006</u> | <u>Dec. 31, 2005</u> |
|----------------------------------|---------------------|----------------------|
| Patents                          | \$ 18,780           | \$ 18,480            |
| Customer relationships and other | 106,171             | 67,211               |
| Less: accumulated amortization   | <u>(34,310)</u>     | <u>(28,758)</u>      |
|                                  | \$ 90,641           | \$ 56,933            |

Aggregate amortization expense for the three and six months ended July 1, 2006 and July 2, 2005 was \$2.9 million and \$5.2 million, and \$1.9 million and \$3.4 million, respectively. Amortization expense is estimated to range between \$5.9 to \$9.2 million per year over the next five years.

The Corporation also owns trademarks and trade names with a net carrying amount of \$44.2 million. The trademarks are deemed to have indefinite useful lives because they are expected to generate cash flows indefinitely.

The changes in the carrying amount of goodwill since December 31, 2005, are as follows by reporting segment:

| (In thousands)                  | Office<br><u>Furniture</u> | Hearth<br><u>Products</u> | <u>Total</u>  |
|---------------------------------|----------------------------|---------------------------|---------------|
| Balance as of December 31, 2005 | \$ 77,659                  | \$164,585                 | \$242,244     |
| Goodwill increase during period | <u>8,689</u>               | <u>2,790</u>              | <u>11,479</u> |
| Balance as of July 1, 2006      | \$ 86,348                  | \$167,375                 | \$253,723     |

In accordance with SFAS No. 142 "Goodwill and Other Intangible Assets," the Corporation evaluates its goodwill for impairment on an annual basis based on values at the end of the third quarter or whenever indicators of impairment exist. The Corporation has previously evaluated its goodwill for impairment and has determined that the fair value of the reporting unit exceeds their carrying value so no impairment of goodwill was recognized. The increase in goodwill relates to the acquisitions completed during the first quarter and final purchase price adjustments related to prior acquisitions. See Note G for further information.

Note I. Long-Term Debt

On April 6, 2006, the Corporation refinanced \$150 million of a revolving credit facility with 5.54 percent ten-year unsecured Senior Notes due in 2016 issued through the private placement debt market. Interest payments are due biannually on April 1 and October 1 of each year and the principal is due in a lump sum in 2016. The Corporation

maintained the revolving credit facility with a maximum borrowing of \$300 million. Amounts borrowed under the Credit Agreement may be borrowed, repaid and reborrowed from time to time until January 28, 2011. As of July 1, 2006, \$132.5 million of the revolver was outstanding with \$80 million classified as short-term as the Corporation expects to repay that portion of the borrowings within a year.

Certain of the Corporation's borrowing arrangements include covenants, which limit the assumption of additional debt and lease obligations. The Corporation has been and currently is in compliance with the covenants related to these debt agreements.

#### Note J. Product Warranties

The Corporation issues certain warranty policies on its furniture and hearth products that provide for repair or replacement of any covered product or component that fails during normal use because of a defect in design or workmanship.

A warranty reserve is determined by recording a specific reserve for known warranty issues and an additional reserve for unknown claims that are expected to be incurred based on historical claims experience. Actual claims incurred could differ from the original estimates, requiring adjustments to the reserve. Activity associated with warranty obligations was as follows during the period:

|  | <u>Six Months Ended</u> |                        |
|--|-------------------------|------------------------|
|  | Jul. 1,<br><u>2006</u>  | Jul. 2,<br><u>2005</u> |
| (In thousands)                                   |                         |                        |
| Balance at beginning of period                   | \$ 10,157               | \$ 10,794              |
| Accruals for warranties issued during the period | 4,972                   | 4,564                  |
| Accrual related to pre-existing warranties       | 445                     | 540                    |
| Settlements made during the period               | <u>(5,139)</u>          | <u>(5,383)</u>         |
| Balance at end of period                         | \$ 10,435               | \$ 10,515              |

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#### Note K. Postretirement Health Care

In accordance with the interim disclosure requirements of revised SFAS No. 132, "Employers' Disclosures about Pensions and other Postretirement Benefits," the following table sets forth the components of net periodic benefit cost included in the Corporation's income statement for:

|                                       | Six Months Ended       |                        |
|---------------------------------------|------------------------|------------------------|
|                                       | Jul. 1,<br><u>2006</u> | Jul. 2,<br><u>2005</u> |
| (In thousands)                        |                        |                        |
| Service cost                          | \$ 163                 | \$ 152                 |
| Interest cost                         | 526                    | 528                    |
| Expected return on plan assets        | (87)                   | (102)                  |
| Amortization of transition obligation | 291                    | 290                    |
| Amortization of prior service cost    | 115                    | 116                    |
| Amortization of (gain)/loss           | <u>47</u>              | <u>18</u>              |
| Net periodic benefit cost             | \$1,055                | \$ 1,002               |

In May 2004, The Financial Accounting Standards Board ("FASB") issued FASB Staff Position No. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug Improvement and Modernization Act of 2003" (the "Act"). The Corporation has determined that the benefits provided by the plan are not actuarially equivalent to the Medicare Part D benefit under the Act based on the percentage of the cost of the plan that the Corporation provides.

#### Note L. Commitments and Contingencies

During the second quarter ended June 28, 2003, the Corporation entered into a one-year financial agreement for the benefit of one of its distributor chain partners, which was subsequently extended through August 31, 2005. During the third quarter of 2005, the Corporation paid \$1.2 million associated with this guarantee. As of July 1, 2006, the Corporation has recovered substantially all of this amount through liquidations of secured collateral and settlements.

The Corporation utilizes letters of credit in the amount of \$24 million to back certain financing instruments, insurance policies and payment obligations. The letters of credit reflect fair value as a condition of their underlying purpose and are subject to fees competitively determined.

The Corporation replaced a previously existing transportation service contract during the first quarter of 2006 with a new six-year contract. The contract provides for minimum payments of approximately \$10 million a year of which \$3.3 million are related to the equipment portion of the contract which has been determined to be an operating lease.

The Corporation has contingent liabilities, which have arisen in the course of its business, including pending litigation, preferential payment claims in customer bankruptcies, environmental remediation, taxes, and other claims.

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#### Note M. New Accounting Standards

In December 2004, the FASB issued SFAS No. 123(R) which replaces Original SFAS No. 123 and supercedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values, beginning with the first annual fiscal period after June 15, 2005. Under the Original SFAS No. 123, this accounting treatment was optional with pro forma disclosures required. The Corporation adopted SFAS No. 123(R) in the first quarter of fiscal 2006, beginning January 1, 2006. See Note B, Stock Based Compensation for the impact of the adoption of SFAS No. 123(R) on net income and net income per share.

In July 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This Interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently reviewing the impact, if any, that FIN 48 will have on its consolidated financial statements.

## Note N. Business Segment Information

Management views the Corporation as operating in two business segments: office furniture and hearth products with the former being the principal business segment.

The office furniture segment manufactures and markets a broad line of metal and wood commercial and home office furniture which includes file cabinets, desks, credenzas, chairs, storage cabinets, tables, bookcases, freestanding office partitions and panel systems, and other related products. The hearth product segment manufactures and markets a broad line of manufactured gas-, pellet- and wood-burning fireplaces and stoves, fireplace inserts, and chimney systems principally for the home.

For purposes of segment reporting, intercompany sales transfers between segments are not material and operating profit is income before income taxes exclusive of certain unallocated corporate expenses. These unallocated corporate expenses include the net cost of the Corporation's corporate operations, interest income, and interest expense. The increase in unallocated corporate expenses compared to prior year is due to increased interest expense and stock-based compensation expense. Management views interest income and expense as corporate financing costs and not as a business segment cost. In addition, management applies one effective tax rate to its consolidated income before income taxes so income taxes are not reported or viewed internally on a segment basis.

The Corporation's primary market and capital investments are concentrated in the United States.

Reportable segment data reconciled to the consolidated financial statements for the three and six month periods ended July 1, 2006, and July 2, 2005, is as follows:

| (In thousands)                       | Three Months Ended     |                        | Six Months Ended       |                        |
|--------------------------------------|------------------------|------------------------|------------------------|------------------------|
|                                      | Jul. 1,<br><u>2006</u> | Jul. 2,<br><u>2005</u> | Jul. 1,<br><u>2006</u> | Jul. 2,<br><u>2005</u> |
| Net Sales:                           |                        |                        |                        |                        |
| Office furniture                     | \$ 514,305             | \$ 455,246             | \$1,005,024            | \$ 882,793             |
| Hearth products                      | <u>156,966</u>         | <u>138,922</u>         | <u>314,924</u>         | <u>273,636</u>         |
|                                      | \$ 671,271             | \$ 594,168             | \$1,319,948            | \$1,156,429            |
| Operating Profit:                    |                        |                        |                        |                        |
| Office furniture                     |                        |                        |                        |                        |
| Operations before restructuring      | \$ 38,500              | \$ 46,401              | \$ 80,679              | \$ 85,209              |
| charges                              | <u>(228)</u>           | <u>-</u>               | <u>(1,947)</u>         | <u>-</u>               |
| Restructuring and impairment charges | 38,272                 | 46,401                 | 78,732                 | 85,209                 |
| Office Furniture - net               | <u>18,206</u>          | <u>16,863</u>          | <u>29,939</u>          | <u>27,343</u>          |
| Hearth products                      | 56,478                 | 63,264                 | 108,671                | 112,552                |
| Total operating profit               | <u>(11,358)</u>        | <u>(9,024)</u>         | <u>(18,717)</u>        | <u>(17,812)</u>        |
| Unallocated corporate expense        | \$ 45,120              | \$ 54,240              | \$ 89,954              | \$ 94,740              |
| Income before income taxes           |                        |                        |                        |                        |
| Depreciation & Amortization Expense: |                        |                        |                        |                        |
| Office furniture                     | \$ 12,972              | \$ 10,960              | \$ 24,127              | \$ 21,928              |
| Hearth products                      | 4,164                  | 3,731                  | 8,697                  | 8,053                  |

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|  |              |              |              |              |
|--|--------------|--------------|--------------|--------------|
| General corporate                                      | <u>894</u>   | <u>1,812</u> | <u>2,034</u> | <u>3,404</u> |
|  | \$ 18,030    | \$ 16,503    | \$ 34,858    | \$ 33,385    |
| Capital Expenditures (including capitalized software): |              |              |              |              |
| Office furniture                                       | \$ 12,388    | \$ 5,344     | \$ 21,859    | \$ 11,942    |
| Hearth products  | 2,674        | 2,037        | 5,444        | 4,599        |
| General corporate                                      | <u>3,863</u> | <u>667</u>   | <u>5,870</u> | <u>954</u>   |
|  | \$ 18,925    | \$ 8,048     | \$ 33,173    | \$ 17,495    |

|                      |                |                |
|----------------------|----------------|----------------|
|                      | As of          | As of          |
|                      | Jul. 1,        | Jul. 2,        |
|                      | <u>2006</u>    | <u>2005</u>    |
| Identifiable Assets: |                |                |
| Office furniture     | \$ 737,297     | \$ 610,399     |
| Hearth products      | 387,641        | 359,236        |
| General corporate    | <u>104,012</u> | <u>103,514</u> |
|                      | \$1,228,950    | \$1,073,149    |

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

The Corporation has two reportable core operating segments: office furniture and hearth products. The Corporation is the second largest office furniture manufacturer in the world and the nation's leading manufacturer and marketer of gas- and wood-burning fireplaces. The Corporation utilizes its split and focus, decentralized business model to deliver value to its customers with its various brands and selling models. The Corporation is focused on growing its existing businesses while seeking out and developing new opportunities for growth.

Net sales for the second quarter of 2006 increased 13.0 percent. The Corporation continued to experience solid growth in both the office furniture and hearth segments driven by solid organic growth and from acquisitions completed in the second half of 2005 and early 2006. Gross margins for the quarter decreased from prior year levels due to broad based increases in material costs. Selling and administrative expenses increased driven by significantly higher transportation costs, the effect of acquisitions and investments in market initiatives. As a result of the higher material and transportation costs and interest expense, net income decreased 18.1 percent for the quarter.

Critical Accounting Policies

The preparation of the financial statements requires the Corporation to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. The Corporation continually evaluates its accounting policies and estimates. The Corporation bases its estimates on historical experience and on a variety of other assumptions believed to be reasonable in order to make judgments about the carrying value of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions. A summary of the more significant accounting policies that require the use of estimates and judgments in preparing the financial statements is provided in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005. As of January 1, 2006, the Corporation adopted FAS123(R) "Share-Based Payment" which requires the Corporation to measure the cost of employee services in exchange for an



award of equity instruments based on the grant-date fair value of the award and to recognize cost of the requisite service period. During the first six months of 2006, there were no material changes in the accounting policies and assumptions previously disclosed except for the adoption of FAS123(R).

### Results of Operations

The following table presents certain key highlights from the results of operations for the periods indicated:

| (In thousands)                                     | Three Months Ended     |                        |                          | Six Months Ended       |                        |                          |
|--|------------------------|------------------------|--------------------------|------------------------|------------------------|--------------------------|
|  | Jul. 1,<br><u>2006</u> | Jul. 2,<br><u>2005</u> | Percent<br><u>Change</u> | Jul. 1,<br><u>2006</u> | Jul. 2,<br><u>2005</u> | Percent<br><u>Change</u> |
| Net sales  | \$671,271              | \$594,168              | 13.0%                    | \$1,319,948            | \$1,156,429            | 14.1%                    |
| Cost of sales                                      | 436,758                | 379,880                | 15.0                     | 855,825                | 746,296                | 14.7                     |
| Gross profit                                       | 234,513                | 214,288                | 9.4                      | 464,123                | 410,133                | 13.2                     |
| Selling & administrative expenses                  | 185,774                | 160,146                | 16.0                     | 367,784                | 315,546                | 16.6                     |
| Restructuring & impairment charges                 | 228                    | -                      | -                        | 1,947                  | -                      | -                        |
| Operating income                                   | 48,511                 | 54,142                 | -10.4                    | 94,392                 | 94,587                 | - 0.2                    |
| Interest income (expense) net                      | (3,425)                | 98                     | NM                       | (4,533)                | 153                    | NM                       |
| Earnings before income taxes and minority interest | 45,086                 | 54,240                 | -16.9                    | 89,859                 | 94,740                 | - 5.2                    |
| Income taxes                                       | 16,457                 | 19,255                 | -14.5                    | 32,799                 | 33,633                 | - 2.5                    |
| Minority interest in earnings of a subsidiary      | <u>(23)</u>            | <u>-</u>               | <u>-</u>                 | <u>(62)</u>            | <u>-</u>               | <u>-</u>                 |
| Net income   | \$ 28,652              | \$ 34,985              | -18.1%                   | \$ 57,122              | \$ 61,107              | - 6.5%                   |

### Results of Operations

The Corporation experienced solid sales growth in the quarter, up 13.0 percent or \$77.1 million compared to the same quarter last year. Acquisitions completed during the first quarter, along with acquisitions completed during 2005 accounted for \$35 million of the increase in sales.

Gross margins for the second quarter decreased to 34.9 percent compared to 36.1 percent for the same quarter last year. The decrease was primarily due to broad based increases in material costs.

Total selling and administrative expenses for the quarter increased by \$25.9 million to 27.7 percent of sales compared to 27.0 percent in second quarter 2005. Included in second quarter 2006 were increased freight and distribution costs of \$10 million due to volume, rate increases, and fuel surcharges; additional selling and administrative costs of \$12 million associated with new acquisitions, \$0.2 million of restructuring charges from two office furniture facilities that began in the third quarter of 2005; \$0.8 million of stock-based compensation expense due to the adoption of SFAS 123(R); and investments in selling and marketing initiatives.

Net income decreased 18.1 percent and net income per diluted share decreased 11.1 percent compared to the same quarter in 2005. Interest expense increased \$3.3 million during the quarter on moderate debt levels, consistent with the Corporation's strategy of maintaining a more efficient capital structure. Net income per share was positively

impacted \$0.04 per share as a result of the Corporation's share repurchase program.

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The Corporation increased its annualized effective tax rate at the beginning of the year to 36.5 percent compared to 35.5 percent in 2005 due primarily to increased state taxes and the expiration of the research investment tax credit.

For the first six months of 2006, consolidated net sales increased 14.1 percent to \$1.3 billion compared to \$1.2 billion in 2005. Acquisitions accounted for approximately \$56 million or 4.9 percentage points of the increase. Gross margins year-to-date decreased to 35.2 percent compared to 35.5 percent last year due to increased material costs. Net income was \$57.1 million compared to \$61.1 million in 2005, a decrease of 6.5 percent. Net income per share remained constant at \$1.10 per diluted share due to a \$0.07 per share positive impact from the Corporation's share repurchase program.

#### Office Furniture

Second quarter sales for the office furniture segment increased 13.0 percent or \$59.1 million to \$514.3 million from \$455.2 million for the same quarter last year. Sales from the Corporation's acquisitions since second quarter 2005 accounted for \$30 million of the increase. Operating profit prior to unallocated corporate expenses as a percent of sales decreased to 7.4 percent versus 10.2 percent in the same quarter last year. Operating profit was negatively impacted by higher material, transportation and other input costs, and \$0.2 million of costs related to facility shutdowns. Transition costs related to the acquisition of Lamex and Allsteel distribution acquisitions negatively impacted profitability during the quarter as anticipated.

Net sales for the first six months of 2006 increased 13.8 percent to \$1.0 billion compared to \$0.9 billion in 2005. Operating profit as a percentage of sales decreased to 7.8 percent compared to 9.7 percent in the prior year.

#### Hearth Products

Second quarter net sales for the hearth products segment increased 13.0 percent or \$18.0 million to \$157.0 million from \$138.9 million for the same quarter last year. The Corporation's acquisitions completed since the second quarter of 2005 accounted for \$5 million of the increase. Operating profit prior to unallocated corporate expenses increased to \$18.2 million from \$16.9 million in the same quarter last year. Operating profit as a percent of net sales decreased to 11.6 percent compared to 12.1 percent in 2005 due to increased freight and distribution costs, a higher mix of lower margin remodel/retrofit business, and continued investment in brand building initiatives.

Net sales for the first six months of 2006 increased 15.1 percent to \$314.9 million compared to \$273.6 million in 2005. Operating profit as a percentage of sales decreased to 9.5 percent compared to 10.0 percent in the prior year.

#### Liquidity and Capital Resources

As of July 1, 2006, cash and short-term investments decreased to \$35.8 million compared to \$84.7 million at year-end 2005. Cash flow from operations for the first six months was \$30.9 million compared to \$56.3 million in 2005. The decline in operating cash flow was primarily due to the amount of marketing program and incentive compensation payouts driven by strong 2005 results as well as the timing of marketing program payments due to customer agreements. Trade receivables increased from year-end due to seasonality, increased volume and acquisitions completed during the year. Inventory increased from year-end due to seasonality, increased volume, acquisitions completed during the year, and additional imported inventory with longer lead times. Cash flow and working capital

management continue to be a major focus of management to ensure the Corporation is poised for growth. The Corporation has sufficient liquidity to manage its operations and as of July 1, 2006 maintained additional borrowing capacity of \$144 million, net of amounts designated for letters of credit, through a \$300 million revolving bank credit agreement.

Net capital expenditures, including capitalized software, for the first six months of 2006 were \$33.2 million compared to \$17.5 million in 2005 and were primarily for tooling and equipment for new products and efficiency initiatives. For the full year 2006, capital expenditures are expected to be approximately 30 to 40 percent higher than 2005 due to increased focus on new products and process improvement, and increased investment in distribution.

The Corporation completed the acquisition of Lamex, a privately held Chinese manufacturer and marketer of office furniture, as well as a small office furniture services company and a small manufacturer of fireplace facings, for a total of \$64.1 million in cash. The Corporation accrued for an additional payment due to the seller of over \$10 million in the quarter with the actual cash payment occurring after quarter end. During the first six months of 2006, net borrowings under the Corporation's revolving credit facility increased \$142.5 million to fund acquisitions, share repurchases, and seasonal cash requirements. In early April, the Corporation refinanced \$150 million of the revolver borrowings with 5.54 percent ten-year Senior Notes due in 2016 issued through the private placement debt market. As of July 1, 2006, \$132.5 million of the revolver was outstanding with \$80 million classified as short-term as the Corporation expects to repay that portion of the borrowings within a year.

The Board of Directors declared a regular quarterly cash dividend of \$0.18 per share on its common stock on May 2, 2006, to shareholders of record at the close of business on May 12, 2006. It was paid on June 1, 2006. This was the 205<sup>th</sup> consecutive quarterly dividend paid by the Corporation.

For the six months ended July 1, 2006, the Corporation repurchased 2,058,176 shares of its common stock at a cost of approximately \$107.9 million, or an average price of \$52.40. As of July 1, 2006, \$35.6 million of the Board of Director's current repurchase authorization remained unspent.

#### Off-Balance Sheet Arrangements

The Corporation does not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material.

#### Contractual Obligations

Contractual obligations associated with ongoing business and financing activities will result in cash payments in future periods. A table summarizing the amounts and estimated timing of these future cash payments was provided in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005. During the first six months of fiscal 2006, with the exception of Senior Notes issued through the private placement debt market (as described in Note I), and a new transportation service contract (as described in Note L), there were no material changes outside the ordinary course of business in the Corporation's contractual obligations or the estimated timing of the future cash payments.

#### Commitments and Contingencies

The Corporation is involved in various kinds of disputes and legal proceedings that have arisen in the course of its business, including pending litigation, preferential payment claims in customer bankruptcies, environmental

remediation, taxes and other claims. It is the Corporation's opinion, after consultation with legal counsel, that additional liabilities, if any, resulting from these matters are not expected to have a material adverse effect on the Corporation's financial condition, although such matters could have a material effect on the Corporation's quarterly or annual operating results and cash flows when resolved in a future period.

### Looking Ahead

Global Insight, the Business and Institutional Furniture Manufacturer's Association's forecasting consultant, estimates U.S. office furniture shipments to increase 11 percent in 2006 compared to 13 percent in 2005. The housing market, a key indicator for the hearth industry, has slowed significantly.

Management believes that its core businesses are well positioned in their markets, are competing well and the Corporation's strategic growth initiatives are on track for solid performance. However, profitability will be challenged due to increased input costs. The Corporation has taken steps to adjust to a higher cost environment, implementing price increases where able, tightening up spending and continuing to aggressively go after reductions in material and other input costs.

The Corporation continues to focus on creating long-term shareholder value by growing its business through investment in building brands, product solutions, and selling models, enhancing its strong member-owner culture and remaining focused on its long-standing continuous improvement programs to build best total cost and a lean enterprise.

### Forward-Looking Statements

Statements in this report that are not strictly historical, including statements as to plans, objectives, and future financial performance, are "forward-looking" statements that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Words, such as "anticipate," "believe," "could," "confident," "estimate," "expect," "forecast," "intend," "likely," "may," "plan," "possible," "potential," "predict," "project," "should," and variations of such words and similar expressions identify forward-looking statements. Forward-looking statements involve known and unknown risks, which may cause the Corporation's actual results in the future to differ materially from expected results. These risks include, without limitation: the Corporation's ability to realize financial benefits from its (a) price increases, (b) cost containment and business simplification initiatives, (c) investments in strategic acquisitions, new products and brand building, (d) investments in distribution and rapid continuous improvement, (e) repurchases of common stock, and (f) ability to maintain its effective tax rate; uncertainty related to the availability of cash to fund future growth; lower than expected demand for the Corporation's products due to uncertain political and economic conditions; lower industry growth than expected; major disruptions at our key facilities or in the supply of any key raw materials, components or finished goods; uncertainty related to disruptions of business by terrorism, military action, acts of God or other Force Majeure events; competitive pricing pressure from foreign and domestic competitors; higher than expected costs and lower than expected supplies of materials (including steel and petroleum based materials); higher than expected costs for energy and fuel; changes in the mix of products sold and of customers purchasing; currency fluctuations and other factors described in the Corporation's annual and quarterly reports filed with the Securities and Exchange Commission on Forms 10-K and 10-Q. The Corporation undertakes no obligation to update, amend, or clarify forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by applicable law.

### Item 3. Quantitative and Qualitative Disclosure about Market Risk

As of July 1, 2006, there were no material changes to the financial market risks that affect the quantitative and

qualitative disclosures presented in item 7A of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005.

#### Item 4. Controls and Procedures

Disclosure controls and procedures are designed to ensure that information required to be disclosed by the Corporation in the reports that it files or submits under the Securities Exchange Act of 1934 as amended, is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures are also designed to ensure that information is accumulated and communicated to management, including the chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

On March 1, 2006, the Corporation completed the acquisition of Lamex as discussed in Note G to the Corporation's condensed consolidated financial statements. As of December 30, 2006, the Corporation's management will exclude Lamex from its assessment of the Corporation's internal control over financial reporting as it was acquired during the fiscal year. The Corporation is in the process of assessing Lamex's internal control over financial reporting and will be implementing changes to better align its reporting and controls with those of the Corporation. Lamex's results of operations and financial position for the fiscal quarter ended July 1, 2006, were insignificant to the Corporation's consolidated financial statements. There have not been any changes in the Corporation's internal control over financial reporting, due to the Lamex acquisition or otherwise, during the fiscal quarter ended July 1, 2006, that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

Under the supervision and with the participation of management, the chief executive officer and chief financial officer of the Corporation have evaluated the effectiveness of the design and operation of the Corporation's disclosure controls and procedures as of July 1, 2006, and, based on their evaluation, the chief executive officer and chief financial officer have concluded that these controls and procedures are effective.

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## PART II. OTHER INFORMATION

#### Item 1. Legal Proceedings

There are no new legal proceedings or material developments to report.

#### Item 1A. Risk Factors

There have been no material changes from the risk factors disclosed in the "Risk Factors" section of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2005 and the Corporation's Quarterly Report on Form 10-Q for the quarter ended April 1, 2006.

#### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

##### Issuer Purchases of Equity Securities

The following is a summary of share repurchase activity during the second quarter ended July 1, 2006.

| Period            | (a) Total Number of Shares (or Units) Purchased (1) | (b) Average price Paid per Share or Unit | (c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet be Purchased Under the Plans or Programs |
|-------------------|---|--|---|---|
| 4/2/06 - 4/29/06  | 202,117   | \$54.89                                  | 202,117   | \$115,758,685   |
| 4/30/06 - 5/27/06 | 997,364   | \$52.28                                  | 997,364   | \$ 63,617,803   |
| 5/28/06- 7/1/06   | 567,820   | \$49.29                                  | 567,820   | \$ 35,629,064   |
| Total             | 1,767,301   | \$51.62                                  | 1,767,301   | \$35,629,064  |

(1) No shares were purchased outside of a publicly announced plan or program.

The Corporation repurchases shares under previously announced plans authorized by the Board of Directors as follows:

- Plan announced November 11, 2005, providing share repurchase authorization of \$200,000,000 with no specified expiration date.

- No repurchase plans expired or were terminated during the second quarter, nor do any plans exist under which the Corporation does not intend to make further purchases.

#### Item 4. Submission of Matters to a Vote of Security Holders

The Annual Meeting of Shareholders of HNI Corporation was held on May 2, 2006, for purposes of electing five Directors to the Board of Directors, and to ratify the Audit Committee's selection of PricewaterhouseCoopers LLP as the Corporation's independent registered public accountant for the fiscal year ended December 30, 2006. As of March 3, 2006, the record date for the meeting, there were 51,941,426 shares of common stock issued and outstanding and entitled to vote at the meeting. The first proposal voted upon was the election of one Director for a term of one year and four Directors for a term of three years and until their successors are elected and shall qualify. The five persons nominated by the Corporation's Board of Directors received the following votes and were elected:

|                         | <u>For</u>              | <u>Withheld/<br/>Abstained</u> | <u>Against</u> |
|-------------------------|-------------------------|--------------------------------|----------------|
| <u>One-Year Term:</u>   |                         |                                |                |
| James R. Jenkins        | 46,663,801<br>or 89.83% | 356,070<br>or 0.69%            | -0-<br>or 0%   |
| <u>Three-Year Term:</u> |                         |                                |                |
| Stan A. Askren          | 46,158,373<br>or 88.87% | 861,497<br>or 1.66%            | -0-<br>or 0%   |

|                       |                         |                     |              |
|-----------------------|-------------------------|---------------------|--------------|
| Gary M. Christensen   | 46,650,826<br>or 89.81% | 369,045<br>or 0.71% | -0-<br>or 0% |
| Joseph Scalzo         | 46,582,896<br>or 89.68% | 436,975<br>or 0.84% | -0-<br>or 0% |
| Ronald V. Waters, III | 46,603,330<br>or 89.72% | 416,541<br>or 0.80% | -0-<br>or 0% |

Other Directors whose term of office as a Director continued after the meeting are: Miguel M. Calado, Cheryl A. Francis, John A. Halbrook, Dennis J. Martin, Larry B. Porcellato, Abbie J. Smith, and Brian E. Stern.

The second proposal voted upon was the ratification of the Audit Committee's selection of PricewaterhouseCoopers LLP as the Corporation's independent registered public accountant for the fiscal year ended December 30, 2006. The proposal was approved with 46,645,955 votes, or 89.80% voting for; 69,247 votes, or 0.13% voting against; and 304,668 votes, or 0.59% abstaining.

Item 6. Exhibits

See Exhibit Index.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HNI Corporation

Dated: August 3, 2006

By: /s/ Jerald K. Dittmer  
 Jerald K. Dittmer  
 Vice President and Chief Financial  
 Officer

EXHIBIT INDEX

|        |   |
|--------|---|
| (10.1) | Directors Deferred Compensation Plan of the Registrant dated August 9, 1999   |
| (31.1) | Certification of the CEO Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| (31.2) | Certification of the CFO Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| (32.1) | Certification of CEO and CFO Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

EXHIBIT (31.1)

CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
Sarbanes-Oxley Act Section 302

I, Stan A. Askren, Chairman, President and Chief Executive Officer of HNI Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-Q of HNI Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report; and
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d) - 15(f)) for the registrant and we have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly, during the period in which this quarterly report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the registrant's disclosure controls and procedures, and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: August 3, 2006

/s/ Stan A. Askren  
Name: Stan A. Askren  
Title: Chairman, President and  
Chief Executive Officer

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EXHIBIT (31.2)

CERTIFICATION OF CHIEF FINANCIAL OFFICER  
Sarbanes-Oxley Act Section 302

I, Jerald K. Dittmer, Vice President and Chief Financial Officer of HNI Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-Q of HNI Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report; and
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a - 15(f) and 15d- 15(f)) for the registrant and we have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly, during the period in which this quarterly report is being prepared;
  - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. evaluated the effectiveness of the registrant's disclosure controls and procedures, and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: August 3, 2006

/s/ Jerald K. Dittmer  
Name: Jerald K. Dittmer  
Title: Vice President and Chief Financial Officer

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EXHIBIT (32.1)

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Certification of CEO and CFO Pursuant to  
18 U.S.C. Section 1350,  
as Adopted Pursuant to  
Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report on Form 10-Q of HNI Corporation (the "Corporation") for the quarterly period ended July 1, 2006, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Stan A. Askren, as Chairman, President and Chief Executive Officer of the Corporation, and Jerald K. Dittmer, as Vice President and Chief Financial Officer of the Corporation, each hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Corporation as of the dates and for the periods expressed in the Report.

/s/ Stan A. Askren

Name: Stan A. Askren  
Title: Chairman, President and  
Chief Executive Officer  
Date: August 3, 2006

/s/ Jerald K. Dittmer

Name: Jerald K. Dittmer  
Title: Vice President and  
Chief Financial Officer  
Date: August 3, 2006

This certification accompanies the Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Corporation for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.