Company Name: Whirlpool
Company Ticker: WHR US
Date: 2018-10-25
Event Description: Q3 2018 Earnings Call

Market Cap: 6,732.01
Current PX: 104.27
YTD Change($): -64.37
YTD Change(%): -38.170

Bloomberg Estimates - EPS
Current Quarter: 4.288
Current Year: 14.004
Bloomberg Estimates - Sales
Current Quarter: 5787.500
Current Year: 21193.667

Q3 2018 Earnings Call

Company Participants

- Max Tunnicliff
- Marc Robert Bitzer
- James W. Peters

Other Participants

- Ken Zener
- Sam Darkatsh
- Curtis Nagle
- Doug Clark

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, and welcome to Whirlpool Corporation's Third Quarter 2018 Earnings Release call.

Today's call is being recorded.

For opening remarks and introductions, I would like to turn the call over to Senior Director of Investor Relations, Max Tunnicliff.

Max Tunnicliff

Thank you, and welcome to our third quarter 2018 conference call. Joining me today are Marc Bitzer, our Chief Executive Officer, and Jim Peters, our Chief Financial Officer. Our remarks today track with the presentation available on the investor section of our website at whirlpool.com.

Before we begin I'll remind you that as we conduct this call we will be make forward-looking statements to assist you in understanding Whirlpool Corporation's future expectations. Our actual results could differ materially from these statements due to many factors discussed in our latest 10-K and other periodic reports. We want to remind you that today's presentation includes non-GAAP measures. We believe these measures are important indicators of our operations as they exclude items that may not be indicative of or are unrelated to results from our ongoing business operations.

We also think the adjusted measures will provide you a better baseline for analyzing trends in our ongoing business operations. Listeners are directed to the supplemental information packet posted on the Investor Relations section of our website for the reconciliation of non-GAAP items to the most directly comparable GAAP measures.

At this time, all participants are in listen-only mode. Following our prepared remarks, the call be open for endless questions. As a reminder, we ask that participants ask no more than two questions.

With that, let me turn the call over to Marc.

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Marc Robert Bitzer

Thanks, and good morning, everyone. On slide 3 we show our third quarter highlights. As you saw in our press release, we delivered record ongoing earnings per share of $4.55 as well as ongoing EBIT margin expansion in 3 of 4 regions. On the second quarter in the row we delivered very strong price and mix in all regions as we continue to realize the benefits of the price mix actions we took earlier this year. Additionally, our North America region delivered impressive results, driving strong top and bottom line growth. We expanded ongoing EBIT margins in North American regions despite soft U.S. industry demand and continued cost pressures as we increase our share positions while also delivering very strong price and mix. Operational and external challenges continue to weigh on our European results but we are encouraged by the sequential progress we made on slowly restoring volume in the third quarter. Today, we are announcing further actions to refocus and improve our Europe performance in 2019, which Jim will discuss later in the call.

Additionally, as part of our ongoing initiatives to respond to external factors including raw material tariffs and currency headwinds we have recently announced new cost base price increases including our U.S. kitchen and Brazilian major home appliance business. Finally, we have taken multiple actions related to recent changes in U.S. tax legislation which favorably impacted our effective tax rate for the quarter, most notable a voluntary prepayment of a portion of our long-term pension obligation.

Turning to slide 4, I will discuss our third quarter results. Excluding currency, we delivered global growth of approximately 1.5%, driven by unit volume growth in North America and Latin America and strong global price mix. Ongoing EBIT margin was 6.2% and price mix was more than offset by continued cost inflation and increased marketplace investments related to recent product launches.

As mentioned earlier, we made a voluntary contribution of approximately $300 million to lower our long-term pension obligation funding which impacted our free cash flow year to date. We will discuss our guidance in more detail later on the call. Our ability to successfully execute cost based price increases and drive improved mix across multiple regions while maintaining strong cost discipline, furthers our confidence that we are well positioned to deliver margin expansion and improve free cash flow conversion over the upcoming quarters.

Turning to slide 5, we show the drivers of our third quarter margin performance. As mentioned earlier, our global price mix improved sequentially as well as year over year and was positive in all four regions. Our previously announced fixed-cost, reduction actions continue to progress in line with expectations.

During the quarter we these benefits were offset by three main drivers. First, the net cost. We experienced rising freight costs as well as volume deleverage, primarily related to our inventory reduction action. Second, raw material inflation continued to be a significant year-over-year headwind impacting third quarter margin by approximately 175 basis points, while unfavorable currency impacted margins by 50 basis points. Finally, our margin was impacted by additional investments related to product launches primarily in North America, which Jim will discuss in more detail later in the presentation.

Turning to slide 6, we once again demonstrated our commitment to delivering significant price mix performance. In total, third quarter price mix improved by approximately 250 basis points compared to the prior year and we delivered positive price mix and all regions. On a sequential basis, every year, every region either maintained or improved price mix, driving quarter-over-quarter improvement of 50 basis points globally. These results demonstrate the success of the initiative which was implemented over the past several quarters.

Finally, we recently announced additional cost based price increases in multiple regions including our you U.S. Kitchen in Brazil businesses, which will become effective during the fourth quarter.

With that, I would like to turn it over to Jim to review our regional results.

James W. Peters

Thanks, Marc. And good morning, everyone.

Turning to slide 8, we reviewed the third quarter results for our North America region. We delivered very impressive results in the quarter with both revenue growth and ongoing margin expansion, in spite of a challenging external environment.

Net sales increased five percent despite an industry demand declined nearly two percent in the quarter. We delivered this growth through strong price mix as well is volume growth due to market share gains, primarily in the kitchen category. Overall, we expanded our ongoing EBIT margin 20 basis points to 12%, as our strong performance overcame more than 200 basis points of raw material, tariff and freight cost inflation. These strong results once again demonstrate the success of our proactive price mix and cost initiatives and show the fundamental strength of our business in North America.

Looking forward, we expect to deliver continued strong results in the region as our previously announced price mix actions and recently announced U.S. Kitchen cost base price increases are expected to offset continued cost pressures next year.

In addition to these actions we expect to deliver continued growth and margin expansion as we improve volume and mix through a steady offering of innovative products including those shown on slide nine.

In the third quarter, we completed the launch of a number of connected kitchen products under the Whirlpool brand. These products combine modern design and compelling features, including Yummly-guided cooking and voice command capabilities. Also, within our North American business, we have made two massive laundry platform investments totaling approximately $100 million.

In the fourth quarter we are launching our brand-new front load laundry line, including a connected all-in-one washer and dryer. These products feature industry-leading innovations.

The second major laundry investment brings significant upgrades to our top load platform and launches later in 2019. This new connected washer and dryer pair will offer brand specific, and consumer relevant innovation in both the mass and mass premium segments. While we continue to focus on cost containment and managing price mix across our portfolio, we are truly excited about the growth and margin expansion opportunities that these and other new products will enable for our business.

Turning to slide 10, we review the third quarter results per Europe, Middle East and Africa region. Excluding the impact of currency, net sales were down 8%. Volume remains a challenge, but we are beginning to see sequential progress with improvement in most countries. EBIT decline versus the prior year as positive price mix was more than offset by unit volume declines and unfavorable productivity due to reducing inventories. Additionally, the combination of raw materials, inflation and unfavorable currency and operational challenges in Turkey impacted results by approximately $40 million or more than 350 basis points.

Turning to slide 11, I would like to update you on the strategic actions we are taking to refocus the EMEA business and return to profitability. First, we have taken specific actions to restore volumes across the core EMEA business. We saw some improvement in the third quarter and expect further improvement in the fourth quarter but the pace and magnitude have been slow. In order to drive a fundamental change in our volume year-over-year, we are focusing on rebuilding relationships with our trade customers and recovering floor spots lost during the peak of the integration. We are also committed to refocusing our marketplace investments towards our most profitable segments to ensure that we not only drive higher volumes but also capitalize on new product innovation to expand margins.

Second, as we announced last quarter we have begun to reevaluate certain aspects of our EMEA business. As part of that effort, we are announcing several new strategic actions to refocus and rightsize our business. We will be exiting a number of lossmaking businesses including our Turkish domestic sales operation which does not include the factory operations, as well as our Hotpoint branded small appliance business. Additionally we are evaluating our South Africa operations for a potential sale as we refocus on our European business.

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Together, these three businesses represent approximately $230 million in revenue and a sizable EBIT loss of $60 million for the full year 2018. Finally, we've announced a new $50 million fixed cost reduction initiative for the region which is expected to deliver benefits in 2019. This initiative is in addition to the $150 million global fixed cost reduction announced last year. As a result of all these actions, we expect to drive approximately $100 million in annualized EBIT improvement in EMEA before exit cost as actions are completed throughout 2019. This represents a step function improvement to our regional cost structure and is the first step to restoring profitability and getting back on track toward our long-term margin targets for the region.

With that, we turn to slide 12 to review the third quarter results for Latin America region. Excluding the impact of currency, net sales increased approximately 2%. Ongoing EBIT increased 11% as strong price mix and volume growth more than offset $15 million of raw material and currency headwinds driving margin expansion. We delivered these strong results through unit volume growth, share gains and positive price mix. We are well positioned to deliver margin expansion in Latin America in the coming quarters through strong cost discipline and realizing the benefits of recently announced cost base price increases in the region.

We now turn to the third quarter results for our Asia region which are shown on slide 13. Excluding the impact of currency net sales decline 4%. We delivered EBIT of $13 million, a solid improvement versus the prior year. Our third quarter results were positively impacted by EBIT improvement in China and positive price mix. We delivered strong results despite raw material inflation of approximately $10 million and productivity headwinds related to lower volume levels and temporary industry demand weakness.

Now I would like to turn it back over to Marc to review our guidance.

Marc Robert Bitzer

Thanks, Jim. On slide 15 we will review our updated guidance assumptions. We continue to expect total revenue to be flat to the prior year, as strong price mix is offset by lower unit volumes. Despite the success of our global price mix and cost reduction initiatives as well as the continued strength of our business in North America, we are slightly revising our ongoing EBIT margin expectations as a result of weaker than anticipated results in Europe from the second half.

We now expect to deliver free cash flow of approximately $600 million, primarily driven by our voluntary pension contribution. Absent of our voluntary onetime items which deliver approximately $800 million in underlying free cash flow this year.

Finally, we expect an ongoing 2018 effective tax rate of approximately 10.5% for full year, driven by our voluntary pension free funding and additional tax pending action. As a result of these adjustments, we are narrowing our ongoing earnings per share guidance towards the high-end of our previous range. We now expect to deliver ongoing earnings of $14.50 to $14.80 per share, which will be an all-time record.

Turning to slide 16, we show the updated drivers of our ongoing EBIT margin guidance. We continue to expect to deliver approximately $400 million or 2 points of net benefits from improved price mix as our global cost base price increases have delivered strong results in line with expectations.

Our previously announced fixed cost reduction actions remain on track to deliver $150 million benefit this year. However, we have reduced our expectation for net cost as volume weakness has impacted conversion and fuel price inflation has continued to impact our freight cost.

Finally, our guidance for raw material inflation, currency and marketing investments are unchanged. Overall, we now expect to deliver 6.4% ongoing EBIT margin this year.

Now Jim will cover our region regional guys and cash priorities.

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James W. Peters

Thanks, Marc. On slide 17 we show our region industry and EBIT margin guidance. We now expect the U.S. industry to continue to build on the growth we saw in September and deliver modest growth of approximately one percent for the full year. And we continue to expect to deliver approximately 12% ongoing EBIT margin in North America for the full year.

In EMEA, we now expect to deliver EBIT margin approximately negative two percent to three percent.

Finally, our guidance for the Latin America and Asia is unchanged.

Turning to slide 18, our total free cash flow guidance for 2018 remains essentially the same as our previous guidance. We have reduced our guidance for cash earnings as a result of our performance in EMEA. Capital expenditures have been slightly reduced due to changes in the timing of certain projects. Excluding the impact of discrete voluntary items, our full year 2019 free cash flow expectation is approximately $800 million. Our updated free cash guidance reflects approximately $350 million of pension pre-funding we discussed earlier, as well is the benefits of a real estate portfolio optimization opportunity expected in the fourth quarter.

Turning to slide 19, we show our capital allocation priorities for 2018, which are unchanged and on track. We continue to expect to close the sale of our Embraco compressor business in 2019. In the third quarter, we repurchased approximately $100 million of common stock and we expect to continue repurchasing shares in the fourth quarter.

Year-to-date, we have returned approximately $1.3 billion in cash to shareholders, which already represents an all-time record on an annual basis.

Now turn it back over to Marc.

Marc Robert Bitzer

Thanks, Jim. Turning it slide 20, I would like to take a moment to provide a few assumptions regarding our current expectations for 2019. We expect modest global industry growth in the low single digits, with the U.S. industry showing growth of approximately one percent.

A positive view on the U.S. appliance industry is based in part on our perspective the regarding the U.S. housing market. While we recognize the sluggish trends in housing starts in existing home sales, there are some more favorable fundamentals related to housing supply and demand that are getting attention.

First, housing recovery has been held back by massive supply constraints. Since the end of the recession, housing starts have been below the 25 year average of 1.3 million units per year.

Further, the current age of the U.S. rental stock is now 40 years and 100% of the new apartment supplies since the recession have been fully absorbed.

Secondly, supply constraints have led to a strong appreciation of home prices. In essence, home prices paced well ahead of where you would expect them to be in the cycle. This, coupled with mortgage constraints and rising interest rates, has tempered demand.

And thirdly, we are now seeing a scenario where slowdown of home price appreciation and a slight increase in inventory will meet strong demand fundamentals, including favorable demographics, a homeownership rate at a 52 year low and a strong need for rental homes and apartments. We expect the culmination of these factors to lead to continued recovery in the housing markets though perhaps at a slower pace, which in turn would help ensure continued healthy to demand for new appliances.

While we believe the U.S. industry will continue to growth in the coming years as a result of these factors, we also want to be clear that our North American business is well positioned to deliver strong results in any environment, as

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evidenced by our performance this year. Shifting to costs for 2019, we currently expect raw material and tariff inflation of approximately $300 million, similar to what we are facing in 2018. We do expect our previous and recently announced cost base price increases to fully offset this cost inflation by continued cost discipline and focused cost take out will enable us to expand margins in the coming year.

Finally, we anticipate significantly reduced restructuring expenses and an ongoing effective tax rate in 2019 of less than 20%. At this point, I also want to remind you that we will provide our guidance for 2019 on our fourth quarter earnings call in January.

Now, we will end our formal remarks and open it up for questions.

Q&A

Operator

[Operator Instructions] We'll take a question from Ken Zener of KeyBanc Capital.

<Q - Ken Zener>: Good morning.

<A>: Good morning, Ken.

<Q - Ken Zener>: So it's been quite a year, very steady U.S. results as you're gaining price amid lots of international volatility. So just because Europe was such a big adjustment, I would say, this year, and I think it's important what you're doing in your small business appliance, so you're walking way from $230 million of revenue, which is a $60 million loss. Just for perspective, was that business, businesses, were those making money in let's say FY '16 and FY '17 we and I ask because I'm trying to understand if you can shrink your way to profitability given your I believe FY '20 margin targets, which are still below your long-term targets of 7% to 8%. I'm just trying to understand how you might be get there sooner on the margin basis.

<A - Marc Robert Bitzer>: So, Ken, is Marc. So maybe let me split the answer in two pieces. First, because of the U.S., obviously, we are very pleased with our U.S. results in Q3. We had revenue growth, we had share growth, pricing found traction, we overcame a lot of headwinds and delivered 12% margin which I think is a very, very strong results given the overall environment, so we are really pleased with our U.S. performance.

Specifically on European, the actions which we are now basically fall into a bucket we call noncore business, the Hotpoint SPA business, the Turkey, domestic sales, it's not for and production, it's domestic sales and we are looking at options for South Africa. As you saw in the presentation, that's roughly around $230 million revenue, $60 million loss this year. Not specific to your question, if I would look back at full year 2016, these are businesses which even over the longer term did not create a lot of value for us or no value at all. Specifically Turkey, even turkey in the health environment is a tough business because you have strong local competitors and there's a strong franchise network in stores which is always difficult to get into.

So I would say even in a normal environment, it's a tough market, and basically this was under the headline we want to stop certain bleeders but we also didn't see a long-term perspective to create value. Now also linked to your point about shrinking your way to profitability, no, what we are doing with these actions is we want to eliminate some bleeders, we want to give the team a chance to focus on the core businesses, which we are making money and we can make a lot of money in our core markets where we are strong, so this is very much about the focus. The ultimate way to profitability beyond restoring volumes, which is more in the short term, ultimately comes back to what I referred to in the previous conference calls. We have to strength in our so called built-in business which is the kitchen business. That's our path to profitability beyond the short-term actions of restoring volumes.

<Q - Ken Zener>: Thank you. Was that two or one. Can I ask another one, Marc?

<A - Marc Robert Bitzer>: Sure.

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<Q>: Okay. In the U.S., looking at the volume and price, I had thought looking at 2012, when you guys got about 5% price, which is where you're kind of running, volumes in the industry or your volumes actually had fallen 5% that year. Realizing there's Canada and Mexico in there. Do you think elasticity, we saw in 2Q where you got price, volume was very weak, now you outpace the market with 5% price. Is there elasticity after a certain period of price introduction, which is to say you're gaining share, is that because the price increase has abated and/or we received lots of questions from clients about the Koreans, LG Samsung perhaps having run out of

pre-tariff product. Could you just talk about price and volume dynamics related to those two items, elasticity in the Korean tariffs? Thank you.

<A - Marc Robert Bitzer>: So, Ken, it's Marc again. First of all, on the question of elasticity, I am always really careful to give a precise number for elasticity for a number of reasons. First of all, particularly if you look at the current quarter, there is sometimes a difference between sell in, i.e., what you sell into trades, sell through and other elements. I would always argue on a full year base, there is limited overall category price, at least what has to do with the consumer side, i.e., I would say on a full year base, consumer prices do not necessarily impact consumer demand in a strong way.

Having said that, of course, is a highly competitive environment so at any given point you have competition out there, which drives a certain amount of elasticity. But I would argue what we are seeing this year the U.S. has probably been our strongest price mix execution by any historical standard. So we are very pleased about the traction, how the team has implemented it.

And you're referring to laundry, I want to remind us also our first price increase was kitchen. So this was a cost based price increase and additional mixed actions throughout our entire business, not just the laundry, it's also on the kitchen side. And we are really, really pleased with that, and I think we've proven that we understand how we manage certain categories in a highly competitive marketplace.

Operator

Our next question is from Michael Rehaut of JPMorgan.

<Q>: Thanks, good morning, everyone. First question, if I could go back to Europe for a moment and think it makes a lot of sense, obviously, exiting some loss making regions or product lines. But if I'm looking at what you're expecting to lose for the full year this year, it will be a little bit above $100 million. So my question is, as you look towards 2019, are there other areas that perhaps top line recovery, that you think could get you towards being in the black for 2019?

And specifically I am thinking about trying to stabilize or recover some of the volume loss, and obviously it's easy to lose flooring or share, and it sometimes much harder to gain it back. So just want your thoughts around what additional items you need to do to push yourself back into the black and how you're thinking about the timing and the fruits of some of the upcoming labors around trying to recover some of that volume.

<A - Marc Robert Bitzer>: Michael, I mean, first of all, on these actions which are known, they are critical, they're necessary, but they are only part of the answer, as you point out. First of all, beyond exiting certain loss-making business, keep in mind [ph] we now have a fixed cost reduction which can structurally lower our infrastructure cost base with a sustained benefit.

But you have to, you're right, we have to stabilize the volume, that's what we always said. And frankly even where we've seen improvement, the improvement has been slow. In the first half, as you saw in the presentation, we lost 18% volume, which obviously given the fixed costs intensive business has a massive impact on how you deleverage and the cost you carry.

In Q3 we have been able to slightly improved minus 12 but from minus 18 to minus 12, yes, that's an improvement, but it's slow, very simply because it's very difficult media to regain floor spots, to re-motivate freight customers given certain annual agreements.

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Q4 starts better as you saw in the presentation. We expect roughly minus 8, so it's a further improvement. But ultimately it comes back to we want to exit the year with pretty much a flat trend from one [ph] perspective and that is the starting point to have a profitable business in Europe.

<A - James Peters>: And, Michael, on top of that – this is Jim – I would say that as you look at some of the inventory actions that we've taken to reduce our inventory levels year-over-year, a significant portion of that does come within EMEA, so there is additional deleveraging due to volume that was on top of just the volume share loss we had within EMEA.

<Q>: Great, thank you.

I guess the second question to shift towards your 2018 margin walk, where you have reduced the net cost benefit for the full year for 125 bps to 75 bps, I think if you look at what you've been able to do so far this year in the first quarter you hit that 75 bp Mark, the last couple of quarters it's one more like 25 bps, if I'm looking right on that line item. So it would imply a much stronger number for the fourth quarter. I believe well over obviously just the math dictates well over 100 bps, 125 bps of a benefit. So what's driving that 4Q waiting in terms of either there are certain actions that you expect to kick in or better just productivity from a higher growth number or higher volume number or revenue number? What's driving that 4Q payoff, so to speak?

<A - Marc Robert Bitzer>: Mike, it's Marc. First of all, just as a point of clarification, what we have in the net costs is also including in freight inflation, which as you know has been massive, in particular in the U.S., but for most parts of the world. So what you see is a raw material tariff inflation is literally only raw material and what we've seeing in tariffs. Anything which we see on freight costs, labor inflation, all these elements are kind of a negative to think of for net cost. Just for a point of clarification.

Specific to your question between Q3 and Q4, want to come back to a point which Jim made before. We made a very significant inventory reduction as a company in Q3. As you may recall, end of Q2 we pretty much had flat inventories year-over-year if you include the in-process inventory. And end of Q3 we are $300 million down. As you all know, every dollar of inventory captures a certain cost leverage, or cost benefit, so that weighs heavily on our Q3 net cost take up, because we are deleveraging, because we took so much volume out in Q3. So in certain ways, that part will not be a burden in Q4 and that explains why we are kind of in Q4 back to I would say the run rate at which you would have expected coming out of Q1 and Q2.

Operator

Our next question is from Sam Darkatsh of Raymond James.

<Q - Sam Darkatsh>: Good morning, Marc, good morning, Jim. How are you?

<A>: Good morning, Sam.

<Q - Sam Darkatsh>: Two questions, first with respect to the implied fourth quarter guide for U.S. industry shipments. At least the math would suggest it looks like you are guiding for AHAM essentially to be up mid-single digit. That optically to some could appear aggressive, especially if the Sears inventory in the channel gets bled down.

Now favorably I'm guessing you're baking in some pre-buy at retail ahead of your price increases, but how should we think about how you're thinking about sell-through at retail in the fourth quarter and why sell-through would improve in the fourth quarter versus what we've seen earlier this year we

<A - Marc Robert Bitzer>: Sam, so first of all, your observation is correct, I mean, Q3 sell-in was negative 1.7. Keep also in mind that was still strong impacted by a soft July and August. September started to come better. Actually in September we saw finally kind of the overall getting closer to what we've seen through a sell-through on a full year base. We already on our previous earnings call we said sell-through we see running between zero and plus one or sometimes it's plus 2%. So our expectation of full year is that sell-in is very similar to the sell-through which is around plus 1%. Particularly on Q4, to your question, first of all, I would not only overestimate the Sears inventory impact,

because I think it's a lot less than you might assume. Second point is, yes, we do expect some industry shipments particularly in November/December related to our already announced cost base price increases. And we already see right now even on the sell-through trends in September and early October that kind of as we are heading into the promotional periods I think the sell-through actually fairly solid.

<Q - Sam Darkatsh>: Next question, you have a lot of moving parts with free cash flow in 2018 with tax, with restructuring, with discretionary items, all that stuff, you have the long-term target of 5% to 6% of sales for free cash flow. I don't want to peg you on a specific free cash flow for 2019, but can we, how realistic is it to think that 2019 might see free cash flow in that 5% to 6% range knowing how many, how much noise there was this year in free cash?

<A - James Peters>: Yes, Sam, this is Jim, and I think that's a safe assumption as you look forward. Because a couple of things will happen here is one, obviously this pension contribution was one a time item, $350 million. And it's the equivalent of what would've been our next five years of pension contributions. So we have accelerated that peace and that comes out of the future years.

Additionally on the restructuring cash, we are at the peak of the payout of the restructuring cash. And so that should come down over future years.

And then as we look forward, while we will have a significant benefit this year from working capital, we still believe there are working capital opportunities not the same level, but there are working capital opportunities as we go forward into 2019.

<Q>: So five percent to six percent is realistic for next year?

<A - James Peters>: It is, yes.

<Q>: Okay. Thank you.

Operator

Our next question is from David MacGregor of Longbow Research.

<Q>: Yes, good morning.

<A>: Good morning, David.

<Q>: I've got a lot of talk about this quarter, a lot of moving parts, you guys of got a lot going on. We haven't really talked about Kenmore yet, so with this year's exit, maybe could just talk about that? I know a lot of people are trying to make sense of this. Can you talk to the extent you can about potential inventory liquidation and what kind of impact that should have on the business, maybe to the extent you're seeing order cancelation right now is a consequence of this? By not just Sears but other retailers looking to get their inventory levels down. Just any kind of color you can provide on that I think would be helpful to people?

<A - Marc Robert Bitzer>: So David, it's Marc. Obviously a lot has been written about Sears and Kenmore and I don't need to add a whole lot to it. First of all, as we already in our announcement last week, the impact on our business is very limited. You saw in our, kind of, announcement, we had, at the end of the day we had receivable explosion or for roughly around $30 million, which is very low if you could have looked at historical standards. So we managed that down in a very proactive manner. You will also see in our details we accrued for more than half, or about half of it. And there is uncertainty around it.

Now obviously, Sears is in the Chapter 11 process, there's a lot of moving pieces right now. I would expect that Sears will be active in the market with a certain store footprint in Q4, and we're right now – while we protect our own interests, we are at the same time are in a very constructive dialogue with Sears about what it all means in Q4 going forward. So I would see some Sears activity also happening in Q4 and we will be part of that.

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But again, there's a lot of moving pieces and, let's see. But I think we are very well engaged in the process, we have the right support and we will manage it appropriately and accordingly as you would expect it from us.

Particularly on the questions of the inventory and inventory liquidation, you should assume that the Sears inventory position was not very high. Sears first of all, by historically always had a very efficient and effective supply chain. So Sears would have historically even been not a big inventory, and that inventory came further down over last year.

So in any model you have, I would remind, don't overestimate last year's inventory which is out there, because it's very limited.

<Q>: Sears is also responsible for whatever work is in process with the manufacturers, so I guess it's a little bit bigger than just the inventory they had in RDCs. Is there any way you can, sort of, give us some kind of assessment is, does it look like a month or a couple of months' worth of shipments?

<A - Marc Robert Bitzer>: So, David, I can give you answers for also the manufacture, keep in mind we are not an overseas producer. We are largely a domestic producer.

<Q>: Right.

<A - Marc Robert Bitzer>: So we have the benefit of a very short and responsive supply chain. So our, basically our Sears products historically, they are what you would call built to order. We produce once we get the order and the forecast. So we don't have the big ships coming over across the Pacific with a lot of inventory. We build to order, have a short supply chain and that's also probably the reason why our impact on our business is very limited. So if you think there is big some warehouse in Ohio where we keep a lot of Kenmore units, the answer is no.

Operator

Our next question is from Susan Maklari of Credit Suisse.

<Q>: Good morning. My first question is, I wanted to think about a lot of the moving parts that are coming through in terms of how the fourth quarter margin could come together. It feels like you've got some tailwinds as it relates to some of the pricing actions that have been taken, some of the volume and maybe even some of the pull forward that can come in there. How should we think about that relative to some of the more normal trends that come through in terms of sort of promotional events and things like that? I guess what I'm trying to get to is could that fourth quarter margin in North America actually sort of have some of its normal seasonality negated by some of these tailwinds?

<A>: No. I would say that you will see within the fourth quarter for North America a similar type of margin seasonality in all that, because as you mentioned, the big drivers within there, one it is a highly promotional period and that's very similar year-over-year, then two, we also, our kitchen, our countertop appliance business, that's the prime season for that. So those are the two big drivers that affect the Q4 margins in North America, and we don't see any significant differences this year.

<Q>: Okay. And then on the slides, you noted that inflation is expected to stay around that $300 million range and there are no changes. Can you just give us some context of what you've been seeing in terms of your key raw material inputs and what the outlook is for those?

<A - Marc Robert Bitzer>: Susan, it's Marc. So first of all, this year, we said we will expect the raw material inflation, and tariff inflation of around $350 million. As we pointed out, that is largely driven this year by steel prices including the Section 232 effect and plastics in all forms. So these were the biggest items behind the raw material inflation. And on top of that we have a tariff impact which impacts certain strategic components like motors or electronics. We do expect a similar effect for next year as you've seen in our presentation. At this point we would assume around a $300 million raw material and tariff against that. It is sustained but it's certainly not higher than we've seen in 2018. And that largely comes from one element is just the carry over elements of the tariff which you can quantify, and the other element is on steel, we see a stabilization or actually slightly coming down from its peak. There's still some uncertainty particularly around the oil based products, that uncertainty still remains and once we see more developments, we will

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give you updated guidance on the real raw material outlook for 2019 in January.

Operator

Our next question is from Curtis Nagle of Bank of America Merrill Lynch.

<Q - Curtis Nagle>: Great. Thanks very much for taking my questions. Marc, just a quick follow-up on the $300 million in pressure you guys are expecting next year. I guess could you be a little more specific on what steel price that was based on? Is it the current, does it assume continued, I don't know, walk down in price? I don't know, I guess how much cushion do you think you have in that $300 million, and I guess the confidence that we don't see another round of increases in the assumptions like we did last year and the year before?

<A - Marc Robert Bitzer>: Curtis again to clarify, as long as we give raw material outlook, it's against the forward expectation. It's never against the current spot price because we don't, in particular with the raw material items we don't by spots. We have long-term contracts or we have hedges. The only elements which we buy more short-term is plastics, because you can't hedge it and you can't have a full year contract. So our outlook is against expected forward rates, not against current spot prices.

Now of course spot price always to some extent influence what you expect on a go forward basis. So what we basically outlook right now is based on steel price development and based on certain spot price. This is what we would expect to lock in on a full year base with current assumptions. So on the I think in the next two or three months we will get a lot more clarity around this one. The uncertainty still remains about plastics. I also want to remind ourselves that in particular, in 2018, the big surprise in raw material in Q1 and Q2 was around the plastics and the sudden development of plastics. I mean on top of that we have the tariffs which frankly we did not have on the horizon when we started the year. So the tariffs are now known so we know what we are counting on this one. But of course in an environment in which we are living, with a lot of inflation there's always some uncertainty around raw materials and inflation associated with that.

<Q - Curtis Nagle>: Okay. Fair enough. And then just a question for Jim. I guess could you help us bridge in some detail the free cash flow for the year? At a pretty big deficit, I understand the 4Q is a quarter where you generate cash flow, but at least historically it looks like the gap is pretty big. So yes, I've just kind of been working the order, one of the biggest pieces and how confident are you in hitting that $600 million target for the year?

<A>: Yes, Curtis. So the biggest driver overall right now year-over-year is working capital. And as I mentioned earlier, our inventory levels are significantly below where they were last year but we reduced those inventory levels in Q3 of this year versus Q4 last year. And when we reduced them in Q3, you will also see a lower level of Accounts Payable, which means we have significantly less that we payout within the fourth quarter this year versus last year. That's the first biggest driver that we see.

The next thing that we see on that, what we've said, CapEx will be slightly lower this year than we originally expected. Most of that is coming the fourth quarter, and that's just due to the timing of some of the investments that we are making as we expect those to flow through.

And then the other things that I mentioned in the prepared remarks earlier was the real estate portfolio optimization opportunities that we have that are partially offsetting the pension contribution. And those are about $125 million which is coming in Q4 this year which will be different from Q4 last year.

Operator

Our next question is from Michael Dahl of RBC Capital Markets.

<Q>: Hi, thanks for taking my questions. My first one's actually a follow-up on free cash, and I wanted to ask two different things about it. The first, just touching on that last response regarding working capital, just given the

significant adjustments you've talked about making this year, how should we think about working cap as it relates to kind of a baseline for 2019 and whether there is further room for improvement or if it should be more neutral?

<A - James Peters>: Well, as I said earlier, for this year, it will be a significant item for us, and a significant opportunity. As we look forward the opportunity will be smaller, but there will be continuing opportunities to reduce working capital. But this year we are looking at that being approximately an incremental $120 million above last year.

I would say next year it will not be at this year's level but will continue to reduce our work capital. That primarily comes through inventory, that's where most of our opportunities sit as we look both globally, but as well as throughout our entire portfolio, we see opportunities to reduce inventory levels and maintain same levels of service.

<Q>: Got it, and the second related question is really, and this ties in taxes as well, but just, I want understand better the change in tax rate expectations. And to the extent that the pension funding contributed to the lower tax rate this year, I would assume that it also is having some benefit on your cash earnings? And so I wanted to understand, kind of, you're pointing out the $800 million of, excluding voluntary items, but it seems like tax rate would've been higher if not for the pension funding. So what's the cash impacts of that from a tax benefit standpoint, and then on your overall tax rate?

<A - James Peters>: Yes, so again, you are correct that this has an impact on our overall tax rate of about three percent for the year. So if you look at that go forward, that's why we've said we are at 10.5% this year, we expect to be below 20 in the future years, but that three percent right now would obviously not repeat itself next year.

In terms of impact to cash earnings, it's relatively small this year. If you just think about the benefit overall in $350 million is around $40-some million. And so again, not all of that comes as cash within this year also, so that's a very small impact on our free cash flow for this year.

Also, looking at the tax rate go forward and the change we made throughout the year, what's happened is the tax regulations have evolved a lot, and it's allowed us to – at the beginning of the year, most of our tax planning strategies we had in past were no longer available, but it's allowed us to identify new opportunities. And so we've continued to refine that as we've understood it better.

Operator

Our next question is from Alvaro Lacayo of Gabelli & Company.

<Q>: Good morning, everyone. Just one question regarding EMEA. You talked about the noncore business exits, the fixed cost reduction, can you maybe just give us an idea of timing on when you expect to see the brunt of these benefits? And then if you can quantify how inventory reductions impacted EMEA in 2018, that would be helpful as well?

<A - Marc Robert Bitzer>: Alvaro, so on the first of all, on the timing of these actions, we said it over the next few quarters, so you should think probably about the next two or three quarters where we try to exit some of these businesses. And so the actions are underway but it will not be done in one quarter. So it could be fast in the Hotpoint small domestic business we have to exit certain franchise networks, so I would say over the next few, i.e., next two or three quarters that's when you should expect them and that's when you should see the benefits ramping up. Same is probably true on fixed cost where you start seeing some benefits as of Q1 next year and then slowly ramping up.

<Q>: And just on the inventory reductions and what kind of an impact it had on EMEA during 2018?

<A - Marc Robert Bitzer>: So on inventory what you have, first of all I mentioned earlier the overall company year-over-year inventory reduction of $300 million. A big part of that is actually related to Europe. So you add in Europe, the combination of both lower volumes from sales side and an initial inventory reduction. So you should assume that kind of our European production base ran this year roughly with about minus 20% volume. So you had a very significant and cost deleverage effect sitting in the entire 2018 numbers in Europe.

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Operator

Our next question is from Doug Clark of Goldman Sachs.

<Q - Doug Clark>: Hey, great. Thanks a lot. I have two related questions on North America. First is in terms of the price increases that you're taking, earlier in the year you took some price increases a bit more aggressively or earlier than some of the competitors. I'm just curious if these price increases are going to be replicated throughout the industry. Or if heading to the holiday season or excuse me that might just cause some noise. That's first question. And second question is I'm curious if you can give us a sense of how much of your North America business in particular is purchased through financing and if the rising interest rate environment, has any impact on that.

<A - Marc Robert Bitzer>: So, Doug, it's Marc. Honestly, on pricing, I can't tell you what the other competitors will be doing, that's their decision. We take the pricing we see cost pressures which we can't mitigate through mix or additional cost take out actions. That's what we've done late last year when we announced the kitchen base and then early this year we announced the laundry one. As you saw from or heard from our comments, we expect raw material and cost inflation also next year and that's why we announced the price increase which will be coming into effect in the kitchen side in early January. Obviously as you will understand I can't make comments about our planned or unplanned price increases because we never do it. And again I can't tell you what the competitors will be doing. All I can say is just judging on the past is that our team has been able to execute these price increases very well. The fact that we picked up market share in Q3 I think speaks volumes to how well we executed these price increases.

<Q - Doug Clark>: Okay. And then my question on...

<A - Marc Robert Bitzer>: On the financing. I was just coming to it. I would say over North America, the pure consumer financing I would say outside the home building industry is somewhat limited. It is actually a fairly small part. There are other parts of the world like Brazil or what I mentioned earlier Turkey, where you have a significant amount of consumer financing. But the actual consumer financing on appliances in the U.S. is somewhat limited, so if you would see an impact of rising interest rates, if at all you have seen it already on the home building side. You have to finance. It's not so much on the single unit purchase on the appliance side.

<Q - Doug Clark>: Okay. In a quick follow-up, just last quarter you been talking to kind of 4% EBIT margin target in 2020. Is that still the right timeframe or has that moved a bit?

<A - Marc Robert Bitzer>: Yes, Doug, we still expect in 2020 or by 2020 have an even margin of 4% to 5% Europe. So that is consistent. But obviously it is all contingent on us showing now the short-term improvement both in Q4 then for 2019. And we will obviously give more precise guidance around this one in the January earnings call.

I guess with that, we are at our last question.

Marc Robert Bitzer

Let me maybe as we close step back and give a little bit of additional perspective on 2018 even though it isn't over yet. Obviously this has been a year where external headwinds in the form of raw materials, tariffs and currency were far greater than anybody could assume at the beginning of the year when we issued our guidance. In fact, these additional challenges amount to more than $200 million on top of the original $200 million we already planned for.

Being able reconfirm today an all-time record ongoing earnings per share guidance in this tough environment is a result of not only a favorable tax rate but also very strong execution of our price and cost actions. Three of our four regions have delivered margin expansions and growth and we will also turnaround our disappointing Europe performance.

We've also taken a number of actions throughout the world and refocus and rightsize our business including a significant global fixed cost reduction, sale of Embraco and a number of strategic actions now underway in Europe. We have and we will continue to take all the actions necessary to manage for external challenges and improve profitability in every region.

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As I look forward to 2019, I am confident that the actions we've taken and the underlying strength of our business will together deliver significant value for shareholders.

So thank you for joining us today, and we look forward to speaking with you again on our fourth quarter earnings call on January 29.

Operator

This does conclude today's Whirlpool Corporation's third quarter 2018 earnings release conference call. You may now disconnect your lines, and everyone have a great day.

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