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New Rec: Whirlpool Corp.	(WHR: \$109.14)	May 4, 2010
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Position: Sell

Target: \$82.00

\$MM	Q1 10a	Q2 10e	Q3 10e	Q4 10e	2010e	2011e
Revs	4,272	4,717	4,616	4,680	18,285	18,977
EPS \$	2.14	2.67	2.20	1.89	8.89	8.24
Y/Y Gr	135%	157%	92%	51%	104%	-7%
PE	n/a	n/a	n/a	n/a	12.3x	13.2x
PSR	n/a	n/a	n/a	n/a	0.46	0.44
Consens*	n/a	2.62	2.35	2.46	9.75	10.37

* This represents the high-end estimates. We think the shares are trading based on these estimates.

Shares Out: 77M

Market Cap: \$8.4B

FYE: December

Concept:

1. WHR has benefited from easy compares, recent cash for appliance rebates in the US, and a sales tax holiday in Brazil over the last few quarters. Bulls project that the market will stay strong in H2 10 and in 2011 even after the expiration of these temporary benefits. We disagree.
2. Bulls claim that WHR has been gaining market share and will continue to do so. The data do not support this contention and our research actually suggests that WHR is currently losing shelf

space to the competition in front load washers (the fastest growing appliance category in the US) at Lowe's, Home Depot and Sears.

3. Bulls' argue that WHR has altered its cost structure to derive permanent operating profit gains. Our analysis of the company's reported data suggests that the cost cuts were mostly related to reduced advertising spend, which will likely reverse in this competitive environment.

Summary: Whirlpool Corporation (WHR) is a leading manufacturer and marketer of home appliances. WHR was founded in 1911 and is headquartered in Benton Harbor, Michigan. WHR had sales of \$19.4B, \$19B and \$17.1B, respectively, in 2007, 2008 and 2009. By category, 2009 sales resulted from refrigerators (31% of total sales), washers and dryers (30%), cooking ranges (16%), and dishwashers, microwave ovens, other small appliances such as mixers, and hermetic compressors for refrigeration (22%). Major worldwide WHR brands include Whirlpool, Maytag, Kitchen Aid, Jenn-Air and Amana. Regional WHR brands include Bauknecht (Germany), Brastemp (Brazil) and Consul (Brazil). WHR makes Kenmore brand appliances for Sears, which also sells WHR branded products. Sears sales accounted for 10% of WHR's sales in 2009, and have declined by a third since 2006.

WHR manufactures and sells its products worldwide. In 2009, 56% of revenues were from North America (48% from the US), 20% from Europe (which includes Africa and the Middle East), 22% from Latin America (15% from Brazil), and 4% from Asia. At the end of 2009, WHR's principal manufacturing operations were conducted at 37 locations worldwide. WHR has 11 US manufacturing plants. The remaining 26 plants are located in 11 countries, primarily in the Europe region, and to a lesser extent in Asia, Latin America, and Mexico.

Bulls think that a recovering global appliance market, along with market share gains should boost WHR's 2010 EPS to \$9.75 from \$4.35 in 2009, well above management guidance of \$8.10 to \$8.60. The bulls also project that 2011 EPS could be as much as \$10.37, which would exceed WHR's 2007 EPS of \$8.10, posted at the height of the housing bubble. Bulls think that the company's cost cutting has permanently improved the margin structure and expect that operating margins could reach 8% in the future.

We think there are a few flaws in the bullish argument. We agree that WHR will have a better year in 2010 than it did in 2009, but we think this is more the result of easy sales compares in H1 10 than any significant market share gains. A factor the bulls appear to be overlooking is that the rebate for appliances program that commenced in most states in April should have the effect of pulling in demand from future quarters, according to store managers with whom we spoke.

With respect to share gain, we show in the discussion section below that, while WHR may have gained share in one quarter and lost share in another, a comparison of US industry shipment data and WHR volume data does not point to any sustainable share gains. In fact, our store checks suggest that Samsung, Bosch and LG have been gaining floor space at Lowe's and Home Depot for appliances at the intersection of the "mass-market" and premium segments. Frigidaire, an Electrolux brand, appears to have gained floor space in the mass-market segment in conjunction with the introduction of redesigned models. We estimate that the floor space allotted to Frigidaire, Samsung and Bosch front load washers at Lowe's has doubled since February 2010. The overall floor space allocated to front load washers has not changed in that time. A quarter of the store managers with whom we spoke suggested that other European manufacturers such as Miele may introduce front load washers at the high end of the mass market segment. Thus, like the data, our checks also do not support the bullish contention that Whirlpool will continue to gain share. Rather, our checks suggest that Whirlpool could lose share.

Another problem WHR faces is that the Brazilian appliance stimulus program from April 2009 to January 2010 boosted sales in that country. Latin American volumes were up 15% Y/Y and Brazilian sales were up 4% Y/Y in 2009, despite the real's 10% appreciation against the dollar in 2009. We think these tough comparisons will come into play in the second half of 2010. Bulls think that Brazilian sales will be unaffected by the expiration of the sales tax holiday.

In addition, we think that cost improvements in 2009 cited by the bulls as a secular benefit in the future are mostly related to advertising cutbacks that are unsustainable. WHR stated that it had reduced SG&A expenses by \$175M Y/Y in 2009. We note that \$125M of this reduction came from advertising expense reduction. We think it unlikely that WHR would be able to maintain its advertising expenses at 2009 levels in a recovering market, especially when it faces intense competition from Bosch, Samsung and LG at the intersection of the mass-market and premium segments, and from Frigidaire in the mass market segment, as we detail below.

WHR's earnings quality seems poor. For instance, if we were to back out pension curtailment gains (lower pension liability as a result of factory closures), adjust for lower warranty accruals and lower advertising expenses, and assume a normalized tax rate of 15% (the company's forecast for 2011), we obtain EPS of \$0.40 in 2009 versus reported EPS of \$4.35. Free cash flow per share, adjusted for changes in working capital, was \$2.67 in 2009, well below the reported EPS number.

WHR issued EPS guidance of \$8.10 to \$8.60 for 2010 when it announced Q1 10 results. The company forecast that incremental commodity costs in 2010 would end up at the higher end of the \$200M-\$300M range of its initial forecast issued in February when it reported Q4 09 results. While “street” analysts are negative on Electrolux because they think its costs could go up due to sharp increases in iron ore and energy costs recently, they appear sanguine about WHR’s ability to manage costs. Just a few days ago, a commodities column in the Financial Times projected that steel costs could be up 33% Y/Y in 2010. Steel is WHR’s biggest commodity cost, and we estimate that it accounts for 10% of COGS. While WHR’s steel costs in the US and Europe are hedged, steel costs in the fast growing emerging markets are not. A 33% Y/Y increase in steel prices alone would add \$200M to costs in 2010, even if one were to assume that only WHR’s emerging markets would be affected. Any meaningful increase in oil prices could result in commodity costs well above what the company is expecting. It is unlikely that WHR would be able to recover these costs through mix shifts, or price increases, given the competitive environment we described earlier.

As a result, while WHR could meet newly raised Q2 10 estimates, the compares get tougher in the second half, and we expect WHR to miss estimates in H2. Our sales expectations are similar to that of the bulls for Q2 10, because of the easy comparisons and demand pull-in from the appliance rebate programs, but our revenue forecasts for Q3 10 and Q4 10 are 2% and 9%, respectively, below those of the bulls. We think the bulls have higher expectations than us for US sales in Q3 10, and much higher expectations than we have for US and Brazilian sales in Q4 10. We expect a Y/Y sales change of -1% in H2 10 versus +4% for the bulls.

Moreover, we think that the advertising expense reductions that we described earlier are unsustainable, given the competitive environment. We think the impact of these margin pressures will become apparent starting in Q3 10 as revenue comparisons get more difficult. As a result, our total EPS estimate of \$8.89 for 2010 is well short of bullish forecasts of \$9.75. Similarly, we estimate 2011 EPS of \$8.24, well shy of the high-end “street” estimates of \$10.37.

WHR shares trade at 11.3X high-end 2010 EPS estimates (which assume a zero tax rate), 10.6X high-end 2011 EPS estimates and 5X high-end 2011 EBITDA estimates. Because, we expect earnings to miss significantly, we apply a slightly lower 10X multiple to our 2011 EPS estimate and a 4.5X multiple to our 2011 EBITDA estimate to set our price target. Both methods yield a valuation of \$82 per share. The primary risk to our thesis is robust H2 2010 demand for appliances as a result of a substantially stronger housing environment. We consider such a possibility unlikely.

Background:

WHR makes and sells a variety of home appliances, including washers and dryers, refrigerators, dishwashers, cooking ranges, microwave ovens, and small appliances, such as mixers. It also produces hermetic compressors for refrigeration systems. Table 1 shows WHR revenue by category for the last four years.

Table 1: WHR sales by appliance category: 2006-2009

(Amounts in \$M)	2006	2007	2008	2009
Home refrigerators & freezer sales	5,474	5,678	5,760	5,345
Home laundry appliances	5,341	5,833	5,825	5,200
Home cooking appliances	2,909	2,995	3,128	2,809
Other	4,356	4,902	4,194	3,745
Total	18,080	19,408	18,907	17,099
Home ref. & freezer % of total sales	30%	29%	30%	31%
Home laundry % of total sales	30%	30%	31%	30%
Home cooking % of total sales	16%	15%	17%	16%
Other % of total sales	24%	25%	22%	22%

Source: Company reports

On March 31, 2006, WHR acquired Maytag Corporation for \$1.9B, consisting of \$848M in cash and 11.5M shares. The acquired Maytag brands included Maytag, Amana, Jenn-Air and Magic Chef. Subsequent to the acquisition, WHR disposed of the Hoover, Jade and Dixie-Narco businesses of Maytag. Maytag had \$4.9B of sales in 2005.

WHR sells its products worldwide. Table 2 shows revenue contribution by geographic region for the last four years. There has been a notable revenue contribution shift from North America to Latin America in the last few years.

Table 2: Revenue contribution by geographic region: 2006-2009

	2006	2007	2008	2009
North America	64%	60%	57%	56%
Europe	19%	20%	21%	20%
Latin America	15%	18%	20%	22%
Asia	3%	3%	3%	4%

Source: Company reports

In Table 3a, we show unit shipments by geographic region. Note that North American unit shipments were sluggish even before the collapse of the housing market. We point out that that while the company reported a 22% Y/Y increase in North American unit shipments in 2006, this increase was due primarily to the Maytag acquisition. On an organic basis, Y/Y unit shipment growth in North America was just 2% in 2006. Also note that the Latin American region is the only

one to exhibit double-digit volume growth recently. Brazil accounts for two-thirds of WHR's Latin American revenues.

Table 3a: Unit shipments by geographic region: 2006-2009

	2006	2007	2008	2009
North America unit sales	32,413	30,352	27,924	26,248
Europe unit sales	13,177	13,641	13,641	13,095
Latin America unit sales	6,987	8,303	9,548	10,503
Asia unit sales	2,346	2,558	2,737	2,929
Other/eliminations	(42)	(3)	(21)	(22)
Total unit sales	54,881	54,851	53,829	52,754
Y/Y North America unit sales	22%	-6%	-8%	-6%
Y/Y Europe unit sales	5%	4%	0%	-4%
Y/Y Latin America unit sales	23%	19%	15%	10%
Y/Y Asia unit sales	6%	9%	7%	7%
Y/Y consolidated unit sales	17%	0%	-2%	-2%

Source: Company reports

Table 3b shows ASPs by geographic region. Note that price pressures have increased in the last few years. While the company (and the industry) was able to offset raw materials costs somewhat by raising prices or keeping them stable prior to 2008, the Y/Y decline in raw materials costs appears to have triggered price competition in 2009. An example of this is the 50% reduction in pricing of front-load washers undertaken by Samsung in the US in the second half of 2009. The depreciation of the Korean Won against the dollar in the first half of 2009 no doubt enabled Samsung to wage this price competition.

Table 3b: WHR ASP by geographic region: 2006-2009

(Amounts in dollars)	2006	2007	2008	2009
North America ASP	359	387	386	365
Europe ASP	260	282	294	255
Latin America ASP	385	414	388	353
Asia ASP	195	218	217	223
Consolidated ASP	329	354	351	324
Y/Y North America ASP	11%	8%	0%	-5%
Y/Y Europe ASP	2%	8%	4%	-13%
Y/Y Latin America ASP	1%	7%	-6%	-9%
Y/Y Asia ASP	2%	12%	-1%	3%
Y/Y consolidated ASP	8%	7%	-1%	-8%

Source: Company reports, OWS estimates

In the US, WHR sells most of its appliances through Sears, Lowe's, Home Depot and Best Buy. Additionally, WHR makes appliances for Sears that the latter sells under the Kenmore label. Sears accounted for 10% of WHR's sales in 2009.

Table 4 shows the trend of WHR sales at Sears in recent years. While WHR sales to Sears rose 10% in 2006 due to the acquisition of Maytag, the company's sales to Sears have declined Y/Y in each subsequent year.

Table 4: WHR sales to Sears from 2006 to 2009

	2006	2007	2008	2009
Sales to Sears % as of total net sales	14%	12%	11%	10%
Sales to Sears (\$M)	2,531	2,329	2,080	1,710
Y/Y change in sales to Sears	10%	-8%	-11%	-18%

Source: Company reports

WHR's competitors in North America include Electrolux (which sells mass market appliances in the US under the Frigidaire brand and premium appliances under the Electrolux brand), GE, Kenmore (Sears's private label brand appliances which are made by multiple manufacturers, including WHR), LG, Samsung, Haier, Bosch Siemens and Fisher & Paykel. Competitors outside North America include Indesit and Miele.

Discussion:

1. WHR's EPS, excluding restructuring and other charges decreased from \$8.10 in 2007 to \$5.77 in 2008, before increasing slightly to \$5.82 in 2009. On a reported GAAP basis, WHR's EPS was \$8.10, \$5.50 and \$4.34, respectively, in 2007, 2008 and 2009. However, the company handily beat consensus in Q1 10, posting EPS of \$2.51 (excluding items) versus expectations of \$1.24. Moreover, the company guided to \$8.10 to \$8.60 of EPS in 2010 versus consensus of \$6.83.

WHR's shares soared 13% on the date of the Q1 10 announcement. Subsequent to the earnings announcement, bulls boosted their EPS estimates for WHR to \$9.75 and \$10.37, respectively, in 2010 and 2011 from \$7.03 and \$7.37 prior to WHR's Q1 10 announcement. The bulls argue first that appliance industry sales in the US (which accounted for 48% of total sales in 2009) should improve relative to previous expectations in coming quarters, and that WHR should continue to gain share. Second, they think that Brazilian sales and operating margins should beat previous "street" expectations for the remainder of 2010.

Our research suggests that while WHR is likely to have another strong quarter in Q2, comparisons get harder in H2 10 and the company is unlikely to meet the expectations of the bulls. Moreover, we expect WHR's share gains of the past two quarters to subside in coming quarters for reasons discussed below. We also think that the ASP pressure cited above will persist, leading to mix degradation.

Finally, while we think Brazilian sales will increase Y/Y for all of 2010, we note that Brazil had a sales tax holiday for appliances from April 2009 to January 2010. This factor, as well as easy comps for Q4 09 and Q1 10 resulted in Y/Y Latin American sales growth of 28% and 40%, respectively, in those two quarters on a constant currency basis. By the same token, comparisons against this period get much tougher in Q4 10, and we think the bulls' expectations of flat Y/Y sales in Latin America in that quarter are unrealistic. We forecast a 10% decline in Latin American sales in Q4 10.

Taking these factors into consideration, we forecast 2010 and 2011 EPS of \$8.89 and \$8.24, respectively, which is well below the bullish expectations. If we are right, the share price could decrease meaningfully.

2. Table 5 shows US industry shipments of major appliances (washers, dryers, refrigerators, freezers, dishwashers, ranges and compactors) since the beginning of 2008. Note that while WHR outperformed the industry in shipments in the last two quarters, its shipment performance has mirrored the industry average over time. Thus, the assumption of some bulls that the company should be a secular share gainer in coming quarters is unsupported by historical data. (We point out that WHR reports Y/Y changes in North American (not US) shipments. However, given that US sales constitute 85% of North American sales, we think the conclusions we draw should be unaffected.)

Table 5: AHAM data for Y/Y change in domestic appliance shipments

	Q108	Q208	Q308	Q408	Q109	Q209	Q309	Q409	Q110
Y/Y change in unit shipments	-9%	-8%	-11%	-10%	-16%	-14%	-6%	6%	6%
Y/Y change in Whirlpool NA shipments	-4%	-5%	-11%	-16%	-22%	-17%	-6%	8%	11%
Y/Y change in Whirlpool NA sales	-3%	-4%	-7%	-18%	-20%	-17%	-9%	4%	7%
Y/Y change in NA ASP	1%	1%	4%	-2%	2%	0%	-3%	-4%	-3%

Source: Association of Home Appliance Manufacturers, OWS estimates

Note that the company's North American sales changes have underperformed unit shipment changes for the past several quarters, suggesting pricing and mix pressures. We know that Samsung has slashed prices on front-load washers, beginning three quarters ago. Based on the data in Table 5, WHR's mix/pricing problems appear to coincide with this pricing attack by Samsung.

On its Q1 10 call, Electrolux said that it did not lower prices on its Electrolux brand front load washers in response to Samsung's price slashing. Additionally, Electrolux did not have a lower cost offering in the space. As a result, it lost market share in laundry. In Q1 10, Electrolux launched lower cost

Frigidaire front load washing machines at competitive price points and claimed on the call that it had started to win back share. Our store checks, as noted in a following section, confirm this contention.

3. We also think appliance sales in Q1 10 and Q2 10 were boosted by easy comparisons and stimulus rebates. Note that US appliance shipments in Q1 09 and Q2 09 fell 16% and 14%, respectively, Y/Y. Unsurprisingly, WHR's North American sales fell 20% and 17%, respectively, Y/Y in those quarters. By comparison, Q3 09 and Q4 09 US appliance shipments were down 6% and up 6%, Y/Y, respectively. WHR's North American sales were down 9% and up 4%, respectively, in Q3 09 and Q4 09.

Most states launched appliance rebates (with funding provided by the 2009 stimulus bill) in April, although a few states had programs in place in Q1 10. These rebates and the associated store promotions should boost sales substantially in Q2 10. During our store checks, more than half of the appliance managers and salespeople with whom we spoke told us that the appliance rebates had brought in large numbers of customers, which is likely to pull in demand from the second half of the year. Most states offered rebates of \$100-\$200 on washers, refrigerators and dishwashers. Given that stores were heavily promoting Energy Star appliances in conjunction with Earth Day, we suspect a number of customers that snagged the rebates accelerated their appliance purchase plans.

On its Q1 10 call, Electrolux estimated that, just a few years ago, 50% of appliance purchases were replacement purchases (i.e., the existing appliance had stopped working) with discretionary purchases and home sales accounting equally for the remainder. Now replacement purchases account for 70%, according to Electrolux. WHR, on the other hand, stated as recently as February that replacement accounted for 50% of its 2009 US sales with discretionary purchases and home sales accounting about equally for the remainder. Based on our conversations with appliance managers at the various stores we have visited, we are inclined to agree with Electrolux's estimate. Thus, we think that the recent strength in appliance sales is more a function of demand pull-in than demand growth. Our notion is supported by comments we heard from store or appliance section managers. One said "Everyone has more inventory than they need for May because no one wanted to miss a cash for appliance rebate sale, and for lack of knowing how many of the rebate users would show up at their stores, and when, we all over ordered."

4. Our store checks over the past couple of months at Lowe's, Sears, Home Depot, Best Buy and local appliance stores in LA, TX, CA, AL, MS and MA confirmed that price competition appears to be intensifying, most noticeably in front load washers, but also in refrigerators. Following are other key observations we made.

As we noted earlier, Frigidaire has increased its showroom space in Lowe's in the past quarter in front load washers, as a result of several redesigned products introduced last quarter. Samsung and Bosch have also introduced front load washers targeting the mass-market segment in the past few weeks. We estimate that 10%-15% of the front-load washer floor space at Lowe's was allocated to Frigidaire, Samsung and Bosch in February 2010. These brands now represent 20%-30% of the front-load washer floor space at Lowe's, or roughly double the floor space we observed in February. However, the display area committed to front-load washers has not grown.

At the Sears stores we visited, the salespeople and appliance managers told us that the floor space for GE, Samsung, LG and Bosch front load washers had approximately doubled in the past quarter, with the majority of the new models having price points in the \$600-\$1,000 range. This price range represents the intersection of mass market and premium front load washers. Over 50% of these new appliances that were added arrived at stores within the last three months. The Bosch front load washers and a few low-end Samsung front load washer models were introduced to the floor in the last few weeks. The Sears personnel also told us that Samsung, LG and Kenmore were the top selling front load washer brands in that store. Sears has also not increased the overall space allocated to front load washers.

Below, we list some of the price data from our store checks. Whirlpool brands are highlighted in each table.

Table 6a: Price comparison of front load washers at Home Depot (4/22/10 to 4/30/2010)

(Amounts in dollars, except capacity)			
Capacity (cubic feet)	Maytag	GE	LG
3.5	699	649	599
4.0 (basic features)	799	699	699
4.0 (advanced features)		899	799
>4.0 (advanced features)	899		899
>4.0 (metal finish)	999	1,199	1,199

Source: OWS channel checks

Table 6b: Price comparison of front load washers at Lowe's (4/22/10 to 4/30/2010)

(Amounts in dollars, except capacity)						
Capacity (cubic ft.)	Whirlpool	Maytag	Frigidaire	GE	Samsung	Bosch
3.5			599	629	599	
4.0 (basic features)	699		649	699	699	699
4.0 (advanced features)	899	798	850	799		
>4.0	999	899				799
>4.0 (metal finish)	1,199	1,199		1,199	1,249	1,099

Source: OWS channel checks

Table 6c: Price comparison of front load washers at Sears (4/22/10 to 4/30/2010)

(Amounts in dollars, except capacity)							
Capacity (cubic ft.)	Whirlpool	Maytag	Frigidaire	GE	Samsung	LG	Bosch
3.5			580			561	
4.0 (basic features)			604		561	646	
4.0 (advanced features)	646		731	646	646	739	732
4.0 (premium features)	986	926		926			
>4.0	833				739	833	832
>4.0 (metal finish)	1,011	1,113			926	1,020	1,019

Source: OWS channel checks

Home Depot and Lowe's also appear to have increased their floor space allocation to LG, Samsung, Frigidaire and Bosch. At Home Depot, LG has been slashing prices on front load washers. At Lowe's, Samsung has three and Bosch has two front load washer models priced at \$699 or less. We also noted that GE had increased promotions at some stores. All these developments should make for a much tougher environment for WHR for the second half of this year.

In response to Samsung's price slashing and Frigidaire's new products, WHR reduced prices across the board by about 10%-15% on most of its lower priced front load washers around November 2009. WHR is promoting front load washers previously priced over \$1,000. For example, at Lowe's, beginning April 18, Whirlpool offered customers \$400 off on the purchase of Whirlpool Duet front-load washer and dryer pair. These SKUs sold previously for \$1,199 each, and now the price is \$999 apiece. At \$999, the Whirlpool front load washer matches the new lower price of the high-end Samsung front load washer. The price of this Samsung front load washer has decreased progressively from \$1,199 in January 2009 to \$999 in February 2010. Several store managers told us that these price cuts are likely to stay in place. Note that these are manufacturer promotions, and the 10% discount promotions at Lowe's and Home Depot are additional retail

promotions. Sears offered 30% off Energy Star appliances in most markets starting Earth Day (April 22) until the weekend (15% off in some markets). We also noted that GE front load washers previously priced over \$1,000 are now being moved to the \$899 price point. In short, all market participants are increasingly reacting quickly to lower prices.

5. Our latest channel checks, completed last week after the expiration of the appliance rebates in most states, indicate that prices stayed low even after the expiration of the rebates. This is not surprising because customers' price mindsets were likely altered by the rebates, which offset 20%-33% of appliance costs. Of the 12 salespeople with whom we spoke last week, 8 told us that sales had slowed noticeably during the week, compared to the previous week when the appliance rebates were being offered. We asked each salesperson by how much they thought sales of front loaders and all other rebated appliances would change in the coming weeks. Overwhelmingly, most thought sales would taper off by more than 10% in the next few weeks, compared to the last few weeks when the rebate was available. Only two thought prices would go back up. One store manager with whom we spoke told us that by year-end, refrigerators should also see similar pricing declines.

We think that as customers become accustomed to these price cuts, it will be difficult to restore higher prices. It is unclear at this time how much of these promotions are store driven versus manufacturer driven, but we think ultimately it will be appliance makers such as WHR that will bear the brunt of the new, lower price regime.

6. WHR issued EPS guidance of \$8.10 to \$8.60 in February 2010, when it announced Q1 10 results. The company said that it expected \$200M-\$300M of additional commodity costs. We note that oil and steel prices have increased in recent months. Steel is WHR's biggest commodity cost. If we assume conservatively that steel constituted 10% of WHR's \$15B of COGS in 2009, a 33% Y/Y increase in steel price, which industry observers are forecasting in 2010, translates to \$500M of additional steel costs in 2010, well above what the company is assuming. Of course, WHR hedges steel purchases in the developed world. However, it is exposed to steel price risk in its emerging market operations, which are growing the fastest. Thus, commodity costs could have a more significant adverse impact on profitability than bulls expect.

7. Recent results.

WHR reported Q1 10 adjusted EPS of \$2.51, which handily exceeded consensus of \$1.24. Revenue of \$4.3B also exceeded consensus of \$3.8B. About half of the revenue beat resulted from favorable FX. While ASP and mix were

pressured in most geographies, the 18% Y/Y volume growth more than offset these issues. WHR had a tax benefit rate of 1.8% in the quarter.

DSO was 51 days at Q1 10 end, up 2 days Y/Y. Days of inventory were 60 days, down 15 days Y/Y. WHR had \$1.7B of net debt at the end of Q1 10. Book value at Q1 10 end was \$48.11 and tangible book was \$2.32.

Table 7 shows WHR's free cash flow performance over the last four years. FCF, by our definition (CFFO – capex), was significantly less than net income from 2006 to 2008, but soared in 2009 thanks to \$900M of inventory reduction and payables increase. Note that WHR's definition of free cash flow includes non-Maytag asset and business sales, which we consider to be one time in nature, and which obscure true operating results.

Table 7: WHR cash flow performance

	2006	2007	2008	2009
Net income	489	647	447	354
D&A	550	593	597	525
Other items	(159)	(313)	(717)	671
Cash Flow From Operations (CFFO)	880	927	327	1,550
Capital expenditures	(576)	(536)	(547)	(541)
Free cash flow	304	391	(220)	1,009
FCF per share	3.95	4.91	(2.90)	13.37
Proceeds from asset & business sales	122	130	119	77
Free cash flow (defined by WHR)	426	521	(101)	1,086
FCF per share (defined by WHR)	5.53	6.54	(1.33)	14.39

Source: Company reports

8. Financial assumptions.

a. Revenues.

i. Units.

Table 8a shows the Y/Y change in WHR's North American shipments for the past couple of years. Note that shipments dropped sharply Y/Y from Q3 08 to Q2 09, which marked the deepest period of the economic crisis. Thus, improvements were to be expected in the corresponding following year quarters, and the results for Q3 09 through Q1 10 show this was indeed the case. We expect Q2 10 to be another good quarter, given the easy comparison and appliance rebates, and forecast 13% Y/Y growth in North American shipments. However, because we think demand is being pulled in from future quarters, as discussed

earlier, we forecast Q3 10 and Q4 10 North American unit shipments to be down 2% and 3%, respectively.

Table 8a: Y/Y change in WHR's North American shipments

	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09	Q1 10
Y/Y change in NA shipments	-4%	-5%	-11%	-16%	-22%	-17%	-6%	8%	11%

Source: Company reports

On an annual basis, our assumptions lead to a 7% Y/Y growth in WHR's North American unit shipments in 2010, compared to -6% Y/Y change in 2009. We assume 4% Y/Y growth in North American shipments in 2011. Note that appliance installation in a new home or a newly resold home is a lagging occurrence. Therefore, one would expect housing starts and home resales to pick up before an up tick in appliance sales. We do not anticipate a strong housing recovery in either 2010 or 2011. The "street" appears to assume mid single digit Y/Y growth in North American unit shipments in H2 2010.

For Europe, we assume 5% and 2% unit sales growth, respectively, Y/Y in 2010 and 2011, versus 4% decline in 2009. We assume 15% and 10% Y/Y unit growth, respectively, in Latin America in 2010 and 2011, versus 10% in 2009. Recall that Q1 10 volume growth in Latin America was up 50% Y/Y. We note that the Brazilian sales comparisons will get tougher as the year progresses due to the sales tax holiday headwind mentioned earlier. In Asia, we assume unit growth of 20% and 10%, respectively, Y/Y in 2010 and 2011, versus 7% in 2009. The Q1 10 Y/Y volume growth in Asia was 49%. Our forecasts for Europe and Asia are consistent with management and "street" assumptions. However, some bulls assume that the impact of tough prior year sales comparisons in Latin America will be minimal. They point to Q1 10's 40% Y/Y sales growth (ex-FX) to support their assumption. The Brazilian sales tax holiday expired on January 31, 2010, but Q1 10 sales were still strong. However, inventory in the pipeline as of January 31 was eligible for the sales tax holiday, and therefore the impact of the holiday expiration in Q1 10 was muted.

ii. ASP.

Table 8b shows the Y/Y change in WHR's North American ASPs for the past couple of years. Note that ASPs have been down Y/Y since Q3 09, which coincided with the launch of Samsung's price attacks. We do not see the ASP pressure abating, based on the channel checks described earlier. Thus, we forecast North American ASPs in Q2 10, Q3 10, and Q4 10 to be down 3%, 2% and 2%, Y/Y, respectively.

Table 8b: Y/Y change in WHR's North American ASP

	Q108	Q208	Q308	Q408	Q109	Q209	Q309	Q409	Q110
Y/Y change in NA ASP	1%	1%	4%	-2%	2%	0%	-3%	-4%	-3%

Source: Company reports, OWS estimates

On an annual basis, these assumptions translate to a 4% Y/Y decline in North American ASP in 2010. We forecast Y/Y ASP decline of 2% in North America in 2011. We forecast Y/Y ASP for all other regions to be essentially flat in both 2010 and 2011. The “street” appears to think that ASPs in North America could be flat to up slightly in H2 10 and in 2011. Relative to the declining historical ASP trends shown in Table 3b, our Y/Y flat ASP estimates are favorable to the company.

b. Gross Margin.

The “street” projects gross margin growth of 70 basis points Y/Y in 2010, and 40 basis points Y/Y in 2011. 2009 gross margin was 14.0%. We think the increase in shipments should result in better manufacturing utilization and gross margin improvement, and our gross margin assumptions for 2010 and 2011 are similar to “street” estimates. We do think, however, that rising raw material costs could pressure gross margins.

While some bulls cite the 70 basis point Y/Y improvement in gross margin in 2009 even as unit shipments and constant currency sales declined 2% and 6% Y/Y, respectively, note that essentially all of this gross margin improvement resulted from a change WHR made to its depreciation accounting. This change yielded a Y/Y benefit of \$83M in 2009. While the benefit from this change will accrue in 2010 and future years, there should be no incremental benefit in 2010 and beyond that would further boost gross margins other than increased unit shipments.

c. SG&A expenses.

We assume that SG&A expense will be relatively flat Y/Y as a percentage of sales in both 2010 and 2011. 2009 SG&A expense was 9.0%. The bulls think that there are still more productivity gains to be had, and forecast SG&A expenses as a percentage of sales to be down 50-100 basis points Y/Y. We note that the bulk of the SG&A savings in 2009 resulted from reduced advertising costs, which was well below prior years as a percentage of sales (Table 9). In our opinion, advertising costs will increase Y/Y in 2010 and beyond because of the competitive environment.

Table 9: WHR’s advertising expenses: 2004-2009

(Amounts in \$M)	2004	2005	2006	2007	2008	2009
Advertising costs	221	239	316	321	336	211
Y/Y change	n/a	18	77	5	15	(125)
Advertising costs as % of sales	1.67%	1.67%	1.75%	1.65%	1.78%	1.23%

Source: Company reports

d. Other items.

Our assumptions for amortization, restructuring expenses, interest expense, tax rate and share count are similar to “street” projections and per management guidance. Management forecast a zero tax rate for 2010 (because of energy tax credits that expire at the end of 2010) and a 15% tax rate for 2011.

9. Valuation & risks.

Our revenue, EPS and EBITDA estimates, based on the foregoing assumptions, are shown in Table 10, along with the corresponding “street” projections. The differences between our projections and those of the “street” arise from assumptions that we highlighted in the previous section. The biggest ones are assumptions regarding North American and Latin American unit shipments, North American ASP, and SG&A expenses.

Table 10: OWS and “street” estimates for WHR

	OWS estimates	“Street” estimates
2010 revenue (\$M)	18,459	18,644
2010 EPS (\$)	8.89	9.75
2010 adjusted EBITDA (\$M)	1,685	1,850
2011 revenue (\$M)	19,155	19,642
2011 EPS (\$)	8.24	10.37
2011 adjusted EBITDA (\$M)	1,767	2,005

Sources: OWS estimates, “street” reports

WHR shares trade today at 10.6X bullish 2011 EPS estimates and 5.0X bullish 2011 EBITDA. Because we expect the company’s H2 10 and 2011 results to miss expectations, we apply lower multiples of 10X and 4.5X, respectively, to our 2011 EPS and EBITDA estimates to set an initial target price. Both yield a valuation of \$82 per share. This is our initial price target.

The primary risk to our thesis is a robust recovery in the housing market in H2 10 and beyond. By continuing our store checks and by monitoring the monthly AHAM data, we think we can limit any upside risks arising from a turn in the trend for appliance demand in the US.

If we are wrong in our thesis, then WHR might earn \$9.50 this year, on a zero tax rate. This translates to \$8 on a 15% taxed basis, and is about what the company earned in 2007. WHR has traded at about 10X-12X forward earnings in the past five years, which suggests that the stock may trade up to \$115 if we are wrong. Today's stock price is close to the highest price at which the stock traded at in 2007, when the housing bubble burst.

10. Financial projections.

a. Quarterly projections.

	Q1 10	Q2 10e	Q3 10e	Q4 10e	Q1 11e	Q2 11e	Q3 11e	Q4 11e
Net sales	4,272	4,717	4,616	4,680	4,352	4,913	4,811	4,900
COGS	3,633	3,963	3,906	3,981	3,703	4,116	4,061	4,157
Gross profit	639	754	711	698	649	797	750	743
SG&A	371	429	422	434	380	447	438	447
Amort.	7	7	7	7	7	7	7	7
Rest. Costs	20	20	20	20	20	20	20	20
Operating profit	241	298	261	237	242	323	285	268
Int. & other inc.	(12)	(25)	(25)	(25)	(25)	(25)	(25)	(25)
Interest expense	(58)	(60)	(60)	(60)	(60)	(60)	(60)	(60)
EBT & other	171	213	176	152	157	238	200	183
Income taxes	(3)	-	-	-	24	36	30	28
Inc. before minority int.	174	213	176	152	134	202	170	156
Minority interests	(10)	(7)	(7)	(7)	(7)	(7)	(7)	(7)
Net income	164	206	169	145	127	195	163	149
Diluted shares	77	77	77	77	77	77	77	77
Diluted EPS	2.14	2.67	2.20	1.89	1.65	2.54	2.12	1.93

Y/Y change

	Q1 10	Q2 10e	Q3 10e	Q4 10e	Q1 11e	Q2 11e	Q3 11e	Q4 11e
Net sales	20%	13%	3%	-4%	2%	4%	4%	5%
COGS	19%	10%	1%	-5%	2%	4%	4%	4%
Gross profit	22%	36%	15%	2%	2%	6%	6%	6%
SG&A	13%	10%	6%	2%	2%	4%	4%	3%
Amort.	0%	0%	0%	0%	0%	0%	0%	0%
Rest. costs	-17%	-13%	-17%	-64%	0%	0%	0%	0%
Operating profit	45%	122%	38%	19%	1%	9%	9%	13%
Int. & other inc.	-74%	108%	-51%	-62%	108%	0%	0%	0%
Interest expense	-6%	3%	3%	46%	3%	0%	0%	0%
EBT & other	200%	232%	120%	64%	-8%	12%	14%	20%
Income taxes	-81%	-100%	-100%	-100%	n/a	n/a	n/a	n/a
Net income	141%	163%	95%	52%	-23%	-5%	-4%	3%
Diluted shares	3%	3%	2%	1%	0%	0%	0%	0%
Diluted EPS	135%	157%	92%	51%	-23%	-5%	-4%	3%

As % of sales

	Q1 10	Q2 10e	Q3 10e	Q4 10e	Q1 11e	Q2 11e	Q3 11e	Q4 11e
Net sales	100%	100%	100%	100%	100%	100%	100%	100%
COGS	85%	84%	85%	85%	85%	84%	84%	85%
Gross profit	15%	16%	15%	15%	15%	16%	16%	15%
SG&A	9%	9%	9%	9%	9%	9%	9%	9%
Amort.	0%	0%	0%	0%	0%	0%	0%	0%
Rest. costs	0%	0%	0%	0%	0%	0%	0%	0%
Operating profit	6%	6%	6%	5%	6%	7%	6%	5%
Int. & other inc.	0%	-1%	-1%	-1%	-1%	-1%	-1%	-1%
Interest expense	-1%	-1%	-1%	-1%	-1%	-1%	-1%	-1%
EBT & other	4%	5%	4%	3%	4%	5%	4%	4%
Income taxes	0%	0%	0%	0%	1%	1%	1%	1%
Inc. before minority int.	4%	5%	4%	3%	3%	4%	4%	3%
Minority interests	0%	0%	0%	0%	0%	0%	0%	0%
Net income	4%	4%	4%	3%	3%	4%	3%	3%

b. Annual projections.

	2007	2008	2009	2010e	2011e
Net sales	19,408	18,907	17,099	18,285	18,977
COGS	16,517	16,383	14,713	15,483	16,037
Gross profit	2,891	2,524	2,386	2,802	2,940
SG&A	1,736	1,798	1,544	1,657	1,712
Intangibles amortization	31	28	28	28	28
Restructuring costs	61	149	126	80	80
Operating profit	1,063	549	688	1,037	1,119
Interest & other income (expense)	(63)	(100)	(175)	(87)	(100)
Interest expense	(203)	(203)	(219)	(238)	(240)
Gain on sale of investment	7	-	-	-	-
EBT & other	804	246	294	712	779
Income taxes	117	(201)	(61)	(3)	117
Earnings before equity inc & MI	687	447	355	715	662
Equity in inc of aff. cos	(18)	-	(1)	-	-
Minority interests	(22)	(29)	(26)	(31)	(28)
Net income	647	418	328	684	634
Diluted shares	80	76	75	77	77
Diluted EPS	8.12	5.50	4.35	8.89	8.24
Y/Y change					
	2007	2008	2009	2010e	2011e
Net sales	7%	-3%	-10%	7%	4%
COGS	7%	-1%	-10%	5%	4%
Gross profit	9%	-13%	-5%	17%	5%
SG&A	-1%	4%	-14%	7%	3%
Intangibles amortization	7%	-10%	0%	0%	0%
Restructuring costs	11%	144%	-15%	-37%	0%
Operating profit	29%	-48%	25%	51%	8%
Interest & other income (expense)	3050%	59%	75%	-50%	15%
Interest expense	0%	0%	8%	9%	1%
EBT & other	29%	-69%	20%	142%	9%
Income taxes	-7%	n/a	-70%	-95%	n/a
Earnings before equity inc & MI	39%	-35%	-21%	101%	-7%
Minority interests	175%	32%	-11%	20%	-10%
Net income	32%	-35%	-21%	108%	-7%
Diluted shares	3%	-5%	-1%	2%	0%
Diluted EPS	28%	-32%	-21%	104%	-7%

As % of sales

	2007	2008	2009	2010e	2011e
Net sales	100%	100%	100%	100%	100%
COGS	85%	87%	86%	85%	85%
Gross profit	15%	13%	14%	15%	15%
SG&A	9%	10%	9%	9%	9%
Intangibles amortization	0%	0%	0%	0%	0%
Restructuring costs	0%	1%	1%	0%	0%
Operating profit	5%	3%	4%	6%	6%
Interest & other income (expense)	0%	-1%	-1%	0%	-1%
Interest expense	-1%	-1%	-1%	-1%	-1%
Gain on sale of investment	0%	0%	0%	0%	0%
EBT & other	4%	1%	2%	4%	4%
Income taxes	1%	-1%	0%	0%	1%
Earnings before equity inc & MI	4%	2%	2%	4%	3%
Equity in inc of aff. cos	0%	0%	0%	0%	0%
Minority interests	0%	0%	0%	0%	0%
Net income	3%	2%	2%	4%	3%

c. Financial metrics.

(Amounts in \$M, except per share amounts)

Debt	2,849
Equity	3,695
Tangible book	2.32
Market value	8,382
Cash	1,191
DSO	51
DIO	60

	2009	2010e	2011e
EBIT (adjusted)	842	1,145	1,227
EBITDA	1,367	1,685	1,767
Free cash flow	1,009	649	624
Surplus cash flow (NI+DA-capex)	338	649	624
Capex	541	575	550
EV/EBITDA	7.3	6.0	5.7
EV/(EBITDA-capex)	12.2	9.0	8.2