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Mohawk Industries' (MHK) CEO Jeff Lorberbaum on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-24-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $2.75 beats by $0.12 | Revenue of $2.52B (-1.05% Y/Y) beats by $12.94M

Earning Call Audio

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Mohawk Industries, Inc. (NYSE:MHK) Q3 2019 Earnings Conference Call October 25, 2019 11:00 AM ET

Company Participants

Ken Huelskamp - VP, IR

Jeff Lorberbaum - Chairman & CEO

Chris Wellborn - COO

Glenn Landau - CFO

Conference Call Participants

John Baugh - Stifel

Stephen Kim - Evercore ISI

Michael Rehaut - JPMorgan

Phil Ng - Jefferies

Michael Wood – Nomura Instinet

Keith Hughes - SunTrust

Truman Patterson - Wells Fargo

Tim Wojs - Baird

Justin Speer - Zelman & Associates

Mike Dahl - RBC Capital Markets

Matthew Bouley - Barclays

John Lovallo - Bank of America

Kathryn Thompson - Thompson Research

Operator

Good morning. My name is Jeffrey and I will be your conference operator today. At this time, I would like to welcome everyone to the Mohawk Industries Third Quarter 2019 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer period. [Operator Instructions]. As a reminder, ladies and gentlemen, this conference is being recorded today Friday, October 25, 2019. Thank you.

I would now like to introduce Mr. Ken Huelskamp. Mr. Huelskamp, you may begin your conference.

Ken Huelskamp

Thank you. Good morning everyone, and welcome to the Mohawk Industries quarterly investor conference call. Today, we'll update you on the company's third quarter results for 2019 and provide guidance for the fourth quarter.

I would like to remind everyone that our press release and statements that we make during this call may include forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995, which are subject to various risks and uncertainties including but not limited to those set forth in our press release and our periodic filings with the Securities and Exchange Commission.

This call may include discussions on non-GAAP numbers. For a reconciliation of any non-GAAP to GAAP amount, please refer to our Form 8-K and the press release in the Investor section of our website.

The key speakers today are Jeff Lorberbaum, Chairman and Chief Executive Officer; Chris Wellborn, Chief Operating Officer; and Glenn Landau, Chief Financial Officer.

I will now turn the call over to Jeff for his opening remarks. Jeff?

Jeff Lorberbaum

Thank you, Ken.

Our third quarter operating results were in line with our expectations so we’re not satisfied with our performance. Our sales were $2.5 billion roughly flat as reported on a constant basis. Our adjusted operating income for the period was $250 million or 10% of sales. Compared to the prior year, the U.S. dollar strengthened creating a $35 million impact on our translated revenues.

As anticipated, our U.S. businesses presented the greatest challenges during the period given soft retail demand, the impact of LVT, a stronger dollar, and excess ceramic inventories in the industry. Lower interest rates in the U.S. are positively impacting housing starts and home sales and many believe this could be the beginning of an improving housing market.

During the period, duties on imported ceramic tiles were increased by an additional 104% which will largely stop shipments coming into the market. Trends in our other major markets weakened creating a more competitive environment. In most regions significant political and trade uncertainties are affecting consumer confidence in spending. In response to economic concerns, Central Banks in many countries are lowering interest rates to stimulate growth. We expect the present condition to persist in the near-term, and we will further adjust our strategies as needed.

We're progressing on the initiatives to improve our business, with the most significant of these being aligning the ceramic production with demand in the U.S., realigning our North American carpet operation, optimizing our LVT manufacturing, and ramping up our new plant. In addition, we're entering new product categories, introducing innovative product extensions, and optimizing our recent acquisitions. We’re investing in more sales personnel and marketing to increase our penetration in new and existing products. We continue to streamline our operations to enhance efficiencies and we're leveraging automation and process enhancements to lower our cost.

Our free cash flow for the quarter is up year-over-year and our balance sheet remains strong. Since the beginning of the third quarter, we purchased over 740,000 shares for approximately $91 million under our stock purchase program.

For view of our financial performance during the period, I'll turn the call over to Glenn.

Glenn Landau

Thank you, Jeff, and good morning, everyone.

Moving right into our financial performance and year-over-year bridges, as Jeff shared third quarter total company net sales were $2.5 billion roughly flat on a constant basis compared to prior year or down 1% as reported.

Year-to-date total company net sales were up 2.8% on a constant basis and flat as reported through the third quarter.

Organic growth in legacy businesses was down 2.5% in the third quarter on a constant basis, bringing our year-to-date legacy growth down 1.6% versus the first three quarters of 2018.

In terms of earnings, the company's adjusted operating income was $250 million in the third quarter or 9.9% of sales. This is off 242 basis points from the third quarter last year largely due to weaker ceramic volume as expected. With that said the company's year-over-year decline in margins improved modestly on a sequential basis by 15 basis points, which represents now three consecutive quarters of improvement.

Bridging from the prior year third quarter, adjusted operating earnings were impacted by one, lower overall volume of $16 million, largely in Flooring North America and Global Ceramics and associated market-related shutdown costs of $9 million all in our Global Ceramics segment to match our supply with our demand in order to manage our inventories in the U.S.

An increase of inflation of about $19 million due to higher wages and benefits partially offset by lower raw materials, an erosion in price mix of $15 million largely in our Flooring Rest of the World segment as input costs have eased, and $10 million higher spending in SG&A as other and other due to investments in sales and talent and marketing to drive sales, including product rollout initiatives and new start-ups.

Moving to the positive offsets productivity, including lower start-up costs swung positive by $8 million versus last year due to better utilization and non-repeating one-time costs.

Lastly, FX translation impact was unfavorable by approximately $3 million.

Still at the enterprise level, SG&A per net sales across the enterprise was 17.8% excluding unusual items. Special and unusual items in the quarter consisted of approximately $10 million in restructuring and integration costs impacting operating income, primarily in Flooring North America, of which most was for cash, and $65 million or $43 million after-tax write-down of our investments in a Chinese supplier in the other income line as a consequence of the September ruling by the U.S. Commerce Department imposing an incremental 104% countervailing duty on ceramic title, effectively stopping Mohawk purchases from this Chinese entity. With this partial offset by about $8 million due to transactional FX in other income for a total special and unusual items of $66 million before tax.

Back to our restructuring and integration for the full-year, we expect to complete the $94 million as previously disclosed this year, plus a further $15 million to $25 million, some of which may fall into 2020. And as we shared last quarter, the cash components of the restructuring of approximately $30 million to $35 million should be recovered in about a year as lower costs.

Adjusted EBITDA was $398 million or 15.8% before interest expense of $9 million, which was flat with last year.

The effective tax rate for the quarter was 18.3% and is expected to move into a range of 17% to 19% in the fourth quarter, driving full-year guidance down to the 19% to 20% range.

Finally, adjusted net earnings per share was $2.75 in the quarter down from $3.29 or 16% versus last year.

Turning now to the segments. Global Ceramics delivered sales of $916 million, an increase of 4.3% on a constant basis versus last year or 3.5% as reported. Operating income on an adjusted basis was $86 million or 9.3% of net sales down from 13.4% margin last year primarily due to weaker demand and higher U.S. inventories associated with duties. Compared to last year, inflation was $18 million higher driven by higher material costs and wages. Volume was softer by $11 million inclusive of $9 million in downtime. Sales and marketing costs were up $8 million and price mix slipped $2 million. All of this partially offset by improved productivity and lower start-up costs of $6 million. FX was neutral in the quarter.

In the Flooring North American segments the business showed better overall performance with sales of $1 billion down 4.4% versus last year as continued weakness in soft surfaces were partially offset by solid laminate performance and continued significant growth in LVT. Adjusted operating income improved for the second quarter in a row sequentially as Flooring North America earned $84 million or 8.4% of net sales in the third quarter, cutting the year-over-year deficit to $20 million versus $47 million in the second quarter. Compared to last year volume accounted for the majority of the deficit down $17 million versus last year and inflation the rest of a net $7 million with improved raw material costs partially offsetting higher wages and benefits. Turning positive price mix improved $4 million and productivity less reduced start-up costs was also positive.

Moving to Flooring Rest of the World, the segment had sales of $601 million, up 2.5% versus last year on a constant basis but down 1.9% as reported, with legacy sales holding at 0.4% at a constant basis. Adjusted operating income came in at $89 million or 14.8% in the quarter off 100 basis points versus last year in a competitive environment. Compared to last year, the business continues to manage well in a more difficult environment supported by solid LVT, laminate, and installation performance.

The primary headwind in the quarter was an erosion of price mix of $17 million largely offset by relief in overall inflation of $10 million by lower input costs and modest improvements in volume and productivity totaling $4 million. Additionally, investments in sales and product marketing were $2 million higher in the quarter and FX translation was unfavorable by $3 million.

Finally at the corporate level expenses and eliminations drove an operating loss of $9 million with a full-year estimate holding the range of $35 million to $40 million.

Speaking now to the balance sheet receivables ended the quarter at $1.8 billion with days sales outstanding up due to changes in geographic and channel mix. Inventories ended the quarter at approximately $2.3 billion or 126 days flat with the prior quarter and higher year-over-year by $124 million through the ramp-up of new investments, acquisitions, and increased source products.

Fixed costs for the quarter ended at $4.6 billion down $100 million compared to the prior quarter on capital expenditures of $125 million in the period lower than depreciation which was $145 million and in line with the plan.

For the full-year, CapEx we are on track to spend about $575 million which is depreciation up to $595 million depending on timing. Total debt was $2.8 billion at the end of the quarter, down $300 million since exiting the second quarter with leverage declining to 1.7 times debt-to-adjusted EBITDA. We also closed our efforts to renew our credit revolver for the full $1.8 billion for five-years plus two automatic one-year extension.

So wrapping up the balance sheet is strong and getting stronger with free cash flow of $286 million in the quarter, totaling $572 million year-to-date, giving us line of sight to our expected solid cash year, in addition to at $700 plus million.

With that, Chris, I'll turn it over to you.

Chris Wellborn

Thank you, Glenn.

In our Global Ceramics segment, our businesses around the world are under pressure caused by slowing economies. Excess industry capacities are creating more pricing and margin pressures. In most of our markets, commercial is outperforming retail as consumers are postponing purchases.

In U.S., ceramic retailers are promoting lower price points, consumers shifting to LVT, and inventories remain high in the channel. During the quarter, the U.S. imposed increased tariffs on Chinese imports and further anti-dumping duties are anticipated. At these levels, U.S. ceramic purchases will be shifted to manufacturers around the world and should benefit Mohawk and other domestic manufacturers. The excess inventories created by the tariffs will take time to be absorbed in the channel.

We expect the U.S. ceramic market to remain soft in the near-term and we are taking actions to improve our sales and costs. We are expanding our offering of stone looks and polished tiles and we are introducing additional value collections. We are adding more salespeople in major markets to increase our participation in commercial projects. We are rolling out new online processes to make our customer ordering and pick-up faster and easier. To complement our ceramic offering, we are selling Dovetail LVT for commercial applications and will introduce residential LVT collection.

We are initiating a limited launch of our new easy installation ceramic tile and we will expand more broadly at the beginning of the year. This patented system cuts the installation time in half with limited expertise and we are receiving positive feedback as we demonstrate the benefits. We're developing new markets for porcelain, roofing and thick landscape tiles which over time will create new sales channels for our business.

Our new countertop plant in Tennessee is ramping up processes and formulations are being refined and new products are being created. Utilizing state-of-the-art robotics, we have begun manufacturing premium countertops that will improve our sales and mix. We are presently staffed to operate three shifts and will expand production further next year.

We have outperformed the Mexican ceramic industry by expanding our product offering and growing our customer base. We are hiring additional architectural reps to increase our commercial sales and enhancing our collections with premium porcelain, large sizes and new wall tile products. We're supporting stores exclusively carrying Dovetail products and expanding our trucking fleet to improve service and costs.

The Brazilian market is showing some signs of recovery and we have outpaced the market with our premium brand and offering. We have a strong position in the new construction market which is outperforming residential remodeling.

We are replacing an old ceramic line with new porcelain production that is more efficient and will produce larger sizes when operational early next year. To meet present capacity needs, we have also restarted two previously idle lines.

The European ceramic industry has slowed with the overall economies and lower exports to other regions. Excess industry capacity and inflation is compressing margins as we are selling more lower value tile, which reduced our mix.

Commercial is outperforming residential and we are leveraging our comprehensive offering, expanding our specification team, and adding showrooms in major cities to grow. Declining consumer confidence is impacting discretionary spending and is compressing the retail remodeling channels. Our commercial technical tile, porcelain slabs and outdoor products are gaining traction and strengthening our higher value offerings.

We are reinforcing our leading design with larger porcelain slabs for walls, printed registration that delivers more realistic visuals, and slip-resistant styles for commercial application. Our resin ceramic business is the market leader and is gaining share due to our national distribution systems owned and franchise stores and project specification teams.

Our technology, design, and scale, give us the foremost position in the premium category as well as a cost advantage. To complement our tile business, we are constructing a small sanitary ware plant that should be operational in the first quarter next year.

In our Flooring North America segment, our margins have improved compared to the prior quarter due to increased sales, lower material costs, and operational initiatives partially offset by lower product mix and inflation in labor.

The business has been reorganized by product category to enhance our sales, product, and operational strategies and execution. By volume carpet still represents by far the largest category in the North American Flooring market though it’s losing share to hard surfaces. Polyester carpets continue to gain share in the soft market which has reduced our overall product mix.

We have completed the expansion of our recycled polyester fiber to support continued growth in the category. We have expanded our offering of multi-colored and pattern carpet as consumer preferences shift from solid colors. We're preparing our new residential introductions earlier this fall, so they can be in the market sooner next year.

The realignment of our residential carpet manufacturing will be largely complete in the fourth quarter and will improve our cost, quality, and service. We are aligning our operations for lower residential carpet volumes and utilizing our best assets. We have closed higher cost extrusion and dying assets and consolidated yarn and tufting production. We have increased automation in upgraded assets to improve our backing and yarn costs. Beyond asset rationalization, we have enhanced our continuous improvement processes to increase efficiencies and process controls.

Our commercial business continues to outperform with carpet tile and LVT growing fastest. We are expanding our sales organization and increasing our carpet tile manufacturing. We have broadened our carpet tile offering with new pattern technology with unique visuals and value alternatives.

We are launching more flexible LVT options for commercial that provides acoustic advantages and are more comfortable underfoot.

During the period, LVT sales outperformed the other categories with demand remaining strong and LVT operations continue to improve production, volume, speeds, and costs. One of our LVT lines is specialized on rigid products, while the other is producing flexible products, with each providing unique features for different requirements.

In September, we set a record for rigid production levels, and the flexible line is now running at comparable speeds to our European operations. Our rigid LVT line is focused on the production of SPC which is the fastest growing category today. We continue to transfer operational improvements that have been executed in Europe to increase throughput and introduce additional features. We have specific ongoing actions that will further increase our output and lower our costs through the first quarter. To utilize our increasing production, we are introducing new products and features under our best brands for both the retail and commercial markets.

Our manufactured sheet vinyl sales continue to grow as we broaden our offering and expand our position in the multifamily and home center channels.

We expanded our waterproof laminate offerings and used our premium laminate collections is extending throughout the home in the remodeling and new construction channels. Our Redwood collection is providing a desirable alternative for both LVT and natural woods with a superior scratch and dent resistance, state-of-the-art visuals and greater value.

We have developed proprietary technology so that our laminate better replicates real wood and has superior water resistance. To support our laminate business, we are upgrading our HDF manufacturing to increase our capacity and improve our cost.

In a slower environment, our Flooring Rest of World segment delivered solid results driven by product innovation, cost improvements, new businesses, and acquisitions.

Our new LVT sheet vinyl, laminate and carpet tile operations are making progress in reaching our expected levels.

In laminate, we outperformed the market as our new premium products with waterproof features gain momentum and improved our mix. We have introduced the Signature collection, which sets the standard for the most realistic visuals and we're adding our waterproof technology to most of our products.

We have further increased our direct distribution footprint with the acquisition of our Eastern European distributor. Our direct distribution strategy positions us closer to our customers and provides them with greater service and value.

Our Russian laminate expansion is operating at expected levels and our sales are growing as we expand our customer base.

As our LVT production increases, we are expanding our product offerings and sales to grow all segments of the market. In rigid, we're introducing new collections with embossed and registration to utilize our increasing capacity. We continue to enhance our line speeds, yield, and formulations to improve our cost position. This process will continue into next year when we anticipate achieving our plant production rates and cost. To increase our distribution, we’re offering retailers fashionable products with better value, service, and inventory turns to enhance their results.

Our sheet vinyl business is performing stronger as our new resin plant expands sales and volume increases. The new plant has freed up capacity in Europe, so we can expand our offerings and customer base.

Our installation business is performing well with volumes at historically high levels; our margins remain good even though pricing has declined, along with lower material cost.

Our panel business has slowed, reducing our pricing and volume partially offset by mix and lower materials. To further improve our cost this year, we are expanding our internal glue production. Next year we will increase our use of recycled wood and start-up a new plant that generates energy from wastewood.

In Australia/New Zealand, the integration of our acquisition is largely complete, while the regional economies have softened, interest rates have been reduced, and there are some signs in improving housing market. To increase our market share, we are upgrading our hard and soft surface product offerings. We are investing to expand our retail distribution and commercial carpet tile production. We have completed the closing of high cost assets in Australia which will benefit our results moving forward.

With that, I'll return the call to you, Jeff.

Jeff Lorberbaum

Thank you.

We see the present market conditions continuing, and we're taking actions to better position our business for the future. We're investing more in sales and marketing to expand placement of our products and increase the utilization of our new plants.

Our new Greenfield projects will progress as sales and costs improve. Our LVT production is improving and increased distribution will follow. Our U.S. and European ceramic businesses are being impacted by lower market demand and we're reducing inventory levels, expanding product offerings, and entering new categories. The restructuring of our U.S. corporate operations will be substantially complete this year and will benefit our costs next year. Taking this into account, our EPS guidance for the fourth quarter is $2.13 to $2.23 excluding one-time charges.

We will adapt our business strategies to the future circumstance as required. Next year our business will benefit from our new products, higher utilization of our start-ups, and cost reductions we have taken in 2019. Our results and balance sheet should improve with strong cash generation to take advantage of future opportunities. We have a strong Global Management team and they are focused on enhancing our results and optimizing our long-term profitability.

With that, we will be glad to take your questions.

Question-and-Answer Session

Operator

[Operator Instructions].

Your first question comes from the line of John Baugh with Stifel. Your line is open.

John Baugh

Thank you. Good morning and I wanted to focus on the North American revenue performance which I think was down just a little over 4% in the quarter versus the prior quarter, second quarter where it was down 7%. Is there any way you could give some more detail on sort of what drove that in terms of laminate versus LVT? And then, was carpet down about similarly I guess? And then also, what -- where we sit today in terms of sourced LVT sales versus produced and I appreciate the record comment of rigid production but not sure how to quantify that? Thank you.

Jeff Lorberbaum

The carpet industry remains under pressure and is losing share. The industry declined about 7% in units with commercial outperforming residential pieces but we see housing sales remodeling could improve as we go forward.

The LVT manufacturing, the other businesses, the laminate business is doing well as we introduced new products that are going into different markets and satisfying all the different markets and acting as an alternative to the other waterproof products in the category. The LVT continued to increase as the sales goes up, as the production goes up. We're increasing new products into the marketplace with different visuals and performance features, which will help us more next year than immediately as we go through. We think the throughput of plant is going to keep going up and we're lining new customers to use it next year as we go forward.

John Baugh

Jeff, on laminate, I thought I heard in there particle board expansion. It was right -- is that in the U.S. or in Europe, I've been worried a little about by the U.S. laminate production rate and it sounds like it’s reasonably strong?

JeffLorberbaum

In U.S. it’s a HDF board which we make the core products in, we have exceeded the capacities of the plants. So we are upgrading them in order to increase the throughput and lower the cost to support the business.

Chris Wellborn

John, just also a comment that premium laminate is growing as an alternative for wood and LVT, while the lower end laminate is declining. The technologies we use that make it very realistic as an alternative to wood, it has superior visual, scratch resistance, water resistance. So we're doing quite well.

John Baugh

Then lastly quickly, Chris. So what can you see or discern in terms of industry ceramic inventory in the United States, where do we sit? Is that getting better I appreciate you won’t see a benefit until we get into 2020. But is there any improvement?

Chris Wellborn

Yes, I think it's a good idea to first explain the difference between our company and the industry. But let's answer your question first the industry. We don't really know exactly what the inventory levels shows, we only see import volume, not the actual inventory. What we know is that this year, the Chinese inventory spiked in front of these tariffs. And our customers are telling us that they have a lot of inventory. Going forward, that will be an opportunity for us as those Chinese inventories deplete, we have options to replace those with our internal production and we have a very short supply chain which should put us in a good position as the industry inventories deplete.

Operator

Your next question comes from Stephen Kim with Evercore ISI. Your line is open.

Stephen Kim

Thanks very much guys, appreciate it, encouraging signs, particularly in Flooring North America. I just wanted to make a comment as well as a question, my comment both about making permanent adjustments in capacity. First, the comment you've been implementing making permanent adjustments in capacity. First, the comment you've been implementing what I would call a formalized restructuring program in carpet this year, and you've given a lot of qualitative commentary about the rationale and the actions you're taking. But unlike, we get with a lot of other public companies restructuring plans; the Street hasn't had a set of quarterly numbers to model with and track your progress --

Jeff Lorberbaum

Operator, we lost you. We lost you for a minute.

Stephen Kim

Oh, I apologize for that. I guess what I was saying is that we don't get from you a good sense of in this corporate restructuring, what the ultimate annualized savings opportunity is and how much should land and what quarter? And I think if you could do that, I think it would really help investors with a medium to longer-term opportunity, prognosis or making that projection. And so in a related way, my question is in ceramic. What would you need to see, Chris, with respect to your assessment or your ability to assess supply/demand in the industry, to embark on a restructuring program in ceramic, will you take out some older capacity to accelerate the inventory decline? Much like what you are currently doing in carpet?

Chris Wellborn

Okay, yes, I can answer that. So this is what we have going on in our Global Ceramic, generally, we have slower economic conditions and greater competition in the market. If you look at the U.S., it's mostly impacted by LVT growth, excess inventory from tariffs and a stronger dollar. And if you look at Europe, it's impacted more by a slowing economy and lower exports to other regions.

And in that environment, as you know, which we expect to remain for some time, we have taken actions to reduce our inventories. And that's contributed to the favorable cash flow that you see.

Now going forward, we're taking a lot of actions to improve our business. We're adding sales people while we're continuing to reduce our internal costs. We're introducing products that are alternatives for imports. We're introducing pioneering really new easy installation tile, roofing and outdoor products. And at the -- what we're looking for then is we've got our inventories in good shape, we will by the end of the year, we're about to ramp-up with all these new products and salespeople. And we have the opportunity to take share from these imports. And I think as you go through the year, our hope is that these things kick-in, and that we are able to use our capacity.

Stephen Kim

Got it. So we really shouldn't be expecting a significant restructuring where you're taking capacity out because you think your inventories are going to be pretty much in good shape by the end of the year, that’s very encouraging.

Chris Wellborn

Yes. Our inventories will be in good shape and we think we have opportunities to grow the business.

Stephen Kim

Yes, that’s very encouraging. I appreciate it. If I could just follow-on in terms of LVT in Europe, you made some comments about how, when we went down there recently, Jeff, I think you mentioned that 90% of the market over there in LVT is actually flex-LVT, not rigid LVT. And I just wanted to clarify, from your press release, it sounded almost like you could make more rigid product over there than you can sell and so you're increasing your sales force over there. So that that was a little surprising because it sounds almost like that means that when you started making the facility building the line that since that time the market for rigid in Europe grew slower than you thought while in the U.S. obviously the markets grown way faster for rigid. So just wondering if you could clarify that?

Jeff Lorberbaum

Yes, the market in Europe is still primarily flexible and there's click and non-click. The rigid is a relatively limited share of the total market, but we think it's going to grow quickly. Our equipment that we put in will make either or as you go through. So we're introducing new products in rigid and we're going to try to push the market to sell more rigid as we go but our equipment will make both.

The other side is the marketplace is also selling much less of it. It has about half the market share in Europe. It does in the U.S. and the growth rates less than half also. So the markets are nothing alike.

Operator

[Operator Instructions].

Your next question comes from Michael Rehaut with JPMorgan. Your line is open.

Michael Rehaut

Thanks. Good morning, everyone. First I just wanted to hit on just trying to get a sense of progress with LVT. And obviously, you mentioned some encouraging factoids about September production of rigid and also matching the European production. When you look at the incremental lines that you put together over the last year and as they've been ramping, where would you peg the capacity utilization of those lines given the progress that you've highlighted so far on your press release today in your comments, how should we think about the capacity utilization is it of the two lines in the U.S. and Europe, are we talking about 75% or greater and similarly from a margin standpoint, how should we think about where you -- what margins those that that production is producing is it still below average or is that a higher level of capacity utilization, is it more in line with the corporate average?

Jeff Lorberbaum

You have to separate U.S. and Europe into different pieces. The U.S. business is utilizing all the capacity as it's running now. And as it speeds up, we have avenues to use it as well as the substitute other product categories we have, as it ramps up.

In Europe, we don't source any products. So as it ramps up, we have to build the sales for it in front of it and you have to put the products in the marketplace. So in Europe, we're going to get ahead of the production rate, we're going to get ahead of the sales rate, and it's going to have to catch-up in the interim. On the cost, none of the costs are where we want them because we don't have the throughput and the material formulation where we want them and we've said we have ongoing programs, week-to-week, and it will go into next, into first of next year and we expect to hit our targeted cost structure sometime as we go into next year.

The other part is the mix on the products and the product mix, you start out with selling the products to use the capacity and then over time, you try to move the product mix up by selling higher value products, which takes time in the marketplace.

Michael Rehaut

Okay, that's helpful. I appreciate that, Jeff. And I guess just one other one if I could squeeze one in, please, on the price mix. I believe you said that, it kind of netted out roughly neutral maybe it's just a slight headwind year-over-year. I want to get a sense of sequentially how you're looking at price mix, how it went from 2Q to 3Q in each of the segments and if that's still kind of a moving target, and obviously, there's been some slippage there. I was hoping if you can address each of the segments directionally sequentially, where price mix particularly mix has trended in 3Q and how you see that playing out through the rest of the year?

JeffLorberbaum

Listen in general, all the businesses the price mix is declining as the volume and the different categories are under pressure. And as people -- as our customers tend to use price to attract cost consumers on one hand and on the other as we tend to sell more lower value products to utilize the plant hire. So they're all going lower.

Chris Wellborn

All I'd add to that is that for the enterprise, it's lower, like Jeff says $15 million, but that's largely in Flooring Rest of the World, but that's with lot of input costs easing. So I think offline we could bridge the quarter by segments. But the theme is essentially that is that there's competitive marketplace out there.

Operator

Your next question comes from Phil Ng with Jefferies. Your line is open.

Phil Ng

Hey, guys, in the last 18 months or so you've obviously had a lot of headwinds, whether it's drawn down production with the downdraft in demand, price costs and start-up costs, way on profitability, when you kind of look at 2020, do you expect these headwinds to moderate and some of the self-help initiatives to kind of kick in and drop through the bottom-line where margins could actually be up your view next year, it would be helpful kind of tie all that together?

Jeff Lorberbaum

The market in general, as we keep talking about is under pressure. And we keep aligning the businesses with the markets. As we look forward, you see us investing more in sales and marketing to increase our share both in existing products as well as to get these new factories up and running.

The positive pieces are the North American restructuring is going to start benefiting the business next year. The LVT lines will be operating more efficiently. These other plants we’re talking about will start adding value versus being a drag on the pieces. And the marketplace will have to keep reacting to whatever happens.

Phil Ng

Got it. And just one last one, Chris, I believe on the call you mentioned that you expect your inventory on ceramics to be in pretty good shape by the end of the year. If that's the case, obviously the back half of this year you've had a big drag on production curtailment for ceramics, should that become like a neutral event when you think about early next year then?

Chris Wellborn

Well, I think as we -- next year as we go into next year we've got all these things to drive our business and how we utilize that capacity will really depend on how fast they ramp up.

Operator

Your next question comes from Michael Wood with Nomura Instinet. Your line is open.

Your next question comes from Michael Wood with Nomura Instinet. Your line is open.

Michael Wood

Hi, good morning. I wanted to shift gears to carpet, particularly in nylon. I'm curious how small that's become as a portion of your mix in carpet and can you scale operation in nylon specifically enough to achieve the required returns that you have?

Jeff Lorberbaum

The nylon part of the business has declined in residential. And we have another category that we compete against nylon with we call smart strand, which is made out of Triexta. Both of those things compete in the higher end of the business. And we have a much larger business in Triexta than we do on nylon in the residential category. On the commercial side, you have the nylon makes up the majority of it and still does and isn't changing.

Michael Wood

Got it. Okay. And could you also just talk briefly about how you're running promotions in ceramics in terms of like how that would actually phase out once the inventory gets worked down? Thanks.

Jeff Lorberbaum

Well, what we're doing in ceramic in some cases, we're running promotions with but I won't even call value engineered products to go after build your business that was where they were previously using LVT. So that's one product that we have offered. We're also have products aimed at getting the products that the Chinese product that will stop coming into the United States. So those are the two main areas.

Operator

Your next question comes from Keith Hughes with SunTrust. Your line is open.

Keith Hughes

Thank you. Questions in ceramic, I think you said it was $18 million of higher input costs in the quarter, soon after that couple of quarters now specifically what product or what inputs are driving that up?

Jeff Lorberbaum

Well, in particular, in South America and in Europe, we had higher costs for energy, that's for one. And then also the material on a global marketplace in the different places around the world, there's inflation in energy and there's inflation in raw material still occurring in most of the markets.

Keith Hughes

And if we look back at 2018 ceramic you incurred about $100 million of higher inputs was at the same sort of things or was it different last year.

Chris Wellborn

Mainly the input cost is globally, like Jeff said, has been in energy, materials, labor, in several areas. One more on the material costs and ceramic in some cases, there's trucking costs that have also gone up to move the stuff to the plant, which has also impacted the material costs.

Keith Hughes

Okay. And I guess final question for Chris, you've been in this industry for a long time, it's going to be two years of just tremendous input cost of inflation, have you ever seen anything like this before?

Chris Wellborn

Well, I think the thing that, as Jeff mentioned, one of the costs that really ramped up last year was the transportation cost. That was a significant cost increase and also the material cost. We had both of those.

Operator

Your next question comes from Truman Patterson with Wells Fargo. Your line is open.

Truman Patterson

Hi, good morning, everybody. First, just wanted to touch on your fourth quarter EPS guidance, backing into it, it looks like that implies your operating profit is going to decline about 20% year-over-year on much easier comps from the second quarter. So it seems to me that operations look like they're going to take another step back in the fourth quarter. Could you just maybe walk us through what the largest buckets of what's causing this in that, it also appears that I hear the improvement in LVT North America and making some capacity rationalization, but it seems like implied in that guidance that North America margins might even take a step back as well, in the fourth quarter, just hoping you can help me wrap my arms around this?

Glenn Landau

Yes, I mean, I think the message here and this is Glenn is essentially the fourth quarter has played out as we expected. The dynamics in the fourth quarter are the same as the dynamics in the third quarter. And the biggest is in ceramics in volume. And ultimately, that and the downtime we're taking against that volume to manage our inventories in the U.S. So those are the two key buckets that that, that build that guidance. There's really no more new issues. It's just a seasonally different quarter in different amount of days and from there fill in the blanks.

Truman Patterson

Okay, okay, got you. And thanks for that. Digging into North America a little bit more, they bumped up, margins bumped up 200 bps sequentially. If you look historically that was kind of in line to maybe a little bit below the normal improvement. If you look at a couple of years, it looks like margins are backsliding a little bit further. You're mentioning positives in the North America, carpet restructuring that should benefit 2020; you've got better LVT manufacturing. We've also been hearing in channel, Jeff, there's, still some excess inventory. There's some increased promotional activity to pass the rationalization, I'm really thinking when you roll all the puts and takes up, should we expect third quarter margins to really be the floor and we can ramp-up and improve through 2020 or do you expect, the pressures to kind of more than offset the positives in possibly a flat to down margins?

Jeff Lorberbaum

Yes. I would think of this year is over. We're talking about 2020 right now. I think the fourth quarter is --

Truman Patterson

Right.

Jeff Lorberbaum

Transitional the dynamics are the same. It's the fourth quarter, but certainly as we've outlined, we're going to have a tailwind in the things we can control in Flooring North America, and LVT will turn profitable as Jeff said, we will get the benefits from restructuring and outside of economic conditions. There is a tailwind to improve margins from where they are today.

Operator

Your next question comes from Tim Wojs with Baird. Your line is open.

Tim Wojs

Yes, hey everybody. Good morning. Just maybe shifting gears to the cash flow statement. I guess first any sense for what preliminarily cash CapEx might look like in 2020? And I guess secondarily how are you kind of thinking about just kind of using or kind of utilizing just some of the increased free cash flow that you should generate in the back half of this year and into 2020? Just wondering, you probably won't pay down debt, you've done a couple of acquisitions but is there an increased emphasis on potentially using some of that cash to buy back stock?

Glenn Landau

On the CapEx next year it will be less than depreciation. The biggest part of it's going to be spend on projects that have good pay backs and reducing our costs and each pieces with limited risk in them. And we think we have a number of those identified and able to do.

On the stock buyback we are going to complete the stock purchases over time as we have said and we haven't made any plans to add to it, we will decide that in the future when we get there.

Operator

Your next question comes from Justin Speer with Zelman & Associates. Your line is open.

Justin Speer

Hi, good morning guys. Thank you. Just wanted to take a look under the hood at Flooring Rest of the World in the Global Ceramic business, you've touched on quite a bit, but we have these softer international market conditions. Can you give us a sense for how you see profitability trending in those segments as we look into the fourth quarter, particularly into 2020 given what you're doing in terms of productivity, given what you see? Is the Flooring Rest of the World business has been pretty sound little weaker into the third quarter, but just give us a good sense for how you view that business casting into 2020?

Chris Wellborn

So when you look at Flooring Rest of the World, the European economy is slowing little. But each of those countries and markets are different and our businesses are performing well in each of them. Our investment in innovation, cost, and new businesses are enhancing our results and we're well-positioned in each of those categories. Laminate, LVT and sheet vinyl are performing the best. And our new operations are making progress. That would be on the Flooring Rest of World.

And on the ceramic side, I think it's just like we talked about. So far Europe has been affected by slowing economy, particularly Italy, Germany, and there also the European ceramic business has been impacted by lower exports to other regions. Now in that context, we're managing our business well, commercial is doing better. And just like in the U.S., we're increasing our sales organization in new showrooms. And we're also selling more mid and low-end product to increase sales. So we're doing a lot but we think the economies will still be relatively weak.

Justin Speer

Okay. So that's it. In terms of line of sight in the inventory management you feel good about the direction, you feel good about some investments you are doing to kind of rev up growth, but I'm still trying to get a sense for how do you think that Flooring Rest of World margins and I know it's doing relatively well but in view of it, if trends remain soft as they are, do you think margins will be stable with where they're casting this year as we think about next year?

Chris Wellborn

You have also these new projects coming on you have LVT that the line is going to change from a drag to a positive. You have Russian sheet vinyl plant has come up and it's going to slip to a positive. You have the laminate businesses, which we put investments in a while that they're running well, and using the capacities and we have more capacity in Russia and it's doing okay. But there are drags from the economy. So you have the economy drags on one side and you have the various positive things we're doing on the other. We'll have to see how they all balance out.

Justin Speer

Excellent, excellent. And then lastly, kind of line of questioning on Flooring North America. I know -- we know you source LVT and we know you're bringing up your internal production, you're still sourcing quite a bit of LVT from what I understand, we have the tariffs in place, just thinking about the implication of a tariff on that source product on your North American margins this year and potentially in the next year. And in terms of that business, looking separately, after that at price mix, input costs and productivity what was that in the quarter? And what's expected going forward?

Jeff Lorberbaum

I will just make one comment on the tariffs. On the Flooring North America, it's not been nearly the issue that we had in ceramic. Ceramic the tariffs are 130% in North America; they were 25% some of which was discounted back. So I don't think the tariffs have been such a big impact.

Chris Wellborn

It's been an impact but not as great. You have the Chinese currency got weaker, and the suppliers absorbed the portion of it as you go through. And we're in the same position as the rest of the market. And there's also production moving, trying to move to other places to be made. So we're in the same boat as everybody else.

Justin Speer

Okay. And then just in terms of the price mix, input cost and productivity in Flooring North America, can you relate what they were in the quarter and what's expected going forward?

Glenn Landau

As I said earlier, price mix turned positive and productivity with factoring start-up costs also were positive. So yes, we have the volume challenges, but from a mix standpoint, was the biggest driver keeping the overall segment across the categories in a flat to positive mode of about $4 million.

Operator

Your next question comes from Mike Dahl with RBC Capital Markets. Your line is open.

Mike Dahl

Thanks for taking my questions. First question is really focused on the European environment and one of your competitors earlier this week talked about how they were seeing excess Chinese LVT capacity and how that was starting to appear in Europe and causing disruption in Europe as that entered the market, can you comment to what extent you've seen LVT imports into Europe pick up and have an impact on your business?

Jeff Lorberbaum

LVT from China has increased as the market has increased. We believe we are positioned to compete against it. In Europe, we're manufacturing all of the product we're selling. And as our new line comes up and our costs come down, we think that we can offer retailers or buyers of the product competitive products with much shorter lead times and more flexibility and we think we can increase our position in the marketplace.

Mike Dahl

Okay, got it. My second question is two parts on ceramic, the first is just a little more color on the impairment on the Chinese asset post the anti-dumping ruling, can you just talk about how much you were importing through that business and whether or not there's a go-forward impact on how we should think about sales and margins in the ceramic segment, has that's been impaired and potentially redirected? And the second part is bigger picture around ceramic; I know you talked about the inventory levels, specifically to the Chinese ceramic. But, as you've had the anti-dumping go into effect, what have you seen in terms of import activity from other countries taking that place? And how do you stack up competitively compared to that?

Jeff Lorberbaum

Okay. So firstly, the investment that we wrote off is something that we've had since 2010. It's a factory where we brought imported products, and that has slowly decreased over time, and that production can be brought into our U.S. factories. So that's the only story about the -- that investment.

The Chinese inventories they spiked. As those tariffs were about ready to be implemented the last way, let's say a Chinese inventory was brought into the system, and that'll slowly work its way down. Now what will happen is that source of supply will get replaced by U.S. manufacturers will be part of it, but it'll also impact Brazil, Turkey, India, and right now, that's being made a little easier because the dollar is so strong. But we should benefit -- us and U.S. manufacturer should benefit from some of it.

Operator

Your next question comes from Matthew Bouley with Barclays. Your line is open.

Matthew Bouley

Hi, thank you for taking my questions. You mentioned kind of seeing those signs of the residential market improving in the U.S. How should we think about how that might flow into your business timing wise? And if you could remind us, maybe which product categories obviously carpets, ceramic tile, et cetera on the homebuilder side where you might see kind of the greater benefits of an improving housing market in the U.S. Thank you.

Jeff Lorberbaum

I have always said in the last few months as you guys get the numbers we've seen an improvement in the housing sales and improving in the housing sales should benefit us. If you look at new homes sales, Flooring is the last thing that's put in before the house is complete. So if it takes nine to 12 months to build a house or 18 months, the Flooring is the last thing that's put in it. So different categories they're all the different categories are used in a homes as you go through. We're seeing increases in all the different categories, I mean increases. The -- all the different hard surfaces are used in, carpets used in it, and so if it goes up, it should positively impact all of the pieces.

Matthew Bouley

Okay, understood. And then just back to LVT, in the U.S. again, I think you mentioned, Jeff, that you've got some visibility to reduce costs in Q1. And you kind of also mentioned hitting the targeted cost structure at some point next year. Can you just elaborate a little bit on that around the timeline to turning a profit in that plant and what type of margin you can actually do with the LVT in the U.S.? Thank you.

Jeff Lorberbaum

I think what we said is that next year, we think that we'll turn a profit in it, we haven't put it by the quarter. In addition as the piece -- as our manufacturing improves, it has to flow through the inventory. So the cost improvements show up about four months later in the cost sheets as you go through. What we expect, also the year for it to keep improving. And then even further beyond that, we would expect the cost structures to continue to improve incrementally. And then over time you change the mix in the business. To get the business to a line you have to sell it at whatever price as you need to get it into the marketplace quickly. And then over time you upgrade the mix which will take more than next year as we do it -- as we go forward.

Operator

Your next question comes from John Lovallo with Bank of America. Your line is open.

John Lovallo

Hey guys, thank you for filling me in here. Can you just help us think about the magnitude and the sales and marketing investments that you're making to expand the placement of your products and should we expect this to kind of ramp sequentially as we head into 2020?

Jeff Lorberbaum

We're putting in all the different businesses as you've heard we are putting more sales people on and we're trying to be more aggressive in the marketplaces as we go through. So there's a spike in it. We're going to continue to monitor it. And if we get the positive results we will continue spending at those levels. If we don't, we'll adjust the strategy and get it in line.

John Lovallo

Okay. And then maybe finally, what percentage of your ceramic offers today or -- would consider to be value oriented? And where do you think this percentage could go over the next year or two?

Chris Wellborn

We have price points -- we have price points up and down the spectrum in ceramic, and I wouldn't overemphasize these lower price points, where in selected situations where we have opportunities, we're targeting it because we are underutilized in our assets. But overall, it's not a huge piece of our production.

Jeff Lorberbaum

But it will get bigger and it will impact the margins. And we're doing the same thing in Europe, is that we're being more aggressive as the industry slowdown. We participate more in lower value products. So it does impact the mix.

more in lower value products. So it does impact the mix.

Operator

Your next question comes from Kathryn Thompson with Thompson Research. Your line is open.

Kathryn Thompson

Hi, thank you for taking my question today. On carpets in the U.S., you last year was somewhat flattish to down a little bit and the overall industry expectation was worse is behind and the industry context and we've been very surprised by taking such as a bigger lie down this year. Wanted to get your thoughts on that dynamic? And what realistically are your expectations looking beyond just the next couple of quarters but what could the mix be as we look two to three years down the road?

Jeff Lorberbaum

If you look at the Flooring market in the United States, historically, it's grown greater than GDP over through the cycle. And I don't know what would have changed it the Flooring would not grow slightly more than GDP over time.

Kathryn Thompson

I was talking about carpet, carpet has not been growing as fast, I'm talking about a specific category, not overall Flooring. So we're talking about a secular change so --

Jeff Lorberbaum

Carpet has been decreasing, and we don't see it changing at the moment. What we believe is that the LVT at some point is going to plateau out. We believe that is probably slowing somewhat at this point from where it was, and it will plateau and then things will go back to some sort of growth rated for leveled over the piece but it's not going to stop tomorrow.

Kathryn Thompson

Yes. So just once again just to follow-up and see if I can clarify, carpet is taking a bigger step down this year, while the LVT has been growing at a pretty steady rate. What do you think the percentage reasonably carpet should be two to three years down the line as we look at this broad mix?

Jeff Lorberbaum

I don't have a number to give you. You can make up one as well, I don't have a number.

Kathryn Thompson

Okay. On transportation, obviously the spend just shortage of drivers and it’s been thorn in the side for so many industries in construction. What are you -- and in manufacturing? What are you doing to ensure the ability to keep drivers and to get some stability and that labor force in the long-term cost for that?

Jeff Lorberbaum

We have done a few things. One is that we have increased our internal trucking fleet in order to move a greater percentage of our products. We think that we offer, we've been able to staff our positions because of the consistency of the routes and the ability for people to make money. So we've done better than the market in general to support our own trucking fleets. And with that we've taken a larger percentage of it that it’s been going in the open market as the costs have increased.

Operator

That's all the time that we have for questions. I will turn the call back to Mr. Lorberbaum for any closing remarks.

Jeff Lorberbaum

So I appreciate everybody joining us. We have a lot of actions we're taking to improve the business and our results. We think we have a lot of opportunities as we look going forward, and we appreciate you being on the call with us. Have a good weekend.

Operator

This concludes today's conference call. You may now disconnect.