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LII.N - Q3 2023 Lennox International Inc Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Welcome to the Lennox Third Quarter 2023 Earnings Call. (Operator Instructions) As a reminder, this call is being recorded. I would now like to turn the conference over to Chelsey Pulcheon from the Lennox Investor Relations team. Chelsey, please go ahead.

Chelsey Pulcheon

Thank you, Kerry. Good morning, everyone. We have had an exciting quarter, and we are looking forward to discussing the details with all of you this morning. With me today is CEO, Alok Maskara, CFO, Joe Reitmeier, and VP of Finance, Michael Quenzer. Alok will take you through some quarter highlights as well as some preliminary perspective on the year ahead. Joe will go into depth on the company's quarterly financial results as well as our revised guidance for fiscal 2023.

At the end of the call, we will move to our Q&A session. Turning to Slide 2. A reminder that during today's call, we will be making certain forward-looking statements, which are subject to numerous risks and uncertainties as outlined on this page. We may also refer to certain non-GAAP financial measures that management considers to be relevant indicators of underlying business performance.

Please refer to our SEC filings available on our Investor Relations website for additional details, including a reconciliation of all GAAP to non-GAAP measures. The earnings release, today's presentation and the webcast archive link for today's call are available on our Investor Relations website at investor.lennox.com. You can also find the press releases for our CFO transition and AES acquisition on the Investor Relations website.

Now please turn to Slide 3, as I turn the call over to our CEO, Alok Maskara.

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

Thank you, Chelsey. Good morning, everyone. I am proud to report that this has been another record quarter for Lennox with results that truly speak to our commitment toward delivering growth acceleration and resilient margin expansion. The record revenue, profit and earnings that we are sharing today reflect the transformative impact of our self-help initiatives put in place last year.

These results were made possible by the hard work of Lennox's 13,000 employees as well as the unwavering loyalty of our dealers and customers. I deeply appreciate the tireless efforts of everyone who played a part in delivering these exceptional results. I also extend my appreciation to our dealers and customers for entrusting Lennox to provide top-tier innovative products and solutions.

Now let me transition into an overview of this quarter's highlights. Lennox's core revenue grew 10% and our adjusted segment margin expanded 334 basis points to 19.3%, resulting in our adjusted earnings per share increasing 30% to $5.37. Our operating cash flow of $313 million was up 83% year-over-year.

Additionally, earlier this morning, we announced Joe Reitmeier's decision to retire and the appointment of Michael Quenzer as our new CFO. We are excited for both Joe and Michael as we complete this planned transition. Additionally, we also announced the strategic acquisition of Architectural Engineering Services, or AES this morning. The acquisition is consistent with our bolt-on acquisition strategy and is a clear strategic fit that will accelerate growth, unlock operational synergies and enhance our service offerings to create incremental shareholder value.

Now please turn to Slide 4 for more details on our CFO transition. Announced earlier this morning, Joe Reitmeier has decided to retire, and I'd like to express my sincere gratitude for his remarkable 18-year tenure at Lennox. Under his leadership, the company achieved many significant milestones, including 7x earnings per share growth and 12x increase in market cap. Beyond his financial stewardship, Joe has cultivated a talented, dynamic finance organization here at Lennox. With that strong foundation and robust succession plan, we expect a smooth transition as Michael Quenzer takes on the role of Chief Financial Officer, effective January 1, 2024.

Michael joined Lennox in 2004 and has been a key contributor to Lennox's strong financial performance. He has a proven track record of driving operational excellence, developing talent and creating shareholder value. Michael's experience as the segment CFO during the commercial turnaround and most recently as VP Finance and Investor Relations, equips him with a solid foundation for his new role.

I'm very happy for Joe, as he looks forward to his well-earned retirement, and I am excited to work with Michael in his new capacity. Please join me in congratulating both Joe and Michael.

Now please turn to Slide 5 for an overview of the AES acquisition. We are pleased to welcome AES customers and employees to the Lennox family. This strategic bolt-on acquisition is in line with our overall capital deployment strategy and provides clear benefits to our customers, employees and shareholders.

As you may know, Lennox's existing national account service team is focused on preventative maintenance and energy monitoring services. Our new acquisition is centered on turnkey installation, accessories as well as refrigerant, reclaim and recycling. The combined portfolio will allow us to serve our customers more holistically, ensuring that all their needs are met by Lennox.

Additionally, it enhances our cross-selling opportunities as we can now offer a broader range of services and solutions to our client base. This will strengthen our relationship with our customers and positions us for a comprehensive life cycle provider in this fragmented light commercial service industry. AES also provides new services to facilitate product life-cycle decommissioning, including refrigerant reclamation and material recycling. For example, a commercial customer can purchase rooftop equipment from Lennox, utilize AES installation services, use us for maintenance and monitoring and leverage our reclaim and recycling services at the end of equipment life.

By offering these services. We not only align with the evolving environmental needs and regulations, but also create a new revenue stream for our business, ensuring that we remain at the forefront of sustainable innovations. Another compelling aspect of this acquisition is the vertical integration into parts and accessories, specifically in curb adapters. By manufacturing curb adapters in-house we will be able to generate cost efficiencies, increase profitability and build a stronger competitive edge in the marketplace. Ultimately, this strategic bolt-on acquisition addresses several critical execution needs in our growth strategy.

It adds installation capabilities to our industry-leading preventative maintenance services, provides new services such as refrigerant reclaim and material recycling to support product life cycle decommissioning and increases the sales of parts and accessories.

Now let me hand the call over to Joe, who will take us through the details of our Q3 financial performance.

Joseph William Reitmeier - *Lennox International Inc. - Executive VP & CFO*

Thank you, Alok, and good morning, everyone. Please turn to Slide 6. As Alok mentioned earlier, the company posted strong revenue and earnings growth. Our core revenue, which excludes our European operations was a record $1.3 billion, up 10% where price and mix drove significant year-over-year improvement. Adjusted segment profit increased $62 million as $97 million of price and mix benefits were partially offset by inflationary impacts on SG&A and distribution costs.

Total adjusted segment margin was 19.3%, up 334 basis points versus prior year. And for the quarter, Corporate expenses were $27 million, an increase of $11 million as a result of higher incentive compensation and wage inflation. In the third quarter -- or the third quarter achieved record levels of revenue, segment profit and adjusted earnings per share. Adjusted earnings per share grew by 30% to $5.37. Our third quarter tax rate of 25.6% and diluted shares outstanding were 35.7 million compared to 35.5 million in the prior year quarter.

Turning to our residential results on Slide 7. The chart shows revenue growth of 7% to a record $896 million in third quarter. The segment benefited from new minimum efficiency standards and a richer mix of higher efficiency products. We also noticed the positive impact from the strategic price increase in June. Although unit sales volumes for the segment declined by 2%, our direct-to-contractor sales volume increased mid-single digits, reflecting healthy end markets and ongoing market share gains. Unit sales volumes through independent distribution channels declined mid-teens, primarily due to continued industry de-stocking, which decelerated during the quarter.

Residential segment profit increased 18% to $181 million, and segment margin improved by 183 basis points to 20.2%, driven primarily by price and mix and partially offset with lower volume, higher incentive compensation and inflationary effects on wages and distribution.

Turning to Slide 8 and our commercial business that continues to deliver strong results. Revenue was $406 million in the quarter, up 15%. Combined price and mix were up 13%, and volume was up 2%. Commercial segment profit was $97 million or up 86%, and segment margin expanded 912 basis points to 24%. These results were driven by price and mix for a total -- for the total of a $47 million increase in profit for the quarter. Increased factory productivity has offset inflation and we have made significant progress on our new factory construction, which will support growth and productivity.

Moving on to cash flow performance and our net debt to EBITDA. Starting on Slide 9. Operating cash flow for the quarter was $313 million compared to $171 million orders in the prior year quarter. Capital expenditures were $40 million for the quarter, an increase of $20 million compared to prior year. Our capital deployment priorities remain consistent, supporting organic growth investments like our new commercial manufacturing facility in Mexico, driving industry-leading innovation and exploring potential bolt-on acquisitions like AES.

In the quarter, the company paid approximately $78 million in dividends. Total debt was approximately $1.5 billion at the end of the quarter, and our net debt-to-EBITDA ratio was 1.7x. Cash, cash equivalents and short-term investments were $141.6 million at the end of the quarter. Construction on the new commercial factory is also coming along nicely with first production anticipated mid-2024. We do anticipate some P&L inefficiencies and temporary working capital build as the factory ramps up. By the second half of 2025, however, we expect the factory will be fully ramped, and we will begin realizing productivity gains.

Now turning to Slide 10. I'll review our revised 2023 full year guidance. As a result of our strong execution on driving growth and expanding margins, we are increasing our full year outlook. We estimate core revenue to be up approximately 5% for the year and earnings per share of $17.25 per share to $17.75 per share. We are also increasing our free cash flow target to a range of $350 million to $400 million.

Our guidance for capital expenditures is unchanged from our prior guide at $250 million, and this includes our investment in the new Saltillo factory and refrigerant transition-related investments. Price and cost benefit are now expected to be $325 million, and net material costs are expected to be flat for 2023.

We revised our corporate expense estimate to be $100 million attributable to higher incentive compensation expenses. We will remain diligent on managing SG&A expense while also making necessary investments in the business to support growth, promote the development of our innovative products and solutions and improve overall productivity. And finally, we still expect our weighted average diluted share count for the full year to be approximately 35.5 million shares. With that, let's turn to Slide 11, and I'll hand it back over to Alok.

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

Thanks, Joe. In addition to delivering impressive results, we are also making significant progress toward streamlining our portfolio. Last year, we announced a plan to divest -- we announced the plan to divest our European operations aligning with Lennox's strategic concentration on the North American market, where we are well positioned to accelerate growth and expand resilient margins. In the third quarter, we reached exclusive agreements for the sale of our European commercial HVACR businesses as well as our European process cooling businesses.

Based on these agreements, we recorded $63 million noncash impairment this quarter. We expect both transactions to be completed before the end of the year. We also made strides in simplifying our already strong balance sheet. In September, we issued $500 million of senior unsecured 5-year notes, which will replace the $350 million notes maturing in November of this year. In order to retire all secured debt we increased our revolving credit facility and introduced a commercial paper program. With these changes, we have lowered our financing cost and created additional liquidity.

Now please turn to Slide 12, where I will provide an initial assessment of 2024 business conditions. 2024 will be another transformative year for Lennox as we ramp up the new commercial factory, transition to low GWP refrigerant and continue our transformation plan. Our strategic management and execution discipline will allow us to navigate ongoing macroeconomic and regulatory uncertainties.

On the left-hand side of this slide, we have laid out several tailwinds and headwinds that are likely to impact industry demand. We anticipate channel de-stocking to end in 2023, which will lead to favorable volume trends in 2024. As channel returns to its usual ordering patterns. Additionally, the IRA, tax credits and other local incentives aimed at promoting energy-efficient upgrades will encourage consumers to replace versus repair as well as boost the sales of higher efficiency products.

Also, as supply chains continue to heal and lead times normalize, pent-up demand for commercial products will drive growth. We continue to monitor demand changes related to the impending refrigerant regulatory transition in 2025. There is likely to be demand disruptions as distributors are going to adjust inventory levels to mitigate supply chain risks, gain possible price advantage and prepare to meet regulatory deadlines.

In terms of headwinds, the most significant source of uncertainty stems from macroeconomic factors. These include 2024 as an election year, fluctuations in consumer confidence influenced by geopolitical concerns and the impact of elevated interest rates on residential new homes and large commercial construction projects.

On the right-hand side of the slide, we have identified several profit drivers. We believe that end market demand and normalization of channel inventory will drive improved volume with consistent incremental profits. We also expect the ongoing benefits of the strategic pricing initiatives and additional pricing opportunity driven by the increase in the cost of 410 refrigerant.

Toward the end of 2024, we'll start experiencing additional price and mix benefits, driven by the higher cost of 454B units that require new sensors, control boards and more advanced heat exchangers to maintain energy efficiency ratings. We forecast additional manufacturing productivity due to higher absorption and fuel for supply chain constraints. These drivers will be partially offset by ongoing inflation, ramp-up costs for the new commercial factory in Saltillo and costs associated with the refrigerant transitions.

Regarding cash flow, we anticipate cash conversion to be impacted by a temporary increase in working capital as well as capital investment to complete the new commercial factory and to meet the 2025 refrigerant transition requirements. Ultimately, our outlook on 2024 is cautiously optimistic. Our strategy remains focused on consistent execution, driving top line growth and expanding our margins. We plan to provide our 2024 financial guidance when we report our fourth quarter earnings early next year.

With that, please turn to Slide 13. Allow me to summarize some of the factors that lead me to believe Lennox is poised to continue delivering great results. First, we are making the necessary investments to enhance our go-to-market effectiveness to meet the attractive long-term industry demand. Second, our unique direct-to-dealer model enables us to deliver sustainable and resilient higher margins by leveraging both our manufacturing and distribution network to optimize profitability.

Third, we deliver consistent execution through utilization of our balanced scorecard-based operating system, dual source supply chain and lean digital processes. Our capital deployment remains disciplined as we prioritize organic growth investments, dividends, acquisitions and share repurchases. The fourth pillar is our advanced technology portfolio that allows us to address mega-trends and provide innovative solutions to our customers.

Finally, we live by our core values and embody our guiding principles to strengthen our high-performance culture. Our pay-for-performance incentive structure also ensures close alignment of talent and stakeholder interest.

I would like to conclude by expressing my appreciation to all of our employees and customers. I also want to thank Joe Reitmeier for his dedication over the years and congratulate Michael Quenzer on his new role as CFO.

Finally, I would like to welcome all the 280 AES employees to the Lennox family. I am excited about what the future holds for Lennox as our best days are still ahead of us. Thank you.

Joe, Michael and I will be happy to take your questions now. Kerry, let's go to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we'll take our first question from the line of Jeff Sprague with Vertical Research Partners.

Jeffrey Todd Sprague - *Vertical Research Partners, LLC - Founder & Managing Partner*

Thank you. Good morning, everyone. Joe, we're going to miss you. I think it was you, me and [LeBron] from Akron. So we're going to be down to 2 now, but...

Joseph William Reitmeier - *Lennox International Inc. - Executive VP & CFO*

I appreciate it, Jeff. Thank you.

Jeffrey Todd Sprague - *Vertical Research Partners, LLC - Founder & Managing Partner*

Thanks for all the help over the years. Alok, thanks for the early view into 2024. I wonder if we could just drill a little bit more into the transition itself. And just thinking about the timing of all this, should we expect, say, kind of cost burdens early in the year that are then kind of recaptured in higher selling prices later in the year? Just kind of thinking about the progression of this through your P&L as you prepare and then ultimately sell on the other side?

Michael Quenzer - *Lennox International Inc. - VP of Finance*

Jeff, this is Michael. Yes, I'll speak specifically to the commercial factory. What you'll see in the first half of next year is that we'll ramp that factory up specifically on the head count and the training needed to start the production kind of late into Q2. So you'll see some costs in the first half with no production output. And then in the second half, we'll start to get some production output, but that also still won't be at full efficiency. It will take a bit of time before we get the efficiency, but the second half will at least start to get some more production out and let us start to get back into the inventory levels that we need to get into emergency replacement.

So most first half of the year is going to be kind of the cost and efficiency getting better in the second half.

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

And Jeff, the same would be true on the refrigerant transition. So I think you're right to assume that the first half, there would be cost burdens as we start converting lines, ordering more spare parts. And then second half is where we start getting the price mix benefits. Most of the price mix benefits for refrigerant transition is likely to be 2025, but we'll start seeing some of that toward the tail end of next year.

Jeffrey Todd Sprague - *Vertical Research Partners, LLC - Founder & Managing Partner*

And maybe just as a follow-on comment here. Just thinking about the commercial margins, obviously, just a very positive story here in 2023. It looks like you are still expecting kind of a significant step down in Q4. Obviously, there's some seasonality, but maybe just give us some color on what you'd expect in Q4 in commercial price/cost mix and how the bridges to a margin expectation there?

Michael Quenzer - *Lennox International Inc. - VP of Finance*

Yes. Naturally, our Q4 has a little less volume and it seasonally, it drops down a little bit. But -- as we look to our backlog, the margin and the backlog still it supports margins that we saw in Q3. So pricing still remains to hold there well as well as the mix dynamic is positive. So we see that continuing into next year. I mean after several years of being behind on the price/cost dynamic, we've kind of gotten back to where we think we have normal margins.

Now it's about maintaining those margins going forward as we start to see costs for refrigerants and some of the new 454B cost additions that we need to do.

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

I think, Jeff, on the guide perspective, I mean, I just want to remind that like we are still heavily volume-constrained. And even in Q3, if we had more capacity, we would have sold more. So I just want to remind that like we made good progress in the factory. There are still -- they are playing Whac-a-Mole some time with supply chain with production output. We wanted to make sure that we didn't get too far ahead of ourselves as to giving guidance for the rest of the year.

Operator

And we'll take our next question from the line of Chirag Patel with Jefferies.

Chirag M. Patel - *Jefferies LLC, Research Division - Equity Associate*

Thank you. Just wanted to also thank Joe for his time and patience with us over the years. And Michael I look forward to your continued insights in the new role. Congratulations. One thing I wanted to kind of hit on was on the acquisition side. Any sort of thoughts on seasonality of that business, if there is something that doesn't match up with where commercial is currently? And then we talked about being accretive to earnings. Just wanted to also get a sense for how that margin profile kind of works. Will it be at the similar levels that we're seeing here in commercial currently? Or is there maybe a little bit of a dilution to that in the near term?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

Sure. Thanks, Chirag. Let me start on that. So first of all, very excited about the acquisition, very consistent with our stated goal of how we look at bolt-on and areas such as service parts and accessories. So super excited on what that brings.

In terms of seasonality I mean, given that it's installation and services, it's going to be very similar to the rest of the Lennox business. So I wouldn't expect anything materially different compared to the rest of the business. The same comment also holds on the margin. The margin on par would be same as the rest of Lennox, neither accretive nor dilutive to us as we embark on 2024.

So a great fit for us, it kind of from a revenue perspective and margin perspective would be similar dynamics to the rest of Lennox's business. I mean the fit is like hand in a glove fit for us on how well this business fits with our existing portfolio.

Chirag M. Patel - *Jefferies LLC, Research Division - Equity Associate*

And then I guess on the commercial side, we talked about, Alok, the idea of being able to sell more if we had more volume capacity currently. But just digging a little bit deeper into the actual end markets themselves, are you seeing any sort of softness or weakness in any of the various markets you serve? Is there a specific area that may be moderating just given the current macro environment that's out there, anything that you can help us within understanding that a little bit better?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

Where we have seen some softness is on like large office complexes and others. The good news is our exposure to that market is very small. Our primary exposure, as you know, is in flat single-story buildings like retail, restaurants, schools and all of them have been doing very well. So we haven't seen any significant change. Now we do see backlog, which is not like big for us, going back to more normal levels as lead times are going back to more normal levels. But from a core demand perspective, we're not noticing any noticeable differences, except in the small pocket where we don't have much exposure that's large office buildings and office complexes.

Operator

And we'll take our next question from the line of Nigel Coe with Wolfe Research.

Nigel Edward Coe - *Wolfe Research, LLC - MD & Senior Research Analyst*

Nice quarter. So the net material inflation now, I think, looks flat. So I think prior, you're looking for, I think, commodity costs, $35 million of deflation offset by component inflation of, I think, [$90 million], if I'm not mistaken. How does -- if you break out that flat between the components and the commodities, how does that look? Is it mainly steel price [deflation] coming through on the commodities. I was just curious how that bucket looks?

Michael Quenzer - *Lennox International Inc. - VP of Finance*

Yes. What we've seen is the commodities (inaudible) favorable. We saw steel year-to-date favorable. And for the rest of the year, we think commodities are going to be pretty flat. We don't see a lot of benefit in the commodities in the fourth quarter. You'll see continued headwinds a little bit on some of the material costs in Q4, but it's not as significant as we previously thought under our last guidance. That's really where the big change is that little bit less expected inflation on some of the non-commodity material. But for now, the commodities have been relatively flat across steel, copper and aluminum.

Nigel Edward Coe - *Wolfe Research, LLC - MD & Senior Research Analyst*

And then if we then carry that through into '24, obviously, with the hedges, you got some visibility there. How does that look in maybe the first half of the year?

Michael Quenzer - *Lennox International Inc. - VP of Finance*

Yes, we'll see a little bit of benefit on the hedges as they drift into next year in the first half for the aluminum. Aluminum, we spent more on that as the copper and the steel that's more fluctuation on the current pricing. So we'll see where steel goes, but we think it will be pretty muted next year on commodities.

Nigel Edward Coe - *Wolfe Research, LLC - MD & Senior Research Analyst*

And then just a quick one, if you bear with me on the refinancing because I think, Alok, you mentioned low financing cost with the refi. I think it was $500 million or 5%, replacing $350 million at 3%. So just wondering how the mathematics work there?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

Sure. I'll take that. I mean, I think if you look at it as an overall financing cost, I mean, clearly, interest rates are out of our control. But many of our secured credit lines and if we look at that the actual financing costs were higher. But from a pure interest rate perspective, you're right. I mean, the new bonds are at a higher interest rate and the bonds that are expiring. But as you look at whole package together, on what we are paying for secured financing versus the benefits of commercial paper, items under control would now be at a lower cost versus otherwise.

Nigel Edward Coe - *Wolfe Research, LLC - MD & Senior Research Analyst*

Okay. I'll dig it into that. And Joe, congratulations, Michael, congratulations. So I'll leave it there.

Operator

And the next question comes from the line of Noah Kaye with Oppenheimer.

Noah Duke Kaye - *Oppenheimer & Co. Inc., Research Division - Executive Director & Senior Analyst*

And I'll add my congratulations to [mix] as well, wishing both lots of luck. Peers are sounding like they may expect a richer mix, the low GWP products next year just based off of the installation requirements under the EPA rules that recently came out. Are you thinking similarly. Could there actually be a stronger front-loaded prebuy of 410A. Just your thoughts on how the rules impact those considerations for next year?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

I mean the rules are still a bit of in a flux. As you know, EPA came out with some final guidelines recently. We are still waiting for some clarifications from DOE and other pieces. Would there be mix benefits for the new refrigerants? Absolutely. Is it going to be early next year? We don't know. We think it's likely going to be more toward second half of next year. As the transition starts ticking forward.

But what we know for sure is given our preparation, which we think we are at or ahead of orders in terms of preparation, given our direct-to-dealer model, and given that our indoor units are compatible with our outdoor units. As we go through the transition, we think we are favorably positioned as we go into the transition year.

But we will give you more details when we announce Q4 results and there be greater clarity on the different regulations and rules that will impact the transition. We are ready for the change, and we feel we're going to do better than others, but the mix impact is still to be TBD, likely to be more in the second half versus first half.

Noah Duke Kaye - *Oppenheimer & Co. Inc., Research Division - Executive Director & Senior Analyst*

Okay. And I'm pleasantly surprised to hear that the margins on the AES acquisition are comparable to the commercial or to the Lennox average, just given that, that's would just be largely an installed business. Can you talk a little bit about that? And what accounts for sort of the quality implications in that business? And what was really appealing about the business that made it a target for you?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

Yes. So the financial profile, as I said, is similar to rest of Lennox, which is good. What was attractive to us was to be able to provide a comprehensive holistic range of services to our customers because earlier, we did not provide installation services.

We did not provide refrigerant reclaim and recycling, and we did not manufacture our own curb adapters. So it was really a very, very good fit with the gaps in our portfolio. We like the team. We like the customer base. As you can imagine, we did significant due diligence including using external services for financial due diligence.

And we are super excited about taking the business forward, getting a greater share of our customer spend, giving them good assurance all the way from cradle to grave for their product to be able to serve as well. So while the financials are small, we are just super excited about the strategic fit and where this business is going to go, including the synergies that we can gain out of this business.

Operator

And our next question comes from the line of Joe Ritchie with Goldman Sachs.

Joseph Alfred Ritchie - *Goldman Sachs Group, Inc., Research Division - VP & Lead Multi-Industry Analyst*

My congratulations to Michael as well. And then thank you, Joe, for all the time and wish you the best on retirement. So maybe my first question, can we just focus on resi volumes for the quarter. Nice to see the decelerating trend this quarter. Curious, can you maybe just kind of parse that out? What do you see specifically in your independent distribution channel versus selling direct?

Michael Quenzer - *Lennox International Inc. - VP of Finance*

Yes. So the independent distribution, we saw volumes down kind of mid-teens. And we saw that improve as the kind of quarter went on. Specifically in our coils business. That was one of the first businesses that started destocking. We're starting to see that improve. So that's a good sign. The destocking is ending on the coil side. So you'll -- kind of mid-teens on the independent distribution.

Joseph Alfred Ritchie - *Goldman Sachs Group, Inc., Research Division - VP & Lead Multi-Industry Analyst*

Got it. And Michael, what's kind of like the expectation then for 4Q on the independent distribution side?

Michael Quenzer - *Lennox International Inc. - VP of Finance*

[Middle] overall, we're getting to kind of a flat volume for Q4. We think it'll be down a little bit. There's still some furnace inventory in the channel that needs to de-stock. It's more of a seasonal product in Q4. So you'll see that for a bit. But then the direct side should be up offsetting that.

Joseph Alfred Ritchie - *Goldman Sachs Group, Inc., Research Division - VP & Lead Multi-Industry Analyst*

Okay. Cool. And then I guess just thinking about 2024, and I appreciate the comments you've already made on commercial margins and the plants and potentially productivity efficiencies as you kind of ramp the plant. At the same time, like you haven't seen a lot of productivity benefits coming through commercially yet. Yet the margins are -- have been really, really good. So I'm just curious like -- how do you kind of -- how do we level set like what the margin profile for the commercial business should be or could be in 2024?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

Sure. Let me speak on that. So as we look at the commercial business, we are very pleased with the progress. And as a reminder, we are sort of ahead of where we had communicated and expected, and we have delivered over $100 million in EBIT improvement even before Q3. If you go back and look at strategically what we did there, we rationalized a significant portion of our product. You can call that a mix benefit. You can cause that productivity benefit. It really doesn't matter. But yes, I mean, we are -- our factories are running much better, getting a greater output and giving us more of the products that we are getting margins on.

So what it does is it sets us up really nicely for '24. Even though we are going to have a onetime cost for factory startup and we'll be bidding kind of extra labor, extra cost before we start production. We think going into 2024, we are not going to be degrading margins in commercial throughout the year. So I think we are set up for long-term success. Second factory gets us more volume at similar margins, and we are excited about the future of commercial. And I wouldn't read too much into whether we got productivity or not because on those walks, you can put mix as any different ways. We just put a lot of those benefits simply into mix.

Operator

And we'll take our next question from the line of Ryan Merkel with William Blair.

Ryan James Merkel - *William Blair & Company L.L.C., Research Division - Partner & Research Analyst*

Nice quarter. Alok, could you just comment on demand trends exiting 3Q and into 4Q? It sounds like the Allied business is improving, but anything else you'd add?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

Ryan, thanks. It's been very similar. We said even when we give '23, guidance that we would expect destocking to essentially end in '23, besides some furnaces. And that's exactly what we're seeing is destocking is tailing down, some furnaces, as Michael mentioned earlier, are still in there. And we haven't noticed anything different compared to the end of Q3 versus the beginning of Q4. That holds true for both direct and indirect channel. Consumer seems to be holding pretty well on the resi side.

On the commercial side, there's lots of sophisticated dialogue around how we transition next year and what we do with capacity when it comes back online. But again, no significant changes in demand over the past few weeks as we finished Q3 and moved into Q4. Everything is very, very consistent with how we thought about it and what we have communicated in the past.

Ryan James Merkel - *William Blair & Company L.L.C., Research Division - Partner & Research Analyst*

And then a question on commercial for '24, you mentioned pent-up demand. I'm just curious how much visibility do you have? Do you have backlog through the first part -- the first half of '24. Just any commentary on sort of your confidence in that part of the business?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

I mean we are not in the long lead backlog type business. So I mean within a quarter, we typically book and ship. When we end the quarter, we might have 6 to 8 weeks of backlog on the books. So no, from a booked order perspective, we don't carry over beyond a quarter or so. But from conversations with our customers and quotation activity and starting to schedule changeovers, we feel good about 2024. Because remember, there's a pent-up demand. The average age of units on rooftops when you look at large customers, whether it's Lowe's, Walmart, others, is much higher than what it should be, which means they're paying more for repairs than they should and a new unit may have a much quick payback compared to in the previous times.

So those conversations all make us feel confident. But we'll get more into this when we announce Q4 results in early 2024.

Operator

Our next question comes from the line of Jeff Hammond with KeyBanc.

Jeffrey David Hammond - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Congrats, Joe, I'm wondering if you're getting your retirement home in Cleveland?

Joseph William Reitmeier - *Lennox International Inc. - Executive VP & CFO*

Believe it or not, yes, and we'll see you around the [stalk the ground] at some point. So.

Jeffrey David Hammond - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Just Alok, I want to go back to pricing you made some comments at a conference kind of 15% price. I think [Carrier] was out with similar comments. Just maybe walk through your confidence in being able to kind of realize those? And then -- it seems like year 1 is maybe more around refrigerant inflation, which we're not seeing yet. Just any feedback on kind of where refrigerant prices go from here?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

Yes. So I think, first of all, we are pleased that the numbers we gave are similar to what the peers are giving. And just a reminder to others who may be less familiar, because those numbers were over 2 years, right? We said starting 2023, ending in, I think, in 2025, we think there's a pricing opportunity in that range over 2 years. First year, yes, there is a refrigerant. Now the spot pricing on 410A goes up and down a little bit. But keep in mind that the production quota has not been reduced yet. That gets into reduction starting 2024. So we still expect refrigerant price to go up.

And all indications based on conversations with suppliers is that it will. So that will force everybody to do price increases, including us. So we are monitoring that closely and no change in our outlook yet. In addition, as we go further into the year and we think of the new refrigerant, higher efficiency, the cost of sensors, that outlook has not changed either. So while you can there be certain and we'll get more into this in early 2024, Jeff, our viewpoint on that has not changed.

Jeffrey David Hammond - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Okay. Great. And then just the mix and resi continues to be impressive. I'm just wondering how much is just straight [CRU] change versus consumers mixing up or I know supply chain was an issue on the higher-end stuff. And then just on share gain. I mean, it's obviously some noise with destocking and everything, but it seems like some share pickup in the residential business, maybe where do you see that coming from?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

Sure. On the mix, Jeff, as a reminder, like last year, we talked a lot about mix being negative. So remember, our mix has been negative for the past 2 years. A lot of it was semiconductor-driven as we tend to have the chips for the high-end products, which uses a lot more chips. So that has reverted itself. We are selling a lot more of the premium products. I think as part of pricing excellence, the team is doing a really good job driving the right mix as we go into larger accounts and running the appropriate promotions. That would promote a higher mix.

The incentive structure helps us well because a lot of the government incentives and rebates come only at higher efficiency products, not at a lower one. And then, of course, there's the [pure CRU change], which we called out earlier. So I think that number has not changed. But I think the upside in the mix is more from all the other factors, mostly on selling higher-end premium products.

Jeffrey David Hammond - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

And then just kind of around share gain?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

On share gain, I like to look at it over a 12-month period. I mean, right now, because of destocking our direct business clearly shows very good share gains. We think some of it is artificial and will go away as destocking again. We are confident some of it is real and will stick around as like in the dust clears between stocking and de-stocking. But it's too early to call victory or too early to take a victory lap here. We'd like to see all the numbers settle in by next year.

But we feel very good based on conversations, based on a number of dealers who are coming back to us, based on our new dealer pipeline and based on just the feedback and customer satisfaction scores that we are getting. Our customer satisfaction had dipped. But as I look at NPS scores, we are back to regular/better than regular, which is always a leading indicator into share. So we feel good where we are, but I'd like to give it a few more months and dust to settle before we kind of claim that to be a win.

Operator

(Operator Instructions) And we'll take our next question from the line of Joe O'Dea One with Wells Fargo.

Joseph John O'Dea - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

I guess wanted to start on just 2024 and your comments around volume growth and consistent incrementals and just touch on the volume growth side of that a little bit and in particular, on the resi side and just the dynamic that you consider as kind of the setup for 2024, maybe some kind of comp benefits, so a little bit of absence of destock but then other factors you're considering kind of how you're thinking about that volume algorithm?

Michael Quenzer - *Lennox International Inc. - VP of Finance*

Yes, that was the main one that you just touched on. The absence of the destock, that's obviously going to revert next year. So we will see that pick up on the indirect side of our business. And then outside of that, we still expect the economy to continue to grow kind of low single-digit [GDP] with that, we see the replacement market continue to expand. We'll get some volume there, potentially some share gains as well in residential. And then as we talked about, we still see good visibility into next year on the commercial after many years of being down in the industry. We're going to continue to see that grow as we talk with National Accounts. They have big planned replacement programs going for several years to come, and we see that as [an evolving tailwind] next year.

Joseph John O'Dea - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

And then on the fourth quarter implied margin step down, you touched on commercial, it sounds like nothing more than typical seasonality? Can you also touch on resi because it looks like what's implied is a larger-than-normal sequential step down. Is there anything within resi that's adding any kind of abnormal pressure versus typical seasonality?

Michael Quenzer - *Lennox International Inc. - VP of Finance*

We'll have a little bit of headwind from absorption. As you saw in Q3, we started to ramp down our inventory levels. We had some absorption headwind in Q3. We'll see some more of that in the Q4, so we get the inventory levels to where we want to be and maximize our cash flow this year. Then next year, we will start to grow inventories again as we transition to the new refrigerant product and get the absorption benefit back next year.

Joseph John O'Dea - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

Okay. And so when we think about the third quarter and fourth quarter kind of this margin move, a bigger impact on resi than what we would see on commercial. Is that reasonable?

Michael Quenzer - *Lennox International Inc. - VP of Finance*

Yes.

Operator

Our next question comes from the line of Brett Linzey with Mizuho.

Brett Logan Linzey - *Mizuho Securities USA LLC, Research Division - Executive Director*

Congrats to Joe and Michael. I wanted to come back to price. And understandably, there's a lot of moving pieces on the regulatory in terms of price mix and everything in resi. But thinking more broadly to commercial, I guess as your lead times and your ability to serve does improve here. Does it give you an inherent price entitlement? And how should we think about that as we flip the calendar here?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

This is Alok. I don't know if it gives us any additional price entitlement that we have today. So we have done better at getting key account pricing that had been stuck with contracts in the past. We have done better at driving mix appropriately. So getting out of lower margin products and focusing our capacity on the higher-margin business where we have kind of appropriate advantages in terms of both price and performance.

As we roll into 2024, beyond the 410A pricing impact that we talked about earlier and toward the tail end of the year, the new 454 units. I don't think there's anything incremental beyond those 2 that we already talked about in getting into there. A lot of the catch-up on National Accounts and commercial was done this year and I wouldn't expect another catch up next year.

Brett Logan Linzey - *Mizuho Securities USA LLC, Research Division - Executive Director*

Okay. Got it. That's helpful. And then just a follow-up on commercial. I was hoping you might be able to provide a little bit of context on the individual vertical performance within that business. I think you noted last quarter, there was a gradual improvement within emergency replacement as you regain your footing there. But does that continue into Q3? And then any color on the individual verticals there?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

Same trend as Q2. I mean some things like schools are always seasonal, so you will see that tailing off in Q3 compared to Q2 as most of those placements happen in summer. But beyond that, no specific trends, and we continue to make inroads, I would call it, into emergency replacement and continue to maintain our key account volume and beyond normal seasonality, nothing else specific to point out.

Operator

And our next question comes from the line of Deane Dray with RBC Capital Markets.

Deane Michael Dray - *RBC Capital Markets, Research Division - MD of Multi-Industry & Electrical Equipment & Analyst*

Maybe I could circle back on the resi destocking this quarter. You said it was decelerated, so it seems to mostly have played out. Has there been any surprises from your perspective?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

No, not really big surprises. I mean, sometimes when we look at the overall industry numbers month-to-month, I think, there are some months where we thought it was, wow, really better, some months were really worse. But net-net, not that many surprises, Deane, because I think overall, it's turning out very much exactly as we thought it would be in terms of when it would end.

Now I think there's different dynamics between independent distributors and large organized distributors. And just keep in mind that our focus and our exposure is largely to independent distributors versus large organized distributors. For us, it's played out very similar to what we thought it would.

Deane Michael Dray - *RBC Capital Markets, Research Division - MD of Multi-Industry & Electrical Equipment & Analyst*

Great. And I appreciate the early look on some of the 2024 dynamics, was hoping you could expand on the free cash flow implications. Just can you size what that temporary working capital bill might be? And when might that get worked down?

Michael Quenzer - *Lennox International Inc. - VP of Finance*

We're still formalizing all the plants, but it might be maybe 1% of sales. It's mostly related to the Commercial business as we ramp up that factory. We're going to need additional raw material might have a little bit of prebuild on the commercial but also with the 410A equipment since the manufacturing day cut off is kind of at the end of the year for all of that package system.

So that's really where most of that growth is going to be -- and then in addition to that, we'll have some higher or elevated capital expenditures going into next year as we finish up the factory and finish up the transition of the commercial factory and finish up the investments we need to make to transition our factories to the 454B product. So CapEx will be elevated maybe kind of $150 million on that for next year as well. And then you ask about burning off that working cap, well, that will take place over 2025.

Operator

Our next question comes from the line of Gautam Khanna with TD. Cowen.

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

I think Gautam moved down in the queue. So maybe go to Steve next -- go to the next question.

Operator

One moment, please. Steve Tusa with JPMorgan.

Charles Stephen Tusa - *JPMorgan Chase & Co, Research Division - MD*

Congrats to both of you, for sure, Joe. It was a pleasure working with you. Always tremendous straight shooter, so I appreciate the work over the years. So just on the commercial side, I mean, I know you guys are putting up some really good numbers. Carrier up 30% again this quarter or something like that. You say orders are solid. Like what is the -- but the lead times are like 50 weeks at some point, which is almost even like a fake lead time to an extent. What is the book-to-bill? What was the book-to-bill this quarter for that business as the backlog normalizes?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

Steve, for us, as we look at our business, we have very little orders that carry over beyond a quarter. And when I mean order like booked order. So our book-to-bill ratio was extremely close to [1], which is what it has been most of the time, except during really bad crisis. And the lead times for -- at least for us are no longer 50 weeks. Lead times are now trending just around a quarter, within a quarter and getting much, much closer to normal.

Charles Stephen Tusa - *JPMorgan Chase & Co, Research Division - MD*

Right. So you're saying that even when those lead times kind of stretched out there there's really no backlog build? I mean, is that what you're saying? I'm just having trouble reconcile on that because everybody else built a lot of backlog, obviously?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

So we did. So if you go back to last year, right, about the same time, we had talked about our backlog, and we had said that is unusual for us to carry so much backlog given the nature of the business. At this point, 12 years after that, we are saying that we still have backlog, but it's more in a normal level. It's no longer an elevated backlog, but our book-to-bill. So we are essentially shipping as much as we are booking at any given time. So that's close to [1].

Charles Stephen Tusa - *JPMorgan Chase & Co, Research Division - MD*

Right. Okay. Got it. And then just on the pricing side, you guys have talked about that kind of mid-season price adjustment for some of the resi customers. Your pricing was kind of consistent 3Q to 2Q. Can you maybe just talk about how that played through? I know that may be a little bit of a tougher comp versus last year, but maybe just some color on that, how that played through?

Michael Quenzer - *Lennox International Inc. - VP of Finance*

Yes. I think what you saw in Q2 is that we still had some benefit of lapping some prices in Q2, and by Q3, we fully lapped all that benefit, but we picked up the incremental strategic pricing in Q3. So that's where we'll start to see that normalize for the rest of the year though. But yes, we did see good pricing on the strategic pricing initiative we launched in June.

Charles Stephen Tusa - *JPMorgan Chase & Co, Research Division - MD*

Okay. And then one last question on pricing for next year. I know you said the double digit over a 2-year period I'm not sure if that meant like mid-singles in '24 and mid-singles in '25. Maybe just a little bit more clarity on how you see that breaking out between '24 and '25.

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

Steve, that's still a bit TBD. We're in October, as we go into price increases, we will get greater clarity in a couple of months because there are lots of moving pieces, including cost of refrigerants, sensors, where the overall situation is in different manufacturing costs as well. Because we haven't even made any measurable quantity of the new product. So we'll be able to give you a much more refined view of that when we announce Q4 results early next year.

Charles Stephen Tusa - *JPMorgan Chase & Co, Research Division - MD*

Right. And no Investor Day, right, obviously in December?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

That's right. No investor Day.

Operator

(Operator Instructions) We'll take our next question from the line of Julian Mitchell with Barclays.

Julian C.H. Mitchell - *Barclays Bank PLC, Research Division - Research Analyst*

Congratulations to Joe and to Michael. Maybe just a first question. commercial margins are not a particularly original topic. But -- if we think about what you said, Michael, earlier on this call, I think it's that the sort of firm-wide operating margin looks like it's down maybe 200, 300 basis points sequentially in Q4. And commercial is down sort of less than that and resi down a little bit more. So we have that sort of jumping off point of a commercial margin of sort of 22% or something for the year, a little bit more than that.

When we look at next year, the sort of puts and takes of all your color, are we assuming kind of fairly normal commercial operating leverage, you have the sort of the balance of the tailwind from volume and price mix and then the headwind from the new plant ramp-up. Is that maybe just confirm that, that thought process for Q4 and next year is roughly correct?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

Julian, I'll start and then Michael will continue. But I just want to start by reminding that we don't really get segment margin targets by quarter. I mean, part of it is we are just too small for that in terms of -- there's always puts and takes. So I think when we give guide, we look at the company overall. And having said that, I will hand over to Michael, who can get into the details of margin expectations and pluses and minuses, both for Q4 and for next year.

Michael Quenzer - *Lennox International Inc. - VP of Finance*

So maybe I'll just talk about next year first. So I think that's mostly our focus at this point. So what we'll see next year is that the margins that are in our P&L currently will retain next year. We'll want to price to maintain those as costs come in, specifically on components and some of the 410A refrigerants will maintain those margins. And then on top of that, we see volume growth. So we'll get 30-plus percent incrementals as we get some additional volume out of that second factory and end markets ourselves. So you'll see that help lift up some of the operating margins offsetting that though will be some of the headwinds that we have in the factory, the new factories, we've ramped those up. That's kind of our early thinking right now. But overall structure of the margins you see in 2023, we think will repeat next year.

Julian C.H. Mitchell - *Barclays Bank PLC, Research Division - Research Analyst*

That's very helpful. And just my quick follow-up is I know we're up on time. The price mix tailwind to EBIT, you've quantified it for this year. Just sort of fourth quarter, are we thinking it's about $50 million or so tailwind? Is that roughly the order of magnitude? And then do we assume that that's sort of a good run rate into early next year?

Michael Quenzer - *Lennox International Inc. - VP of Finance*

That's the guide that we have right now. We'll see where the final results come in. You need to remember that commercial last year, we had a lot of price increases that we started to get in Q4. So we are lapping pretty big comps in commercial, which is why it drift off a little bit in Q4. But yes, we should retain that. And then you'll get a carryover price benefit next year for the residential strategic pricing that we did in June. So that will be on top of any price increases we announced effective January 1 that will come out in the next month or so.

Operator

And we'll take our last question from the line of Gautam Khanna with TD Cowen.

Gautam J. Khanna - *TD Cowen, Research Division - MD & Senior Analyst*

All right. Well, first, congratulations, Joe and Michael, I appreciate that. All your help over the years, Joe, and wish you well.

Joseph William Reitmeier - *Lennox International Inc. - Executive VP & CFO*

Thank you.

Gautam J. Khanna - *TD Cowen, Research Division - MD & Senior Analyst*

A lot of questions have been asked and answered. But I was curious, some companies have remarked that there's been evidence of trading down, if you will, repair over replacement in North American resi HVAC. Have you seen any evidence of that in your sales in the third quarter?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

Gautam, I'll take that. It's unclear. Our exposure to repair is much lower than some of the other players in the industry, as you know. So we have read the same transcripts and we have gone through the same earnings and that does cause us some concern. But when I look at our own results and what we're hearing from our own dealers, we don't see that. So I mean I've read the same thing. It makes us a little cautious as we look at the guide going forward and making sure we continue to train our dealers to inform the consumer and make a very informed sale. But at the end of the day, as price of refrigerant keeps going up, whether it's R-22 or 410A as cost of repair keeps going up and the fact that new units come with full warranty and are making it better in terms of efficiency our dealers do the right thing to educating the consumers around it.

So but we have read the same things. We have not heard that or seen that from our channel or our dealer base yet, but we're going to keep a close eye on that for Gautam.

Gautam J. Khanna - *TD Cowen, Research Division - MD & Senior Analyst*

Okay. And just to reconcile a comment, I think you made to Steve on book-to-bill and then earlier on productivity and within the commercial business. It sounds like I'm just curious at what level of backlog are you kind of operating off of this at this point? Because it sounds like had you had capacity to do more, you would have shipped more. Yes. Just I'm curious like how much of the next quarter or 2 is actually visible to you in terms of demand?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

So I think we -- and maybe the term backlog is used differently by different companies. I mean when we think of backlog, it's for us, orders that are POs in the system, right, confirm. And then there's pipeline. Pipeline we could be having discussions with the customer and getting their commitment about shipments in 2025 but those are not confirmed PO in our system. So our pipeline visibility is much higher, and we can see that through the next 12 to 18 months, but there's a conversion drop out in there. So we can't be 100% sure.

What we're 100% sure is our backlog. Typically, we book and ship within the same quarter. And during supply chain disruption, it became more than 1 quarter, and now we are back to sort of within the quarterly range. And we don't want to get into a situation where we start publishing backlog numbers because it's really not that relevant to our business. It is all within the quarter. So that's the comment on the backlog that I specifically mentioned.

Michael Quenzer - *Lennox International Inc. - VP of Finance*

And I'll just add to that. It will be even less important as we move more into [emergency replace], that is really fast backlog activity.

Gautam J. Khanna - *TD Cowen, Research Division - MD & Senior Analyst*

Yes. And just maybe a last 1 for me on that productivity journey at the commercial facility in Arkansas, like how far along are you in that journey? Are you kind of where you expect to be? And I'm just curious like how much headroom is actually left in terms of throughput and as the supply chain has gotten better and the like. How much upside do we still have?

Alok Maskara - *Lennox International Inc. - President, CEO & Director*

There is upside remaining. And I think some of that has to be captured after the second factory is online. I mean right now, we are still running at as I called it earlier, sometimes with [Band-Aid] and [Twigs], I mean we have put in new management, great leaders. We have got -- solved our labor issues. So there's a lot of good things going on there. But from a lean operations perspective and to be able to run a factory with consistent output, very low defect rates, very little rework.

We have significant room for improving productivity in that factory. A lot of that is happening, but a lot more will happen as we get the second factory online and not run the factory above sort of where its capacity has been or what we think is capable of.

So some of that will happen only after the second factory comes online. Second, we'll keep working through that.

Operator

Thank you for joining us today. Since there are no further questions, this will conclude Lennox's third quarter conference call. You may disconnect your lines at this time.
