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LII.N - Q4 2022 Lennox International Inc Earnings Call

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OVERVIEW:

Co. reported FY22 revenue of $4.7b, 4Q22 revenue of $1.1b, FY22 adjusted EPS of $14.07, and 4Q22 adjusted EPS of $2.63. Expects FY23 revenue to be flat to up 4% and EPS of $14.25-15.25.

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PRESENTATION

Operator

Welcome to the Lennox International Fourth Quarter 2022 Earnings Conference Call. (Operator Instructions) As a reminder, this call is being recorded.

I would now like to turn the conference over to Alok Maskara, CEO. Alok, please go ahead.

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

Thank you, Ashley. Good morning and welcome. I hope everyone is having a good start to 2023. It was nice to meet many of you face-to-face during the Investor Day on December 14. Thanks for attending and sharing your feedback.

Turning to Slide 2, a reminder that during today's call, we will be making certain forward-looking statements that are subject to numerous risks and uncertainties, as outlined on this page. Please refer to our SEC filings available on our website for additional details.

Before we begin, I want to express my gratitude and appreciation to all of our employees who enabled us to deliver record financial results in 2022. Last year, our dedicated employees improved our customer experience while facing significant supply chain disruptions. This enabled us to reestablish our cadence of gaining residential market share. I want to take this opportunity to also thank our dealers and customers for their loyalty to Lennox. We will continue to improve our service levels while maintaining the best HVACR products and solution in North America so that we can continue gaining share in the future.

Now please turn to Slide 3 where I want to highlight 4 key messages. First, we are proud to report solid fourth quarter results that capped off another record year for Lennox. Q4 revenues of $1.1 billion and full year revenues of $4.7 billion were both up 13% year-over-year. Strong price execution and continued volume growth enabled us to set new records for both quarterly and full year revenues. Q4 adjusted earnings per share of $2.63 and full year EPS of $14.07 both grew 12%, establishing a new record for full year EPS.

Second, we successfully transitioned our product portfolio to meet the new minimum regional efficiency regulation that went into effect on January 1, 2023. We believe that our superior design and solid execution has put us in a strong position to win share during and after the transition.

Third, we ended the year with fully replenished finished goods inventory levels to support our customers through this year transition. In addition, we are also carrying higher level of raw material safety stock to mitigate the impact of ongoing supply chain disruptions. Given this, our 2022 free cash flow was $203 million, which was below our expectations. We are undertaking countermeasures to improve our cash flow forecasting and remain committed to converting 90% to 100% of our net income into free cash over the long term.

Fourth, our 2023 full year outlook remains unchanged, and we still expect revenue growth of 0% to 4% and an EPS range of $14.25 to $15.25.

Now please turn to Slide 4 to discuss business updates as a follow-up to our dialogue during the Investor Day. In terms of end market update, as we approach February, our order rates remain consistent with our prior expectations. While we are noticing signs of a slowdown, we remain confident in our dealer networks' ability to continue driving both replacement and new construction sales, especially as equipment lead times normalize.

We do anticipate some channel destocking in our 2-step distribution businesses like Allied Air, ADP and Heatcraft. We are maintaining solid communication with our distribution partners to effectively manage channel inventory levels.

In addition to successful execution during this year transition, we are pleased to report that we remain on track to transition our portfolio to comply with the upcoming 2025 low GWP regulation.

In terms of order updates on our innovation road map, we recently launched our next-generation thermostat controller, the Lennox S40, which has built-in indoor air quality monitoring capabilities and improved connectivity to further improve the experience of our customers and our dealers. We also continue to make progress on accelerating our heat pump growth, and we're a proud recipient of the good design award for that our Dave Lennox Signature Series collection, heat pump.

Switching gears. As part of our commercial recovery effort, the construction of our new commercial factory in Saltillo has started and will be complete by the end of 2024.

Lastly, on this page, the formal process for divesting our European assets has started, and our internal segment consolidation is complete. We expect to close the European divestiture sometime this year.

With that, let me hand the call over to Joe, who will provide you a more detail view of our financial performance.

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

Thank you, Alok. Good morning, everyone. Please turn to Slide 5. Looking at the quarter for Lennox overall, the company posted strong revenue and profit growth. Revenue was a record $1.1 billion, up 13% as reported and up 14% at constant currency, with the growth driven by volume and price. Total segment profit increased $30 million or 30% versus prior year as pricing gains more than offset cost inflation, and all 3 segments contributed to profit growth.

Total segment margin was 12.1%, up 150 basis points, as price gains outpaced cost inflation, and Commercial margins improved due to higher factory output. GAAP EPS of $2.65 was up 17%, and adjusted EPS rose 12% to $2.63.

Regarding special items, the company had an $800,000 adjustment for the fourth quarter and $6.6 million for the full year. Corporate expenses were $34 million in the fourth quarter and $91 million for the full year. Overall, SG&A was $155 million in the fourth quarter or 14.2% of revenue, down from 15.7% in the prior year quarter. And for the full year, SG&A was $627 million or 13.3% of revenue, down from 14.3% in the prior year. Our full year 2022 income tax rate was 19.3%, which was up from the 17.2% last year, the result of higher tax benefits from share-based compensation and the finalization of our prior year tax obligations with taxing authorities.

For 2022, the company generated cash from operations of $302 million compared to $516 million in the prior year. The reduction in cash flow was primarily due to inventory cost inflation and investments to both minimize supply chain disruptions and prepare for the minimum-efficiency regulatory change that took effect January 1, 2023.

Capital expenditures were approximately $101 million for the full year compared to $107 million in the prior year. Free cash flow was $203 million for the year compared to $410 million in the prior year. In 2022, the company paid approximately $142 million in dividends and repurchased $300 million of the company's stock. Total debt was $1.5 billion at the end of the fourth quarter, and we ended the year with a debt-to-EBITDA ratio of 2.1. Cash, cash equivalents and short-term investments were $61 million at the end of the year.

Moving to the business segments, starting on Slide 6. Our Residential segment delivered record fourth quarter revenue and profit. Residential revenue grew 13% to $703 million. Volume was up 5%. Price and mix were up 9%. And foreign exchange had a negative 1% impact. Residential segment profit rose 8% to $119 million. Segment margin contracted 90 basis points to 16.9%, primarily due to incremental costs associated with supply chain disruptions and the factory changeover for the new 2023 minimum efficiency standard products. For the full year, Residential segment revenue was a record $3.2 billion, up 15%. Volume was up 4%. Price was up 11%. And product mix was flat for the full year. For the full year, Residential profit was a record $597 million, up 10%. Segment margin was 18.7%, down 80 basis points, primarily the result of supply chain challenges, which drove manufacturing inefficiencies and unfavorable product mix with reduced production output for higher-end products.

Now turning to Slide 7 and our Commercial business. Revenue was $241 million in the quarter, which was up 19%. Commercial price and mix was up 17%. Volume was up 3%, and foreign exchange had an unfavorable 1% impact. Commercial segment profit was up 79%, and segment margin expanded 390 basis points to 11.6%. Commercial demand and backlog remains solid, and our Arkansas factory recovery is progressing well. Staffing in the plant is at our desired levels, with productivity progressing and production output increasing. For the full year, Commercial revenue was $901 million, up 4%. Price and mix were up 13%, and volume was down 9%. For the full year, segment profit was $81 million, down 27%. Segment margin was 9%, down 380 basis points.

Looking at our Refrigeration business on Slide 8. Revenue was $150 million for the fourth quarter, up 5% as reported and up 10% at constant currency. Price and mix were up 21%. Volume, down 11%. And foreign exchange had a negative 5% impact. Revenue growth was led by our North American business with price and mix, which was up more than 20%. Europe revenue was up 9% as reported and up 22% at constant currency. Overall, the Refrigeration segment profit rose 42% to $19 million, and segment margin expanded 330 basis points to 12.5%. Refrigeration demand, order rates and backlog remain strong. For the full year, Refrigeration revenue was $619 million, up 12%. Volume was up 3%. Price and mix was up 14%. And foreign exchange had an unfavorable 5% impact. Segment profit was $79 million, which was up 60%. And segment profit was 12.7%, up 380 basis points.

Turning to Slide 9 for a free cash flow update. Free cash flow was $203 million and was impacted by inventory replenishment to get our distribution network back to effective levels to serve our customers, along with inventory investment to buffer the supply chain to support demand for the new minimum efficiency standards that became effective January 1.

As we look to 2023 in free cash flow, we expect cash from operations to increase as we work to optimize inventory levels while we prepare for the next regulatory change to take effect in 2025 for the new low GWP refrigerants and minimize supply chain disruptions.

Our capital expenditures in 2023 will be approximately $250 million and includes investments for a second commercial factory and investments necessary to prepare us for the 2025 refrigerant change. Free cash flow in 2023 is planned within a range of $250 million to $350 million, including increased capital spending to support regulatory growth -- to support regulatory change and growth initiatives, including factory capacity.

Free cash flow in 2023 is planned within a range of $250 million to $350 million, including increased capital spending to support regulatory and growth initiatives, including factory capacity.

Now turning to Slide 10. Let's review our 2023 full year guidance. Our outlook collectively for the end markets we serve remains unchanged. We expect revenue to be flat to up 4% for the year. There is no change to our EPS guidance of $14.25 to $15.25 that we shared with you during our Analyst Day. Free cash flow is targeted within the range of $250 million to $350 million, as I mentioned. And we are planning capital expenditures of $250 million that includes the necessary investments in a second factory, as I mentioned, and investments related to the refrigerant transition that take effect in 2025. Price benefit, including price associated with the 2023 SEER transition, is now expected to be within a range of $150 million to $175 million.

Now turning to the cost side of the equation. We expect net material cost to be at $35 million headwind in 2023. That material cost headwind is driven by component cost inflation of $100 million, net of $30 million in savings from sourcing and engineering initiatives, along with a $35 million commodity cost benefit. Corporate expenses are still targeted at $80 million. We will manage SG&A tightly while continuing to make the necessary investments in the businesses to support growth initiatives and to drive productivity. And finally, we expect the weighted average diluted share count for the full year to be between 35 million to 36 million shares, which incorporates our plans to repurchase $100 million to $200 million of the company's stock this year.

With that, let's turn to Slide 11, and I'll hand it back over to Alok.

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

Thanks, Joe. For summarizing our financial results and providing an update on the assumptions behind our 2023 fiscal guidance. Please turn to Slide 11 for the key success factors for Lennox this year that are summarized on this page.

While we have little control over the industry unit shipments in 2023, that are still expected to decline year-over-year. Given that, we are focusing our effort on the 3 controllable factors to grow our revenues and expand our margins. First, to offset inflation, we are maintaining and expanding our pricing initiatives. We have already implemented price increases for 2023 and are confident in our ability to offset cost inflation with pricing.

Second, on the heel of a strong Q4 performance, we continue to maintain focus on commercial profit recovery. As Joe mentioned earlier, staffing levels are stable, and the Stuttgart plant has switched over to the 2023 SEER standards while simplifying our product portfolio. Our new commercial product lineup provides greater value to our customers, and we intend to share part of that value through pricing and contract negotiations.

Third, Lennox is now well positioned to start gaining share again. As you may recall, our service levels suffered after the Marshalltown tornado in 2018, and we were unable to fully restore the service levels during the COVID years. Now the Marshalltown reconstruction is complete. Our finished good inventory levels have been replenished. Saltillo continues to add capacity, and our commercial lead times are approaching competitive levels.

The improved service levels, along with recently introduced new products, put us in a strong position to relaunch our share gain programs.

Even during a period of economic uncertainty, our confidence in executing on the 3 controllable key success factors makes us cautiously optimistic for 2023. Again, I want to thank our employees who are working hard to sustain and improve our customer service levels.

Now please turn to Slide 12 for some final thoughts before Q&A. I would like to close our prepared remarks by summarizing why I believe LII is an attractive investment opportunity. Lennox is narrowly focused leader in energy-efficient, environmentally friendly climate controlled solutions. We operate in high-growth end markets with strong replacement demand that provides us with resiliency even during periods of economic uncertainty. The company has a unique direct-to-dealer network, which creates a sustainable competitive advantage. And finally, we have a history of robust execution with disciplined capital allocation.

Thank you for listening. Joe and I will be happy to take your questions. Ashley, let's go to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll take our first question from Julian Mitchell with Barclays.

We'll go next to Gautam Khanna with Cowen.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD & Senior Analyst*

It's Gautam here. I was just curious if you could elaborate on your opening remarks about seeing some channel or seeing some pressure on volumes. Just if you could talk about the Allied versus the Lennox brand, if you're seeing -- what you're seeing in terms of destocking, if any? And how -- maybe you think it's just maybe an early read on Q1 based on what you're seeing on resi.

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

Sure, Gautam. So I guess, first of all, as you know, majority of our sales are direct to dealers. And we highlighted Allied, ADP and Heatcraft as the 3 business units that do go through 2-step distribution model. Each of them are in a different cycle stage on distributor inventory levels. For something like Heatcraft, we saw some destocking already occur, and we might be back to more normal levels. For Allied and ADP, as we talk to our channel partners, we believe there's some destocking that's going to occur this year, which frankly puts our Lennox brand in a strong position. That all is baked into our guidance as we look at 0% to 4% revenue growth.

While we don't give quarterly guidance, Gautam, as you know, I mean, so far, I mean, as we said, the Q1 order rates are consistent with our expectations. And I don't see anything falling off a cliff or so, but we do see gradual slowdown that we have talked about in the past.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD & Senior Analyst*

Okay. And then if you could just comment on the recovery on the high-end product, Lennox products. Sort of what -- where are we in that journey? And do you expect to be a full participant in the summer selling season with that product line that was impacted last year?

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

Yes, Gautam, now since Marshalltown tornado, this would be the year, in 2023, we have all the inventory levels needed to launch our programs, to recapture our position on the high end, especially as we look at some of the new products like the Dave Lennox Signature Series heat pumps and the new higher efficiency furnaces. So we feel good going into the year to be able to capture our fair share of market and higher than growth in 2022 on the higher-end products.

Operator

We'll take our next question from Nigel Coe with Wolfe Research.

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

So I was a little late joining the call. So I was just wondered, could you give any color in terms of the order activity in 1Q? I'm guessing not, but if it did, it'd be helpful to hear that.

But just -- my broader question is, how has the SEER transition from a market perspective and obviously in that segment, how has that gone versus expectations? And has it caused any sort of air pockets post the year-end?

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

Sure. Yes. So we didn't give any numbers on Q1, but we did talk about that January order rates were consistent with our expectations and outlook. So no change. It went as we expected.

On the SEER change, overall, I think it went been fine for the industry. The industry has gotten used to these changes. Now we think our design has got the winning formula in terms of -- we talked about in the last call. We don't need to change some of the indoor units. We can only change the outdoor units. So we think we did quite well, and we'll wait for some of the industry numbers to compare our share. But in general, I think the industry is used to it. I think us and majority of other industry players had a seamless SEER transition.

Some of the smaller players may have had hiccups. But overall, I think it went as good or better than expected for the industry.

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

Okay. That's helpful. And then my follow-on is on inventories. You built inventory into 4Q versus 3Q, quite unusual from a seasonal perspective. But I'm curious, was that planned? Or were there some issues that caused that build?

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

I think the inventory build was very planned. We wanted to make sure of 2 things. One is that we have sufficient high-end products in stock, even though that's not selling until the summer season given the challenges we had. Second is given the SEER change, we wanted to make sure that we have sufficient inventory of the new SEER product as we went into the new year. So I think that was planned.

I think where we fell short, honestly, was more appropriate forecasting and where we landed up on some of the raw material side where I think as supply chains normalize, we should have opportunity to convert more of that inventory into cash. So we are at this stage, I think complete with inventory build.

Operator

(Operator Instructions) And we'll go next to Joe Ritchie with Goldman Sachs.

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

Alok, can we just -- maybe just talk about the Commercial business for a second? It sounded like pretty positive comments on the hiring front. I guess just where does production stand relative to normal levels? And then maybe just talk about how you're seeing that business from a share gain perspective. It sounds like you're starting to recover some gains or recovering some share that you may have lost previously.

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

Sure. So first of all, we are pleased with the recovery in Commercial and remain committed to $100 million EBIT improvement in Commercial over the planning period. We had a strong Q4, as you saw from numbers, slightly better than expected, and that was kind of the prime driver of why we came to the higher end of our guidance.

The recovery was driven by very stable levels of staffing. I mean at this stage, we're hiring as much as we are losing, and that's kind of back to normal levels. I think the team has done a good job making sure that the output has come back up compared to the lows of the year, but we are still not back to normal. I would say we are probably still about 20% below normal on factory output, where we could get there just with this factory even before the next factory comes online. So we remain pleased with the efforts in Q4.

Q1, that's going to go through SEER transition. And obviously, that's something we are very excited about given the change in product lineup. So net-net, excited about the new Commercial segment. We will continue delivering and focusing. And even as we take a step into '24, '25, the new factory would give us more productivity, more capacity.

And the last question you have is, yes, we did lose share in Commercial despite all the things I said earlier. Most of that was earlier in the year. Towards the end of the year, we started recovering shares, and we did a little better. And we think that trend will continue because the industry lead times remain extended, and ours are now getting to very competitive levels within the industry.

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

And just to elaborate a little bit on what Alok mentioned. Where we lost share was in the emergency replacement segment of the market. And as productivity and output improves, it'll enable us to replenish our distribution channels with that stockable product. And then you should really see the share gain, gain traction. Once again, we're able to reengage in the emergency replacement side of the market.

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

Got it. That's super helpful and great to hear. I guess my one follow-up question. Residential volumes are continuing to stay positive. I know that you're expecting a decline in the year, and I know that you don't give quarterly guidance. But I guess just based on what you see with inventory levels today, I mean, are you expecting things to turn negative at the start of the year? Is that something that maybe happens later on in the year? I'm just -- any color that you can give on like the seasonality as we progressed through 2023 would be helpful. .

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

Sure. First of all, the significant uncertainty remains. And at some stage, your guess is going to be as good as ours. January met expectations. Because majority of our business is dealer direct, the impact of channel destocking would be minimal. But for the industry, I do saw it happening more in the first half versus the second half. So I think the industry will see some decline in sales to distributors, that distributors pull back orders, just to get the inventory rightsized.

I think the seasonality, as we typically expect as in the summer seasonality, still remains. So I would say, yes, there's going to be some channel destocking impact in the industry in the first half. It's going to impact us less. But beyond that, it's going to be watching all the numbers that you would watch, consumer confidence, interest rates, new home starts, and see where we come up. Because the new home starts, that fell in second half of 2022, will have an impact in 2023 at those -- that will come up for completion because our new home business did well in Q4. That's lower margin, as you know. But going into '23, we expect that to slow down for sure.

Operator

We'll take our next question from Tusa Steve with JPMorgan.

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

I've been called worse. So just on the Allied side, what was the growth rate, the difference between Allied and your -- the Lennox brands in the fourth quarter?

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

I don't have it in front of me. I think it was pretty consistent.

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

I'll be honest with you, Steve, I don't think it was radically different than what we saw in the direct-to-dealer business because we had a really solid -- and we had a record year in our Allied business. They did a tremendous job. They gained more than 100 basis points of share, along with our Lennox business. So it was a pretty good quarter for both businesses.

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

So when you kind of roll forward into the first half, and you talk about some destocking, what kind of split would you expect here in the -- how is it trending in January? And then what kind of split would you expect as this destock cycle move into the first half?

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

Yes, in the Allied business, we would expect a slower start because, as Joe said, I mean, they had a good year. I mean in Q4, they grew very well. Lennox grew well as well. Allied grew faster than Lennox in Q4. And as we take this forward, I would expect 20% of our business, which is on -- through 2-step distribution to have a slower start to the year versus the rest of our business, which is dealer direct.

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

Can you just provide a little bit of color on that? So is it like -- is it a 10% difference, a 20%? I mean there's just a lot of moving parts here, so it'd be helpful to figure out just roughly what kind of split you would expect there between -- effectively between sell-through and sell-in we're asking for the industry, if you even want to put it that way. .

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

Yes, I think that's a fair question. And we are wondering the same questions in that. I mean, 30 days in, we haven't noticed a huge difference between the 2. So like time will tell. Some of it also comes down to how distributors are thinking of the year and what kind of signals and tea leaves they are reading about demand this year.

But sometimes when these air pockets come in, in the 2-step model, they last a few weeks. We haven't started experiencing that yet. We're just prepared to experience that. Unfortunately, we don't have any numbers. And your guess is going to be as good as mine, Steve.

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

Okay. And then one last one. What was the actual, like -- just what were the inefficiencies from the SEER changeover, what exactly was that? .

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

Sure. Quite a bit. I mean when we -- like get 3 different areas, right? First is in our factories, we had to turn over different lines, which means there was work stoppage at different lines at different times. We did that on a rotating basis. But clearly, there was labor inefficiency and underutilization as we went through that. Second, we had to air freight and look at some prebuy of components at elevated prices just to make sure we met all the deadlines and pull that together. And I think finally, within our own distribution network, we have to spend extra because we had to manage old SEER, new SEER, different freights, move it around. So like those would be the 3 different things that we looked at, right, is just air freight and component costs, factory and efficiency, and then additional distribution cost.

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Operator

And we'll take our next question from Julian Mitchell with Barclays. .

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

Sorry about earlier. Just -- I wanted to check on the Commercial business, not so much the sort of internal self-help initiatives. We can see that clear green light on Slide 11 for that, but more just on the sort of the market as you see it. Classically, there was a lag, but a relationship from Residential trends to light Commercial unitary, just wondered how you see that dynamic playing out this time, if you have seen any more kind of choppiness in project activity or so forth amidst higher interest rates and weaker housing starts activity.

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

Sure. So Julian, you're right. Historically, there has been a lag with the correlation. If there is one this time, I think it's going to be extended because the industry has such long lead times, and there's still a pent-up demand because of number of replacements that were converted into repair over the past few years. So if a unit broke, historically, they could have replaced it, but they chose to repair it.

So when we talk to our larger customers, we don't notice any change in their replacement plans, their spend plan, their capital. Now that could change. But so far, we haven't noticed that.

We see a lot of customers still talking about 2025 and how they plan to significantly upgrade their facilities and HVAC system with the low GWP refrigerant to meet their carbon footprint goals and get better ESG values out of it. So we have not noticed anything in the short term. The lead times are still anything from 24 to 52 weeks. And then we start hitting 2025, which we do expect a lot of the key accounts to start ordering more and planning for 2025 replacement.

But we're watching it closely, the same data that you would look at, Julian, from -- everything from ABI to other indexes. But so far, it's more lead time and supply constrained, not demand constrained.

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

That's helpful. And then just looking at Slide 10, you laid out some of those moving pieces below the top line around the net material cost inflation. So notice, I think the components headwind that you expect went up a bit from what you'd said in December. Any more color around that?

And when you're looking at that net material cost inflation of sort of minus $35 million, what are the latest thoughts on how that headwind is weighted sort of first half versus second half? Are you getting a good tailwind in the back half or it's closer to flat?

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

We get some tailwind in the back half. I mean it's right now heavily weighted. But at the same time, we haven't locked in the commodities for the second half yet. So some variability still exist in that.

The component piece is higher, and we wanted to be upfront, it's higher than what we thought. But some of the items such as compressors, variable speed motor, given the supply constraints that everybody is facing, I think vendors have decided to charge higher, and we clearly are -- had to play a part in that. So yes, the component costs are higher, and that just puts more owners on us to get pricing. That's why you see pricing, we increase our range and talk about $150 million to $175 million versus just a flat number of $150 million. So different moving pieces.

We'll remain committed to offsetting material costs with pricing and keep doing our best to bring components down. And if commodities ease in the second half, the number could get better.

Operator

(Operator Instructions) We'll go next to Jeff Hammond with KeyBanc. .

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

So really just want to dig in a little bit more on kind of share gain momentum. One, on the Commercial, I think you said you're kind of getting back into that emergency replacement. I'm just wondering, one, how easy it is to kind of gain back share and kind of gain dealer distributor trust?

And then on the Residential side, I think you mentioned like you're -- for the first time in a while, you're positioned for share gain. Just maybe elaborate a little bit around, is it just kind of having everything together organizationally and with the plants? Or is it, hey, you think you got better products, better availability, et cetera?

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

Yes. I think on the emergency replacement side, Jeff, I think it's very difficult to distinguish. Where you compete there is on availability and price. And we've got the distribution network. We've got the people who would sell it.

In 2022, we're just short of product. So it's a matter of once again, I'm just replenishing those distribution channels such that we have the product available, and we feel we're back in the game on emergency replacement. And we expect that to happen over the course of 2023.

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

And if I could just answer the Residential piece, Jeff. We have been constrained in '18 on the appropriate product mix, the appropriate inventory. And we are excited about the new leadership there. We're excited about being back with fully stocked warehouses. We are -- put some specific efforts around sales excellence. I mean all of those efforts are coming to fruition.

And historically, as we go back through regulatory transitions, we do always win more share because at least we believe that our products are superior and our current design is going to lead us to greater benefits. I think that's what gives us confidence on the Residential side. Yes.

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

Okay. And then I don't know if I missed this, but any kind of update on the noncore divestiture and when you think that might be complete? .

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

Yes. Jeff, we just kicked off a process. Literally this week, the teasers went out. So we're waiting for, once again, the NDAs to flow in and engagement to take place with potential suitors. We should have more news for you on the first quarter call, but we're out of the gate with the process. And we're excited about what lies in front of us with the portfolio of businesses that we have in 2023.

Operator

There are no further questions, and this concludes Lennox Fourth Quarter and Full Year 2022 Earnings Call. The earnings release with GAAP to non-GAAP reconciliations, today's presentation slides and the webcast link for today's call are available on our website at www.lennoxinternational.com. This webcast also will be archived on the site for replay. Thank you for joining us today.