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Lennox International, Inc. (LII)

Q4 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Please stand by, your program is about to begin. [Operator Instructions] Welcome to the Lennox Fourth Quarter and Full Year 2024 earnings conference call. All lines are currently in listen-only mode, and there will be a question-and-answer session at the end of the presentation. [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

Director-Investor Relations, Lennox International, Inc.

Thank you, Angela. Good morning, everyone. Thank you for joining us today as we share our 2024 fourth quarter and full year results. Joining me is CEO, Alok Maskara, and CFO, Michael Quenzer. Each will share their prepared remarks before we move to the 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 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. Now, please turn to slide 3., as I turn the call over to our CEO, Alok Maskara.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Thank you, Chelsey. Good morning, everyone. I want to start by expressing my gratitude to our 14,000 employees, our 10,000 plus dealers, and all of our customers for their loyalty and innovation that enabled us to deliver an exceptionally strong finish to 2024. One of the highlights for 2024 is that for the first time ever, Lennox delivered over $5 billion in revenue and over $1 billion in adjusted segment profit. Another achievement in 2024 is that both our segments delivered double-digit revenue growth. In addition to delivering record results, we also made thoughtful investments such as starting a new commercial factory to create growth capacity.

Let us turn to slide 3 for the fourth quarter and full year 2024 overview. Adjusted earnings per share was a record $5.60 for the quarter and $22.58 for the full year. Core revenue grew 22% in the quarter and 13% for the full year. Our adjusted segment margin expanded 250 basis points in Q4 and 150 basis points for the full year to 19.4%. The team also delivered a record $332 million in operating cash flow in the quarter, and $946 million in the full year. Michael will provide more details later in the presentation, but I want to highlight how proud we are of the work the team did this year to deliver significant year-over-year improvement in our cash conversion.

Now, please turn to slide 4 as I review some of the drivers of our 2024 success. In 2024, we successfully completed the initial phase of our self-help transformation plan. The team's effort in 2023, including pricing initiatives, portfolio simplification and strategic acquisitions, not only restored margins but also established a strong foundation for an exceptional 2024. Our strategic initiatives enabled us to successfully navigate the construction of a new commercial factory and overcome challenges associated with the refrigerant transition, showcasing our resilience and outstanding execution.

In 2024, we continued making strategic investments while delivering impactful results, positioning us to continue our momentum into 2025 and beyond. We successfully navigated the manufacturing transition from R-410A refrigerant, effectively meeting customer needs and investments in sales and distribution channels elevated the customer experience. Our ongoing focus on pricing excellence programs partially offset the investments for improving customer experience. Our new commercial factory is now online and will be key to enhancing output and productivity.

The AES integration remains ahead of schedule, exceeding the original value proposition. We maintained our strategic M&A pipeline and our disciplined M&A approach. The best deals for Lennox in 2024 were the deals that we decided not to pursue, thus safeguarding long-term shareholder value. Finally, by driving accountability through the Lennox Unified Management System, we ensured consistent performance.

Before I hand the call to Michael, I want to extend my heartfelt gratitude to Gary Bedard, President of our HCS segment since 2023, who has announced his decision to retire from Lennox. Gary's 26-year tenure at Lennox will leave a legacy that will continue to shape our future. We have initiated a search process to identify our next HCS President.

I'll now hand it over to Michael, who will walk you through how we successfully invested in the business while also delivering strong results.

Michael Quenzer

Executive Vice President & Chief Financial Officer, Lennox International, Inc.

Thank you, Alok. Good morning, everyone. Please turn to slide 5.

We are pleased to report our eighth consecutive quarter of double-digit year-over-year adjusted earnings per share growth. This quarter, we increased our adjusted segment margin by 250 basis points and achieved an impressive 22% revenue growth, resulting in 54% adjusted EPS growth. Our success is driven by volume growth in both segments, as we continue to effectively manage the transition to low-GWP refrigerants. As expected, customers pre-purchased R-410A equipment, which is estimated to have positively impacted revenue by $125 million and increased earnings per share by $1.

Now, let's proceed to slide 6, to review the fourth quarter financial performance of our Home Comfort Solutions segment. The Home Comfort Solutions segment had an exceptional quarter delivering 25% revenue growth, 67% segment profit growth, and an impressive 550-basis point expansion in segment profit margin. Sales volume increased by 21%, driven by over 50% growth in our two-step distributor channel, primarily reflecting the industry-wide R-410A equipment pre-buy. Our one-step contractor channel also saw volume increase low-double digits. This was supported by better R-410A product availability compared to the broader market, as well as some pre-buy. After adjusting for the pre-buy, segment sales volume still grew by mid-single digits. Pricing initiatives continue to progress well. Although the impact to the quarter was limited, we have implemented price increases on our new R-454B products and these initiatives are progressing as expected.

Moving on to slide 7. The Building Climate Solutions segment delivered a very strong fourth quarter with revenue growing 17%. Of this growth, 3% was driven by inorganic contributions from our AES acquisition. From an organic perspective, sales volume increased 14% during the quarter. This reflects early revenue benefits from our new

Saltillo, Mexico manufacturing facility, as well as some R-410A equipment pre-buy activity. Segment profit increased by $8 million. However, profit margin declined due to $20 million in higher product costs related to new factory ramp-up activities and inefficiencies at our existing manufacturing facility. Production output continues to grow and is well-positioned to support our 2025 emergency replacement growth initiative.

Turning to slide 8. Lennox delivered an impressive performance for 2024. We successfully navigated the low-GWP refrigerant transition, achieving notable volume gains. Our disciplined pricing strategy drove consistent quarterly price yields, contributing to margin expansion of 150 basis points. While strategic investments for future growth tempered this margin improvement, these investments are expected to deliver significant benefits in the coming years, including sustained revenue growth and further margin expansion.

Turning to slide 9. Let's review our cash flow and capital deployment. While revenue and earnings growth were impressive, our cash flow performance stood out even more. As highlighted in the Q3 earnings call, enhanced working capital efficiency has been a key focus. We've made significant progress, particularly in accounts payable initiatives, resulting in a free cash flow conversion rate of 97%. This strong cash flow conversion comes despite capital expenditures exceeding depreciation by approximately $65 million.

Capital expenditure investments in high ROI projects remain a core component of our cash deployment strategy. Over the past two years, capital expenditures have consistently outpaced depreciation. This trend is expected to continue in 2025, with estimated capital expenditures of $150 million.

We maintained a robust balance sheet with net debt to adjusted EBITDA at 0.6 times, down from 1.3 times in the prior-year quarter. Our free cash flow deployment strategy continues to prioritize inorganic growth opportunities that deliver ROIC exceeding WACC within three years of acquisition. Additionally, we will continue leveraging share repurchases to efficiently return excess cash to shareholders.

If you will now turn to slide 10, I will review our 2025 full year guidance. Anticipating another year of profitable growth, let's begin with the table on the left, which summarizes our full-year revenue growth drivers. Total company core revenue is projected to increase by approximately 2%. However, the 2024 pre-buy will result in year-over-year revenue headwinds in both Q1 and Q4. We also expect a low-single digit increase in sales volume driven by growth in our BCS segment. Additionally, mix growth from the introduction of the new low-GWP products will contribute an estimated 4% to revenue growth. The phase-out of legacy 410A products is expected to conclude by the second quarter.

Turning to the right side of the slide, we've outlined key cost assumptions for 2025. Inflation is anticipated to increase costs by approximately 3%. At the same time, we plan to make strategic investments in areas such as information system advancements, distribution growth initiatives and projects designed to improve customer service. These investments will also include enhanced sales and marketing efforts, with total investments estimated at approximately $25 million for the year. In terms of cost productivity, we expect to generate savings of $50 million as the ramp-up cost of our new BCS factory subside and material cost efficiencies are realized.

In summary, even with the headwinds from the 2024 pre-buy, we anticipate revenue and profit growth with profit margins relatively flat. We expect adjusted earnings per share to fall within the range of $22 to $23.50, and free cash flow is projected to fall within the range of $650 million to $800 million.

With that, please turn to slide 11 and I'll turn it back over to Alok for an overview of our 2025 priorities.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Thanks, Michael. Let us revisit our self-help transformation plan, which has been a cornerstone of our success since 2022. We transitioned from the recover and invest phase to the growth acceleration phase at the end of 2024. As we move through 2025 and into 2026, we will maintain a disciplined approach to investing in the business while prioritizing growth. This year will lay the groundwork for the next phase of expansion, supported by the momentum from share gains and new product introductions. Investments in digital customer experience are making it easier for customers to engage with us, strengthening loyalty and satisfaction across all touchpoints. Our expanded heat pump offering, supported by the Samsung JV, not only broaden our product portfolio, but also position us to capitalize on growing demand for energy efficient solutions.

Additionally, our focus on improving attachment rates for parts and accessories ensures that we provide a more comprehensive customer experience while driving incremental growth. An additional growth driver is our commercial emergency replacement program, enabling us to better serve a significant segment of the market that we have been unable to fully supply in recent years.

Second, we are committed to resilient profit margins. Benefits expected from the low-GWP product transition, increased productivity from BCS volume improvements and material cost reductions strengthen our ability to deliver consistent and reliable financial performance. Lastly, we will continue to utilize our Lennox Unified Management System to deliver superior execution with clear priorities.

Defined M&A strategies, a robust distribution network, and ongoing investment in customer satisfaction underscore our commitment to operational excellence. As we look ahead, the investments made over the past two years set the foundation for growth in 2025, with a strong trajectory into 2026 and beyond as we move towards the expansion phase. With our collective commitment and strategic focus, I am confident that we are not merely executing a plan, we are creating a path for ongoing success. We remain confident in our long-term vision and given progress so far, we believe we will be within the 2026 revenue target range of $5.4 billion to $6 billion and at the high end of our ROS target range of 19% to 21%. The pre-buy dynamics in 2024 will create impact in 2025, which is expected to normalize by the end of this year. Hence, we anticipate a stronger 2026 as our strategic investments continue to drive momentum. Now, let us turn to slide 12.

Let me wrap up by summarizing the five reasons that make Lennox an attractive opportunity for all our stakeholders. First, we are 100% focused on North America growth end market of HVACR and are accelerating growth through share gains. Second, we are expanding our resilient profit margins through pricing, productivity, and mix optimization. Third, we deliver superior execution through the Lennox Unified Management System. Fourth, we are an advanced technology industry leader with high efficiency products and services supported by a digital customer ecosystem. Fifth, we win because our exceptional talent and culture is defined by our core values and guiding behaviors. Our pay for performance philosophy ensures that our internal goals are closely aligned with those of our shareholders.

As I look forward, I remain confident that our best days are ahead. Thank you. We will be happy to answer your questions now. Angela, let's go to Q&A.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] We'll go first to Ryan Merkel with William Blair. Your line is open. Please go ahead.

Ryan Merkel
Analyst, William Blair & Co. LLC

Q

Hey, thanks. Good morning and congrats on a nice quarter. I wanted to start with the pre-buy. It looks like it was a little bigger than maybe you were expecting. Could you just comment on what you saw and why that was? And then what does it mean for 1Q, I think, is really the question I have.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Hey, Ryan. Good morning. I don't think I heard the second part of the question properly, but the first part on the pre-buy, listen, we are calling out $125 million in pre-buy. As you can imagine, it's an estimate. We don't have 100% visibility into the number. And we know there were some cloudiness because we had temporary share gains that happened in Q4 as some of our competitors were out of product. So, it's a little higher than we expected, but I would say it's within the range of where our expectations are.

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

And then, Ryan, on the second part of your question, the impact to Q1, yeah, really, the $125 million was a pull forward into Q4 from Q1. So, we'll see a headwind there. And then also, you'll see that in Q4 in 2025 is the year-over-year comps won't have that as well.

Ryan Merkel
Analyst, William Blair & Co. LLC

Q

Got it. Okay. So, $125 million revenue hit 1Q sort of the math.

[indiscernible] (00:19:19)

Ryan Merkel
Analyst, William Blair & Co. LLC

Q

Okay. And the second question is the flat volume outlook for the HCS segment, I mean, I think it makes sense to be conservative, but talk about some of the assumptions behind that.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Sure. I mean, there's a lot of uncertainty in the market, right? I mean, you saw existing home sales are at a very low level. Interest rates, mortgage rates, they continue to be high. So, based on what we saw in 2024, we continue to model a flattish industry volume. It may be a little conservative, but given the uncertainty in the market, just seem like that's the right assumption to make at this point.

Ryan Merkel
Analyst, William Blair & Co. LLC

Q

Yeah. That's fair. Okay. Thank you.

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

Thanks, Ryan.

Operator: We'll go next to Joe Ritchie with Goldman Sachs. Please go ahead.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Hey, good morning, guys. Great year. Thank you. So, look, historically, you guys have tended to guide very conservatively as I look at the components of this bridge in slide number 10. It seems like what you're baking in for incremental margins. If I just take into account price, mix and inflation, it's very low, like I'm calculating something that's like low-double digits. So, just help me kind of understand, number one, just like where you think there might be some potential cushion in the guide and how to think about that equation between price, mix and inflation?

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

Hey, Joe. I think there's some opportunity potential, Alok just mentioned, there on the volume. If interest rates go down, maybe the HCS volume could give us a little bit more. That's obviously would come through at 30% incrementals. But if you look at the overall guide, it does imply overall margins are approximately flat 19.4%. The inflation assumption at 3% might come in a little less, but I think right now, it feels prudent to keep inflation up there. And, obviously, we, as a group, are trying to drive as much productivity as possible. So, from a cost productivity perspective, we're going to focus to drive a little bit higher if we can as well.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

And I think the bigger issue here is the amount of uncertainty that's present. I mean, if you look at noise around tariffs, if you look at noise around migrant labor and labor shortages for our dealers, and if you just look at mortgage rates, interest rates, I mean, there's just a lot of uncertainty. So, we went with a fairly wide range. I wouldn't call it very conservative, but I think it's consistent with what we have done in the past.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC

Q

Okay. That's helpful. And then, as I kind of think through just the 1Q number, I think in answering Ryan's questions, so the right way to think about things sequentially in HCS is you've got, call it, $125 million; it goes away 4Q to 1Q. And then there's typically like a, I don't know, mid-single digit sequential step down. So, is the – you're still assuming then organic growth in H2 in the first quarter. Am I thinking about it correctly.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Well, first of all the Q1 is an estimate, right? We are only in January. Some of it could extend to Q2 depending on how dealers convert, because we are now already selling the R-454B equipment, and it's just drawing like a line in the sand somewhere. But on your sequential question, maybe Michael can give you some idea.

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.
A

Yeah. I think that's generally close, but not all $125 million was in the HCS segment. Some of it was in the BCS segment. But I think, as Alok said it right, we did have a little bit of R-410A inventory going into the quarter. So, some of this might kind of move into Q2, but predominantly will be in Q1.

Joe Ritchie
Analyst, Goldman Sachs & Co. LLC
Q

Okay, great. Very helpful. Thanks, guys.

Operator: We'll go next to Julian Mitchell with Barclays. Please go ahead.

Julian Mitchell
Analyst, Barclays Capital, Inc.
Q

Hi. Good morning. Maybe just wanted to switch tack for a second to the BCS segment and sort of the guidance there. I think people have been concerned about the revenue outlook there because you don't have AI exposure or what have you in BCS, and there's some question marks around the Ezra funding unwinding into 2026. So, maybe just help us understand kind of what you're seeing in the BCS segment, top line wise across different verticals, mid-single digit underlying volume growth assumption clearly speaks to, I think, a much healthier market than what a lot of investors have been thinking.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.
A

Sure. I would say from our perspective, the markets that we serve remain healthy. And at least this week, on Monday, [indiscernible] (00:23:59) Chinese told us that it was good not to have data center exposure in our stock. So, I think from that perspective, we are not terribly concerned since our exposure there was [indiscernible] (00:24:10) to start with.

If I look at our exposure, it remains in places such as retail, food service, warehouses, big box DIY-type stores. And we see the replacement volume, which is primary our sales actually picking up now since we have made the conversion to R-454B and some of these companies had been waiting to go to the new refrigerant before they put more sales.

Second thing underlying our confidence is that, clearly, we have a new factory. We were primarily supply constrained, not demand constrained. And that was still the case in Q4. So, we do expect us to get more fair share of the market, including emergency replacement that we talked about. In terms of your funding for the schools? Yeah. I mean, I've heard that concern, just like for the IRA, but we see most of the programs continue to move forward, and some schools are issuing bonds and other things. I mean, just keep in mind, this is a non-discretionary spend. When the air conditioning breaks, you can't run the schools. So, from a nature of the replacement program and the non-discretionary nature that we look at, we don't see that as a much impact; and that gives us sufficient confidence on our guide.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

Thanks very much. And then just my second one, I don't really want to mention the P word, but if we're thinking about Q1 specifically and it's been touched on a couple of times understandably, but classically, Q1 in recent years has been sort of 16%, 17% of the year's earnings, so not a huge quarter and I understand there's some extra pressure right now because of the refrigerants change. But if we had to put a finer point on it, is the right interpretation maybe it's a couple of points less of the full year's earnings in Q1 than one would normally expect, and then we get the full sort of catch up in the rest of the year, particularly Q2 with a big mix tailwind coming in.

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

Yeah, Julian, I think I'd bucket it a little different, maybe look more at the first half just because the dynamic of things kind of shift in Q1 to Q2 with the selling out of the R-410A. So, from a revenue perspective, we think kind of the first half will be about 45% of the year, second half being 55%. This is a little bit different than the normal kind of 50-50. Second half of the year, you'll really start to see the mix benefit of the R-454B product coming up, as well as some more of the gains from the new commercial factory in the second half.

Julian Mitchell
Analyst, Barclays Capital, Inc.

Q

That's great. Thank you.

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

Yes.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Thanks, Julian.

Operator: We'll go next to Noah Kaye with Oppenheimer. Your line is open. Please go ahead.

Noah Kaye
Analyst, Oppenheimer & Co., Inc.

Q

Thanks very much. So, although we've had a couple of years now of regulatory transitions where the company has executed well, and, really claim the opportunity around pricing and share gains. You mentioned in some of the factors that went into your thinking did include potential tariffs and labor and other considerations brought about by administration change. So, how do you think about your opportunities related to that? And, for example, if we do have tariffs on USMCA partners and others, perhaps that could be a pricing opportunity, perhaps with your investments, there's some share gain opportunities there. The essential question is how are you thinking about contingency planning and responding to any potential changes?

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Sure. No, that's a great question. And things remain very dynamic as you know. But if we take each of these, if tariffs come into more in China and less in Mexico, Canada, we would be net beneficiary, as we have done a really good job of reducing our supply chain reliance on China. And the fact that we did the Samsung JV also means that things like our mini splits are now coming from Korea, not from China. So, I think that, in hindsight, not just the benefit of Samsung's better quality product, but avoiding any tariffs coming from China would be a big win for us.

So, if there are tariffs coming in from Mexico, 40% of the industry capacity is in Mexico roughly, which means we'll all have to work through offsetting with productivity, seeing the impact of any peso devaluation, but then offset with price. So, we look at that price going to be incremental to what we have positioned here. But, clearly, there could be a delay in timing, given I'm not sure how much time we would have to react to any tariffs and tariffs announcement.

On the labor piece, listen, there will be no impact to our factories since, obviously, we are a different type of employer versus people who might be doing construction or HVAC installs in the field. I think what does happen with that is since replacements require less skill and less labor versus massive repair, I think the repair versus replacement trend would probably continue shifting more towards replacement, as the units are harder to repair. That requires much more skilled labor and not more labor versus higher ticket items such as full replacement. But from our contingency planning, we are staying close to our customers, close to our dealers, making sure that we can address any of those concerns and also continue to monitor tariffs and work on supply chain redundancies, because we are now – have a much heavier dual source focus than we had two to three years ago, giving us flexibility in supply chain movements.

Finally, the last thing on the consumer side, which is probably going to have the biggest impact, we just need to watch consumer confidence, interest rates, mortgage rates and help our dealer offset any weaknesses that come in either through financing programs, either through like really more education to the consumer and keep working with new homebuilders and others, which are more guaranteed volume for us. So, I hope that answered your question. That was a little winded.

Noah Kaye Q
Analyst, Oppenheimer & Co., Inc.

No, it was comprehensive. And I realized I asked, in some respects, a multi-part question. So, out of respect to colleagues, I'll take myself offline and follow up then. So, thank you very much.

Alok Maskara A
Chief Executive Officer & Director, Lennox International, Inc.

Thanks, Noah.

Operator: We'll go next to Tommy Moll with Stephens. Please go ahead.

Tommy Moll Q
Analyst, Stephens, Inc.

Good morning, and thank you for taking my questions.

Alok Maskara A
Chief Executive Officer & Director, Lennox International, Inc.

Good morning, Tommy.

Tommy Moll
Analyst, Stephens, Inc.

Q

I want to start on the topic of your R-454B pricing. Are we still thinking 10% or maybe 10%-plus? There's at least one OEM in the market that's less disciplined than that. And if we just look at the mix guide for Home Comfort, anyway, in the mid singles range, maybe you could bridge us from whatever the R-454B contribution is to how you get to that mid-singles.

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

Sure, Tommy. Yeah, I'll give you some more clarity on that. Yes, our plan still is a 10% price increase on average on the R-454B product, and that equates to about 70% of the revenue in the HCS segment. And as we've been talking about, we're going to continue to sell through some R-410A equipment in the first half of this year. So, it will take a little bit of time to bleed into the R-454B product. So, we think about 65% of the full year will be sales of that R-454B product. So, you kind of do all that math, it dilutes down to that mid-single digit mix benefit for Home Comfort Solutions.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah. And on the competitive question, Tommy, I mean, we have heard that too. But I also think we were talking about 2024 pricing because some of the OEMs released R-454B in 2024, and we released 2025 pricing. So, we are optimistic that as we take this forward, all the OEMs will be adjusting price in 2025. That typically happens in the first quarter anyway.

Tommy Moll
Analyst, Stephens, Inc.

Q

Thank you both. And as a follow-up, I wanted to unpack the Home volume outlook a bit. So, where you've – you've talked about the pre-buy as a mid-single digit headwind and then the separate volume call out you have there as flat. I just want to make sure I'm interpreting this correctly that for the volumes that you would report and your financials that you just add those two together, so it would be a mid-single headwind. Maybe you could just clarify how we should think about that.

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

That's exactly right. That's exactly how to look at it.

Tommy Moll
Analyst, Stephens, Inc.

Q

Okay. And then if we take that mid-single headwind for the segment level, can you give us any sense of the sell-in versus the sell-through assumptions you're making there?

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

I think you could see in the results in the fourth quarter. We were more impacted in that channel for the sell-in, the two-step channel, but we did see a little bit of a pre-buy on the sell-through as well.

Tommy Moll
Analyst, Stephens, Inc.

Q

Okay. Thank you. I'll turn it back.

Operator: We'll go next to Chris Snyder with Morgan Stanley. Please go ahead.

Chris Snyder
Analyst, Morgan Stanley & Co. LLC

Q

Thank you. Appreciate the question. You guys talked to the $125 million pre-buy in Q4. But if I kind of look at that into next year, it's about a 2% headwind on a $5 billion-plus revenue base. I guess, does that imply that there's maybe like a similar amount of pre-buy in the Q3 numbers as well or am I missing something in that math?

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah, Chris, this is a great question. So, what happens is if you take that $125 million, first, we will get the destocking impact of that, and let's say that's in the Q1, Q2. And then in the Q4 timeframe to Q4 2025, we will face difficult comps. So, that kind of impacts you twice, right? So, from that perspective, that's why the number seems twice.

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

And then in Q1 2026, you'll get that benefit back.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Right. So, one is a destocking, and one is a comp impact, right?

Chris Snyder
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thank you. I really appreciate that. So, I guess the assumption is that there wasn't, I guess, a material pre-buy impact in Q3 and then maybe just following up on that. I know it's kind of hard, I imagine, to kind of triangulate it and kind of pinpoint what the pre-buy is. I'd just be interested in how you guys went about doing it because, obviously, a lot of focus on that into 2025. Thank you.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Great. But, first of all, thank you for acknowledging. And we admit that it is not easy nor is it precisely accurate, right? We think we are directionally correct, not precisely accurate on $125 million, but we just wanted to give a clean number. We did not encourage any pre-buys. We did have last call on R-410A. So, that may have like kind of forced some distributors and others to order pre-buy. We remain fairly neutral.

And now, we did not switch all our lines over to R-454B, as some of our competitors did, and we only did that at the tail end of the year, and we delayed that as much as possible. I believe that led to better availability for Lennox products in the marketplace when it comes to R-410A product, and that gave us share gain in addition to the pre-buy impact that we are talking about. Our goal is, of course, to keep as much of that share gain as we can, but realistically speaking, we have baked in that we are unlikely to keep all the share gain that we had had, and that's one reason we are being more muted in the volume outlook for 2025.

Chris Snyder
Analyst, Morgan Stanley & Co. LLC

Q

Thank you. I appreciate that.

Operator: We'll go next to Brett Linzey with Mizuho. Please go ahead.

Brett Linzey
Analyst, Mizuho Securities USA LLC

Q

Hey, good morning, everyone. Just...

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Good morning, Brett.

Brett Linzey
Analyst, Mizuho Securities USA LLC

Q

Yeah. First question is on the new commercial Mexico facility. So, you're moving from the piloting to the production; you said it's online. Are you able to quantify what you're embedding in 2025 in terms of the volume contribution and better throughput there?

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

Yeah. If you look at the volume guide in BCS, we're up about mid-single digits. There's a few points in there for share gain, which would be predominantly related to the new factory supply improvement.

Brett Linzey
Analyst, Mizuho Securities USA LLC

Q

Okay. Got it. I imagine that's a little more back-end loaded or should we think about that as progressing evenly through the year?

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

A little more back-end loaded. I mean, the season for emergency replacement is predominantly Q2 to Q3. So, that's starting more in late Q2 into Q3 is when it'll start to ramp up.

Brett Linzey
Analyst, Mizuho Securities USA LLC

Q

And then just to follow up on the inefficiencies in the existing facility, maybe just a finer point there. Was that Arkansas late in the year and then any update on the status of those improvements into January?

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Sure. Yeah. I think the existing facility inefficiencies were related to the startup, as we got a lot of components from Stuttgart during ramp up to send to Mexico and do trial runs and otherwise. But, yeah, that was late in the year, and it was on the higher end of what we were expecting, so those inefficiencies, which obviously we will capture back in 2025 as we are through the ramp up phase, but, yes, it was Stuttgart. And then the ramp-up vision in Saltillo, but Stuttgart was a bigger impact.

The factory in Stuttgart is doing much better and frankly, having the new factory in Saltillo means we are going to reduce the number of SKUs we manufacture in Stuttgart as some of the emergency replacement SKUs move over to Saltillo. So, we are more optimistic on recovering. But as you know, that's been a difficult factory for many years. So, fingers crossed, we are optimistic for this year.

Brett Linzey Q
Analyst, Mizuho Securities USA LLC

All right. Appreciate the insight.

Operator: We'll go next to Joe O'Dea with Wells Fargo. Please go ahead.

Joseph O'Dea Q
Analyst, Wells Fargo Securities LLC

Hi. Good morning.

Alok Maskara A
Chief Executive Officer & Director, Lennox International, Inc.

Good morning.

Joseph O'Dea Q
Analyst, Wells Fargo Securities LLC

I think, Michael, you touched on maybe the inflation has a bit of conservatism in there, but can you unpack that a little bit? And that's 3% inflation presumably across all costs. And so, you're talking sort of labor materials, freight, kind of all-in bundled, and in anything in particular where you're seeing more of sort of inflationary headwinds coming through.

Michael Quenzer A
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

Sure. Yeah, it's on average on all of our costs. We have about $4 billion of costs. We're seeing higher inflation [ph] and SG&A (00:38:54) around healthcare and some of the wages. They're more than the three a little bit lower on the commodity side. But, in general, it kind of blends to 3%. I think we'll continue to watch it. And like I said, there could be some conservatism. But inflation definitely continues to exist and especially on some of the SG&A side.

Alok Maskara A
Chief Executive Officer & Director, Lennox International, Inc.

And keep in mind that some of the tariff uncertainty impacts that as well. If there are tariffs on things like steel, then we clearly want to acknowledge that and be prepared for that.

Joseph O'Dea
Analyst, Wells Fargo Securities LLC

Q

Right, but I guess – so the idea is that price and the revenue bridge of up 1% compares to inflation up 3%. So, you're not going out to the market and saying we have a right to get more because the costs were getting burdened with.

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

Right. I mean we have some of that through the mix as well. That we're getting a little bit better incrementals to cover for some of that, but we're also looking to drive more productivity as well.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

And keep in mind, the R-454B, we could [ph] have put in (00:39:53) mix and price; you put that in mix. So, you got to think of a lot of that as covering inflation as well.

Joseph O'Dea
Analyst, Wells Fargo Securities LLC

Q

Yes, right. Okay. And then just as it relates to that R-454B price and the 10% you talked about, which I think is the side, not the BCS side, but that 10%, at what point in the year do you think you'll have confidence in visibility to kind of realization just when we think about the seasonality of the business and you're trying to understand kind of when you'd really get a good sense of that 10% sticking?

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

I think the mid to late Q2 when we'll get a good sense because we also, like some of the OEMs, have not announced their 2025 pricing. So, that's when we'll get a good sense of it. But so far, the early signs are positive. I mean, there's no reason for us to be concerned about it. The reason the impact is what we called out, is it 70% of 70% of that 10%. So, that's why you kind of see the numbers what they are, which mean progressively as we go towards the second half, we have a greater portion of that getting captured. But right now, there's no reason to waver or be concerned with that number.

Joseph O'Dea
Analyst, Wells Fargo Securities LLC

Q

Got it. Thank you.

Operator: We'll go next to Jeff Hammond with KeyBanc. Please go ahead.

Jeffrey D. Hammond
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey, good morning, everyone.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Hi, Jeff.

Jeffrey D. Hammond
Analyst, KeyBanc Capital Markets, Inc.

Q

Just a few cleanups. So, just on the Mexican production, you said industry capacity 40%. Can you just level set us on what your mix is and if there's any particular OEMs you're aware have particularly lower mix versus the industry?

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah. I mean, I guess, we have just looked at all the different OEMs and looked at other reports and come with that number. It's a – I wouldn't say it's precisely accurate, Jeff. It's directionally correct. For our perspective, we make the low-end merit products in there. And we haven't previously talked about it; there are tariffs we believe about $1 billion of our – so, 20% of our output would be impacted through that since we make our premium products in US, and we also have three residential factories.

Commercially, so far, all our production was in US and none in Mexico. So, we're just starting on that together. But we do know many of our competitors, often sometime in the same geographical area within Mexico, that they manufacture in Mexico as well. So, we think the 40% number is about right. Obviously, more skewed towards residential versus commercial.

Jeffrey D. Hammond
Analyst, KeyBanc Capital Markets, Inc.

Q

So, you'd say, today, you're probably below that industry average?

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Slightly below, but it depends on which OEM, right? For some OEMs, we are significantly below. With some OEMs, we're actually a little bit higher. So, it just goes OEM by OEM, Jeff.

Jeffrey D. Hammond
Analyst, KeyBanc Capital Markets, Inc.

Q

Okay, great. And then just on this distribution margin focus, can you just level set us on kind of progress over the past year. What are some of the big opportunities this year? And do you think you start to move those margins up or is that a longer timeframe?

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

It is over a long timeframe, but some of the results that you see today are based on that initiative as well. So, if you think about HCS, we did have a record ROS, and you have followed us for a long period of time. And that is consistent with us getting more distributor margins. Realize a lot of the incentive changes that we made and the reorganization that we did happen at the end of Q2 in 2024. So, I think some of those results are just coming through. But that's a long journey, right? We've talked about manufacturers plus distributor margin is higher than our 2026 targets. So, I think that continues beyond 2026. But progress so far gives us the confidence to say that we would be on the high end of our previously published targets for 2026.

Jeffrey D. Hammond
Analyst, KeyBanc Capital Markets, Inc.

Q

And what's your parts and accessories mix today and what do you think entitlement is?

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Hasn't changed much over the past year, and we remain at about 20% in parts and accessories. I'm confident my entitlement is twice that much. But we've been talking about that for many years, and I think it's finally time to show some results over the next few months and years. But entitlement remains high and our current volume remains low.

Jeffrey D. Hammond
Analyst, KeyBanc Capital Markets, Inc.

Q

Great. Thanks, Alok.

Operator: We'll go next to Nicole DeBlase with Deutsche Bank. Please go ahead.

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. Thanks. Good morning, guys.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Good morning, Nicole.

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc.

Q

A lot of ground has been covered here, but I guess maybe just some clean ups for me. How are you guys thinking about new construction versus replacement demand within HCS for 2025?

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

And new construction is about 20% of that segment. We think it's going to be kind of flattish, but the big driver there is going to be if interest rates continue to go down. If it goes down, we think that there's pent-up demand in that space for new home construction that could happen. But there's obviously some labor challenges as well in that side of the industry to making sure they can keep up with the demand. So, it's mostly interest rate driven but kind of flattish within the guide.

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Okay. Got it. Understood. And then just thinking through kind of the margin dynamics by segment. I know you guys don't give official margin guidance by segment, but is directionally the right way to think about it. Maybe HCS could be a bit more challenged year on year, given some of the pre-buy in 2024, and then BCS should be up. And, I guess, is it fair to assume that BCS sees more margin expansion in the second half as some of the new plant ramp-up costs roll off? Thank you.

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.
A

Yes, that's correct. Overall, the margin guide is about flat, up in BCS, down in HCS. A larger portion of the $50 million of productivity will be BCS, which is a big driver of that margin expansion. That'll kind of happen throughout the year. But the volume gains, the share gains will mostly be kind of in the second half [ph] or be just as our (00:46:06) factory ramps up.

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc.
Q

Thanks, Michael. I'll pass it on.

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.
A

Yes.

Operator: We'll go next to Deane Dray with RBC Capital Markets. Please go ahead.

Deane Dray
Analyst, RBC Capital Markets LLC
Q

Thank you. Good morning, everyone.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.
A

Good morning, Deane.

Deane Dray
Analyst, RBC Capital Markets LLC
Q

Hey, I'll let go of some of the previous comments. You provided some really good calibration on what you think the pre-buy was for you guys. And, look, could you expand a bit, your referenced some of your competitors who had stock outs because they switched over earlier. How much of a surprise was that? How tactical were you in how you position in the fourth quarter? And could you give us a sense of how the individual months played out? Was it a big like windfall in December or was it level-loaded?

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.
A

Yeah. First of all, we were not surprised that a competitor had a misstep, almost always happens in any of these regulatory transition. But, yeah, we were surprised as to which competitor had that misstep. I mean, we would have expected somebody else to have it. So, from that perspective, there was a bit of a surprise.

How it impacted us was like we were fully-loaded and we had really high filled rates throughout. So, we were able to capture additional share. And now, the whole challenge is to take that share and make it more of a permanent share. And we know that's going to be a challenge, and we baked that in.

Q4, it was fairly even across all three months, and part of it was driven by just like anything we could manufacture, we were selling. So, it was more constrained by a manufacturing capacity and where we had different inventory stationed in our supply chain. Some of the temporary share gain did start in Q3. So, I think, if you think from the share gain that happened and we remain very optimistic, that will convert a part of that to more permanent share gain.

But, tactically, our response was we were very selective, I mean, to make sure that customers that we took on were customers who would stay with us for more permanent and were not buying from us just during the stock out. So, I think we were able to gain some new customers and convert some loyalty from existing customers as well.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

Yeah. Let's be clear that that's a high quality problem to have to talk about, temporary market share and windfall from a pre-buy and a tough comp, so that's – appreciate all the calibration.

And then the second question. Look, can you expand on your comment where you said some of your best deals in 2024 were those that you did not do? Was it just a question of price? But I have a hunch there's – probably there was a data center opportunity that you passed on, but any kind of color there would be helpful.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Sure. Yes, there were data center opportunities that we passed on. There was international expansion opportunities that were passed on. There were some domestic consolidation opportunities that we passed on as well. I mean, all came down to a very disciplined framework. I mean, it helps having a conservative CFO, to give Michael some credit for this, right? I mean, we have ROIC target. We are kind of don't wear rose-colored glasses to look at the industry. And we feel that often we can get more share with better execution versus going and buying share through M&A. So, I think we were kind of proud of those calls. I was hoping somebody would catch on to my comment. We had a lot of fun with that comment when we were writing the script.

Deane Dray
Analyst, RBC Capital Markets LLC

Q

All right. Good. Glad I didn't let you down, Alok. Thank you.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Thank you.

Operator: We'll go next to Nigel Coe with Wolfe Research. Please go ahead.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Thanks. Good morning, everyone. Alok, maybe can you just maybe just dig into the BCS volume guidance for the year, up in the mid-single digits. Any way to quantify how much is baked into the Saltillo ramp-up? And I'm thinking is it industry flattish and that mid-single digits is all share gain, anything that would be helpful.

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

Yeah. We think there's a little bit of market growth. Now remember, we have three businesses, a service business, refrigeration and an HVAC business, so a little bit of market growth, but about 1 or 2 points of that would be share gains specifically around emergency replacement.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay. That's helpful. And then just back to R-410A. I don't know if you want to sort of put your industry hat on, but if you had to sort of guess on the excess R-410A units shipped in 2024, would that be $1 million or any way to size that? And then just thinking about your inventory levels in 4Q, obviously, a little bit higher Q-over-Q. I don't know, [ph] $25 million (00:50:57) perhaps higher than I would have expected. Is that a good way to think about the R-410A inventory held at year end?

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

So, first of all, on the previous one, there are lots of industry reports. And I will first admit I'm no industry expert, but I think the units are estimate ranges from low end of $300,000, high end of $600,000. So, it's in that number, not $1 million. So, I think, it's $0.5 million that you're talking about, so that's a range. We think it's within that range and nobody has more insight to be more precise within that.

On our own internal inventory, I mean, it was a case of two things, right? I mean, commercial, we are building a bit of inventory. To get into emergency replacement, you need inventory positioned in the local market. So, we are building inventory for commercial, and you will probably see that trend continue in Q1 because Q2 is our peak season. But that's probably driving the variation to your model there.

Nigel Coe
Analyst, Wolfe Research LLC

Q

Okay. That's helpful. Thanks, Alok.

Operator: We'll go next to Damian Karas with UBS. Please go ahead.

Damian Karas
Analyst, UBS Securities LLC

Q

Hey, good morning, everyone.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Good morning.

Damian Karas
Analyst, UBS Securities LLC

Q

I wanted to ask you about the free cash flow guidance. So, cash flow, obviously, came in a good bit better than you had expected in 2024. But the guidance for this year, the range is pretty wide. So, could you just maybe spell out the moving pieces there?

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

Yeah. I think if you look at it from a conversion perspective, the midpoint of our free cash flow guide to the midpoint of our net income guide, it's about an 85% conversion, so a little below compared to the 90% conversion that we've traditionally targeted, mostly because of us having to reinvest in inventory both in BCS and HCS as we depleted some of that, as well as the capital expenditures continuing to be a little bit higher than depreciation. But we think when we get back into 2026 and beyond, we're going to be well into the 90% again. High end of the range would, obviously, reflect just better performance on receivables and accounts payable initiatives that I'm leading.

Damian Karas
Analyst, UBS Securities LLC
Q

Got it. That's helpful. And then, Alok, you talked a little bit before about potential policy implications from tariffs and immigration policy. Just curious, thinking about the pause on IRA funding, is that something that gives you some cause for concern at all just thinking about your 2026 targets and beyond and what that might mean for heat pump penetration where I know you guys are very confident that you'll be gaining some share in the market.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.
A

Yeah. I mean, I think the good news with the IRA pause is that it was not making a huge difference in our volumes in 2024 or 2023. We were all sort of waiting for that to come through the States and come back to it. Now, the tax part of it is already there, right, so the energy efficiency rebates on tax, that has not changed. So, no, I think the IRA has no – whether it was paused or going on, did not have a material impact for us in 2024 and not going to have a material impact in 2025, even if it's paused. So, it's a bit of a no news for us.

Damian Karas
Analyst, UBS Securities LLC
Q

Okay, great. Thanks a lot.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.
A

Thanks.

Operator: We'll go next to Steve Tusa with JPMorgan. Please go ahead.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

Hi. Hey. Good morning.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.
A

Hi, Steve.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC
Q

So, I just wanted to kind of clarify a couple of things. So, are you guys still saying there was no pre-buy in 3Q? You're saying that most like the vast, vast majority came in 4Q?

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah. Yes, that's true, Steve, but also with the caveat that Q3 we did see some share gains, which we were calling the temporary share gain when some of the OEMs were not, like, able to fulfill demand.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Right.

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

But, yes, otherwise, all of our pre-buy we expect was in Q4.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

And then on that share gain, do you think the share gain in for 4Q is kind of like commensurate with that rate that you booked in the 3Q or was there any difference? Because, obviously, I don't think those guys kind of changed it. Maybe they did change their strategy a little bit but do you think like commensurate split between the share in 3Q and 4Q?

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

No, I think Q4 was less. They did improve their position, and then they launched the R-454B and they were aggressive in the marketplace with that. So, I think from that perspective, I think share gain was more of a Q3 story. It obviously bled into Q4, but towards the tail end of Q4, I think it was almost all pre-buy.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Right. So, what happened was you guys – they didn't really have a competitive product. You guys shipped a lot of the R-410A some share. And then when they came with their R-454B, those share gains ebbed a bit. Is that kind of the right...

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah, slowed down a bit. That's right.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Yeah. Okay. And then on the inflation numbers, the 3%, what is the hard number, like, what's the base on that? Is that, like, total cost, just sales minus profit or COGs or what is the actual run rate, like, the actual number on that, the absolute number?

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

Total cost, sales minus profit, about $4 billion of cost.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Yeah. Okay. That's super helpful. And then, sorry, one more. Just on Mexico, what is the plan for you guys? Will it be mostly price increases or can you ship some back here if they do go through with some of these things, which I'm not sure that they will, but if they do, will it be mostly price increases or can you ship some stuff back to the US?

Alok Maskara
Chief Executive Officer & Director, Lennox International, Inc.

A

So, in the short term, besides any impact from peso devaluation and productivity, it will be mostly pricing on the long term. If it is a long term, then yes, we'll start looking at getting more in Marshalltown, more in Orangeburg, like some of these factories used to make this product. But to ramp that back up will take us some time.

C. Stephen Tusa
Analyst, JPMorgan Securities LLC

Q

Got it. Okay. Thanks a lot. I appreciate all the color.

Operator: We'll go next to Jeff Sprague with Vertical Research. Please go ahead.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Hey, thanks. Good morning. Just one more on inventory if I could. You addressed it a little bit, but actually, your inventories relative to sales, right, were a lot lower than normal here in the fourth quarter, right, so, obviously, you're blowing out R-410A. But if I think about what you said about kind of some commercial inventory build and the fact that inventories look a bit low relative to sales in Q4, it doesn't really jump out to me that you have a lot of R-410A left in house to be pushing into the channel in the first half or the first quarter. Maybe can you just triangulate me on that and a little bit more color on the position. And maybe a second part of that, too, Michael, sorry. Just you did give us kind of the 45-55 revenue split. But, I guess, my question about inventory is going to you had over absorption in Q4, obviously, under absorption likely in Q1. Maybe just a little more color on how to think about the margin trajectory would be helpful.

Michael Quenzer
Executive Vice President & Chief Financial Officer, Lennox International, Inc.

A

Sure. Yeah. I think it's a good point on the inventory. And what we're seeing is we did have some R-410A availability at the end of the year, but a lot of that was pre bought into Q4. So, we'll kind of sell that through kind of early into Q1. It'll kind of start to mitigate and be gone, fully gone by the second quarter. But I think that's really the depletion of that inventory you're going to start to see going into the first quarter.

And then on the absorption side, you're right, we will – could to start to ramp up the new R-454B product in the first half of the year, and that should give us access to some more tailwinds on HCS. On the BCS side, though, we're going to have unfavorable comparisons in the first half as we continue to launch that new factory. Second half of the year, you'll get a lot better productivity from that absorption on BCS.

Jeffrey Todd Sprague
Analyst, Vertical Research Partners LLC

Q

Great. Thanks. I'll leave it there.

Operator: Thank you for joining us today. Since there are no further questions, this will conclude Lennox's 2024 fourth quarter and full year conference call. You may disconnect your lines at this time.