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28-Oct-2026

Lennox International, Inc. (LII)

Q3 2026 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Lennox 2026 Third Quarter Earnings Call. All lines are in a 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 will now turn the call over to Chelsey Pulcheon from Lennox Investor Relations. Chelsey, please go ahead.

Chelsey Pulcheon

Director-Investor Relations, Lennox International, Inc.

Thank you, Chloe. Good morning, everyone, and thank you for joining us as we share our 2026 third quarter results. Joining me today is CEO, Alok Maskara; 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 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, and thank you for joining us today. Let me start with our third quarter results on slide 3. Third quarter revenue grew 10.2% to \$1.6 billion, while total segment profit declined approximately 2% to \$323 million. Adjusted earnings per share declined 7% to \$6.84. Double-digit revenue growth was driven by continued outperformance in Building Climate Solutions, contributions from acquisition, and improving residential sales volumes. Profitability, however, fell short of our expectations. In response to the competitive environment, we adopted a more dynamic pricing approach to defend and stabilize our residential market share position. We are encouraged by the early results from these actions, but the trade-off was lower price realization at a time when tariff and inflationary pressures continue to increase.

Within Home Comfort Solutions, organic sales improved meaningfully from the second quarter and our share position began to stabilize. At the same time, underlying demand remains constrained by homeowner affordability, elevated mortgage rates, and broader consumer uncertainty. Building Climate Solutions delivered another quarter of double-digit growth with revenue up 24%. Margins remained healthy although higher tariff and inflationary cost were not fully offset by pricing during the quarter. Given our third quarter performance and expectations for the remainder of the year, we are reducing our full year earnings outlook. Our focus now is not only delivering a strong finish to 2026, but also on retooling the business to target consistent growth and revenue, profit, and EPS in 2027. Now, please turn to slide 4. We have launched a recovery plan focused on regaining share and restoring margins. While the near-term environment has changed, we remain confident in our long-term strategy.

Our recovery plan is centered on four actions and we are moving with urgency on each of them. First, pricing. We are rewiring our pricing approach to be more dynamic in current competitive conditions. This means being more responsive and targeted by region and customer segment, particularly where a competitive price gap affects our ability to win or retain business. The objective is to defend our existing position and recapture share where we have lost it while remaining disciplined about the economics of our business. Second, productivity. We are rightsizing the residential business for current market conditions and accelerating productivity across manufacturing, distribution, and SG&A. With the A2A conversion behind us, we are able to dedicate more resources to productivity, which is expected to play a larger role in restoring margins.

Third, portfolio. Affordability has become increasingly important for homeowners and entry-tier products have gained more relevance in the market. We are refreshing our entry-tier portfolio with new products including additional side discharge offerings. More accessible price points will also strengthen our product portfolio for new construction. We are pleased with the Heat Controller acquisition and early performance is in line with our expectations. Strategically, it has provided new insights and capabilities in the entry-tier market and broadened the portfolio available to us. We see additional opportunities across parts and accessories to broaden how we serve our contractors and distributors. Finally, promoters. As evidenced in our Net Promoter Score insights, we have a strong base of promoters across our traditional, residential, and commercial contractors, as well as our Commercial National Account.

Within Residential National Accounts, particularly private equity-backed contractor groups and residential new construction, we see an opportunity to deepen relationships and create more promoters. To capture that opportunity, we are updating our value proposition and expanding our capabilities to better meet the evolving needs of these customers. We also continue to strengthen the relationships that has made us successful across our traditional contractors and commercial national accounts. These are actions within our control and execution is already underway. The near-term objective is to stabilize share and improve profitability. Over time, a stronger portfolio, a more advantageous cost structure, and deeper customer relationships position us to return to consistent growth and margin performance.

With that, I'll turn it over to Michael to walk through the third quarter financial results in more detail.

Michael Quenzer

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

Thank you, Alok. Good morning, everyone. Please turn to slide 5. Third quarter revenue increased 10% driven by continued volume growth in commercial equipment and services along with contributions from M&A. Recent acquisitions are performing well delivering approximately \$20 million of operating profit accretion in the quarter. That growth helped us in higher tariffs and other costs. However, competitive pressures, limited price realization, and total segment profit declined 2%. Our immediate priority is turning revenue growth into improved profitability. Alongside the product and pricing actions Alok outlined, we are accelerating cost productivity across manufacturing, distribution, and SG&A including restructuring where appropriate. Restructuring actions are already underway with associated charges included in GAAP net income and excluded from adjusted results. Against that backdrop, let's take a closer look at our segment results starting with Home Comfort Solutions on slide 6.

Home Comfort Solutions revenue increased 3% in the third quarter with organic revenue down 1% compared with the 9% decline in Q2. Direct-to-contractor sales declined 6% improving from a 12% decline in Q2, while two-step organic sales increased 13% benefiting from last year's industry de-stocking comparison. Sales trends are improving though we are not yet seeing a broad recovery in underlying demand. Acquisitions contributed \$39 million in revenue and \$6 million in segment profit performing in line with expectations. Despite improving sales

trends, organic segment profit declined \$46 million. Favorable mix and price provided \$13 million of benefit. However, tariffs and related inflation net of cost productivity savings drove \$47 million in cost headwinds. We expected the price increase we introduced in late Q2 to cover more of the cost headwinds, but homeowner affordability pressures, softer demand, and increased competition limited realization.

With current competitive conditions, we are placing greater emphasis on cost productivity across manufacturing, distribution, and SG&A to support margins in the near-term and position us for stronger margin expansion as volumes recover. Let's turn to slide 7 and review Building Climate Solutions. Building Climate Solutions revenue increased 24% in the third quarter, including 15% organic growth. Acquisitions contributed 9% to revenue growth and approximately \$13 million in segment profit. Our investments in factories and sales coverage are improving quoting speed and product availability, helping us win more emergency replacement business. We also continue to grow with national accounts through our full lifecycle equipment and service offerings with new heat pump product offerings further expanding our opportunities. Together, these capabilities position us for continued growth in both channels over the next several years.

Higher sales volumes drove organic segment profit growth, but margins declined as pricing did not fully offset higher tariffs and inflation. Price increases take longer to implement under large national contracts, while competitive pressures limited realization with local contractors. We are focused on narrowing the price/cost gap through additional productivity, while we expect continued volume growth will provide further margin leverage. Let's now turn to slide 8 to review cash flow and capital deployment. We generated \$395 million of operating cash flow in the third quarter, up \$95 million from last year, with trailing 12 months' free cash flow conversion reaching 108%. We continued to reduce inventory with organic inventory units down more than 15% from last year. Inventory dollars were slightly higher and acquisitions added approximately \$100 million of inventory, and inflation further increased inventory costs.

Net debt-to-adjusted EBITDA increased to approximately 1.4 times, reflecting in part the \$200 million acquisition of the Comfort-Aire and Century brands completed in Q3. We also repurchased approximately \$151 million of shares during the quarter. Looking ahead, our capital deployment will place greater emphasis on opportunistic share repurchases when our shares trade below our assessment of intrinsic value, while maintaining a disciplined net debt-to-adjusted EBITDA ratio. We continue to expect approximately \$225 million in capital expenditures this year to support our entry-tier product launch in early 2027, new contractor training facilities, innovation labs for data center cooling applications, and AI tools to drive growth and productivity. With that, let's turn to slide 9 and discuss our updated financial guidance. As Alok outlined, we are updating our full year adjusted EPS guidance range to \$21.00 to \$21.50. Lower price realization and expected tax rate of 21% compared with 20% in our prior guidance are the primary drivers of the reduction.

Sales trends are improving in HCS and growth remains strong in BCS. However, competitive conditions have limited our ability to realize the pricing we expected to offset higher tariffs and inflation. Our updated outlook assumes these pressures continue through the remainder of the year. We now expect revenue growth of approximately 6% compared with 8% previously. This primarily reflects a lower contribution from price and mix which we now expect to deliver low single-digit growth compared with mid-single-digit growth in our prior guidance. Our overall volume outlook is also modestly lower, although we continue to expect a low single-digit decline. Stronger BCS volumes partially offset lower volume expectations in HCS. At the segment level, we now expect BCS revenue growth of approximately 23%, up from 20%, while HCS revenue is expected to decline approximately 4% compared with our prior expectation for 1% growth.

Consistent with the lowered net income outlook, [ph] we (00:13:35) reduced free cash flow guidance to \$700 million to \$750 million from \$750 million to \$850 million. We remain focused on reducing inventory and sustaining

our progress in cash conversion. Looking ahead, improved residential sales trend and continued growth supported by our commercial investments provide opportunities to build momentum. Entry-level product introductions and cost productivity actions also provide opportunities to improve profitability without relying solely on an end-market recovery.

With that, I'll turn the call back to Alok.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Thanks, Michael. Before we close, I want to share some early perspective on our 2027 outlook. Please note that we are not providing 2027 guidance today, but we will discuss several assumptions that are shaping our planning. Starting with price and cost, we expect inflationary pressures to continue, particularly from tariff, components, and commodities. As we reset the business, the first half of 2027 will be more challenging as we work through year-over-year tariff headwinds. Our pricing approach will be responsive to competitive conditions, while productivity will play an increasingly important role in balancing the price/cost gap. Successful execution of our recovery plan is expected to drive sales, EBIT, and EPS growth in 2027 with momentum building as the year progresses. Importantly, our plan does not depend on a significant market recovery. We are planning around muted industry volumes with resilient replacement demand and continued softness in new construction.

Instead, our growth opportunities are largely driven by actions within our control. In HCS, that means recapturing share, expanding our entry-tier offering, and growing penetration of parts, water heater, and ductless. In BCS, it means continuing the momentum with national accounts, emergency replacement, and services. The third tier, and the one most directly within our control is productivity. We have meaningful opportunities for material cost reductions, manufacturing productivity, and further efficiencies across distribution and logistics. Improved volumes should also provide factory absorption benefits. We will provide our detailed 2027 guidance with our fourth quarter results, but the actions underway are intended to reset the stage for continuous growth and productivity for 2027 and beyond. Let me close on slide 11. While we are clearly not satisfied with our profitability this quarter, the short-term challenges we are addressing do not change the long-term value proposition of Lennox.

We operate in attractive markets with significant replacement demand. We have strong brands, differentiated technology, and a direct-to-dealer model that creates close relationship with our customers. Over the last several years, we have also expanded the business through investments in capacity, innovation, acquisitions, and joint ventures thus creating additional avenues for growth. The near-term priority is translating those trends into better financial performance. That means, restoring share in residential and improving profitability by closing the gap between price and inflation, while maintaining the momentum we have built in our commercial businesses. We are proud of our talented team and winning culture, and grateful for the loyalty of our customers. Our long-term strategy remains intact and we are confident in Lennox's ability to deliver sustainable value, strong margins, and high cash conversion. I truly believe that our best days are still ahead. Thank you.

Michael and I are happy to take your questions now. Chloe, let's go to Q&A.

QUESTION AND ANSWER SECTION

Operator: Certainly. [Operator Instructions] We'll take our first question from Jeffrey Hammond with KeyBanc Capital Markets. Your line is open.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Hey, good morning, guys.

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Hi, Jeff.

A

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

I'm really just trying to unpack the level of margin degradation in HCS. I mean, I understand kind of the more competitive dynamic in kind of the resi new construction walk away, but just help me a little bit better understand what else is going on to drive kind of the margin degradation?

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Sure. Jeff, I think it's pretty simple. We were expecting to go out with the price increase that with the higher realization, and as you know we talked about doing that towards the tail end of Q2. At the same time, we faced tariff and other inflation, and most of the tariffs impacts started coming through with the Section 232 derivative tariffs in Q3. And I just believe there's a short-term mismatch between our pricing realization which was very low and inflation and tariff that came through. That's kind of the one and only change since we talked last on why the margin in HCS were lower.

A

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

And the price realization being low is a function of the competitive dynamic?

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

It is a function of corporate dynamics. It's also some pricing fatigue. I mean, we had done so many price increases with the ever-changing tariff environment. I mean, at this stage, we are planning to go out with a price increase for 2027, which I think works better for our national accounts, better for our contractors, and we expect that to offset inflation as we work through the year. We just couldn't stick a mid-year price increase.

A

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Okay, that's helpful. And then it looks like your inventories are still kind of stubbornly high. Just wondering where you think you're at in the destock. Do you need to destock more?

Q

Michael Quenzer

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

A

Yeah, actually our inventory progress, we're making some really good progress. The units are down 15%. Some of it is up because of acquisitions. We'll continue to see some decline go into the fourth quarter, seasonally decline, but most of the absorption headwind that we've seen is already behind us. As we look into next year, we have some additional productivity initiatives around reducing inventory around raw materials, some of our source products, but those won't impact our absorption. So, we think the inventory will continue to go down, support free cash flow guidance, and we're in a good spot on that.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

Okay, thanks.

Michael Quenzer

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

A

Thanks, Jeff.

Operator: We'll move next to Ryan Merkel with William Blair. Your line is open.

Ryan Merkel

Analyst, William Blair & Co. LLC

Q

Hey, everyone. Thanks for the questions. Wanted to start with the actions to regain share. Can you just talk about where the share loss occurred? And if the price adjustments you've made, has that helped you regain share, or is there a lot more to go?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

I think that's a good clarification. I mean, we have talked in the past about our share loss in RNC and we are now at a stage where within the next quarter or so, like that will be lapping itself, and we get back to more of a normalized year-over-year comparison. In addition, when we talk about share, we didn't talk about share loss as much as we talked about defending our share. And we had to essentially go to a much lower price realization in Q3 as we've look to defend our share in the remaining portion of the business. So there's no incremental share loss beyond what we talked about, but just to defend our share and not lose any more share, we had to go to the dynamic pricing approach, which meant we couldn't cover the steep tariff impact and inflation in Q3. But just want to clarify, there's no additional share loss that we're talking about.

We are clearly gaining share in BCS, gaining share in commercial, and the only share loss that's noticeable and evident is the ones we have talked about in the past.

Ryan Merkel

Analyst, William Blair & Co. LLC

Q

Got it. Okay, thanks for clarifying that. And then on the HCS revenue guide for 2026, it's going to be down 4% now. Can you give some color on one-step versus two-step there? And then is the biggest factor for the negative revision just the increased competitive dynamics or is it equally residential new construction is a little bit worse?

Michael Quenzer

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

A

No, overall, what we expect is in the one-step to be down on the full year low-double digits. Two-step we expect to be up kind of low-single digits. This is total organic sales and it's pretty much in line with our previous guidance with the expectation that maybe a little bit softer on the one-step as we enter the fourth quarter. Most of the revenue decline though in the guide was related to second half pricing actions.

Ryan Merkel

Analyst, William Blair & Co. LLC

Q

Okay, that makes sense. All right, thanks guys. I'll pass it on.

Operator: We'll take our next question from Noah Kaye with Oppenheimer. Your line is open.

Noah Kaye

Analyst, Oppenheimer & Co., Inc.

Q

Yeah. Thanks for taking the questions. Maybe – and good morning. Maybe talk a little bit about the competitive pressures you're seeing. How much of this is coming from the incumbents versus kind of smaller entrants, non-US based players? And then what do you think you need to do to the cost structure at this point to kind of put the operating costs on a more equal footing given those competitive pressures?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Sure. So yeah, let me first answer the competitive question. The competitive pressure is just in the industry in general, I mean we are a competitive industry. We have had some new entrants. I think the lower-tier products typically come from more of those new entrants. And then the competitive pressure for the rest of portfolio is typically from incumbents. But those lines are blending. We look at lots of people partnering with one another, but net-net it remains competitive, and the lower-tier offering is definitely in response to some of the overseas new competition coming in, because we want to make sure we remain competitive in the very long term, so that's where it is. From a cost structure perspective, we're very good with cost structure. As you know we have done this successfully many times. The large portion of the cost structure, and I would say about half of that is going to come from our distribution network.

We've been retooling our distribution network. We added the FDC earlier this year as you saw. And the second part of that is obviously now retrenching and taking out capacity from the regions, which makes the distribution network overall more efficient. We come up with lower cost when it comes to intra-network frame. We've talked about millions of savings opportunity there. We can exit some leases in different locations including as we retool our stores network. And then of course, there's [ph] room (00:25:12) for SG&A, and we do start getting the productivity benefits from non-negative absorption. It's – sorry, that was double negative. We do start getting the benefit of absorption back in the picture. So it's a broad-based effort on our part on the cost structure. I'm not including in this the lower cost of new products or the new tier products. I just want to say that is separate, because we just look at that as a new offering, realizing that there will be some cannibalization from the current offering.

Our aim is to maintain a margin percentage with these lower cost products, which will be lower cost and lower price with similar margin than we're experiencing today.

Noah Kaye

Analyst, Oppenheimer & Co., Inc.

Okay. Thank you, Alok. I guess you did mention, in terms of the CapEx guide some allocation of spending to innovative data center cooling. Again, I know that this is very preliminary, but can you share some color on those efforts and how you see your opportunity. Why it makes sense to invest at this point?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

The investments are all in our refrigeration business, where we do have the core technology to address large-scale cooling requirement. What we are working on is an innovation lab, which has got proof of concept and offering. It's on the two-phase cooling technology, so the technology which is 18 months away perhaps from the current state technology. And we have seen some good early results, good early momentum, but at the same time, that's not baked into any of our plans. We are not going to bake it into our 2027 plan. I mean, from our perspective, that's just maintaining the health of the business going forward. And if there's any upside that comes in terms of large orders, we'll let you guys know. But at this stage, just the investment to make sure that our technology keeps up-to-date and showcase our two-phase cooling technology, which we are already very good at.

Noah Kaye

Analyst, Oppenheimer & Co., Inc.

That makes sense. Thank you very much. I'll pass it on.

Operator: We'll take our next question from Tommy Moll with Stephens, Inc. Your line is open.

Thomas Allen Moll

Analyst, Stephens, Inc.

Good morning and thank you for taking my questions.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Good morning, Tommy.

Michael Quenzer

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

Good morning.

Thomas Allen Moll

Analyst, Stephens, Inc.

Alok, I want to start on the topic of the entry-tier product you expect to launch early next year. This is not the first time it's been mentioned, but it does seem to have an increased level of importance now, and I'm curious if there's something you have observed over the last quarter that's escalated that up the list of priorities for you? Thank you.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Tommy, thanks for the question. No, you are right. This is not the first time we are talking about it. Chances are this is not the last time we'll talk about it either. As we look at overall consumer affordability challenges, as we look at overseas competition coming in, we did a full study, which we have started before Q3 on just tearing apart all the products, looking at our product cost versus other product cost, and given that we are direct-to-business, direct-to-contractors, we know we have an inherent advantage in the supply chain and how we do this. So we ran some pilots in Florida, where we went after the whole market including overseas competition. We launched the side discharge earlier in the year at our trade show and now we are putting it all together to come back with a whole set of SKUs, including the mini-splits that we launched last year.

And the pilot we did in Florida was around a unitary product that would go head-on with unitary products from anybody, including overseas competition. So those all [ph] design-out (00:29:08) efforts are now at a stage where we can talk about that being an inherent part of our portfolio, with a full launch coming up in Q1 2027. We just think it helps consumers with the affordability concerns. It helps our loyal contractor fight off any overseas competition, whether it's unitary or side discharge or mini-splits; and gives us offering to defend our share in other areas, including RNC and AOR. So we just think it's an ongoing effort that now we have reached a stage in our maturation that we can talk about it publicly and start offering to our customers.

Thomas Allen Moll

Analyst, Stephens, Inc.

Q

Thank you, Alok. I wanted to ask a follow-up on HCS volumes. Making what I think are some reasonable assumptions about the fourth quarter on price/mix and the other line items there, it looks like we have to assume a double-digit decline in those HCS volumes for Q4, which if you look at the compare from last year is rather favorable. So I just want to see if your math is aligned with mine and what would drive the big decline there in Q4. Thank you.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Michael will answer that question. I'll just tee it off by saying our focus at this stage is to make sure we are set up for success in 2027 and beyond. I mean, it's a small quarter. Obviously, it's got lots of puts and takes. But we want to make sure that 2027 is set up for full success and we take all the actions, the options we have outlined on the page and drive success through that.

With that, I'll hand it over to Michael to actually answer your numbers question.

Michael Quenzer

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

A

Yeah. Tommy, it's a smaller quarter. The quarter's off to a bit of a softer start with warm weather in the Midwest as we're focused on kind of furnaces in that region. Overall, the guide assumes a mid-single-digit total sales decline for the fourth quarter organically. Better, obviously, on the indirect for some of the comparisons and less on the one-step, but we feel it's a good guide and it looks like we're focused on closing out the year strong and moving on to 2027.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

And as you do the math, I would suggest you also look at sales per day as a factor versus sales for the full quarter.

Thomas Allen Moll

Analyst, Stephens, Inc.

Sure thing. Thank you.

Q

Operator: We'll take our next question from Nigel Coe with Wolfe Research. Your line is open.

Nigel Coe

Analyst, Wolfe Research LLC

Thanks. Good morning. Appreciate all the color guys. This is really helpful. I want to take another crack, Mike, at the implied 4Q math since we warmed up on that on the revenues. On the margins, I mean, just doing similar kind of implied math, it looks like, I don't know, HCS margins down in the low double digits sort of zone. Just want to make sure that's correct. And then how do we think about the confidence in margin expansion in 2027? Sounds like first half down, second half up. Any more color around that would be helpful.

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

I'll take the second part of the question and then Michael will come back and address the margin thing. I think it's too early to talk about 2027 in that level of detail. I mean, what we did say and we feel confident about is that 2027 will have higher sales, will have higher EPS, and higher EBIT dollars. And you need to give us some time so that when we come back in January we can break that out. I mean, our intent is to go with a price increase that goes into effect like early, early beginning of 2027, and that will reverse a lot of the margin pressures we are having. But let us work through all of the math and we'll lay it out for you at the beginning of 2027.

A

For Q4 margins, let me hand it back to Michael.

Michael Quenzer

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

Sure. So, implied in our financial guides for the full year is about 200 basis points of margin decline at the enterprise. When you break that down by segment, BCS full year margins we think are approximately going to be flat. So we're getting volume leverage with some price cost, headwinds going against that. And within HCS, in the full year we expect about 350 basis points of margin contraction, mostly driven by volume declines in the one-step as well as some price/cost headwinds that we've seen through the year.

A

Nigel Coe

Analyst, Wolfe Research LLC

Okay. That's really helpful. Thanks. And then just coming back to the inventories, I think again, Mike, I think you quantified \$100 million of impact. I think that's a year-over-year impact. I think when we look at the acquisition you closed in the third quarter, that's maybe, I don't know, was [ph] \$30 million (00:33:44) or so. Is the high inventory balance intentional to kind of get ahead of some of this inflation that's been coming through the pipeline? Or is it just a function of weaker demand or, I don't know, combination of both? I'm just wondering what the policy is in terms of that inventory going forward.

Q

Michael Quenzer

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

Yeah. And I mentioned I think we are making some really good progress on the unit decline down 15%. We do see a \$100 million increase from the acquisitions we completed, one in the fourth quarter of last year and then

A

we've also completed one in the third quarter of this year, so that added on top of it. Let's kind of reiterate we do see some opportunities still in raw materials and source products. Those are higher than what we would like and we're going to continue to drive some of that down. That won't have an absorption impact. We think the absorption impact, it was really negligible in the third quarter. We don't see a lot of that headwind going into the fourth quarter, and it actually should turn into a tailwind as we look to increase production levels in 2027 versus 2026.

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

A

And just to specifically answer your hypothesis, no, we are not building up inventory to get ahead of inflation or anything else. Our organic volumes of inventory as Michael said is down 15%, and we feel comfortable with where our overall finished goods inventory is. Yet, in the spirit of continuous improvement and lean that we live in, we keep pushing on that but there is no big step change coming.

Nigel Coe*Analyst, Wolfe Research LLC*

Q

Okay. Thanks guys. Good luck.

Operator: We'll move next to Steve Volkmann with Jefferies. Your line is open.

Stephen Volkmann*Analyst, Jefferies LLC*

Q

Hi, thanks for fitting me in here. Michael, I think you mentioned some restructuring that was running through the P&L. Any details there on what that might look like in terms of saving benefits?

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

A

Sure. Yeah, as Alok mentioned, we've started to take some restructuring actions. It's mostly around some of the acquisitions we've done around the consolidation of distribution and some SG&A actions. So these will start to materialize next year as additional synergies through the acquisitions we've done as well as SG&A productivity. We still have additional potential opportunities on the distribution network within our one-step, so we continue to look next year how we can accelerate some of those. So we may have some more restructuring as we look to maybe exit some leases quicker than we normally would have done with the new FDC facility that we've put within Dallas. So we still see some more opportunities on restructuring going forward, but these should definitely help us as we get into 2027 on our cost per activity journey.

Stephen Volkmann*Analyst, Jefferies LLC*

Q

Okay. All right. Thank you. And then, sorry to go back to this, but on the HCS share recapture, I just want to verify that we're just talking about the builder channel there, and I'm just not understanding how you think you'd do that while also kind of pricing up for the inflation that you've seen.

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

A

A lot of it just comes down to, as we said, defending our share. So that's kind of our number one priority. Going back to capturing share, I do think that portfolio of products, including the entry-tier products that we mentioned,

could and is suitable to the builder channel because in many cases, they're looking with the lowest first cost. And I think overall, if I take a step back, we are strong with our traditional dealers and have a business model that works very well. As private equity-based contractors have grown, as RNC has consolidated, we are just refreshing our value proposition. I believe, and we believe, that given our direct-to-contractor model, we are structurally advantageous to serve these larger national accounts.

And now we need to convert that into concrete actions, and we are actively working with these national accounts, both PE groups and RNC customers to see how can we lower our joint cost to serve to create a win-win model realizing the fact that we are both a manufacturer and a distributor. So while I don't want to play out our entire value proposition on an earnings call, we feel comfortable with where we are and our overall value proposition and that will get enhanced with the entry-tier product that we are introducing.

Stephen Volkmann

Analyst, Jefferies LLC

Understood. Thank you so much.

Q

Operator: We'll take our next question from Joe Ritche with Goldman Sachs. Your line is open.

Luke McCollester

Analyst, Goldman Sachs & Co. LLC

Hey guys, this is Luke McCollester on for Joe. I just wanted to follow-up on the question on the entry-level product platform. I'm curious how should we kind of be thinking about the margin profile on those offerings as they scale?

Q

Michael Quenzer

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

Yes. So what we'll do is we'll cost reduce that product and we'll be expected that after that cost reduction we'll see margins similar to what we have in our current entry-level products.

A

Luke McCollester

Analyst, Goldman Sachs & Co. LLC

Okay, got it. Helpful. And then on Comfort-Aire and Century now in the fold and contributing nicely to top line, how are the logistics and SG&A synergies kind of tracking there and are you still confident that those businesses will be accretive to EPS in 2027?

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Yes, we remain confident in that. So – and remember, first of all, both those brands are entry-level brands. So going back to – while we talked about entry-tier as a big focus, that's not new. The relationship they have with some of the overseas supplier has provided us some really good strategic insight into the cost structure and strengthened our existing relationship with existing overseas suppliers as well. So in certain products like side discharge, now we have three really good partners that we can work with to immediately bring more to our customers. So being a manufacturer and distributor, we don't always have to manufacture on our products. So, net-net, it's going well. We are on track for synergies. The big part of SG&A obviously happens next year when we get into our ERP platform, but we are pleased with the acquisition, pleased with the strategic insights, and we think it's going to continue driving growth for us above and beyond 2027 as well.

A

Luke McCollester

Analyst, Goldman Sachs & Co. LLC

Great. I'll pass it on.

Q

Operator: We'll move next to Joe O'Dea with Vertical Research. Your line is open.

Joseph O'Dea

Analyst, Vertical Research Partners LLC

Hi, good morning. Thanks for taking my questions. Wanted to start on what you're planning for on the price-cost dynamic as you're moving into next year. When we think about the inflationary side of things, that moved from kind of low-single digit to mid-single digit over the course of this year on tariffs. Sounds like there's a continuation of headwinds in the next year, whether that continues at kind of mid-single digit type of magnitude. And then the pricing side of it, just given the fact that the pricing was a little bit more challenged middle of this year, explain confidence behind success on pricing as we go into next year.

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Joe, from an inflation perspective, I mean, obviously it's a moving picture. The Section 232 derivative tariffs took us for a surprise in the middle of the year. Otherwise, generally we are pretty good at working with pre-purchases, locking in purchases to lock all those things and give you guys a good guidance. This year was just an exceptional because we are blindsided with the Section 232 derivative tariff, including 25% on certain product categories. So, too early to give any numbers for 2027 or answer that question in a meaningful way. But as we normally do, we'll wrap everything up and bring you a full detailed guidance on 2027 at the end of Q4 and published results in January. On the pricing side, going back to what we said, there was just a pricing fatigue in the market. We had done price increase at the beginning of the year. We had done tariff-related price increases earlier. We just couldn't stick the mid-year price increase.

A

Quite a few of our national accounts, as you know, have inflation clauses and material riders backward looking into what all the different prices are, and you know steel's up substantially, copper's up substantially. So we feel very good about price capture starting 2027, when many of those contracts have automatic riders built-in, and as we go with the annual price increase in the contractor channel as well. So I know Q3s are disappointed, we are disappointed in the price capture, but we believe this is a short-term timing issue, and we will be able to get price-cost to be in a much better position starting 2027.

Joseph O'Dea

Analyst, Vertical Research Partners LLC

And then on the entry-tier part of your portfolio, just any color on what percent of the mix that is, where you think it's going to go. It sounds like the margin side of that will not be much of a mixed headwind, but just in terms of the revenue side of that, how big a portion of the portfolio it is and where you think it could be.

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

I would tell you it's a small portion of the industry today, it's a small portion of our portfolio, but it is growing rapidly. So part of this is about making sure that we don't miss out on that growth, and also that we remain competitive compared to other competition that the new entrants coming in from overseas. So I don't think the numbers move meaningfully in a year or six months, but we just want to be prepared for future trends in the industry and defend

A

share on certain areas as appropriate. As you know, it's also a regional market. It's also driven by many different things such as consumer affordability and pricing. So you're working through all of that, but this is more futuristic to stabilize and make sure, as we said, that our portfolio remains competitive.

Joseph O'Dea

Analyst, Vertical Research Partners LLC

Thank you.

Q

Operator: We'll take our next question from Amit Mehrotra with UBS. Your line is open.

Amit Mehrotra

Analyst, UBS Securities LLC

Thanks, operator. Hi, Alok. I just wanted to come back to your comment about changing or resetting the value proposition and sort of explain to me or us how that's not structurally bad for margins, because on one side, it's kind of another way of saying revenue per unit is coming down, and while you can value engineer costs out of that unit, overall, costs are inflating. And so it's probably too bullish to assume costs per unit come down on absolute basis. So how is that structurally not bad for margins?

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Yeah. So Amit, let me separate two different things out, right? One is the – or maybe three different things. One is price cost, which we can talk about. Second is the impact of the entry-tier. And third is the value proposition for these large national accounts. There's obviously overlap in all three of those, but I do look at all three. On the price-cost, as we talked about, we fully intend to go and capture price in 2027, and that would offset overall inflation. On entry-tier, small portion of the portfolio, we have introduced products and done pilots which have shown the power of that. It's really important for our contractors, our distributors, to have that as a part of the portfolio so they can offer it to those consumers who really need it. We don't expect it to grow substantially and take over majority of the portfolio.

A

Largely, the value proposition of national account, that's not necessarily based on price. Because we are direct-to-contractors, we can do a lot of things that a traditional two-step channel cannot do. I will recap some of those, and we've talked about that in our strategy days. I believe our digital strategy, digital footprint, of providing prognostic, diagnostic, direct contract with the manufacturer is big deal. You're working with at least one or two of them on topics like lead generation, which some of our other industry players do better. And I don't mean HVAC but outside HVAC there's good examples of companies like Generac who do a really good job on lead generation, working with their contractors. And then finally, on the logistics side, we can be really good with our FDC to deliver mixed loads direct to a certain site, and work on that to avoid extra handling, multiple transfers, and get to a win-win situation where a joint cost and supply chain comes down that benefits them and us.

So I was talking about those set of value propositions that we need to revise. It's not purely just based on cost, Amit.

Amit Mehrotra

Analyst, UBS Securities LLC

Got it. Okay, that's helpful clarification. Thank you. And then, just maybe as a quick follow-up, we obviously all understand the affordability challenges and the macro dynamics, interest rates, et cetera, but I'd just, Alok, try to get your perspective on, have you seen the channels sort of increasingly welcome non-US OEMs? Has that sort

Q

of been something that's sort of perked up more recently as these issues have been exacerbated by the macro environment? Can you just comment on that?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Sure. First of all, I think non-US OEMs are not new. Remember, Goodman got bought by Daikin many years ago, YORK got bought by Bosch many years ago. So the line between a US OEM and a non-US OEM has been blending for many, many years. Now there are many other players who manufacture their product overseas, including some very established US players. I think from our perspective, we have found that certain products, including side discharge, including lower-cost unitary products, including mini-splits, provide the consumers an alternative when they need it for certain application like zero-lot-lines; new lower-tier consumer homes; small sections of the house, whether it's garages or bedroom and loft conversions. And obviously to a dealer, it gives them the opportunity to bring value, good, better, best as a full offering versus just sticking with good, better, best and potentially losing out on the value tier.

So I think that's what we are working towards, is making sure our good, better, best portfolio has entry-level, good, better, best as a four-tier offering so consumers who are very challenged can choose the entry-level portfolio. So again, I don't think it's new. This is just the first time we've put it all together in a package. And we believe we're in a really good shape with the Heat Controller acquisition, our partnership with Samsung on mini-split, and some of the pilots we have recently run on that, including a manufacturing cost-out as a result of all those actions.

Amit Mehrotra

Analyst, UBS Securities LLC

Q

Right. Great. Helpful. Thank you very much, Alok. Appreciate it.

Operator: We'll move next to Steve Tusa with Wells Fargo. Your line is open.

C. Stephen Tusa

Analyst, Wells Fargo Securities LLC

Q

Hi, guys. Good morning.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Hi, Steve.

C. Stephen Tusa

Analyst, Wells Fargo Securities LLC

Q

So I'm just still trying to kind of figure out where – last quarter, I think you guys talked about the resi, like resi new home pressure. I'm just really trying to figure out how like broad-based the new entrants are in this. Like, what percentage of the market? I think the newest product is really this hybrid side discharge thing. I don't think ductless is really making – it's always been competitive, but this new hybrid side discharge product, is it that or is it like 410A units that are coming in as replacement components and impacting the low end? And if it is the side discharge, like what percentage of the market do you think it is today and where do you think it goes in the next call it three years?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Sure. So let me just backtrack and confirm. So in our perspective, the entry-tier has three different products, right? And everybody can make assumptions on how big. I do think ductless acts as an entry-tier products in certain areas. I do think the hybrid/side discharge is the second one. The third one is also a lower-cost unitary product, especially as some of the overseas competition is bringing those in and have certain advantages. So our focus is on all three of those, Steve. The side discharge, which you have seen, has been successful. It's actually done better than we expected, both in one-step and two-step, and we have reinforced that with the Heat Controller acquisition. I wouldn't guess market numbers, but for at least for heat pumps it's becoming a substantial portion of heat pump sales on the ducted side. But at this stage, I don't have the market numbers handy to give to you. I'm sure you'll have your own analysis and research to pull together.

Our point here is we want to make sure we are fully prepared in all three of those. And then as the market evolves and grows, our contractors and our national account customers should benefit from choices: here's entry tiers; here's our good, better, best following that.

C. Stephen Tusa

Analyst, Wells Fargo Securities LLC

Q

Right. And I guess as far as the approach to how is this like mechanically working on the ground, are you losing share to established US players that have these products or are you losing share to kind of these new entrants? And I'll consider Bosch one of those new entrants or a Midea or somebody like that. Where do you see the most of the fight from a market share perspective?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Sure. So first of all, since – I mean, this comes down to, like, we might lose share because we were just not in that market. But over the past two years, we have entered the market. But it's not that we are lose – people are leaving us because we don't have it. What I would say, those lines have always blended and they continue to blend as many of the established US players often buy and re-label those products as well. And it's not very clear to us that how many of those are re-labeled and how many people are self-manufacturing. But I would say those lines are very blended, so it's very hard to answer your question in a definite A or B. It's kind of A and B. It's established players who are blending the line or overseas players who are selling it under their own brand.

C. Stephen Tusa

Analyst, Wells Fargo Securities LLC

Q

Got it. Super helpful color and I appreciate all the detail in the slides. It's a helpful conversation to kind of parse through what's happening out there so I appreciate it. Thanks.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Thanks, Steve.

Operator: We'll move next to Nicole DeBlase with Deutsche Bank. Your line is open.

Nicole DeBlase

Analyst, Deutsche Bank Securities, Inc.

Q

Yeah, thanks. Good morning, guys.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Hi, Nicole.

A

Nicole DeBlase

Analyst, Deutsche Bank Securities, Inc.

Hello. Just want to come back to the discussion around price. Alok, I think a couple minutes ago you said you fully intend to capture price in 2027. I guess if you think about the inflation that you guys have seen so far and the impact of tariffs, how much price do you think you need? Like, is this kind of a normal 1%, 2%-ish pricing environment that you're seeking in 2027? And I guess what happens if the market doesn't follow suit? And how do you think about the trade-off between share and price into 2027, if you have to make that choice?

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Sure. Nicole, so this is a great question and there's still a lot of moving pieces. So I'll tell you it's more than the traditional one to two, and that's what we'll be aiming for. To the second part of the question, we don't know and we can't speak for competition. But this is driven by just significant increase in steel, significant increase in copper, significant increase in tariffs for any imported components. We don't think we are uniquely positioned in the industry and facing any abnormal inflation compared to every other player. So from our perspective, this is about recovering our costs. And I believe everybody else in the industry who manufactures products that are very, very similar to us is facing the same, same pressure and would likely do their own efforts to recover those. So from our perspective, we'll wait and see. I can't speak for competition, but at this stage, it's very important and we feel confident about recovering that price.

A

Nicole DeBlase

Analyst, Deutsche Bank Securities, Inc.

Okay, understood. Thank you, Alok. That's very helpful. And then just as a follow-up, the discussion around resizing capacity, focusing more on productivity, et cetera, any thoughts on the potential magnitude of that resizing and maybe from a cost perspective, how much that could potentially impact your cost base if you're going that route starting next year?

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Yeah, we are working through all of that and in many of these cases, I would rather talk to our own employees first before discussing that on a public earnings call. So they just so – but there's a lot of actions that we are working through. I highlighted a few areas already like distribution, and I think that's going to be an area where it's sometimes about just reducing intra-company freight cost, we're looking at leases on those. And then of course, we do believe the spirit of continuous improvement, but Nicole, we can share a lot more of that when we give you details in January for 2027 guidance.

A

Michael Quenzer

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

And I'll just add on top of that, we'll continue to focus on manufacturing absorption as well as tariff mitigation as we go into next year as well.

A

Nicole DeBlase

Analyst, Deutsche Bank Securities, Inc.

Understood. Thank you, both. I'll pass it on.

Q

Operator: We'll move next to Toby Okwara with Morgan Stanley. Your line is open.

Toby Okwara

Analyst, Morgan Stanley & Co. LLC

Hi, thank you for the question. I just wanted to ask again on like the mitigation efforts and some of the investment in the JV. Is there any sense on how that impacts mix from both the margin dynamic and the dollars per unit?

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

First of all, we are pleased with our JVs. We're in early stages of both the JVs, the Ariston JV with water heaters, the Samsung JV to really drive our penetration into the ductless area. Both are doing well. As we've talked about in the past, we don't expect those to be margin dilutive. And we are working through that and making the appropriate investments and trade-off to take that forward. It does add to our growth. The Samsung one does add to provide customers and consumers different product options. And water heater is a brand new category for us, so it's all upside, but we don't expect there to be margin dilutive. It's going to be similar to our overall margins when it falls down.

A

Toby Okwara

Analyst, Morgan Stanley & Co. LLC

And would it be similar from a dollar basis there, or would there be any slowdown in the dollars per unit?

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Well, they are facing similar inflationary environment, like – I mean, they're also made out of metal and face a similar environment impact, so no, I think even on a dollar basis, we would see the same trend that we see in the rest of the portfolio.

A

Toby Okwara

Analyst, Morgan Stanley & Co. LLC

Thank you. And then on parts and accessories, is some of the investment there indicative of some of the repair dynamics in the market? Are you seeing any acceleration in repair demand there and that brings opportunity for further growth?

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

The repair versus replace dynamic, pleased to say that's pretty stabilized at this point. And what we saw last year is no longer valid, so people are not choosing repair more than replace. I think we have reached a status quo or steady state there, so we're not worried about degradation there. Our effort on parts and accessories was about our own attachment rate. I mean, the timing was good in a way because, yeah, there was a short-term pickup in repair. But overall, where we are is our attachment rate, as we talked about in the Investor Day, is hovering around 15%. We think it should be twice that much. So as we take that forward, that continues an opportunity.

A

Again, early next year, we'd be launching new capabilities there and are super-excited about that remaining a growth engine. Just to go back to all the growth things, right, we've talked about our heat framework. Heat pumps continue to be a growth opportunity.

Some of the entry-tier products that we talked about fit in that category. Emergency replacement for commercial remains a growth opportunity. You've already seen strong results. Attachment rate, as we just talked about for parts, accessories, services remains an opportunity. And the JVs help us with expanding our tab. So from our perspective, none of that has changed. What has changed is the short-term price inflation dynamic that is impacting us, especially given the uncertain amount of tariffs and what we got surprised early in the year. So we just have to work through that and we're confident that we will.

Toby Okwara

Analyst, Morgan Stanley & Co. LLC

Q

Super helpful. Thank you, again.

Operator: Since there are no further questions, this will conclude Lennox's 2026 third quarter earnings call. You may disconnect your line and have a wonderful rest of your day.

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