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# Lennox International, Inc. (LII)

Q3 2025 Earnings Call

## CORPORATE PARTICIPANTS

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**Alok Maskara**

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

**Michael Quenzer**

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

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## OTHER PARTICIPANTS

**Ryan Merkel**

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**Damian Karas**

*Analyst, UBS Securities LLC*

**Nigel Coe**

*Analyst, Wolfe Research LLC*

**Joseph O'Dea**

*Analyst, Wells Fargo Securities LLC*

**Julian Mitchell**

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Welcome to the Lennox Third Quarter Earnings Conference Call. All lines are currently 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 would now like to turn the conference over to Chelsey Pulcheon from Lennox Investor Relations. Chelsea, please go ahead.

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### Chelsey Pulcheon

*Director-Investor Relations, Lennox International, Inc.*

Thank you, Katie. Good morning, everyone. Thank you for joining us as we share our 2025 third quarter results. Joining me today 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 GAAP to non-GAAP measures.

The earnings release, today's presentation, and the webcast archived link for today's call are available on our Investor Relations website at [investor.lennox.com](http://investor.lennox.com).

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

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### Alok Maskara

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

Thank you, Chelsea. Good morning, everyone. I am proud to report that Lennox maintained resilient margins and high customer service levels amidst a very challenging external environment. Our talented team work tirelessly with our loyal customers and channel partners to deliver these results, and I am very grateful for their hard work. Our results were also fueled by our recent investments, which will accelerate our growth and expand our margins as the industry turns the corner into a brighter 2026.

Let us turn to slide 3 for an overview of our third quarter financials. Revenue this quarter declined 5% as growth initiatives and share gains were unable to fully offset the impact of soft residential and commercial end markets. Ongoing channel inventory rebalancing and weak dealer confidence following the regulatory transition created more complexity for the quarter.

Our segment margin was 21.7%, a record for the third quarter. Operating cash flow was \$301 million, which was lower than last year as a sharp industry decline has temporarily elevated our finished goods inventory levels. Adjusted earnings per share was a third quarter record of \$6.98, a 4% year-over-year increase.

HCS segment profit margin expanded by 30 basis points as the team executed meaningful cost actions to offset industry headwinds. HCS revenues declined 12% as the residential industry faced a weak summer selling season and as both contractors and distributors rebalance inventory post regulatory transition.

BCS segment results were impressive as profit margins expanded 330 basis points and revenue grew 10% even though the end market remained weak.

The team was able to offset end market conditions with rigorous execution of growth initiatives such as share gains in emergency replacement, business development in refrigeration, and full life cycle value proposition in commercial services. Given current end market conditions, we are adjusting our full-year outlook to reflect an anticipated sales decline of 1%. We now expect adjusted earnings per share in the range of \$22.75 to \$23.25.

Now let's move to slide 4 to discuss how our recent acquisition will increase the attachment rate for our parts and accessories. Differentiated growth at Lennox is driven by four growth vectors: heat pump penetration, emergency replacement share gains, higher attachment rates for parts and services, and total addressable market expansion through joint ventures such as Samsung and Ariston.

Our bolt-on acquisition of AES Industries in 2023 helped accelerate the attachment of commercial services and was a tremendous success based on financial and strategic metrics. As a result, our commercial services business has more than doubled over the past three years.

Similarly, the recent acquisition of DuroDyne and Supco will help accelerate attachment of parts and accessories across both HCS and BCS segments. The acquired business has annual revenues of approximately \$225 million and a solid growth trajectory with strong margins. This acquisition meets our discipline criteria and will be accretive in 2026. The acquired business provides Lennox with additional products, brands and distribution scale to accelerate the growth of our parts and accessories portfolio. We see a significant opportunity to increase the attachment rates, one of our four key growth vectors.

The integration of DuroDyne and Supco will also lead to meaningful cost synergies that make this transaction even more attractive to Lennox stakeholders. Our integration team has already identified sourcing opportunities, and we are confident about creating additional value as we align the business with Lennox's standard infrastructure and implement our unified management system.

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

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## Michael Quenzer

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

Thank you, Alok. Good morning, everyone. Please turn to slide 5. As Alok outlined, in the third quarter, we continue to navigate a dynamic operating environment characterized by uneven demand due to the new refrigerant transition and broader macroeconomic uncertainty. These pressures resulted in a 5% decline in revenue. However, our team acted decisively and maintained operational discipline, delivering 2% growth in segment profit and achieving margin expansion.

This profit improvement was primarily driven by favorable product mix and pricing, supported by the successful launch of our new R-454B products. We also saw benefits from improved cost management, including reductions in selling and administration expenses. These gains were partially offset by lower sales volumes and increased product costs, largely due to ongoing inflationary pressures.

Let's now turn to slide 6 to review the performance of our Home Comfort Solutions segment. Home Comfort Solutions experienced a softer demand in the third quarter with revenue declining by 12%, primarily due to a 23% decline in unit sales volumes. While we anticipated a decline in sales volume, the extent was greater than expected due to several contributing factors: contractors and distributors actively reduced inventory levels; macroeconomic softness weighed on both new and existing home sales; moderate weather dampened demand; and there was a clear shift towards systems repair rather than full replacements. Despite these challenges, mix and pricing remained favorable, supported by ongoing transition to the new R-454B products.

On the cost front, inflationary pressures on materials and components continue to weigh on product costs. These headwinds were partially offset by successful tariff mitigation strategies and sustained improvements in operational efficiency driven by targeted cost actions. We also benefited from SG&A cost reductions, though these were partially offset by ongoing investments in our distribution network.

Moving on to slide 7. Building Climate Solutions gained momentum in the quarter, delivering a strong 10% revenue growth, driven by a 10% benefit from favorable product mix and pricing, while volumes were flat. Light commercial HVAC, which represents approximately 50% of BCS revenue, continued to see year-over-year declines in industry shipments.

Despite these market headwinds, we maintained volume levels through share gains in emergency replacement products and solid growth across our refrigeration and service offerings. On the cost side, material inflation remained elevated, but was partially offset by gains in factory productivity as our new facility continues to enhance operational efficiencies.

Turning to slide 8, let's review cash flow and capital deployment. From a free cash flow standpoint, we are revising our full-year 2025 guidance to approximately \$550 million. This adjustment reflects elevated inventory levels driven by lower than expected sales volumes. We expect inventory levels to normalize in 2026 while continuing to support strategic investments in commercial emergency replacement and the launch of our new Samsung ductless product line.

The \$550 million of free cash flow includes approximately \$150 million in capital expenditures, primarily focused on expanding our distribution network, enhancing the customer digital experience, and establishing multiple innovation and training centers designed to help our customers succeed in their local markets.

On capital deployment, we've repurchased approximately \$350 million in shares year-to-date. And with \$1 billion remaining under our current authorization, we will continue to opportunistically repurchase shares. We also continue to evaluate strategic bolt-on acquisition opportunities that enhance our distribution capabilities and expand our product portfolio. As we pursue these initiatives, we remain committed to preserving a healthy debt leverage across all capital allocation decisions.

If you'll now turn to slide 9, I'll review our full-year 2025 guidance. In response to evolving market conditions, we are updating our full-year guidance to reflect deeper inventory destocking trends and continued macroeconomic weakness, particularly in home sales and consumer confidence.

Starting with revenue. We now expect full-year revenue to decline by 1% compared to our previous guidance of 3% growth. This revision is primarily driven by lower total sales volumes in Home Comfort Solutions, which are now expected to decline in the mid-teens range compared to our previous guidance of high-single digit decrease.

With the successful closing of our DuroDyne and Supco acquisition, we expect an approximately 1% contribution to full-year revenue growth, with a minimal impact on EBIT due to purchase price amortization of approximately \$10 million. On mix and price, we continue to expect a combined benefit of 9%, consistent with our prior estimate.

Turning to cost estimates. We now expect cost inflation to increase total cost by approximately 5%, down from our prior estimate of 6%. This improvement is driven by successful tariff mitigation efforts and additional cost actions.

Looking at other key metrics. We now expect interest expense to be approximately \$40 million, reflecting our recent \$550 million acquisition and lower free cash flow due to elevated inventory. Our tax rate is projected to be around 19.3%.

On earnings per share, we are updating our EPS guidance to a range of \$22.75 to \$23.25, down from the previous range of \$23.25 to \$24.25. And finally, as mentioned earlier, we now expect full-year free cash flow to be approximately \$550 million, revised from a prior guidance of \$650 million to \$800 million.

In summary, while 2025 remains challenging with industry softness and double-digit declines in sales volumes, our continued focus on operating discipline positioned us to grow earnings per share, and we remain optimistic about a return to market growth in 2026.

With that, please turn to slide 10 and I'll turn it back over to Alok.

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## Alok Maskara

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

Thanks, Michael. As we reflect on this quarter, I want to acknowledge the challenges we have faced as a company and an industry. The environment has been tough with destocking, higher interest rates, and shifting consumer patterns, all of which have weighed on our results. However, I am confident that these headwinds are temporary.

Our team has navigated this period with discipline and resilience, and the actions we have taken have positioned us for a strong rebound next year. Looking ahead to 2026, we expect channel inventory to normalize. And with the prospect of lower interest rates, both new and existing home sales should begin to recover.

We are also moving past the disruption of this year's refrigerant transition. While dealers were understandably cautious due to industry-wide canister shortages and supply chain friction, we expect dealers to regain confidence as the transition-related component shortages are finally in the rear view. We are positioned to gain share through several avenues, including a renewed focus on new product introductions and contributions from joint ventures including ductless products and water heaters.

Of course, we are mindful of some headwinds. As economic pressures persist, we anticipate higher demand for value-tiered products, along with elevated repair activity in lieu of system replacements. As federal energy efficiency incentives sunset, they may create some additional uncertainty. However, we do not expect them to materially impact overall demand, especially as some states and utility incentives for energy efficiency are expected to continue.

On the margin side, we expect mixed improvement from carryover of R-454B refrigerant products, particularly in the first half of the year. In addition, we also anticipate customary annual pricing actions to offset inflation. Beyond pricing, we are driving disciplined cost productivity efforts to sustain margin resiliency. Optimization of our distribution network will lead to lower logistics cost, higher fill rates, and better customer experience.

Targeted SG&A cost actions will streamline our processes and enhance efficiency across the organization. With our new commercial factory in Saltillo now fully operational and delivering measurable improvements, we expect additional manufacturing productivity in 2026.

At the same time, we are making strategic investments that strengthen our foundation for future growth, including digital front end tools that simplify how our businesses work with our dealers. Expansion of our distribution network enhances our capabilities and reach, and the addition of new innovation and training centers accelerates product development and dealer loyalty.

We continue to closely monitor inflation, tariff, and rising input cost across commodities, components, health care, and benefits. However, our disciplined cost management, effective pricing, and focus on operational excellence gives me confidence in our ability to navigate these pressures while sustaining margin resiliency.

Now let's turn to slide 11 for why I believe Lennox outperforms the industry.

As highlighted last quarter, our strategic focus has not wavered. Even with recent challenges, we continue to execute ahead of schedule on the commitments outlined in our transformation plan. Looking forward, we expect growth to accelerate, supported by consistent replacement demand and initiatives across digital enablement, ductless solutions, commercial capacity, and the parts and services ecosystem.

Cost productivity has become increasingly important to maintain resilient margins, and we are achieving this without compromising growth investments. We continue to make targeted investments to elevate customer experience and product availability. Simultaneously, we are scaling our digital capabilities across both product offerings and customer touchpoints, leveraging proprietary data and broadening our portfolio of intelligent controls. This progress is made possible by a highly talented team and a culture rooted in accountability and results.

I remain confident in our strategic direction, and I am committed to delivering sustained value for our customers, employees, and shareholders. I firmly believe our best days are ahead.

Thank you. We'll be happy to take your questions now. Katie, let's go to Q&A.

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions] Thank you. Our first question will come from Ryan Merkel with William Blair. Your line is open.

**Ryan Merkel**

*Analyst, William Blair & Co. LLC*

Q

Hey, everyone. Thanks for the question, and nice job on margins.

**Alok Maskara**

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

A

Thanks, Ryan. Good morning.

**Ryan Merkel**

*Analyst, William Blair & Co. LLC*

Q

Good morning. My first question is just, Alok, can you put the residential volume declines into perspective a little bit more? Comment on what was the performance of one-step versus two-step. And then if you excluded the destock, any sense for what sell-through volumes would be for resi in the quarter?

**Michael Quenzer**

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

A

Hey, Ryan. What I can do is, I'll give you some clarity. On the total sales within Q3, we saw total sales on sell-through down about 10% and about 20% down on sell-in. So, that's total sales which would include the price/mix benefit.

Alok, did you want to talk about that?

**Alok Maskara**

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

A

Yeah. And I think, Ryan, one thing that's been very clear to us during this quarter is when we look at our sales to our contractors, or whom we call dealers, they also were holding inventory. And in some cases, it was more than we thought. So, as we've gone around and spoken to hundreds of our contractors and dealers, we have realized they have done some destocking as well. So, it's not purely as the numbers are coming through. So, I think there was destocking happening on both sides.

But if your question is taken differently and said, what do we believe the consumer demand for this looks like, we do think it's weak, impacted by interest rates, impacted by housing stock that's not turning over as it used to be, and, in some cases, impacted by the type of a summer we had, for the past 10 summers with the hottest summer on record for the 10 years. So, I think that also impacted our relative sales.

**Michael Quenzer**

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

A

And, Ryan, I'll just add. On the parts and supplies, we did see some growth on parts and supplies in our business, which suggests that there is a bit of a trend toward more of a repair versus replace.

**Ryan Merkel**

*Analyst, William Blair & Co. LLC*

Q

Right. Okay. Thanks for that. And then my follow-up would be on fourth quarter margins. Third quarter was much better than I expected. But sequentially, the margins are coming down a little more than I would have expected on sort of similar volume declines in for Q3. So what are some of the key assumptions there that you can unpack for us?

**Alok Maskara**

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

A

Sure. I think, Ryan, the biggest one is, we are pulling back on manufacturing to rightsize our inventory level, and that the absorption benefit that we had in Q3 would be less as we look forward to Q4. That's probably the single largest factor, Ryan.

**Ryan Merkel**

*Analyst, William Blair & Co. LLC*

Q

Got it. All right. Thanks. I'll pass it on.

**Operator:** Thank you. Our next question will come from Damian Karas with UBS. Your line is open.

**Damian Karas**

*Analyst, UBS Securities LLC*

Q

Hey. Good morning, everyone.

**Michael Quenzer**

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

A

Morning.

**Alok Maskara**

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

A

Morning, Damian.

**Damian Karas**

*Analyst, UBS Securities LLC*

Q

So, just a follow-up question, thinking about this channel inventory destocking. What's your sense on when the inventory levels will be more normalized? Is that going to happen kind of sooner rather than later? Or is this going to kind of be a trend that we see through the first half of next year?

And getting the sense that the destocking is not just kind of a two-step. I think you mentioned also on the one-step side. Is the reality that, like, maybe some of the contractors out there just have been carrying more inventory than you guys have suspected?

**Alok Maskara**

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

A

Yeah. I think we talked about in the past that many of our contractors rented barns and put inventory in the barns during COVID situation. Now that the supply chains have improved and our own lead times are down to one or

two days, they no longer feel the need to maintain that extra barn full of inventory. So, these are not months of inventory that are contractors were carrying, but they were carrying a few weeks of inventory. And that destocking did take us a little bit by surprise. But I think, in a way, it's testament to the improved industry lead times and just the lack of confidence they had after a weak summer selling season.

**Damian Karas***Analyst, UBS Securities LLC*

Q

Okay. That's helpful. And then I wanted to ask you about the BCS segment. Obviously, that's – you're seeing some nice trends there in relative strength. When the dust settles on 2025, where do you think you'll be in terms of the emergency replacement market share? And what do you view as achievable thinking about 2026?

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

A

Yeah. We're really pleased with the progress in emergency replacement, started with the factory, getting the inventory availability, getting all deployed. So we saw significant growth; nearly 100% growth on a very small base of emergency replacement in the quarter.

To put in perspective, if you look at the total BCS segment, about 5% of the revenue is emergency replacement. We see a lot more growth potential there because we didn't fully catch the full season with emergency replacement. So we're ready for next year, we've got the inventory deployed, and we see multi-year growth within that channel.

**Damian Karas***Analyst, UBS Securities LLC*

Q

Thank you very much. Good luck.

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

A

Thanks.

**Operator:** Thank you. Our next question will come from Nigel Coe with Wolfe Research. Your line is open.

**Nigel Coe***Analyst, Wolfe Research LLC*

Q

Thanks. Good morning and, really, a very good job on the margin preservation. Really impressive, Alok; and Mike as well, of course. Just going back to the inventory...

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

A

Thanks, Nigel.

**Nigel Coe***Analyst, Wolfe Research LLC*

Q

...obviously, your inventory levels are quite high. Pretty flat Q-on-Q, which is very unusual. I just want to make sure that the bulk of that would be within your captive distribution network, which seems to suggest that maybe inventory levels across the industry are still at pretty high level. So I just want to maybe just kind of double-click on

that inventory number. Is it a buildup of emergency replacement inventory? Just some context. It does look like we've got a fair ways to go here on the destock.

**Alok Maskara**

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

A

Yeah. I think from our inventory levels, it's true. It's mostly in the direct to contractor level. And I think we were cautious and optimistic going into the quarter, hence we have got more inventory than we would have liked to be.

I didn't fully answer the question that was asked in the last question as well. It's hard to predict when the destocking would be over. But if I had to guess right now, I'd say the destocking would probably be over by Q2 of next year. So not the entire first half, but I think this is going to continue for a while, and we are preparing accordingly. And I think that's the same forecast we have for our inventory is that we'll be back to normal levels by Q2 next year.

**Nigel Coe**

*Analyst, Wolfe Research LLC*

Q

Okay. That's helpful. And then, just quickly on the repair versus replace dynamics, maybe just your perspective on why now. Is it consumer confidence? Is it more around the A2L dynamics? Is it the price? Is it all three? Any context there would be helpful.

**Alok Maskara**

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

A

Yeah. I mean, clearly, by the way, this is a difficult thing to come back and give you a data-based answer. I think it is all three. But the primary reason, in our view, was the A2L conversion. Our contractors and dealers, who are the one who convince homeowner that replacement is a better economic decision in the long term, were just hesitant to sell new products because of canister shortages and everything else that was going on. So they were not as effective as they normally are. There is, obviously, some impact of consumer confidence, which, as you know, is now in multi-months low. So it will be all three, but I think the primary was just the confidence of our own dealers.

**Michael Quenzer**

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

A

And I'll just add one more on the existing home sales. As some of these homeowners have very low interest rates, they're wanting to move into new homes, but they don't want to put a whole new system investment and if in the next two years interest rates come down, they can move to a new home as well.

**Nigel Coe**

*Analyst, Wolfe Research LLC*

Q

Okay. Thank you.

**Operator:** Thank you. Our next question will come from Joe O'Dea with Wells Fargo. Your line is now open.

**Joseph O'Dea**

*Analyst, Wells Fargo Securities LLC*

Q

Hi. Good morning. Thanks for taking my questions. I just wanted to start on trying to take a step back and think about what normalization means from a volume standpoint in the industry. And so, when we look at resi volumes

over the past number of years, it's been anywhere from kind of 8 million to 10 million units. This year, it's probably pacing below that 8 million. But as you think about a setup for a return to normalization as we head into next year, how you think about that? And in particular, if we're still in a period of time where we've got lack of turnover in existing homes, we're waiting on interest rates, just how it all comes together to think about industry volumes for you next year?

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**Alok Maskara**

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

**A**

Yeah. As you know, that's been a hard thing to predict. And our goal, being one of the smaller players in the HVAC industry, has always been to outperform the industry, no matter where the industry goes. I mean, the 8 million to 10 million range, as you mentioned, has been the range, and this year is abnormally low. And that, we can be 100% confident is due to destocking, that if you look at the actual number of unit that go on the ground, I think that's obviously a higher number.

I would say the normal next year that we are going to be working through, and we'll probably have more details when we are declaring Q4 results in January next year, we look at a number closer to a 9-ish million to 10 million number for the industry as a normal year for 2026. But a lot more to come. We want to see how Q4 comes through. But I do think a normal is closer to a 9 million to 10 million for next year.

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**Joseph O'Dea**

*Analyst, Wells Fargo Securities LLC*

**Q**

Perfect. And then, also just wanted to touch on pricing and how you think the industry will approach pricing moving into next year when you think about coming out of a period with minimum efficiency, and then A2L, the amount of inflation that customers have faced. We think about a normal algorithm where maybe we're looking at list that's kind of mid-single in realization, that's sort of [ph] 1% to 2% (00:30:47). Are we in a place where that can repeat? Or just given the amount of price that's hit the market, is that something that could be difficult?

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**Alok Maskara**

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

**A**

Sure. So I would first say, I was pleased with the industry's pricing discipline in this year, both for A2L conversion and to offset tariff. We saw, like, a uniform approach across all the key competitive players. So we were pleased with that. In some pockets such as residential new construction, we chose to walk away from businesses where we were losing money or were low-margin. And I think that's probably the one area you would see some impact for us going forward is we would not be taking negative margin businesses that is often associated with new construction.

The answer to your broader question for next year, I do think we would all be looking at pricing to offset inflation. I mentioned that in my script a little bit. And I think it's going to be similar to what has happened in the past. Now, keep in mind, 2026, we'll have some carryover effect, both from tariff-related pricing and from A2L-related mix. But I do think, 2026, you will find pricing would again offset inflation, which would probably be in the range that you were referring to earlier.

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**Joseph O'Dea**

*Analyst, Wells Fargo Securities LLC*

**Q**

Great color. I appreciate it. Thank you.

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**Operator:** Thank you. Our next question will come from Julian Mitchell with Barclays. Your line is open.

**Julian Mitchell**

*Analyst, Barclays Capital, Inc.*

Q

Hi. Good morning. Maybe just wanted to start with the sort of operating margin trajectory. So, I think the guidance implies sort of flattish operating margins year-on-year in the fourth quarter. Wondered within that if you could unpack maybe any sense of magnitude around how much HCS is down year-on-year because of that underproduction. And when we're thinking about the margin headwinds from underproduction and also from acquisition amortization, how severe or how long through next year or the next several quarters are those expected to last?

**Michael Quenzer**

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

A

Sure. I'll take that one, Julian. Yes. On the full year guide, we're still projecting our ROS to expand, our profit margin expansion of about 50 basis points. And that includes some headwinds that we have with the [ph] Breathe (00:33:24) acquisition. We're picking up revenue with zero EBIT on that. And within that guide of 50 basis points improvement for the segment, we have the HCS full year up slightly. From a ROS expansion, BCS kind of flat. And then on the corporate expenses, we see them go – corporate gains, losses, and other going from about \$120 million last year closer to the \$105 million to \$100 million this year. So, still real pleased with the margin trajectory. It implies about a 20% decremental in the fourth quarter. So, we think that's a good guide.

And then your second question for next year, yeah, we'll continue to see some absorption go through the first quarter. Normally what we do in the first quarter of every year is we grow inventory by about \$150 million to achieve the summer selling season. We already have that inventory. So, we'll see a little bit of absorption headwind in the first quarter of next year as well.

**Julian Mitchell**

*Analyst, Barclays Capital, Inc.*

Q

That's very helpful. Thank you. And then just second question, trying to understand on that HCS side of things. When you're looking at sort of sell-out behavior, yeah, maybe help us understand how you've seen that change in recent months and help us understand, I suppose, how quickly you think you can get back to some kind of volume growth in the coming quarters, assuming inventory reduction takes maybe another six months.

**Alok Maskara**

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

A

Sure. I mean, I will try and tell you, like, things are no longer getting worse. So, let's start with that. I mean, we are now at a stage where we have bounced along the bottom, and I'm starting to see some green shoots and looking at some growth going forward. And that's obviously driven by multiple factors. We have moved from air conditioning to furnace season in many of the areas where the inventory generally was low. So, there's not that much destocking. And also, I think some of the bad news around consumer confidence, tariffs, and all that kind of coming up in the rearview mirror.

So, if you put that all together, we remain confident about growth next year, especially as there's no destocking. I do think it will be about Q2 next year where destocking ends and we start looking at meaningful growth numbers. But net-net, I would expect 2026 to be a growth year for both the segments.

**Julian Mitchell**

*Analyst, Barclays Capital, Inc.*

Q

That's great. Thank you.

**Operator:** Thank you. Our next question will come from Tommy Moll with Stephens. Your line is now open.

**Thomas Allen Moll**

*Analyst, Stephens, Inc.*

Good morning, and thank you for taking my questions.

Q

**Alok Maskara**

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

Morning Tommy.

A

**Thomas Allen Moll**

*Analyst, Stephens, Inc.*

On the fourth quarter outlook, really, the implied outlook you can infer from your guidance for the HCS volumes, is there a finer point you can give us on the direct versus two-step expectations? It's only a quarter, but the comps there are substantially different if we just look at the 4Q performance from last year. Just so we're not surprised, a quarter from now, is there anything you would frame for us in terms of the expectations there?

Q

**Alok Maskara**

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

Tommy, I'll start by saying our forecast in Q2 and expectations did not turn out to be true. So, it's hard for us to, like, give you something with a lot of confidence. We simply took our Q3 direct versus indirect and applied that to Q4. So, we took our Q3 actuals, applied that to Q4, which would mean that obviously the two-step would decline more than one-step. So, that part is going to be true. We do see the parts and accessories growing across both. We're growing more in the two-step than in the one-step. And the one-step where we have higher exposure to residential new construction, that seems to impact us as well because that has remained pretty weak.

A

So net-net, I mean, we essentially took our Q3 performance on one-step versus two-step and applied that to Q4 as the kind of best guess we can have at this point. And so far as we have looked at three weeks of October, I think we are right close to our expectations.

**Thomas Allen Moll**

*Analyst, Stephens, Inc.*

Thank you, Alok. Wanted to follow up with a question on the acquisition. No, you don't want to get too specific on what the accretion might be in 2026. But similar to my last question, just anything you can do to frame the art of the possible or what's reasonable here. Are we thinking low single digits just on a percentage for accretion in 2026? Or is there anything you would do to frame expectations for us?

Q

**Michael Quenzer**

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

Yeah. We're going through doing a lot of the work on the final purchase price allocation. I think that's going to be a – the amortization around that, a big driver for next year. But overall, we do see accretion. I mean, it could be somewhere to the \$0.30 to \$0.40 range. We have some more work to do on it, but it's great business, 25% EBITDA margins before we look at purchase price amortization. So, it should be incremental from an EBITDA margin perspective as well, and definitely on the top line growth accretion as well.

A

**Thomas Allen Moll**

*Analyst, Stephens, Inc.*



Thank you, Michael. I appreciate it. And I'll turn it back.

**Operator:** Thank you. Our next question will come from Chris Snyder with Morgan Stanley. Your line is open.

**Chris Snyder**

*Analyst, Morgan Stanley & Co. LLC*



Thank you. Alok, earlier you were talking about maybe part of the pressure this year is that the dealer's incentives maybe weren't aligned with the OEM incentives, and they were pushing more repair given the supply chain challenges. I guess do you think there is risk into 2026 that these incentives will remain misaligned? Just because as we move through the refrigerant transition and homeowners have to replace both the indoor and the outdoor unit, that delta between the repair and the replace bill is widening, which would just kind of keep that maybe misalignment in place. Thank you.

**Alok Maskara**

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



Thanks, Chris. I think the biggest cause of why our contractors did not push replacement as much as they do normally was the shortage of canisters. They were just not comfortable selling a R-454B unit when they were not sure if they would have a canister and be able to top off the system as required, so they were more willing to do that.

That's firmly behind us at this stage. There is sufficient supply of R-454B canister. So I think with less about incentives, more about just product availability and in some cases just training with like some contractors got trained well earlier or those just delayed their training to a different date and they needed tools and preparedness. So, I think from an incentive perspective, it was less of an issue.

The indoor versus outdoor thing, I mean, that's kind of settled down pretty well. I mean, they've all figured out how to best serve the customer at the lowest cost by being able to use older furnaces and put the sensors like RDS kits in the system. Of course, the coil is almost always replaced with the outdoor unit anyway, so I think that's less of an issue. It's mostly was around part shortage.

**Chris Snyder**

*Analyst, Morgan Stanley & Co. LLC*



Thank you. I appreciate that. And then I guess maybe turning to Q4 and I know this is a very difficult market to forecast, but I guess, it seems like we're effectively calling for unchanged volumes in resi versus comp. That's about 10 percentage points harder in Q4 versus Q3, and the destock doesn't seem to be letting up. It seems to be going into about Q2 of next year. So, obviously better two-year stock in Q4 versus Q3. Are there any positive offsets here that could keep that growth unchanged versus the more difficult comp into Q4? Thank you.

**Alok Maskara**

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



I think from our perspective, putting the destock thing aside, because I think all the OEMs we were caught with, like, greater surprise and the destock was more than we expected, we do see the green shoots, right? I mean, the lower interest rates and the resulting impact on mortgage rates, that's been positive. All the conversations with our customers is more optimistic these days given where the mortgage rates are trending.

We also see, like, homebuilder confidence finally turning the corner. I mean, it's still not great, but it's turning the corner. I expect new home sales to maybe languish, but existing home sales to pick up from next year. So, we see those.

And I think finally when a lot of units got repaired instead of replaced, all they did is tag on a year or two to the life of the unit, and that creates a pent-up demand situation which will start coming loose as well. So, net-net, that's what gives us confidence on 2026 being a growth year despite all the factors that we talked about earlier.

**Chris Snyder**

*Analyst, Morgan Stanley & Co. LLC*

Q

Thank you. I appreciate that.

**Operator:** Thank you. Our next question will come from Noah Kaye with Oppenheimer. Your line is open.

**Noah Kaye**

*Analyst, Oppenheimer & Co., Inc.*

Q

Thanks for taking the questions. I guess on the 2026 early thinking, you highlighted meaningful JV growth from Samsung. Can you dimension what meaningful would look like? Is that 1 point or 2 of growth to top line?

**Alok Maskara**

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

A

As you know, we launched the product this year. We still spend majority of the year selling the old R-410A product, and we were faced with inventory shortages in that. So, this year is going to be sort of neutral compared to the previous year on that category. Over the long term, which we have talked about, I mean I expect that to add like 1 point or so of growth every year for the next multiple years.

And I think 2026 would be the first year where we would have the full portfolio, and then launch it. So, I think that's kind of the range I would look at is 0.5 point to 1 point of growth with Samsung JV. Ariston JV adds value only in 2027 in a meaningful way. But it's going to get some growth next year because that's when the product will be launched.

Michael, what will you add?

**Michael Quenzer**

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

A

Yeah. And I'll just add, within the HCS segment, the ductless product represents about 2% of our sales. If you look to the industry, ductless is closer to 10%. So, we have a multi-year benefit here within the ductless product. And we saw growth in our Samsung product for the first quarter – first time in Q3. So, really pleased with that progress. And the sales force is really pleased with the progress on selling that with the customers really appreciating the brand name.

**Noah Kaye**

*Analyst, Oppenheimer & Co., Inc.*

Q

Thank you both. And then you also indicated rationalizing the low-margin RNC accounts, which seems prudent, but know that it's about typically 25% or so of sales RNC total. Can you help us understand or dimensionalize

what level within that we'll be talking about in terms of a tier of low-margin accounts? Is this, like, the lowest 10% or so? We're just trying to understand what kind of a headwind that could be for next year.

**Alok Maskara**

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

A

Yeah. I think the lowest 10% to 15% is a good way to think about it. I mean, we were overweight on RNC compared to the industry, especially when it came to the one-step model. So, I think, first of all, we don't give up any account easily. We only give up when we feel like we are taping dollar bills to every outgoing box. So, again, those are not easy decisions for us. But I think 10% to 15% of RNC volume over multiple months is the way to think about it.

**Noah Kaye**

*Analyst, Oppenheimer & Co., Inc.*

Q

Over multiple months...

**Alok Maskara**

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

A

All of this would be margin accretive.

**Noah Kaye**

*Analyst, Oppenheimer & Co., Inc.*

Q

Okay. So you said over multiple months or years? I just want to clarify.

**Alok Maskara**

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

A

Multiple months.

**Noah Kaye**

*Analyst, Oppenheimer & Co., Inc.*

Q

Okay. Thank you.

**Operator:** Thank you. Our next question will come from Jeff Sprague with Vertical Research. Your line is open.

**Jeffrey Todd Sprague**

*Analyst, Vertical Research Partners LLC*

Q

Hey. Thank you. Good morning, everyone. Maybe just wanted to come back...

**Alok Maskara**

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

A

Hey, Jeff.

**Jeffrey Todd Sprague**

*Analyst, Vertical Research Partners LLC*

Q

...to channel and inventory maybe one last time. Maybe somebody behind me have another one. But it just looks to me you overproduced in Q3, right? Sounds like it was unintentional. Things kind of really dropped off. But if

you're looking at kind of this hangover lasting into the first half of next year, is there not scope to more severely cut production in Q4 and just clear this up more quickly? Or are you just kind of facing labor retention or other issues that maybe are not popping to mind? But it just seems to me like you could take it down a lot harder in Q4 than what's implied in the guide and just really set up 2026 instead of having this lingering issue through the first half.

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**Alok Maskara**

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

A

Yeah. No, Jeff, it's a good question and good observation. I think the issue is more around the mix of the products because in Q4, as you know, most of our production and sales plans are switching towards furnaces. We ramped up air conditioning back on in Q1 again. So I think we have done balanced job with fairly aggressive actions. I mean, our head count across factories is down by more than 1,000 people.

And if you look at some of the WARN notices, in fact, we have ratcheted back pretty fast. But at the same time, if we go any further, we believe it will crimp our ability to restart production next year. So I think by Q2 and Q1, when we are heavy production month, we'll just go slower at that point. Net-net, by the end of Q2, we'll be back to normal level. So we think that's just a better approach to make sure we don't face challenges that Lennox has faced in the past, where we couldn't ramp up in time.

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**Jeffrey Todd Sprague**

*Analyst, Vertical Research Partners LLC*

Q

Yeah. No, that makes sense. And then, just thinking about your comment about the value tier, I think the value tier has shrunk over the years, right, as the SEER levels have moved up and up and up. But how big is that tier for you now in 2025? Like, how much of your business would you characterize as operating in kind of the lowest possible price point in your portfolio?

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**Alok Maskara**

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

A

So if you think about the overall portfolio, 70% of the business now is what we call the lowest SEER. And that's not the way we think about the value tier though. So value tier would be a – within the lowest tier, what's a, like, value product with no bells and whistle, limited warranty, cages versus casing across on the outdoor units. And I think that's around probably in the 10% to 20% range. And we expect it to remain in that range as like other products with better warranty, better controls continue to be, like, majority of the business. But that business, even taking from 10% to 20%, is a trend that we are prepared for, and we want to make sure we address it appropriately.

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**Jeffrey Todd Sprague**

*Analyst, Vertical Research Partners LLC*

Q

Great. Thank you for the color. Appreciate it.

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**Operator:** Thank you. Our next question will come from Joe Ritchie with Goldman Sachs. Your line is now open.

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**Joe Ritchie**

*Analyst, Goldman Sachs & Co. LLC*

Q

Hey. Good morning, guys.

**Michael Quenzer**

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

A

Good morning.

**Alok Maskara**

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

A

Hi, Joe.

**Joe Ritchie**

*Analyst, Goldman Sachs & Co. LLC*

Q

Yeah. So sorry to disappoint Jeff, but I did want to ask another question on inventories. So just thinking about this, quantifying the fact that your inventories are up roughly \$300 million year-over-year, and the sales growth for the company is going to be, let's just call it, roughly flattish, down modestly, how do I think about, like, what the – what is kind of, like, the right size of inventories heading into 2026?

And then, I guess, really just my follow-on question is more of a clarification for Michael. I heard you say 20% decrements in the fourth quarter. Was that for the entire business? Was that for HCS? And then, how do we think about the decrements in HCS as you're continuing to wind down inventories through the beginning part of next year?

**Michael Quenzer**

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

A

Sure. I'll answer that one first. Yeah, the 20% decremental was the entire business within the fourth quarter. So it's a little bit more of a decremental on the HCS side, mostly because the absorption impact there will be more than the BCS side.

**Alok Maskara**

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

A

Yeah. And I think on the inventory question, first of all, we'll acknowledge that our inventory is higher than where we expected and wanted. So let me just acknowledge that part. If we look at the \$300 million or so number that it came, I think it's about \$150 million to \$200 million is what we want to bring down. The other is a result of just like in our investment, trying to get into emergency replacement, making sure our fill rate is higher. And that's the number we expect to normalize by Q2 next year. So I think you kind of break it up into two-thirds, one-third of the \$300 million number.

**Joe Ritchie**

*Analyst, Goldman Sachs & Co. LLC*

Q

Okay. That's helpful. And I guess just as part of the – it's a multi-part question I asked. I guess, as you're thinking about decremental margins and as you're bringing down your inventory, is there an appropriate way for us to think about that within HCS in the first half of the year?

**Alok Maskara**

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

A

I would say first half, usually, as the opposite has a benefit of production. But at the same time, we are structurally at a lower cost situation because of all the changes we have made. And as we finish Q4 and we come back in

January, we can give you a lot more color at that point with a lot more confidence. Right now, everything has just got too many error bars on any of the numbers I'll give you.

**Joe Ritchie**

*Analyst, Goldman Sachs & Co. LLC*

Okay. Fair enough. Thank you, guys.

Q

**Operator:** Thank you. Our next question will come from Jeff Hammond with KeyBanc Capital Markets. Your line is open.

**Jeffrey D. Hammond**

*Analyst, KeyBanc Capital Markets, Inc.*

Hey. Good morning.

Q

**Alok Maskara**

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

Hi, Jeff.

A

**Jeffrey D. Hammond**

*Analyst, KeyBanc Capital Markets, Inc.*

Hey. Maybe just to start with price, I mean, I think the last five years, the price increases, the levels between COVID regulatory changes have been pretty eye-popping. And now, we're kind of finally seeing this kind of consumer tightening, shift to value, repair-replace. So I'm just wondering, when you think – if at all the industry kind of starts to think about price elasticity more and taking a breather from pricing actions.

Q

**Alok Maskara**

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

Yeah, Jeff. I mean, that's a fair point. If you look at over the past four, five years, if the price from OEM to the channel has gone up 40%, the price from the channel to the consumer, in some cases, has gone up 100% to 200%. So as we look at where the pricing pressure is going to be, it's going to be more between the consumer and the channel, less so between OEM and the channel. And we are seeing consumers getting multiple codes.

A

During COVID, they're very happy. One contractor came in and gave them one code, and they would go with that. Today, consumers are definitely getting more codes than they were getting last year. And often, it's about three codes versus the one code that was referring in COVID. So, I think that's where you're going to see some price adjustments that will need to happen on the installation, on the consumer price. Keep in mind, the OEM price has gone up much, much less than the price that the consumer is paying today.

**Jeffrey D. Hammond**

*Analyst, KeyBanc Capital Markets, Inc.*

Okay. That's helpful. Just on the 2026 moving pieces, I'm just wondering if you can put any kind of quantification or numbers around just the commercial plant getting to full efficiency, all the transition, R-454B transition noise. Like, what is the delta on that? 2025 to 2026 seems like a pretty big tailwind.

Q

**Alok Maskara**

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

A

It is going to be a good tailwind. I mean, first of all, we talked about having \$10 million in productivity from, like, the new soil to your plant and avoid the bad news, and we delivered that. So, I think we are pleased to say that we are on track to deliver that productivity. I think that continues going into next year.

We have to balance it out with any absorption impact, and we'll give you greater color next year. But, I mean, we do historically have always talked about, like, \$20 million to \$30 million in productivity with MCR and other factors. And I think next year is going to look more normal versus the past recent year where there were too many moving pieces.

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**Jeffrey D. Hammond**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Okay. Thanks a lot.

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**Operator:** Thank you. Our next question will come from Deane Dray with RBC Capital Markets. Your line is open.

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**Deane Dray**

*Analyst, RBC Capital Markets LLC*

Q

Thank you. Good morning, everyone.

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**Alok Maskara**

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

A

Hi, Deane.

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**Deane Dray**

*Analyst, RBC Capital Markets LLC*

Q

I was hoping you could help us understand the magnitude of the free cash flow guidance cut. It implies a pretty low 70% conversion. Is this all the destocking, higher finished goods? Is there anything else going on there that you can share?

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**Alok Maskara**

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

A

No. It's all destocking. I think we cut it by about \$150 million compared to the previous number. And that's all finished good inventory, and we expect to recover all of that by Q2 next year. And as you know, I mean, our depreciation has been lower than our CapEx for the past few years, and I think that continues as we have invested more in the business.

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**Deane Dray**

*Analyst, RBC Capital Markets LLC*

Q

Great. I appreciate that. And then on the new factory, you said it's fully operational. So, what kind of efficiencies are you expecting to be realized in 2026? And maybe just kind of give us some examples.

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**Alok Maskara**

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

A

Sure. So, I think there are two specific things that I'll point out to, right? One is, we had start-up inefficiencies all through the first half of this year. We won't have that. So, I think that's part of it, what you're going to see

immediately. They will transfer costs, especially in Q1 of 2025 where we had talked about and we had some moves go wrong. And we had taken some, like, hits to our margin, significant hits to our BCS margin in Q1 because of that.

And then finally, keep in mind that the labor arbitrage that we get by making these products in Saltillo versus making them in Stuttgart, that's going to add to as well. So, one whole bucket start-up inefficiency, and all those is just a labor arbitrage.

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**Michael Quenzer**

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

A

And I'll just add to that. It's taking some pressure off the existing factory at Stuttgart, Arkansas, which is helping drive some efficiencies there as well.

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**Deane Dray**

*Analyst, RBC Capital Markets LLC*

Q

That's real helpful. Thank you.

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**Operator:** Thank you. Our next question will come from Steve Tusa with JPMorgan. Your line is open.

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**C. Stephen Tusa**

*Analyst, JPMorgan Securities LLC*

Q

Hi. Good morning.

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**Michael Quenzer**

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

A

Hi.

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**Alok Maskara**

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

A

Hi, Steve.

---

**C. Stephen Tusa**

*Analyst, JPMorgan Securities LLC*

Q

Can you just maybe help, like, quantify what you think the over-absorption benefit was? I mean, you said you're going to get some under-absorption. But any kind of, like, rough math? I would assume it's in the kind of tens of millions. But there's kind of a wide range on how that calculation can be kind of complex. So, maybe just a bit of help on that front.

---

**Michael Quenzer**

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

A

Yeah. So, within Q3, there really wasn't absorption kind of benefit or hit. It's the fourth quarter where we're going to see an impact. And if you think about our cost of goods sold, about 15% to 20% of our cost of goods sold are factory costs. So, you can kind of do some math there to figure out depending on how much we're going to reduce down the factory to normalize some inventory. It will have an impact within the fourth quarter.

**C. Stephen Tusa**

*Analyst, JPMorgan Securities LLC*

Q

Okay. But I mean, you don't get a benefit from kind of over-producing though and putting that cost in the inventory?

**Alok Maskara**

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

A

No. I think in the beginning of Q3, we had higher production, and we did ramp it down substantially towards this second half of Q3. So, I think Q3, I would call it neutral. Q4 is when we'd see the full hit.

**Michael Quenzer**

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

A

I mean, most of the inventory growth was by the second quarter.

**C. Stephen Tusa**

*Analyst, JPMorgan Securities LLC*

Q

Oh, okay. That makes sense. Are you guys seeing any in the channel? I mean, there are some online pricing stats that look relatively weak. I mean, are you seeing real anybody kind of get out of line from a price competition perspective here? I mean, you guys are not chasing the low-margin RNC business, I guess. Anywhere else where you're seeing competitors try and pick away from a market share perspective?

**Alok Maskara**

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

A

I mean, the industry remains competitive. I mean, we see account by account battle everywhere. But in general, all OEMs have maintained the pricing that we got through A2L pricing due to tariff, and we think that continue. A lot of the online and skirmishes are all again between the contractor and the consumer, less so between the OEM and the contractor. So, no change in any behavior that we can call out besides the low-margin RNC business that I called out earlier.

**C. Stephen Tusa**

*Analyst, JPMorgan Securities LLC*

Q

Okay. Great. Thanks a lot for the color, as always. Appreciate it.

**Alok Maskara**

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

A

Thanks.

**Operator:** Thank you. Our next question comes from Brett Linzey with Mizuho. Your line is open.

**Brett Linzey**

*Analyst, Mizuho Securities USA LLC*

Q

Hey. Good morning. Thanks. Wanted to follow up on free cash flow. Obviously, a lot of moving pieces this year with the regulatory transition and the ramp on emergency. But it sounds like that normalizes next year. But you also do have potentially some load-in from NSI as you move through the one-step. So, hoping you could maybe frame some of those moving pieces into next year and what the conversion could look like.

**Alok Maskara**

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

A

Yeah. We expect good conversion next year. I mean, NSI, we'll sort of clearly call out. But NSI, we are getting it at a fairly healthy or even better than healthy level of inventory. So, I don't expect any specifically lowered-in impact of NSI. If anything, I think once we get through all the accounting and intangible amortization and inventory step up, I expect NSI to convert free cash at a pretty high level. So, I think the biggest impact would be reduction in finished goods inventory level. So, whatever we reduced this year would be a gain next year.

**Brett Linzey**

*Analyst, Mizuho Securities USA LLC*

Q

Understood. Just one more on resi, and I'm looking to maybe drill down on the magnitude and the scope of the consumer trade-down. And I guess in the context of regional variances, is there any correlation to regions that maybe had cooler weather conditions as a determinant for the repair decision? Or was it, it's fairly broad-based on this trade-down that we're seeing?

**Alok Maskara**

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

A

We saw more of that in the Northeast. And I'm not sure if it's related to the weather pattern. I think it's probably more related to just different states of the economy. We don't see as much of that in the Southern states because that's where, I mean, air conditioning is just super important. And people know that this thing will break versus in other areas. They might look at that. So, I won't say there's specific regional trend.

Also, I mean, as you know, all of this is a bit of a guesswork. And based on anecdotal data, there's no scientific data that's available. But what we have seen is increase in spare parts sales, increase in our coil sales, which is typically used for replacement, and I think that's how we put this, like, hypothesis together. We do think a lot of that turns around next year when the canister availability is no longer an issue, our contractors are fully trained on R-454B, and I think with lower interest and consumer confidence will also help.

**Brett Linzey**

*Analyst, Mizuho Securities USA LLC*

Q

I appreciate the detail.

**Operator:** Thank you for joining us today. Since there are no further questions, this concludes Lennox 2025 third quarter conference call. You may disconnect your lines at this time.

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