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LII.N - Q4 2020 Lennox International Inc Earnings Call

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OVERVIEW:

Co. reported full-year 2020 revenue of $3.63b, GAAP operating income of $479m and GAAP diluted EPS from continuing operations of $9.26. Also reported 4Q20 revenue of $914m, GAAP operating income of $139m and GAAP diluted EPS from continuing operations of $2.91. Expects full-year 2021 revenue growth to be 4-8% and GAAP and adjusted EPS from continuing operations to be $10.55-11.15.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Lennox International Fourth Quarter Earnings Conference Call. (Operator Instructions) As a reminder, this call is being recorded.

I would now like to turn the conference over to Mr. Steve Harrison, Vice President of Investor Relations. Please go ahead.

Steve L. Harrison - *Lennox International Inc. - VP of IR*

Good morning. Thank you for joining us for this review of Lennox International's financial performance for the fourth quarter and full year of 2020.

I'm here today with Chairman and CEO, Todd Bluedorn; and CFO, Joe Reitmeier. Todd will review key points for the quarter, and Joe will take you through the company's financial performance for the quarter and year as well as the outlook for 2021. (Operator Instructions)

In the earnings release we issued this morning, we have included the necessary reconciliation of the non-GAAP financial measures that will be discussed to GAAP measures. All comparisons mentioned today are against the prior year period. You can find a direct link to the webcast of today's conference call on our website at www.lennoxinternational.com. The webcast will be archived on the site for replay.

We'd like to remind everyone that in the course of this call to give you a better understanding of our operations, we will be making certain forward-looking statements. These statements are subject to numerous risks and uncertainties that could cause actual results to differ materially from such statements. For information concerning these risks and uncertainties, see Lennox International's publicly available filings with the SEC. The company disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise.

Now let me turn the call over to Chairman and CEO, Todd Bluedorn.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Thanks, Steve. Good morning, and thank -- everyone, and thank you for joining us. In the fourth quarter, we continue to see strong momentum in our residential business and year-over-year improvement in commercial and refrigeration. Overall, for the company, revenue was up 3% and hit a new fourth quarter high of $914 million.

GAAP operating income was $139 million compared to $192 million in the prior year quarter that included $93 million net gain from insurance recoveries. GAAP EPS from continuing operations was $2.91 compared to $2.92 in the prior year quarter that included $93 million in insurance benefit, I mentioned, and a $39 million pretax pension settlement.

In addition to record fourth quarter revenue, the company set new fourth quarter highs for total segment profit and margin and adjusted EPS from continuing operations. As reported, total segment profit was a fourth quarter record, $139 million, up 5% from the prior year quarter that included $25 million of insurance recovery. Total segment margin was a fourth quarter record 15.2%, up 10 basis points. Adjusted EPS from continuing operations rose 18% to a fourth quarter record of $2.89.

From an operating perspective, excluding the $25 million of insurance benefit in the prior year quarter, total segment profit was up 29%, and segment margin expanded 300 basis points.

Looking at our business segments for the fourth quarter. Residential set new fourth quarter records for revenue, profit and margin. Residential revenue was up 11% on double-digit growth in both replacement and new construction business. Residential indoor air quality revenue was up more than 30% in the quarter. Segment profit rose 18%, and segment margin expanded 130 basis points to 20.9%. From an operational perspective, adjusting for the $25 million of insurance benefit in the prior year quarter, residential profit rose 58% and margin expanded 630 basis points.

In commercial, fourth quarter revenue was down 13%, and profit was down 11%. Segment margin expanded 40 basis points to a fourth quarter record, 19.4%.

We continue to see year-over-year improvement in the business in both replacement and new construction as well as in national accounts in the regional and local business. Commercial Equipment revenue overall was down mid-teens in the quarter. Within this, replacement revenue was down low single digits at constant currency with planned replacement down high single digits and emergency replacement, up low double digits. New construction revenue was down mid-20s percentage.

Breaking out revenue another way, regional and local business revenue was down low double digits. National accounts equipment revenue was down mid-teens. On the service side, Lennox National Account Services revenue was down high single digits.

Some highlights to mention for commercial. Our team added 6 new national account equipment customers in the quarter to bring the total to 32 for the year. Though small today, we are seeing fast indoor air quality revenue growth led by our new Building Better Air initiative. And in the first quarter, we are on track with the launch of our new Model L rooftop unit as we continue to lead the field in energy efficiency. The Model L features variable speed technology and an all-new advanced control system. We are seeing high customer interest in this industry-leading product for 2021.

Overall, commercial backlog is up double digits. In refrigeration for the fourth quarter, revenue was up 7% as reported, and up 3% at constant currency. North America revenue was up low single digits. Europe refrigeration revenue was up mid-single digits as reported and low single digits at constant currency.

In Europe, HVAC revenue was up mid-teens as reported and up high single digits at constant currency. Refrigeration segment profit declined 28%, and margin contracted to -- 360 basis points to 7.5% on the timing of expenses in the quarter and unfavorable mix with the strong growth in Europe HVAC.

Currently, refrigeration backlog is up double digits, led by North America, and we are seeing strong order flow. We expect segment margin to be up year-over-year starting in the first quarter and be up for the full year in 2021.

For the company overall in 2021, we are reiterating guidance. We expect revenue growth of 4% to 8% this year and GAAP and adjusted EPS from continuing operations of $10.55 to $11.15 for the full year. While there's an economic and market uncertainty, momentum continues for the company, and we are well positioned for a year of strong growth and profitability. Given the outlook and the company's strong balance sheet and cash generation, we are restarting our stock purchase program in 2021 and plan to buy back $400 million this year.

I'll now turn it over to Joe.

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

Thank you, Todd, and good morning, everyone. Let me start with a quick summary of our full year 2020 for the company and then the financial details on the business segments for the quarter and full year.

Overall for the company, revenue for 2020 was $3.63 billion, down 5% on a GAAP basis and down 4% on an adjusted basis, excluding the impact from the divestitures in the prior year. Foreign exchange was neutral to revenue. GAAP operating income was $479 million compared to $657 million in the prior year that included a $179 million net gain from insurance recoveries. GAAP EPS from continuing operations was $9.26 compared to $10.38 in the prior year that included the $179 million insurance benefit and $99 million in pretax pension settlements.

Total adjusted segment profit for the full year was $507 million compared to $610 million in the prior year that included a $99 million of insurance recovery. Total adjusted segment margin was 13.9% for the year compared to 16.2% in the prior year with the insurance benefit.

Adjusted EPS from continuing operations was $9.94 compared to $11.19 in the prior year with the insurance benefit and pension settlements. From an operational perspective, excluding the $99 million of insurance benefit in the prior year, total segment profit was down 1%, and total segment margin was up 40 basis points.

Now turning to the business segments for the quarter and the year. In the fourth quarter, revenue from Residential Heating & Cooling was a fourth quarter record $553 million, up 11%. Volume was up 10%, price was up 1% and mix was flat with foreign exchange neutral to revenue. Residential profit was a fourth quarter record $116 million, up 18%. Segment margin was a fourth quarter record 20.9%, up 130 basis points.

And as Todd mentioned, operationally, profit was up 58% and margin expanded 630 basis points. Segment profit was primarily impacted by higher volume, favorable price, lower material and other product costs, higher factory productivity and lower SG&A. Partial offsets included $25 million of nonrecurring insurance proceeds in the prior year quarter, the COVID-19 pandemic and higher tariffs, freight, distribution and warranty.

For the full year, residential segment revenue was a record $2.36 billion, up 3%. Volume was up 2%. Combined price and mix was up 1%, with both up. Foreign exchange was neutral to revenue. Residential profit was $429 million, down 8% from the prior year that had the $99 million of insurance recovery. Segment margin was 18.1%, down 220 basis points as reported. Operationally, excluding the insurance recovery in the prior year, segment profit was up 17% and margin expanded 210 basis points.

Now turning to our Commercial Heating & Cooling business. In the fourth quarter, commercial revenue was $226 million, down 13%, volume was down 8%, price was flat and mix was down 5%. Foreign exchange was neutral to revenue. Commercial segment profit was $44 million, down 11%. Segment margin was a fourth quarter record 19.4%, up 40 basis points.

Segment profit was primarily impacted by the COVID-19 pandemic, lower volume, unfavorable mix and higher freight, distribution and SG&A. Partial offsets included lower material and other product costs, higher factory productivity, lower warranty and tariff exclusions and refunds due to exclusions. For the full year, commercial revenue was $801 million, down 15%. Volume was down 14%. Price was flat and mix was down 1%. Foreign exchange was neutral to revenue. Segment profit was $137 million, down 17%. Segment margin was 17.1%, down 40 basis points.

In refrigeration, revenue was $135 million, up 7%. Volume was up 3%, price was up 1% and mix was down 1%, and foreign exchange had a favorable 4% impact on revenue. Refrigeration segment profit was $10 million in the fourth quarter, down 28%. Segment margin was 7.5%, down 360 basis

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points. Segment profit was primarily impacted by the COVID-19 pandemic, unfavorable mix, higher distribution, warranty and other product costs, and the timing of SG&A expenses. Partial offsets included higher volume, favorable price and lower material costs.

For the full year, refrigeration revenue was $472 million, down 12%. Volume was down 14%, price was up 1% and mix was flat. Foreign exchange had a favorable 1% impact. Segment profit was $33 million, down 47% and segment profit margin was 7%, down 470 basis points.

Regarding special items in the fourth quarter, the company had net after-tax gain of $800,000 that included a net gain of $3.4 million for insurance recoveries related to damage at the company's manufacturing facility in Iowa, a benefit of $2.3 million related to environmental liabilities, a benefit of $1.5 million for excess tax benefits from share-based compensation. For charges, we had $2.7 million for asbestos-related litigation, $1.5 million for special product quality adjustments, $1.4 million for personal protective equipment and facility deep cleaning expenses incurred due to the COVID-19 pandemic and a net change -- charge of $800,000 in total for various other items.

Now looking at special items for the full year. The company had net after-tax charges of $26 million, and they included: a charge of $8.5 million for other tax items; $8.4 million for restructuring activities; $6.2 million for personal protective equipment and facility deep cleaning expenses incurred due to the COVID-19 pandemic; $4.2 million for asbestos-related litigation; a net loss of $2.3 million related to damage to the company's manufacturing facility in Iowa; a net charge of $600,000 in total for various other items; and a benefit of $4.2 million for excess tax benefits from share-based compensation.

Corporate expenses were $30 million in the fourth quarter and $92 million for the full year. Overall, SG&A was $143 million for the fourth quarter or 15.7% of revenue, down from 16.3% in the prior year quarter. For 2020, overall, SG&A was $556 million or 15.3% of revenue, down from 15.4% on an adjusted basis in the prior year.

For 2020, the company had cash from operations of $612 million compared to $396 million in the prior year. Capital expenditures were approximately $78 million for the full year compared to $106 million in the prior year, and proceeds for damage to property and disposal of property were $1 million compared to $81 million in the prior year.

Free cash flow was $535 million for the year compared to $371 million in the prior year. In 2020, the company paid $118 million in stock -- in dividends and repurchased $100 million of company stock. Total debt was $981 million at the end of the fourth quarter, and we ended the year with a debt-to-EBITDA ratio of 1.7, and cash and cash equivalents were $124 million at the end of the year.

Now before I turn it over to Q&A, I'll review our outlook for 2021. Our underlying market assumptions for the year remain the same. We expect industry to see mid-single-digit shipments growth in residential, commercial unitary and refrigeration markets in North America. The company's guidance for 2021 remains the same as we presented at the December investment community meeting. Our guidance for 2021 revenue growth is 4% to 8% with neutral foreign exchange impact. We still expect GAAP and adjusted EPS from continuing operations in a range of $10.55 to $11.15, with about half of the earnings in the first half of the year and half in the second half of the year.

Let me now run through other key points in our guidance assumptions and the puts and takes for 2021, all of which are unchanged. We expect a benefit of $50 million in price for the year. We expect a benefit of $25 million from sourcing and engineering-led cost reductions and a $20 million benefit from factory productivity. We are guiding for residential mix to be neutral and we anticipate that foreign exchange will be neutral as well.

For the headwinds in 2021, we expect a $30 million headwind from commodities. Freight is expected to be a $1 million headwind. We will be at more -- at a more normal run rate with distribution investments this year with 30 new Lennox stores planned. Tariffs are expected to be a $5 million headwind. We are planning for SG&A to be up approximately 7% for the year or a headwind of about $45 million. Within SG&A, we will be making investments in R&D and IT for continued innovation and leadership in products, controls, e-commerce, factory automation and productivity.

A few other guidance points. Corporate expenses are targeted at $90 million. Net interest and pension expense is expected to be approximately $35 million. We expect an effective tax rate of approximately 21% on an adjusted basis for the full year. We are planning capital expenditures to be approximately $135 million this year, about $30 million of which are for the third plant at our campus in Mexico. We expect construction to be completed by the end of 2021 and have the plant fully operational by mid-2022.

We expect nearly $10 million in annual savings from the third plant. Free cash flow is targeted at $325 million as we reinflate working capital to support strong growth. And over the long term, we expect free cash flow to approximate net income on average. And finally, we expect the weighted average diluted share count for the full year to be between 37 million to 38 million shares, which incorporates our plans to repurchase $400 million of stock this year.

And with that, John, let's now go to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And first from the line of Jeff Hammond with KeyBanc.

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

Just I want to understand on resi margins, just the strength there. I mean it was considerably higher, and just what were the big drivers? And if there was any real impact as you kind of produce more to kind of restock and if that continues into 1Q?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. I mean, I read your pre-note. Yes, the short answer is there was some benefit from absorption as we continue to produce in fourth quarter for the demand rolling into 2021. But even more important than that, as the drivers of the margin were the aggressive SG&A cost that the team took out early in the year. We haven't added back a lot of them and so we had great SG&A leverage. Also, we had very strong quarter material costs. And just in the factories themselves, even above absorption, some of the productivity initiatives really kicked in second half of the year, and we saw the benefit. So absorption helped and it will help, as you suggest, as we roll into next year. But there were benefits across -- there was strong performance across the board in resi.

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

Okay. And then maybe switching over to commercial. Can you just -- did book-to-bill -- was book-to-bill positive in 4Q? Did you see order acceleration? When do you think that backlog starts to flow out in sales growth?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

We're seeing sales growth in first quarter so far. I mean, it's starting to accelerate in the first quarter. Orders have taken a bit of a pause during the first 3 weeks in January, which I think is normal as you go into a new year, that's not unusual for us. And I think there's a little bit of uncertainty out there in the commercial marketplace. But we're set up for a nice quarter in Q1 and the backlog is starting to build for the -- for second quarter and balance of the year.

Operator

Next, we'll go to Julian Mitchell with Barclays.

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

Just a first question on the incremental margins. So just wanted to sort of check on your conviction in being able to get that 30% incremental for the year across the company. And any segment color you could provide, I suppose, particularly in refrigeration, how should we think about operating leverage there this year?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

The good news -- for anyone who's ever worked in a large corporation, the good news after having a tough year is that next year you have great comps. And I think that's true on the refrigeration business. So I think we'll have positive news in refrigeration. Overall, for the corporation, we guided 30% incrementals. We're still feeling pretty good about that. We're going to have price of $50 million that will offset the commodity headwind of $30 million, freight and tariff headwind each of $5 million. So $40 million of costs in those 3 buckets offset with price and the MCR and additional volume.

So as we talked about in December, we feel pretty good about the 30% incremental.

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

And then maybe just following up on the commercial side. If you could just give any color around sort of different verticals that you're seeing, any update as well on the sort of competitive landscape in commercial? And how quickly we can expect revenue to turn positive? Is it Q2 or perhaps earlier in terms of year-on-year?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. I understand. I'm not going to answer that last part. We said we have double-digit backlog going into the year. Where we saw the pickup in order rates in fourth quarter were in planned replacement as large national account customers got more comfortable on placing orders. And I also think some of them had capital at the end of the year that they didn't spend because of uncertainty earlier in the year. And so we had -- we didn't deliver those units, but we booked those business and that will flow into the first half of this year.

Emergency replacement was up in fourth quarter, so that continues to flow. I think the area that's weakest right now, quite frankly, continues weak is commercial new construction given the uncertainty that still exists around the recovery from COVID.

Operator

Next, we'll go to John Walsh with Crédit Suisse.

John Fred Walsh - *Crédit Suisse AG, Research Division - Director*

Question around your opportunity as you see it in the K-12 vertical. We're starting to hear people talk about some of these executive actions that President Biden took trying to get students and teachers back into schools healthily and quickly in his first 100 days. Are you seeing any of that in your commercial business?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Schools tend to move relatively slow. So from the time there's sort of a mandate on top until -- the time that you see the revenue flow-through the business takes time. We have a very strong K-12 program, if you will. We have dedicated salespeople just for that vertical. Our indoor air quality product serves that market, our high-efficiency product serves that market. So we're in lots of dialogues with people, but I don't think there's been a light switch turned on, on that market.

John Fred Walsh - *Crédit Suisse AG, Research Division - Director*

Got you. And then, I guess, maybe not necessarily surprising a bunch of the detailed items in the guidance walk didn't change. But I guess I'm a little bit surprised on the commodity costs still in line with the December outlook, given the move in steel. Maybe you could just remind us, I know you have a hedging program on copper. I thought you bought a little bit more spot steel, but maybe can you just help us understand that a little bit better?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Well, I'll give you the specific answer, and then I'll directly answer the broader question of why it didn't change. Narrowly, we buy steel a couple of different ways. We have some fixed contracts. We have some contracts that are tied to scrap. And the majority of it is we buy from the mills based on CRU pricing in the prior quarter. When you -- so when we're "predicting" copper and aluminum, we have a large hedge already in our books. And so we have a pretty good view of what we're going to have. For steel, we have to sort of predict what's going to happen. And the honest answer is in December, we were depending, I guess, what side of the trade you were on, either the bearish or bullish, but we assume steel is going to go up, and we rolled that into our guide. And so it's plus or minus commodities is still a $30 million headwind.

Operator

Our next question is from Gautam Khanna with Cowen.

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

I was curious, just can you speak to any changes in the competitive dynamics? We'd heard that Daiken's Goodman facility was hit with some COVID outbreaks, and then you saw kind of the big channel refill in resi in Q4. And I'm just curious, like any sort of things to think about year-over-year as we kind of comp the weirdness of 2020 in resi competitively?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. I mean I think the most important thing is what I spent a ton of time talking about in December, which is the broader your -- the larger your independent distribution network is, the more our belief is that you pulled volume from 2021 into 2020. And that distributors not only were reloading for inventory that was down, but sort of the scarcity mindset was taking over and they were trying to make sure they had lots of inventory in case OEMs ran into production issues.

And so our sense is people with independent distribution have inflated sales numbers in fourth quarter and that will bleed off as you go through the year compared to us, which is we delivered in resi up 11% overall. And that we think -- in fact, we know in our Lennox business, which is 80% of our residential, we see demand when the customer is buying the unit to a vast large degree.

So I think that's the one thing to model for. And as we talked about with us narrowly that sort of the timing of EPS or earnings is a little bit different than normal, that we expect about half of our EPS to come in first half and about half of the EPS in the second half, which is a little different weighting than what we've had in the past.

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

That's helpful. And Todd, maybe I know you used to work at Carrier. I'm just curious have you seen any change in their behavior competitively now that it's an independent company, anything you can speak to just based on your…

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

No. I think the short answer is no. Carrier has always been a very good competitor, and they -- publicly different things happen and they say different things on the earnings call. But on the ground, it's the same tried-and-true sales force and strong dealer network, and they've always had good product, and they haven't changed their pricing strategy.

They haven't changed, I don't think, how they buy components and commodities, their sourcing strategies. So we -- and they haven't changed their distribution strategy. So from where we sit, it's very similar to what we've seen in the past.

Operator

Next, we'll go to Nicole DeBlase with Deutsche Bank.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

So the commentary around the first half versus second half split is definitely helpful. But Todd, anything you want to say about calibrating expectations for 1Q based on what you guys have seen like into January?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

I'll answer the question obliquely. In residential, we continue to see strong momentum in commercial and refrigeration. As I talked about, backlogs are up double digits as we ended the year. And so we're hitting first quarter at a pretty stiff pace, and we'll see how the balance of the quarter goes, but we feel pretty good as we start the year.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. Got it. And then on the seasonality of free cash flow, how do we think about the quarters in 2021 relative to what you normally see? Just thinking about how the cadence of working capital use could look throughout the year?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

I think it will be more of a normal year where we'll sort of peak in working capital early and then burn it off second half of the year, where 2020 was abnormal that we never sort of reloaded on working capital second half and sort of we outperformed on free cash flow. I think it will be more of a traditional year. And again, just to connect some of the dots, I'll take your question and expand on areas that I want to talk about, maybe, Nicole, that you didn't directly ask. But I would just sort of underline the free cash flow of $535 million in 2020, which is a record. We're guiding for $325 million next year. Over the 2-year period, it's about 110% of net income. So 2020 added to 2021 over the 2-year period, 110% of our adjusted net income, which is a pretty strong performance in cash flow over a couple year period.

Operator

And we'll go to Nigel Coe with Wolfe Research.

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

So we had a pretty thorough discussion on '21 back in December. So just not so much from me, but I'm curious, the 10% volume growth in residential during 4Q, how did that look by brands, Allied versus Lennox brands?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. Overall, we're up 11%. Our Lennox was up high single digits and our Allied grew mid-20s. And so what we saw in our business is what we've been saying others are seeing, which is our independent distribution business. Allied grew much stronger than our Lennox business, but not because they're winning share, just we have distributors who are reloading. And quite frankly, with a scarcity mindset trying to pull some volume in.

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

The HARDI data -- I mean, I'm not sure how accurate that actually is, but the HARDI data showed a big pickup in shipper shipments in December. But I'm curious if you saw the same pattern in your Lennox brands in terms of the sell-through to dealers. It makes sense from a weather perspective. I'm just curious what you saw.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

No. I mean, we didn't -- I mean, just from a weather perspective, it wasn't so cold in January this year versus last -- or excuse me, December this year versus last year. We saw some pick up in December, but not near the HARDI data. Again, I think you're right that the HARDI data in any given month is suspect. I think directionally over a 12-month rolling data, sort of gives you the right area for the number, but I think in any given month, it could be a little misleading.

Operator

And next, we'll go to Steve Tusa with JPMorgan.

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

Can you just maybe clarify the margin kind of color on resi, I think, to Julian's question. You mentioned refrigeration would be good. I just didn't catch what you said on resi specifically?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

I'd reframe the question. I'm not sure he asked me a question on residential margins.

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

Sorry, I thought he asked about residential margins. You had said overall guide 30% incrementals and positive -- refrigeration would be pretty positive. So what's kind of the -- what's the resi kind of view?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. I think on the round, they're all plus or minus 30%. So from a resi viewpoint, 30%, commercial 30% and refrigeration, I was -- could probably be a little bit higher, but that's such a small part of our business. The other 2 will drive it and then what we do in corporate expenses.

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

Got it. And then just lastly, kind of looking out over the next couple of years. I know there's another efficiency regulation coming in. Is there any kind of change to your approach on product development beyond '22? Do you see the industry shifting more towards these kind of hybrid ductless products with the inverters in them beyond that with this new step-up in cost on this efficiency regulation? And are you guys -- what are you doing to kind of address that vertical, that kind of hybrid ductless inverter-based product vertical?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. I mean, the hybrid ductless, again, we can develop whatever product we want, but 80% of the product's replacement. And the ducts are already in the home. And so the lowest cost solution for the 80% that's out on replacement is our ducted systems. We are coming out with a 28 SEER unit in first quarter that we talked about. We think we have as good or better variable speed technology with our compression partners. And so we think we're playing right in the sweet spot, which is to have the lowest cost point to have the highest efficiency in the marketplace. And we think with our compression technology, our coil strategy and our Mexican assembly facility, we're able to do that.

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

Got it. And when you look out to the next couple of years, I mean, do you expect prebuy in '22? What's kind of your -- what's your latest and greatest on kind of the multiyear view?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

I don't think there'll be a prebuy in any meaningful way. Again, it always comes down to the fine-tuning of the actual details, how it's implemented. But the last time we did this, which was a more normal way to do it, you had sort of months to prepare and get it correct. And you don't have this huge step function change like we did back in -- or the industry had back in 2006, 2007. So I think there may be a bit of prebuy, but not like there's been in the past.

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

Got it. So there won't be that much of a change in competitive landscape coming away from this in your mind?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

No. And again, it's -- when we went from 10% to 13%, or the industry -- I wasn't here, but we went from 10% to 13% that -- and it had been the first major jump in a while. That really screwed up the premium competitors in retrospect. And the big winner was Goodman because all of a sudden, differentiation got collapsed.

One, I think everybody has understood that. And so one of the reasons we come out with 28 SEER in 2021 is to prepare to sort of have the high end stretched out for when we have to make the transition. And then the other is, it's a much smaller bite. When you're going from 14% to 15%, that's much different than going from 10% to 13% as a percentage, obviously. And so you just don't have this huge cost shock to the system and size shock to the system with the big units back in 2006, 2007.

So I view it as sort of not quite ho-hum, but pretty close to ho-hum. And then the other thing that's on the horizon in residential regulatory wise is change in refrigerants to lower greenhouse gas emissions. And with the current administration, it looks like it's going to be national rather than just in a few states. And again, we'll be prepared for that as I think the rest of the industry will do.

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

But that California reg was pushed, right, more or less?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

California reg was pushed, but it looks like it's going to -- the Biden administration, our best understanding is it will drive it as a national implementation, just not [Carrollton].

Operator

Our next question is from Joe Ritchie with Goldman Sachs.

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

Maybe just starting off on refrigeration margins. I know you mentioned there were some mix issues in the quarter and some step-up in SG&A. Can you guys just maybe parse that out a little further and help quantify some of the impacts this quarter?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. I mean, the 2 I gave you were sort of -- or the 2 you rattled off were the 2 big drivers. It was the fact that we were up in HVAC in Europe and down in our North America refrigeration business had a significant impact on the margins. And then the other piece was just the timing of costs and getting into the accounting sort of accrual adjustments and sort of year-over-year differences and fourth quarter took a hit compared to fourth quarter last year. I think I mentioned in the script, we expect to have margins up in Q1 in refrigeration and for them to be up full year.

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

Got it. Todd, as you maybe take a look at your backlog in refrigeration. And it sounds to me like there's going to be a mix benefit then in 2021. Are you seeing the North America piece of your business growing a lot quicker than Europe at this point?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. Yes.

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

Okay. Cool. And then my just -- my one follow-up question, going back to commercial for a second. On planned replacement, I'm just curious, it seemed like you saw an uptick there in the quarter. I'm just curious, I guess, in terms of like getting on-premise access for your services, like how do things compare today with coronavirus cases surging versus what we saw maybe earlier in 2020?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Can you -- you broke up a little bit or I didn't hear. Can you ask the question one more time?

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

Oh, sure. No problem. Sorry about that. So the question is really just around getting on-premise access to do your planned replacements today versus what you thought a few months ago.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

We have no issue. We're able to get on the job site, do what we need to do. Our guys are mashed up and commercial customers have no issue to [come in].

Operator

And with no further questions in queue, I'll turn it over to you, Mr. Bluedorn, for any closing comments.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Thanks, everyone. To wrap up, as I mentioned in Q&A and during the script, momentum continues in the first quarter and 2021 is off to a nice start.

Lennox team is executing well to capitalize on market growth and share gains, and we look forward to a year of strong growth and profitability. Thanks again for everyone for joining us today.

Operator

Ladies and gentlemen, that does conclude your conference. Thank you for your participation. You may now disconnect.
