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Lennox International, Inc. (LII)

Q2 2025 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Lennox Second Quarter Earnings Conference Call. All lines are currently in listen-only mode and there will be a question-and-answer session at the end of the presentation. [Operator Instructions] As a reminder, this call is being recorded. I would now like to turn the call over to Chelsey Pulcheon from Lennox Investor Relations. Chelsey? Please go ahead.

Chelsey Pulcheon

Director-Investor Relations, Lennox International, Inc.

Thank you, Margo. Good morning, everyone, and thank you for joining us as we share our 2025 Second Quarter Results. Joining me today is CEO, Alok Maskara; and CFO, Michael Quenzer. Each will share their prepared remarks before we move into 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. Now please turn to slide 3, as I turn the call over to our CEO, Alok Maskara.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Thank you, Chelsey. Good morning, everyone. Let me begin today's call by highlighting the impressive results we achieved in Q2, results that reflect our team's strategic focus and resilience. In the face of a challenging external environment, both segments delivered revenue growth and margin expansion. This performance was fueled by our continued emphasis on cost discipline, elevating the customer experience, and enhancing our go-to-market differentiation. As we build on this momentum, I want to express my sincere gratitude to our employees for their dedication and to our loyal customers for their continued trust and partnership.

Let us turn to slide 3 for an overview of our second quarter financials. Revenue this quarter grew 3%. Our segment margin was a record 23.6%, an increase of 170 basis points. Operating cash flow was \$87 million. Adjusted earnings per share in the second quarter was \$7.82. Our team is performing well despite ongoing challenges, including softness in new construction demand, industry refrigerant canister shortages, customer uncertainty and inflationary pressures. In HCS, profitability remained strong, as we transitioned into selling primarily our R-454B products. Destocking in Q2 was largely in line with expectation, though we anticipate some spillover into Q3, as industry lead times continue to normalize. While residential new construction remains subdued, the HCS segment continues to perform well given the broader market conditions.

In BCS, factory productivity has improved, helping to mitigate inflationary pressures. Emergency replacement wins have partially offset end markets that have been weaker than we anticipated. In addition, growth from our full lifecycle strategy has delivered year-over-year revenue growth and margin expansion. We are raising our full year outlook to reflect our consistent execution in a challenging environment and continued progress on our growth initiatives. We now expect adjusted earnings per share in the range of \$23.25 to \$24.25, and revenue growth of approximately 3%.

Now, let us move to slide 4 for a brief look at how we expanding our portfolio and the value we bring to our customers through joint ventures with leading global partners. As we continue to execute our transformation plan, we are taking a deliberate approach to building long-term value through strategic partnerships that strengthen our heat pump portfolio and enhance customer experience. Our joint ventures with Samsung and Ariston are clear examples of this strategy in action. These partnerships allow us to offer a broader range of products that our customers are already installing, making it easier for them to do more business with us.

With 75% of our dealers already selling mini-splits and 50% offering water heaters, these additions are a natural fit that will provide one-stop shopping convenience to all our customers. These joint ventures position us well for future growth. Samsung brings advanced technology, SmartThings integration, and strong brand recognition that will enhance our portfolio in both HCS and BCS through ductless mini-splits and VRF products. Ariston contributes deep expertise in global heat pump water heating, and our North American joint venture strengthens the position of both companies during the ongoing convergence of HVAC and water heating trades. These partnerships align with the growth acceleration phase of our transformation strategy and establish the foundation for the expansion phase. We expect Samsung to begin contributing meaningfully to growth in 2026, followed by Ariston in 2027.

Now, let me hand over the call to Michael, who will take us through the details of the Q2 financial results.

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 second quarter, we operated in a challenging environment shaped by persistent inflationary pressures, industrywide destocking of R-410A equipment and a continued transition to the low GWP R-454B products. Despite these dynamics, our team delivered record results with a 3% increase in revenue and 11% growth in segment profit. A key driver of this performance was the successful introduction of our new low GWP R-454B products. These enhanced products will replace approximately 70% of our Home Comfort Solutions product portfolio and 40% of our Building Climate Solutions portfolio. During the quarter, approximately 90% of our refrigerant-based product sales contained the new R-454B refrigerant, driving favorable product mix and contributing meaningfully to both top line and profit growth.

Let's now turn to slide 6 to review the performance of our Home Comfort Solutions segment. Home Comfort Solutions delivered strong financial results this quarter despite softness and sales volumes. Revenue increased 3%, driven by favorable product mix and pricing, which rose by 12% as these initiatives reached full effectiveness. As anticipated, sales volumes declined, mainly because contractors and distributors are still selling through their R-410A inventory. The slowdown was also influenced by continued softness in residential new construction and industrywide shortages of R-454B canisters, which are required for many new system installations. These shortages may have led to an increase in system repairs instead.

On the cost side, inflationary pressures on materials and components persisted, however we successfully offset part of these impacts through effective tariff mitigation and improved factory productivity. Distribution costs were higher this period due to ongoing investments in expanding and strengthening our network. These investments are part of our long-term growth strategy aimed at improving customer fulfillment rates, broadening product availability, and making it easier for customers to access the solutions they need when they need it. By enhancing our distribution capabilities, we are working to deliver a more seamless and responsive customer experience.

Moving on to slide 7, after a slow start to the year, the Building Climate Solutions segment delivered a strong rebound in the second quarter, as customers regained confidence since Q1. The segment achieved a 5% increase in revenue, driven by an 8% benefit from favorable product mix and pricing, which more than offset volume declines. Light commercial HVAC, which accounts for approximately 50% of BCS revenue, continued to face pressure from soft end market demand, with industry shipment volumes down double-digits. However, our segment sales volumes declined just 3%, supported by growth in emergency replacement products and continued strength in our refrigeration and service offerings. On the cost side, material inflation remained elevated. Encouragingly, for the first time in several quarters, we delivered year-over-year factory productivity gains as the ramp-up of our new facility nears completion.

Turning to slide 8, let's review cash flow and capital deployment. From a free cash flow perspective, we remain on track to achieve our full year guidance of \$650 million to \$800 million, while we made temporary inventory investments to support a smooth transition to the new R-454B products, we expect inventory levels to normalize in the second half of the year. We're also strategically investing in the inventory to strengthen our position in the commercial emergency replacement segment and to support the launch of our new Samsung ductless product line.

On capital deployment, we have repurchased \$300 million in shares year-to-date. In the second quarter, we also received authorization for an additional \$1 billion in future share repurchases. Reflecting our strong earnings and cash flow outlook, we increased our quarterly dividend by approximately 15% in May. Lastly, we continue to take a disciplined approach to M&A, actively evaluating attractive bolt-on opportunities that enhance our distribution capabilities, expand our product portfolio, and integrate smart technologies.

If you'll now turn to slide 9, I'll review our full year 2025 guidance. Let me walk you through the updates to our 2025 financial guidance, which reflect a strong first half and improved visibility into the second half of the year. Based on our performance so far and the momentum we're seeing, we are raising both our revenue and EPS guidance. This speaks to the strength of our execution and the confidence we have in our outlook.

Starting with revenue. We now expect full year revenue to grow by 3%, up from our previous guidance of 2%. This modest improvement reflects a slightly more optimistic view on sales volumes, which are now projected to decline 6% compared to our prior estimate of down 9%. This includes the impact of pre-buy and temporary share gain.

On mix and pricing, we now expect a combined benefit of 9%, slightly below our previous estimate of 11%. This adjustment reflects lower-than-anticipated material tariff inflation. As noted in Q1, our pricing strategy is designed to flex with input cost trends which have moderated. In line with this, we now expect cost inflation to increase total costs by 6%, down from our prior estimate of 9%. This improvement is primarily driven by successful tariff mitigation efforts. Looking at other key items, we now expect interest expense to be approximately \$30 million and our tax rate to fall between 19% and 20%.

And finally, on earnings, we are raising our EPS guidance to a range of \$23.25 to \$24.25, up from our previous range of \$22.25 to \$23.50. Overall, these updates reflect strong execution across the business and confidence in our ability to deliver on our commitments for the remainder of the year.

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

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Thanks, Michael. Let me take a moment to provide a view of how we are positioned for growth and how we see the market evolving across both of our segments. The smooth transition to a low GWP refrigerant maintained our exceptional track record and deepened trust with our customers. We are now selling mostly R-454B product, with limited R-410A remaining in the channel. While the transition was well executed by Lennox, dealer confidence has been impacted by concerns around R-454B canister availability. This may have led to a partial reversal of last year's temporary share gain. We are beginning to see that more homeowners are choosing repair versus replace and trading down, as inflation and government incentives continue to influence some consumer behavior.

While the broader environment remains challenging, our internal momentum continues to accelerate. Equipment inventories in the channel are moving towards more typical levels, and the availability of R-454B canisters is expected to continue improving. This will enhance our ability to support dealers and meet customer demand in a timely manner.

In our Building Climate Solutions segment, we are beginning to see early signs of demand stabilization, following prolonged industry softness. Additionally, our strategic investments are generating positive results. Order rates and backlog remain healthy, given steady replacement demand, as aging systems approach end of life.

Our operational execution has been strong, and we now have the necessary capacity to meet demand. Margins have sequentially recovered as factory productivity improved, which helped offset inflationary pressures on materials and components. Demand is also increasing for comprehensive RTU life cycle solutions, as national account customers are placing greater value on partners who can support them across the entire value chain, from equipment and installation to service and long-term preventative maintenance.

Our ability to deliver across this spectrum sets us apart. We're also seeing growing traction in emergency replacement, where our brand quality, availability and responsiveness have proven to be a success. Looking ahead, we see opportunities to expand our product and service portfolio through growth initiatives that strengthen our ability to serve customers and deepen our relationships.

Now, let's turn to slide 11 and why Lennox continues to be well positioned for sustained growth and margin expansion. We remain focused on executing the Lennox transformation strategy introduced in 2022 and advancing into our next phase of strategic expansion. Our growth is supported by a steady replacement demand and targeted initiatives across digital customer experience, ductless technology, commercial capacity, and parts and services.

We continue to expand resilient margins through productivity and pricing excellence, while investing in distribution to further enhance customer experience and availability. We are also scaling digital capabilities across products and customer interactions, while leveraging proprietary data and expanding our intelligent product lineups. All of this is powered by a high-performing team and a culture grounded in accountability and results. I am confident in our strategy, encouraged by our progress and focused on delivering value for our customers, our employees, and our shareholders. As I look forward, our best days are ahead of us.

Thank you. We will be happy to answer your questions now. Margo, let's go to Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We'll take our first question from Jeff Hammond with KeyBanc Capital Markets. Please go ahead.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Hey. Good morning, guys.

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Good morning, Jeff.

A

Michael Quenzer

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

Good morning.

A

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Hey. So, the gap between price and cost was pretty stunning, and obviously showed through in the margin. I'm just wondering what you're seeing with the A2L manufacturing cost, given that there are some added cost related to that equipment. And then tariffs, if they really showed up or came into 2Q or do they step up into the second half, just trying to understand that price/cost gap better as we go forward?

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Sure. So on A2L conversion, both our cost and price are very close to our expectations and our previous communication, Jeff. So there has been no change. As what we have been able to do is get more factory productivity, and we have done significant head count retrenchment as, like, we finally were able to get out of some of the factory inefficiencies that came into play during the A2L conversion. So I think as expected and mostly driven by productivity, not price in that case. Both price and mix were as expected and it's holding just fine.

A

Michael Quenzer

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

And Jeff, your question on tariffs, in the second half, we do have tariffs increasing a little bit in the second half, but that's all built in the guide. Both businesses are still reflecting margin expansion in the second half of the year, demonstrating our good price, cost excellence.

A

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Okay. And then, can you walk through kind of what your volume assumptions are for the second half? Looks like you bumped it up a little bit or it's less bad in HCS. And then, should we expect price/mix to be similar to 2Q in – as – in the second half as it was in 2Q? Thanks.

Q

Michael Quenzer

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

A

Yeah. Implied in the guidance for the HCS segment is the balance of the year volumes including the destock and just overall volumes are down about 8%. That compares to about down 6% year-to-date. So, little bit more decline in the second half than the first half. And then on price/mix, that implies about up 10% in the second half, in line with where we saw the first half. BCS down volumes in the second half was about 4% compared to down 6% year-to-date and the balance of the year price/mix similar to what we saw in the first half, at up 6% – 6% or 7%.

Jeffrey D. Hammond

Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. That's helpful. Thanks so much.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah.

Operator: Thank you. We'll take our next question from Julian Mitchell with Barclays. Please go ahead.

Julian Mitchell

Analyst, Barclays Capital, Inc.

Q

Hi, good morning. Just wanted to circle back to the margin outlook there for a second. Just wanted to confirm the sort of full year EPS guide, is that embedding kind of 50 bps, 60 bps of operating margin expansion, that type of rate. And when we're thinking about kind of third versus fourth quarter, anything to call out there in terms of moving parts, maybe as kind of the tariff effect comes in for that 6% cost inflation number, any more color around that, please?

Michael Quenzer

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

A

Yeah, Julian, that's correct. For the full year, we're projecting about 50 basis point expansion in margin. So we had about 50 points in the first half, another 50 points in the second half. For full year, HCS will be up a little bit more than the 50 basis points, and the BCS will be closer to flat with the volume reduction that we just took, but both businesses will show margin expansion in the second half, little bit more margin expansion in BCS as that factory productivity kicks in.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

And Julian, I think there's lots of moving pieces here. But overall, this is consistent with our journey, as we are looking to make margins both as a manufacturer and distributor. And if you just go back three years, we can see that our margins in Q2 have expanded 680 basis point over the past three years. So we don't think of this current margin expansion of anything, but just part of our overall trajectory to earn margins both as a manufacturer and a distributor.

Julian Mitchell

Analyst, Barclays Capital, Inc.

Q

That's helpful. And just to follow up on that. So I understand the sort of margin increase first half, second half year-on-year is a pretty similar delta, but I suppose the sort of first versus second quarter was quite a big difference. And just trying to understand, would you argue that the second quarter represents a more natural performance, given where we are in the A2L cycle and plant productivity, whereas Q1, you're obviously dragged down by the early phase of A2L plus the Mexican plant issues?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah, I think you're right, Julian. Q1 was tainted by significant inefficiencies in our manufacturing, both as we transition our BCS factories into A2L products. We obviously had an air pocket that we talked about both from sales and production perspective. And yes, overall, like, in Q2, we saw mix shift more towards R-454B versus R-410A. So, just Q1 inefficiencies and then more normal mix for the year, both makes us confident that Q2 is a better gauge of our margin versus what abnormal Q1 margins look like.

Julian Mitchell

Analyst, Barclays Capital, Inc.

Q

Thank you. Michael, I don't know if you mentioned sort of anything on Q3 versus Q4. Maybe I'd missed it.

Michael Quenzer

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

A

We don't give the quarterly guidance, but what I will say is the second half, you will have more of that comp issue in the fourth quarter, as we had the \$125 million in the second half of last year for pre-buy and temporary share gains. So that will weigh a little bit more in the fourth quarter.

Julian Mitchell

Analyst, Barclays Capital, Inc.

Q

Makes sense. Thank you.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah.

Operator: Next we'll go to Damian Karas with UBS. Please go ahead.

Damian Karas

Analyst, UBS Securities LLC

Q

Hey, good morning everyone.

Michael Quenzer

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

A

Good morning.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Good morning, Damian.

Damian Karas

Analyst, UBS Securities LLC

Q

I actually wanted to ask you about the Ariston partnership. Obviously, interesting move to get involved in water heaters. Alok, could you maybe share some of the early feedback you've gotten from your dealers on the water heater business? And what's a reasonable expectation for the pace that you could start to see some of those sales showing up in your results?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Sure. Great questions. The early feedback from our dealer and overall from our channel has been very positive. As we mentioned in our script, 50% of our current dealers or contractors are already selling water heaters. So for them to be able to buy from us would significantly change the kind of logistics hurdles that they have to go through, we can consolidate shipments, and more of our tech advanced dealers are excited about the fact that we can integrate the controls, and they can provide a common service option. So they're going twice a year to change filters. They can also flush the water heaters while they are going there. So the dealer reaction has been very positive. We're going to launch the product in kind of Q1 next year, which means from a practical perspective, we will see meaningful growth starting in 2027. So I think 2026 is going to be more of a launch year, and we'll work through all the, like, launch pieces.

At this stage it's kind of early to give you numbers. But I think over the long term, we see this convergence between the two continue to play out and positions us really well as a lot of the water heaters have to make the transition to heat pump. At that point, the overlap and the growth will go up even higher. And that, as you know, happens in 2029 when all electric water heaters over 35 gallons need to be heat pump based. So we think a lot of acceleration will happen at that point. But we would be very well-positioned by then.

Damian Karas

Analyst, UBS Securities LLC

Q

That's really helpful. Thank you. And then I wanted to ask you about market share. Sorry if I missed this. I know you talked a little bit about starting to gain momentum in emergency replacement. But on the residential side of the market, are you still expecting to more or less give back all of the share gains from last year or has your view changed at all there based on what you're seeing?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

It is too early to say. I think we did expect to give back some of that share. We think we might have given back some in Q2 already, because of the R-454B canister shortages, and that's kind of guided our view of the rest of the year. But overall, we are pleased with where we stand. We are pleased with how we have been able to renew most of our contracts and continue to improve our availability, hence attract more dealers. So – but yeah, I think we are not banking on keeping all that share. We will give back quite a bit or partially that share back.

Damian Karas

Analyst, UBS Securities LLC

Q

Got it, got it. Thanks a lot. Good luck out there, Alok.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Thanks.

Operator: We'll go next to Ryan Merkel with William Blair. Please go ahead.

Ryan Merkel

Analyst, William Blair & Co. LLC

Q

Hey, everyone. Thanks for the question. I had a two-parter on BCS to start. You lowered the volume to mid-single digits for the year. Could you just talk about why that was? Is it – I think you mentioned industry softness, but if you could expand on that? And then what do you mean by commercial is nearing a bottom? Just unpack that.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Sure. So I think they're related. I mean, we were expecting BCS industry volume to start hitting bottom by the end of Q1, and it turned out it kept declining, the industry volume, all throughout Q2. But now we are seeing signs of stabilization, and we do expect things to kind of bounce along the bottom for a bit before the uptick back to more normal levels starting maybe like, late in the second half. So that's the reason we brought our overall BCS volume guide down based on what we saw in Q2. But at the same time, we do see signs of stabilization. And hence we called out that, like, we are kind of bouncing along the bottom at this stage. You never know how long this will last, but things are no longer getting worse.

Ryan Merkel

Analyst, William Blair & Co. LLC

Q

Okay. Got it, that's helpful. And then, just a question on whether people are worried about the mild weather. You didn't mention weather as a headwind in the script. So just curious if you thought it was a headwind. And maybe just comment on the shape of the quarter, did you see better trends as you got into late June, July, just given the heat wave?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah, that's part of my rule, Ryan. I think you and I have talked about it. I don't think we should ever blame weather for our numbers, so we shouldn't talk about that. But obviously, we have seen over the past many years that there has been late start to the summer and that seems to be continuing this year. May was very soft, and towards the end of June, we saw much stronger sales. So, yes, there's clearly a pattern that's related to weather, but that June's trend continues as we look at, like, first few weeks of July as well. So from our perspective – there's some anecdotal data about May being the coldest May in the past, whatever, 20 years plus or so. But for us, like, as we look at the replacement demand and we look at where consumer confidence and R-454B canister shortages, those all probably played an equal amount of roll into the softer Q2 for HCS. But yeah, there's definitely was a weather impact that got better throughout the quarter.

Ryan Merkel

Analyst, William Blair & Co. LLC

Q

Got it, and all right, thanks. Congrats on the quarter. I'll pass it on.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Thanks, Ryan.

Operator: Thank you. And next we'll go to Stephen Volkmann with Jefferies. Please go ahead.

Stephen Volkmann

Analyst, Jefferies LLC

Q

Hey, great. Good morning, everybody. I wanted to dig in a little bit into the price/mix question, maybe, Michael. I'm curious, it sounded like from Alok's comments that maybe the mix was negative. So was price like a little stronger and mix perhaps a little bit negative, did I read that right?

Michael Quenzer

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

A

Yeah, it's the opposite. So we've had very strong mix and also continued price. And we blended the two together just because at this point, we started the year with a 10% increase for mix on the R-454B product and then followed on with two price increases. So it's a bit challenging to spike out the difference between mix and price. But overall, the mix is still achieving what we believe is that 10% increase that we began the year with.

Stephen Volkmann

Analyst, Jefferies LLC

Q

Got it. Okay. And I guess what I'm really trying to think about here is whether, like, on the repair side, Alok, I think you mentioned that it was sort of canister related. But are there any signs of just kind of price pushback in the sense that affordability is just getting tough for some people and therefore they're perhaps looking to trade down or repair versus replace? Is that a dynamic or is it all in your mind more just canister related?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

It is hard to be extremely precise with this, Steve, but I think the way we have looked at it, the R-454B canister shortage had impacted the dealer confidence. And they are the ones who typically do a great job convincing the consumer on the benefits of replace versus repair and benefit of upgrading. So I think that was a primary.

On secondary factor, yeah, we have seen consumers trade down. But you know the entire industry has moved to 70% as the minimum SEER equipment. And that continues to be the case for many years. So I do see that trade down trend continues. We have not seen any impact of kind of consumer price elasticity or anything like that. It remains a necessary purchase. But we do see consumers getting two to three coats if earlier they were getting one to two coats. So I think there's a lot more consumers who are, like, able to get multiple coats, versus during COVID, they were delighted if they just got one coat and somebody willing...

Stephen Volkmann

Analyst, Jefferies LLC

Q

Right.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

... [indiscernible] (00:32:11) availability to do that. So we do see some more consumers looking to get deals. And I think that puts, like, multiple dealers into play at any given time. So we are watching all those trend, but nothing unusual this quarter compared to what we had seen earlier, except the R-454B canister was unusual. That's why we called that out.

Stephen Volkmann

Analyst, Jefferies LLC



Got it. Okay. Thank you so much. I'll pass it on.

Operator: Thank you. We'll take our next question from Jeff Sprague with Vertical Research Partners. Please go ahead.

Jeffrey Todd Sprague

Analyst, Vertical Research Partners LLC



Hey. Thank you. Good morning, everyone. Just a point of clarification before I get to my question, just on to that inflation number you're giving us, the 6%. That's on total COGS and total SG&A, and then investments in productivity numbers you gave us are separate and apart from that?

Michael Quenzer

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



Yeah, that's correct. So, it'd be on the total cost, both the cost of goods sold and SG&A. And then from there, then you add on top of it any investments and subtract productivity.

Jeffrey Todd Sprague

Analyst, Vertical Research Partners LLC



I wonder if you could – thank you for that. Can we just maybe address kind of managing price/mix? I think we've kind of tiptoed around a little bit in some of the earlier questions. But it does sound like you're seeing some price elasticity come into play. It also looks to me like you're "getting more price than you need" and congratulations if you can do that. But as you try to toggle price you need versus price you can get and the impact that it has on the consumer buying decision, is there some clear trade-off there, in your view, in terms of making sure price is not at a level that it negatively impacts mix and then has other ramifications on the whole repair versus replace dynamic?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.



Sure. As you know, you never get pricing exactly right. You're always going to be a tad too high or a tad too low. And I think pricing excellence remains overall a very core initiative for us. We often find that we may be underpriced in certain markets and may be overpriced in certain other markets. And I'm talking geographically within US, because each region and each local zip code has its own pricing.

So we continuously, on a daily basis, manage that and have now started using some really good tools, AI-based tools, and a lot of data to make those decisions. And that's probably behind when we talk about why our pricing has yielded good results. But overall, we remain very sensitive to the trade-off between pricing and share or pricing versus consumer, like price elasticity. But keep in mind, the consumer price elasticity depends on dealers selling to consumers, not us selling to dealers. And there's a significant markup because of labor, installation, permits and supplies that happens between when we sell to a dealer versus a dealer sells to consumer.

So net-net, I don't know if I would say that our pricing turned out to be much better than expected. I think it was as expected. Tariff costs continue to come through. Remember we did two price increase, one price and one surcharge, that we talked about in Q1. We landed up withdrawing a large portion of that surcharge as some of the

tariffs came out lower. So we remain focused on making sure we price fairly and we price competitively in the marketplace.

Jeffrey Todd Sprague

Analyst, Vertical Research Partners LLC

Q

Great. Thank you for that. And then I'm sorry I was – missed the first five minutes of the call, but has the line length increase on OEM units going out the door hasn't fully addressed kind of the issue of the canister shortage or do you think we're going to be done talking about canister shortages here, as we move through the third quarter?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah, I hope we are done talking about the canister shortages. So the line length issue, and we all have done that, right, gone to 30 feet line length. And that has addressed the concerns from our dealer. Unfortunately, a lot of that inventory hit the sales or our warehouses only in June. So we started to see some of that impact where dealers' concerns were less towards the end of June versus beginning of May. But I think all of us now have inventory with 30 feet line length pre-charge. And that, plus there are more canisters available than they were two months ago. So overall, I sincerely hope that we won't be talking about this when we talk about Q3 earnings and we'll be talking about in a more positive way.

Jeffrey Todd Sprague

Analyst, Vertical Research Partners LLC

Q

Right. Thank you for that color.

Operator: Thank you. And next, we'll go to Noah Kaye with Oppenheimer. Please go ahead.

Noah Kaye

Analyst, Oppenheimer & Co., Inc.

Q

Thanks for taking the questions. Wanted to ask about the inventory build. You've provided some color, but was hoping to maybe unpack a little bit further what drove the sequential build between just more build of R-454B versus the channel being able to take that. And you had Samsung and a couple of other things you called out. And to put a bow on it, how we should think about kind of the cadence of inventory reduction and where you expect to be at year-end?

Michael Quenzer

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

A

Sure. Yeah, just to add some clarity. So we always wanted to make sure we did a successful transition to the new R-454B product. And within that, we thought there might be this air pocket coming in the second quarter. But we wanted to have sufficient inventory for the season in case that air pocket didn't come in. It came in a bit as expected. So what we're going to do in the second half of the year is decelerate some of that inventory and drive it down to more normal levels. There'll still be a growth year-over-year at the end of the year, mostly for these investments for Samsung and the emergency replacement, but it will normalize in the second half of the year, and that's all built into our free cash guide.

Noah Kaye

Analyst, Oppenheimer & Co., Inc.

Q

Okay. Just a quick follow-up on that. That inventory that you've built and that you expect to come down, does most of that kind of be mixed towards the longer line length that we were just talking about in the prior question?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah. For residential, that would be true. And I think that puts us all in a really...

Michael Quenzer

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

A

Yeah.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

...good position. But we also have some of the older line length as well. So I think it's a good mix, but most of the one we built recently were the longer line length.

Noah Kaye

Analyst, Oppenheimer & Co., Inc.

Q

Yeah. I think people just want to understand, like, any risk around strain in inventory. It sounds like that's not an issue. Last question...

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

No, [indiscernible] (00:38:57)

Noah Kaye

Analyst, Oppenheimer & Co., Inc.

Q

...25C, you mentioned there, Alok – yeah, yeah. You mentioned, Alok, the 25C expiration. Of course, that's eligible through the end of the year to claim. Any anticipation in the guide of a demand pull-forward around that? Are you driving any initiatives with dealers to kind of try to get the credit monetized before it expires?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

I don't expect a significant demand pull. As you know, it was only in single digits that units – compared to units sold that took advantage of the 25C credits. So I think it's a small amount. In 2026, maybe the mix would be slightly – I mean, again, so only 6%, 7% of the units were impacted. But no, at this stage, I don't expect any demand pull-forward because of that.

Noah Kaye

Analyst, Oppenheimer & Co., Inc.

Q

Okay. Perfect. Thank you.

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

Brett Linzey

Analyst, Mizuho Securities USA LLC

Hey. Good morning. Appreciate all the detail.

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Good morning, Brett.

A

Brett Linzey

Analyst, Mizuho Securities USA LLC

Yeah. Wanted to start with commercial. So you noted the manufacturing productivity continues to ramp in the Mexico facility. I guess as that capacity gets stood up and you're back in the emergency replacement market, do you have any updated thinking on factory output and how that might ramp over the coming quarters as you're filling it out and driving more revenue there.

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Sure. First of all, I'm delighted that we're talking about factory productivity versus factory inefficiency. It seems like for the past four, five quarters, all we were talking about was factory inefficiencies. But yes, delighted that we now have two factories, both doing well. One in Saltillo, very focused on standard product for emergency replacement, non-configured, and the one in US in Stuttgart, very focused on configured products, mostly for key accounts and other applications. So I think that balance is going very well for us.

A

We have scaled back our labor force and the factories as our inventory has come to a good level, mostly through attrition and otherwise. And we will continue to kind of balance demand across both to make sure that we serve the customers in the most appropriate way and get the right financial outcome. So I think we're just pleased with that balance and that flexibility we have, which we've never had before. So I do expect our productivity run that started in Q2 to continue for the next multiple quarters as we continue balancing those two.

Brett Linzey

Analyst, Mizuho Securities USA LLC

That's great. And then, just wanted to follow up on the repair versus replace discussion, you noted the trade down. I guess, is there any data you can share on the rate of growth in the parts categories versus equipment or something fundamental in the second quarter driving that sentiment? And then I guess, how do we think about that dynamic in the context of the raise in the guide for the segment against some pretty tough comps here in the back half?

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Sure. So I'll take it one at a time, right. On the repair versus replace, we are underweight in parts as you know. So, I mean, I'm actually interested to see when others declare their results to see if they have noticed an uptick. But if there was a big uptick in repair parts, we won't necessarily see that, but our part sales were pretty normal in Q2, so no evidence. But this is more based on just talking with dealers, talking with our key accounts and looking at, like, other industry trends. This was a comment based on that, but no numerical evidence to support that.

A

On the second piece, as we look at it, when we gave the guide for 2025 at the end of Q1, our view was shaped by a potential impending recession. Our view was shaped by potentially tariffs leading to a lot of inflation and that inflation leading to a lot of demand pullback and consumer uncertainty. Things have just become more stable for the US economy, as you know, since then. So that's primarily the reason for change in our guide is just more stable consumer demand, more stable consumer confidence. The new home construction is the one area that remains weak, just like existing home sales. And we did take that into account as we came back with the guide. But that's the piece that continues to be weak.

Brett Linzey*Analyst, Mizuho Securities USA LLC*

Q

Okay, great. Appreciate the detail.

Operator: Thank you. Next we'll go to Tommy Moll with Stephens. Please go ahead.

Thomas Allen Moll*Analyst, Stephens, Inc.*

Q

Good morning and thank you for taking my questions.

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

A

Good morning, Tommy.

Thomas Allen Moll*Analyst, Stephens, Inc.*

Q

Alok, I wanted to start on tariffs and associated surcharges or price increases, whatever we want to call them. I heard you earlier say that you ended up removing all or a substantial portion of the surcharge. That was, I guess, announced in second half of April, just as the tariff picture improved. So, if you could walk us through any of the details there, I think it would help to clarify for folks. And then as we look forward, what are some of the potential changes in the tariff landscape where you would have to think about potentially needing to come back for another surcharge or it could go the other way as well. There's a lot of influx. So maybe just frame for us what are you watching over the next couple of quarters?

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

A

Sure. Let me start by giving you where we are on the overall tariff landscape, right. I mean, when we give our Q1 guidance, we talked about \$250 million in tariff impact to us. If you were to ask us the same question again now, we will say the impact is going to be less than half of that. And that's because our teams have done a really good job of mitigating tariffs by switching suppliers and others. And as you know, some of the tariffs have been changed or lowered. So putting that, like, an overall impact is much lower. To offset the impact, we had always talked about we're going to focus heavily on productivity, focus on cost control, which we did and we did pretty effectively. And then we relied on pricing. We had done one price increase and one surcharge related to tariffs. And eventually we did withdraw I wouldn't say all, but majority of the surcharge, given that the China tariffs came down substantially from \$145 million-some to a lower number. But the first piece continues and that continues to offset the tariff impact which we are still facing. And that impact is, as I said, less than before.

Going forward, there's lots of uncertainty. You and I both wish we knew what's going to happen on tariffs tomorrow, but we don't. But we remain concerned about tariffs coming from South Korea. We remain concerned about some of the August 1 tariff deadlines. And we remain concerned about the future of the US, Mexico, USMCA production and exemption. So we continue to watch out for those. But our goal has always been to provide our dealers and contractors a certain level of certainty and a certain level of confidence, which I think we've managed to do successfully by being very disciplined with our tariffs versus cost and cost versus price approach.

Thomas Allen Moll

Analyst, Stephens, Inc.

Q

Thank you, Alok. As a follow-up, I wanted to address the EPS guidance which you raised today and maybe stepping back from some of the numbers and just talking philosophically here, if we can do that on earnings day, I don't know if that's possible, but I think where a lot of the questions are coming from today are you raised largely on pushing through the beat in the second quarter. And given some of the recent price/cost trends where your incremental margins were pretty impressive this quarter, it might suggest a bigger raise would be appropriate for the year. Maybe there's some conservatism embedded in the second half. Maybe there are some other factors that haven't come out in the questions today. But anything you could do to help us understand your philosophy here would be helpful. Thank you.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Sure. I read a McKinsey article once which said that successful companies, 80% of them have an aggressive CEO, but they are balanced by having a conservative CFO. So apparently, those two make a good pair. So maybe I'll let Michael answer the question. But listen, at the end of the day, there's a lot of uncertainty that still remains in the market. There's lots of uncertainty around tariffs. There's all the pieces we mentioned about R-454B, residential new construction remains weak. And so we think our range – we kept the range of EPS guide to be \$1. Normally we would have narrowed that range at this stage. But given the uncertainty, we kept that range to be \$1. And we feel like we are appropriately, neither conservative nor aggressive with the new range that we have given out. But Michael, anything you want to add to that?

Michael Quenzer

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

A

Sure. I'll just add, I mean, our goal is to have confidence to make sure that we meet our commitments. And I think we've done this with the guidance that we've laid out. But there is a bit of some conservatism in some of the assumptions, maybe around some of that cost inflation around 6%, I mean, a half point difference there can make a difference in the EPS. But with inflation and uncertainty around that, I think it still makes sense to hold it at 6%. But we'll keep watching that.

Thomas Allen Moll

Analyst, Stephens, Inc.

Q

Thank you both. I'll turn it back.

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

Christopher Snyder

Analyst, Morgan Stanley

Q

Thank you. I wanted to ask about the back half volume outlook for the resi business. In Q2, volumes were down 9% and the comp was plus 1%. In the back half, calling for volumes, mostly maybe a little bit worse than that 9%, but the comp goes from 1% in Q2 to a plus 16% in the back half. So I guess, in that context, like, why are you guys confident that volumes will be mostly stable here, given those comps? Is it that the destock came through in Q2 and it's now over? Is it the canister issue getting sorted itself out? Any color there would be appreciated.

Michael Quenzer

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

A

All right. So maybe what I'll do is first clarify the numbers. In the balance of the year, we have volumes down in HCS about 8%. So it's a little bit more than the year to date 6% that we saw. And just recall that we will have the comp issue in the second half of – basically the fourth quarter. So that's kind of built in there. But then we have 10% increase in price/mix also on that. So we are building in a little bit more decline in volumes in the second half than what we saw in the first half.

Christopher Snyder

Analyst, Morgan Stanley

Q

I appreciate that. I was kind of asking more about the second half versus Q2. I think Q2 volumes were down 9% and the comp was...

Michael Quenzer

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

A

Yes.

Christopher Snyder

Analyst, Morgan Stanley

Q

...plus 1%, and that was minus 8% versus plus 16%.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah. And I think a lot of that obviously is we talked about destocking, while you can never get the exact numbers, we think like destocking is largely behind us after Q2. And we talked a little bit about the canister shortage and how that impacted us, especially before the 30 feet line set units hit the marketplace. And then, finally, we are also guided by the weather pattern that we talked about, right. We've always had a late start to summer, and we ended the quarter with much better sales rate than we did during the middle of the quarter. It's never a perfect science, Chris, as you know, but we feel like we have come and given a fair set of numbers to the best of our visibility at this stage.

Christopher Snyder

Analyst, Morgan Stanley

Q

Thank you. I appreciate that. And then maybe just on price, obviously the industry has a really great track record of pushing price and holding that. I guess, it feels like here price, I imagine just across the industry, you seems to be running a bit ahead of costs following the de-escalation. Are you confident that the industry will be able to retain all of this price as you look out over the next 6, 12 months, just kind of given some of the earlier comments that there is a little bit more repair versus replace, maybe some trading down in the market? Thank you.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah. Listen, I mean, our industry still makes less money than some of the other industries like water heaters. And if you think about all the investments that are needed over the past few years, I mean, we spend hundreds of millions of dollars in capital to get to the R-454B transition. We are spending hundreds of million dollars to get better distribution, so we can deliver products the same day and give quotes back within two hours. I mean, all of those investments are not made by just Lennox. Every other player is making that investment as well. And to recoup those investments, I mean, we do need the price impact. And our cost of R-454B units are higher and we are facing other inflation such as refrigerants and other news that we have looked at. So I can't speak for others, but if history is of any guide, us and other players will continue to be price disciplined so we can invest in delivering safe products to our customer, support them appropriately and make sure we live up to our quality and warranty standards.

Christopher Snyder

Analyst, Morgan Stanley

Q

Thank you. I really appreciate. That makes sense.

Operator: And next we'll go to Deane Dray with RBC Capital Markets.

Deane Dray

Analyst, RBC Capital Markets LLC

Q

Thank you. Good morning, everyone.

Michael Quenzer

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

A

Good morning.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Good morning, Deane.

Deane Dray

Analyst, RBC Capital Markets LLC

Q

Hey, was hoping you give us progress report on the emergency replacement initiative. I saw that you had added some inventory, so it – you got to start there to have it ready on that 24 hour notice kind of thing. But just give us an update there, please.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Sure, Deane, when we talked in Q1, we were talking about one or two pilot markets on where we learned and kind of got our approach finalized. Since then, we have expanded and we are now up to about five or six of those markets. And that's what you start seeing in Q2. But clearly, there's more room for us to continue expanding through that. Very soon in the future, you will also see our commercial products even in our residential stores, things that we have never done before, as we look at, like, using our distribution footprints more effectively and placing that inventory in the most convenient location for our contractors.

So, overall, early innings, but we are pleased with the progress that we have seen. Our pilots have gone well. Our initial rollout has gone well. But there's still a lot of room for us to continue taking this forward. So, we're going to be disciplined about it. We are going to be aggressive in our approach, and we're going to continue to make a dent in this. As you know, the overall bogey here is much larger than we are seeing in any quarter. So we think this is a good tailwind for next couple of years, plus more.

Deane Dray

Analyst, RBC Capital Markets LLC

Q

Really good to hear. And then second question, Alok, on page 10 of the deck, you gave some hints about the opportunity to expand product and services in the portfolio. I know you're not going to give a lot of detail here, and we can rule out international, but just the idea of where and how are these growth levers? Is it more JVs, more on the distribution side? Anything about the timing of where we would see further initiatives, kind of like along the lines we saw with water heaters?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Sure. I think on water heaters and mini-splits, the reason we did JVs is because we needed the global technology platform that comes with that, because in both of those, our capabilities could not extend that far. But in other areas, and Michael talks about that in capital deployment, that could be parts and supplies, that could be in technology areas, that could be in geographical reach and distribution. Like, we would be obviously very open to acquisitions.

I mean, from our perspective, we have a highly underutilized distribution network, [ph] as the 250 (00:55:32) stores could add a lot more products compared to what we are selling today, without adding that much fixed cost. So we would continue looking at that from M&A perspective. And on the JVs, we only did that because we had, like, companies which had well-established products, well-established reputation that could allow us a faster entry into those markets. So stay tuned. Definitely more to come.

Deane Dray

Analyst, RBC Capital Markets LLC

Q

Great. Thank you.

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

Joseph O'Dea

Analyst, Wells Fargo Securities LLC

Q

Hi. Good morning. Wanted to just touch on destock and market share a little bit more. And so, Alok, I think the way you framed it is that, your view is that the destock headwind you talked about has largely played out. So that \$125 million, I think you saw it in BCS in Q1. And it sounds like you think you saw most of the HCS impact in Q2, obviously, back half of the year comps, but just in terms of what that downdraft would have been in the first half of the year and so largely done there. And then, just also to add market share to the question, how many points a share do you think you gained last year? And within the guide, how much are you giving back this year in HCS?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah. So the first one I would say, yes, all of those statements are largely true, right? And you realize that \$100 million – \$125 million, these are large approximate numbers, right? We don't have precise accurate math behind it. But in general, it's fair to say that, at this stage, the \$125 million in destocking that we talked about is essentially done. There might be some bleed-through in Q3, but I think it's going to be small. The comps obviously remain difficult, right? So I think that's the pause we watch out for, and that we embedded in our guide going forward to make sure that we've been very clear to that.

Regarding market share, I mean, it's a moving piece. Remember, we look at both HARDI and AHRI, because 70% of our sales go directly to dealer. And with stock up and – stocking and destocking, those numbers often have large error bars when we go into this season. But I would say that we ended – I'm not going to give a number, but I will say that in 2024, we ended up having the largest market share we have ever had in the history of Lennox when it came to residential. And even if we give some back this year, as we expected and as we had broadcast, we'll probably still land in 2025 at very healthy and a large market share that's better than what we had in the past.

Joseph O'Dea

Analyst, Wells Fargo Securities LLC

Q

Got it. For a second, I thought you might actually give the number, but appreciate the color there. And then on – Michael, just thinking about the 25.3% margin in Q2 in HCS, as we think about that as a jumping-off point in the bridge into the back half of the year and what's embedded within guidance, is there anything from a mix shift on the trade-down you guys have talked about, any cost impact with tariffs or copper or, like, anything that just changes within the complexion of that 25.3% or it's just like normal seasonality from there?

Michael Quenzer

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

A

Yeah, I think what we built in is a little bit more cost escalation in the second half if the tariffs come back in. But still, overall, we feel confident that margins are going to increase in the second half of this year, at least 50 basis points in HCS and that's with volumes down 8%, up maybe 70 basis points for the full year. We'll see where inflation comes, hopefully comes in a little bit lower, and we could maybe do a little better than that. But we feel good on price/cost management at the moment.

Joseph O'Dea

Analyst, Wells Fargo Securities LLC

Q

Great. Thanks very much.

Michael Quenzer

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

A

Yes.

Operator: We'll take our next question from Steve Tusa with JPMorgan. Please go ahead.

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Q

Hey. Good morning.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Good morning, Steve.

A

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Alok, congrats on the execution in a pretty choppy environment there.

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Thanks. That means a lot, especially coming from you, Steve.

A

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

I wouldn't over-punch the worth of my opinion. But thank you for that. So I just wanted to kind of clarify some numbers. So you got the 6% on the \$4 billion, that's like \$240 million. Now you're talking about as far as inflation is concerned. I know there's like some moving parts between that and like the bridge items, I think, because the product cost numbers in the first half are, like, running at, like, \$45 million, something like that. Are those two numbers the right comparables or I think I'm missing maybe something productivity-wise in between those? But I guess out of the \$240 million, I guess simple question is, how much have you kind of booked year-to-date?

Q

Michael Quenzer

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

Yeah, Steve, I think what you want to do is look at the product cost and the other combined. Since the inflation is on our total cost perspective, those two combined are about up \$80 million in the first half and implies about \$180 million kind of in the second half.

A

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Okay. So, \$180 million in the second half of that cost flowing through?

Q

Michael Quenzer

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

Right.

A

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Yeah. To get to – okay.

Q

Michael Quenzer

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

Hold on, sorry. Sorry, \$180 million on the full year. [indiscernible] (01:01:04)

A

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Q

On the full year, okay. Right. So that is...

Michael Quenzer

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

[indiscernible] (01:01:07) full year.

A

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Yes, that includes that – like, that productivity and the other numbers above the line on product cost. Okay, that...

Q

Michael Quenzer

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

Right.

A

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

...makes some sense. And then I guess just from a pricing perspective, what have you – have you guys, like, booked – is this kind of a normal now run rate here or you guys have – did that price get booked kind of midway through the quarter or is that something that's now kind of fully embedded in the run rate of the second quarter?

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

I would say it got booked midway through the quarter. The A2L pricing, as you know, depends on the mix as well. And then mix shifted much more towards R-454B to the end of the quarter. And the tariff pricing, the way the announcement work, we probably had two-thirds of the quarter where the tariff pricing was in effect on that, so...

A

C. Stephen Tusa

Analyst, JPMorgan Securities LLC

Okay. All right. That makes a lot of sense. Thank you.

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Margo?

A

Operator: Joseph, your line is open. Please go ahead.

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Hey, guys. This is Joe. I didn't hear the operator. So, [indiscernible] (01:02:30) couple of quick questions, and I'm sorry if I missed this earlier, but if you take a look at the residential volumes down 9% this quarter, what is your independent distribution channel view versus what you flow through the dealer network?

Q

Michael Quenzer

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

A

Yeah. What we saw is on the two-step, total revenue was up about 10%; the one-step, total revenue was about flat. So that's with volume and price mix.

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

That's with volume and price mix. Okay. Okay, got it.

Q

Michael Quenzer

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

[indiscernible] (01:03:07)

A

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

And then just basically if – got it. Okay. And then just kind of like the volume assumptions then in the second half of the year. I know that the \$125 million isn't a totally precise number, but it implies, like, basically like a 6% to 7% volume headwind in the second half. So, like, really what you were expecting out of your residential volumes, excluding that one-time impact from the pre-buy last year is really kind of like down, call it, 1% to 2%. Am I thinking about it the right way?

Q

Michael Quenzer

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

Yeah, I think roughly that's about right. I think I haven't done the exact math. But yeah, that's the right way to think about it.

A

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Okay. All right. So that's good. So things getting a little bit better on the kind of like volume assumptions as we exit the year. And then I know somebody earlier asked about pricing and, call it, like the inelasticity of pricing into next year. I'm actually curious on the surcharge because you didn't fully [indiscernible] (01:04:10-01:04:19) on the mix side. You should improve on mix in 2026 as well because you'll have – you'll be selling R-454B. Is that the right way to think about it? So even though mix was very positive in 2025, there should be some improvement on mix in 2026 as well?

Q

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

Yeah, I think that's right, Joe. We talked earlier about in 2025, 60% of our product was going to be R-454B and 40% was going to be R-410A. In 2026 that will be 100 R-454B and zero R-410A. So yes, we do expect mix to improve. And you'll see year over year, it will be better in Q1 and Q2. By Q3, Q4, I think it'll start normalizing more, but I think that's a fair way to think about it for 2026.

A

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Okay. That's great. All right, guys, thanks so much. Appreciate it.

Q

Operator: And our last question comes from Nigel Coe with Wolfe Research. Please go ahead.

Nigel Coe

Analyst, Wolfe Research LLC

Q

Oh, thanks, good morning. And we appreciate you going long here to fit us all in. Just wanted to follow up on the direct versus indirect, I think you said, two-step up 10% all-in revenues and then direct flat. If we saw the destock happening in 2Q, I would expect that to be expressed more in the two-step channel. So just little bit confused there, maybe I'm thinking about it the wrong way, but any thoughts on that?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

First of all, I think our exposure to two-step is much smaller than others. So I wouldn't read too much into that from an overall industry perspective. I think one thing to keep in mind is in the two-step channel, because of tariffs and because of the R-454B uncertainty and all of that, people continue to, like, maintain high levels of inventory. And that's one thing we refer to saying some of this might bleed into Q3 as we look at distributors and how much inventory they have. On the one-step, as we looked at it, we did talk about even one-step is not immune to holding any inventory during transition. There was some inventory one-step was holding as well. But net-net, as you put together, I'd put that within the overall fluctuations and the uncertainty that we experienced. But, Michael, go ahead.

Michael Quenzer

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

A

Yes. The thing I'll add to is the two-step doesn't have the RNC exposure as the one-step does as well.

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah, that's right Michael. That's a good reminder.

Nigel Coe

Analyst, Wolfe Research LLC

Q

Yeah, that's a great color. And a quick follow-on just kind of on the notion of inventories, your inventories stepped up pretty meaningfully from 1Q to 2Q and normally we see inventories bleed down in the second quarter. So I know we've got higher unit costs with R-454B and I know that we've got some build with ER, but any more color in terms of how you see inventories? Well, first of all, why inventory is so high and then how do you see that progressing through the year?

Alok Maskara

Chief Executive Officer & Director, Lennox International, Inc.

A

Yeah, we wanted to play it safe during the R-454B transition and given the industry uncertainty. As you know, the number one complaint from our dealers over the past 5, 6 years has always been around availability of our product. So we wanted to address that fully. So I think we did that. And, yeah, some of it was also the seasonality of having a slow start to the summer. Net-net, as you know, we would generate most of our cash in the second half and we have good confidence on our overall cash outlook. And we will bring the inventory depleted down over the next several months. So we look at it internally and say, is it a little bit more than we thought, yeah, but we are confident that it's the right thing to do and we'll bleed it down before the end of the year.

Nigel Coe

Analyst, Wolfe Research LLC

Q

Okay. That's great. Thanks, Alok.

Operator: Thank you for joining us today. Since there are no further questions, this will conclude Lennox's 2025 Second Quarter Conference Call. You may disconnect your lines at this time.

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