# Lennox International (LII)

*Updated July 28th, 2023 by Nikolaos Sismanis*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $362 | **5 Year CAGR Estimate:** | 6.4% | **Market Cap:** | $12.9 B |
| **Fair Value Price:** | $315 | **5 Year Growth Estimate:** | 8.0% | **Ex-Dividend Date:** | 08/30/23 |
| **% Fair Value:** | 115% | **5 Year Valuation Multiple Estimate:** | -2.8% | **Dividend Payment Date:** | 09/15/23 |
| **Dividend Yield:** | 1.2% | **5 Year Price Target** | $463 | **Years Of Dividend Growth:** | 15 |
| **Dividend Risk Score:** | C | **Retirement Suitability Score:** | F | **Rating:** | Hold |

## Overview & Current Events

Lennox International (LII) is a company that manufactures and sells HVAC products (heating, ventilation, and air conditioning). About 94% of sales come from North America (particularly the US and Canada), and about 6% of sales are International. The company operates through 3 segments: Residential Heating & Cooling, Commercial Heating & Cooling, and Refrigeration, which made up 68%, 19%, and 13% of 2022 sales, respectively. To preface this business, 75% of sales come from Replacements, and only 25% of sales come from New Construction – which means that this business's performance isn't directly tied to new home sales. On the Residential side of the business, the company is focused on geographic expansion of their store footprint, so they can continue to serve more households.

At the end of 2022, the business had over 260 stores and has the vision to have 350 stores by 2026. While Return on Sales has been declining on the Commercial side of the business, management expects this segment to benefit from pent-up demand and new construction. Management is looking to grow the Refrigeration business (~13% of sales) in North America and in Europe as they leverage their new digital tools and new efficiencies in their factories. Although the business is expected to have strong long-term growth, we forecast that the business will face headwinds from inflationary pressures in the near term. We expect the business to leverage its investments in e-commerce and in more streamlined factory operations as the business continues to focus on growing its higher-margin Residential Heating & Cooling business.

On May 15th, 2023, Lennox International raised its dividend by 3.8% to a quarterly rate of $1.10

On July 27th, 2023, Lennox International reported Q2 results for the period ending June 30th, 2023. The business earned $6.15 in adjusted earnings-per-share in the quarter, which beat analysts' estimates by $0.98, and was up 22% year-over-year. Core revenue, which excludes Lennox's European operations (for which the company has announced it is exploring new strategic options), was $1.34 million, up 3% year-over-year. Revenue growth was once again driven by a favorable product and pricing mix, partially offset by lower sales volume.

For FY2023, management raised their outlook, projecting GAAP and adjusted earnings-per-share to be between $15.50 and $16.00 (up from $14.25 to $15.25 previously). We utilize the midpoint of the updated range in our estimates.

## Growth on a Per-Share Basis

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **EPS** | $3.55 | $4.28 | $5.14 | $6.95 | $7.92 | $9.42 | $11.19 | $9.94 | $12.60 | $14.07 | ***$15.75*** | ***$23.14*** |
| **DPS** | $0.92 | $1.14 | $1.32 | $1.58 | $1.88 | $2.43 | $2.82 | $3.08 | $3.53 | $ 4.10 | ***$4.40*** | ***$7.41*** |
| **Shares** | 49 | 45 | 43 | 43 | 42 | 40 | 39 | 38 | 37 | 36 | ***36*** | ***34*** |

Over the past 9 years, Lennox International has seen earnings-per-share grow at an average annualized rate of 16.5%, and over the past 5 years, the business has seen earnings-per-share grow at 9.4% annually. For the full fiscal year 2023, we expect the company to earn $14.75 in earnings-per-share. We forecast that the business will continue to grow earnings-per-share at 8% annually from 2023 to 2028, which guides our 2028 earnings-per-share estimate of ~$23.14.

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Over the past 9 years, the business has grown dividends at 18.1% annually, and over the past 5 years, the business has grown dividends at 11.8% annually. Over the next 5 years, we forecast that the business will grow dividends at 11% annually. Lennox International has increased its dividend payments for 14 consecutive years.

## Valuation Analysis

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | Now | 2028 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Avg. P/E** | 19.2 | 20.4 | 22.4 | 20.5 | 22.2 | 22.3 | 22.8 | 24.7 | 25.2 | 17.0 | ***23.0*** | ***20.0*** |
| **Avg. Yld.** | 1.3% | 1.3% | 1.1% | 1.1% | 1.1% | 1.2% | 1.1% | 1.3% | 1.1% | 1.7% | ***1.2%*** | ***1.6%*** |

Over the past 5 years, Lennox International has averaged a P/E ratio of 22.4, and over the past decade, the stock has averaged a P/E ratio of 21.7. We estimate that a P/E ratio of about 20 will be fair for the business over the intermediate term as the business continues to grow earnings-per-share, while taking into account the ongoing rise in interest rates. The stock's recent rally has pushed the stock's P/E to 23, which we find rather pricey. The stock offers a low dividend yield of about 1.2%, but investors might be more interested in this business's expected earnings and dividend growth.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

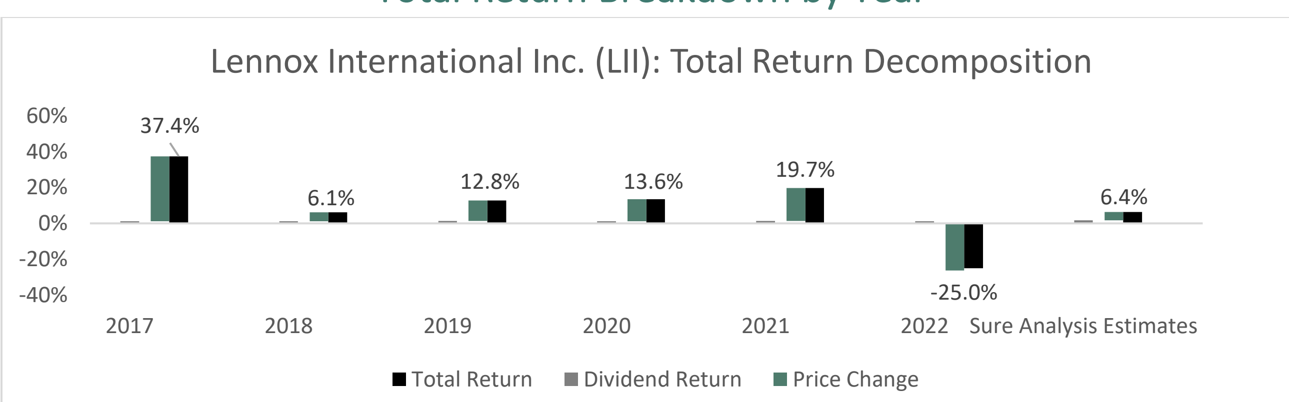
| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2028 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Payout** | 26% | 27% | 26% | 23% | 24% | 26% | 25% | 31% | 28% | 29% | ***28%*** | ***32%*** |

The business has averaged a very low payout ratio of 26% since 2013. We believe that the dividend is safe today and will continue to be over the intermediate term. The business doesn't have the strongest balance sheet because they have a lot of debt. The business has a negative shareholders' equity, but this really shouldn't be too concerning for investors, because the company has ample liquidity to pay off current liabilities, and the business can manage its long-term debt. The business has competitive advantages, including having a national presence and being a leader across many different industry verticals (including supermarkets, restaurants, discount stores, etc.) in the commercial space.

## Final Thoughts & Recommendation

Lennox International offers investors an opportunity to invest in a growing business that serves an evergreen and growing market. Since the bulk of the company's revenue comes from replacing Residential HVAC systems, they are not directly tied to new home sales, and they serve an industry that will always be around. At today's price, we rate the stock as a hold because total return prospects come in at 6.4% annually over the next five years. Total return prospects are derived from earnings-per-share growth of 8% annually and the 1.2% yield, offset by a 2.8% annual valuation headwind.

## Total Return Breakdown by Year

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## Income Statement Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | 3,199 | 3,367 | 3,467 | 3,642 | 3,840 | 3,884 | 3,807 | 3,634 | 4,194 | 4,718 |
| Gross Profit | 861 | 903 | 947 | 1,077 | 1,125 | 1,111 | 1,080 | 1,040 | 1,188 | 1,285 |
| Gross Margin | 26.9% | 26.8% | 27.3% | 29.6% | 29.3% | 28.6% | 28.4% | 28.6% | 28.3% | 27.2% |
| SG&A Exp. | 570 | 574 | 581 | 621 | 638 | 608 | 586 | 556 | 599 | 627 |
| D&A Exp. | 59 | 61 | 63 | 58 | 65 | 66 | 71 | 73 | 72 | 78 |
| Operating Profit | 291 | 330 | 364 | 455 | 487 | 503 | 496 | 486 | 591 | 686 |
| Op. Margin | 9.1% | 9.8% | 10.5% | 12.5% | 12.7% | 13.0% | 13.0% | 13.4% | 14.1% | 14.5% |
| Net Profit | 172 | 206 | 187 | 278 | 306 | 359 | 409 | 356 | 464 | 497 |
| Net Margin | 5.4% | 6.1% | 5.4% | 7.6% | 8.0% | 9.2% | 10.7% | 9.8% | 11.1% | 10.5% |
| Free Cash Flow | 132 | 96 | 284 | 290 | 227 | 400 | 291 | 534 | 409 | 201 |
| Income Tax | 94 | 110 | 95 | 124 | 157 | 108 | 99 | 88 | 96 | 119 |

## Balance Sheet Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Assets | 1,627 | 1,764 | 1,677 | 1,760 | 1,892 | 1,817 | 2,035 | 2,033 | 2,172 | 2,568 |
| Cash & Equivalents | 38 | 38 | 39 | 50 | 68 | 46 | 37 | 124 | 31 | 53 |
| Acc. Receivable | 408 | 421 | 423 | 470 | 507 | 473 | 478 | 448 | 508 | 609 |
| Inventories | 379 | 463 | 419 | 419 | 484 | 510 | 544 | 439 | 511 | 753 |
| Goodwill & Int. | 242 | 233 | 201 | 202 | 201 | 187 | 187 | 187 | 187 | 186 |
| Total Liabilities | 1,141 | 1,755 | 1,576 | 1,722 | 1,841 | 1,967 | 2,205 | 2,050 | 2,441 | 2,771 |
| Accounts Payable | 283 | 324 | 320 | 361 | 349 | 433 | 372 | 340 | 402 | 427 |
| Long-Term Debt | 383 | 909 | 741 | 852 | 989 | 1,022 | 1,138 | 941 | 1,198 | 1,485 |
| Total Equity | 485 | 8 | 101 | 38 | 50 | (150) | (170) | (17) | (269) | (203) |
| LTD/E Ratio | 0.79 | 108.2 | 7.32 | 22.67 | 19.74 | (6.83) | (6.68) | (55.0) | (4.45) | (7.31) |

## Profitability & Per Share Metrics

| Year | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|
| Return on Assets | 10.4% | 12.1% | 10.8% | 16.2% | 16.7% | 19.4% | 21.2% | 17.5% | 22.1% | 21.0% |
| Return on Equity | 35.0% | 83.4% | 341% | 400% | 697% | --- | --- | --- | --- | --- |
| ROIC | 19.8% | 23.0% | 21.2% | 32.1% | 31.7% | 37.6% | 44.4% | 37.7% | 50.1% | 45.0% |
| Shares Out. | 49 | 45 | 43 | 43 | 42 | 40 | 39 | 38 | 37 | 35.8 |
| Revenue/Share | 63.22 | 69.29 | 76.04 | 82.76 | 89.71 | 94.50 | 96.63 | 94.15 | 111.84 | 131.80 |
| FCF/Share | 2.61 | 1.98 | 6.22 | 6.58 | 5.30 | 9.74 | 7.37 | 13.83 | 10.90 | 5.62 |

*Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.*