



Lennox International (LII)

Updated October 27th, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	\$360	5 Year CAGR Estimate:	8.6%	Market Cap:	\$12.8 B
Fair Value Price:	\$350	5 Year Growth Estimate:	8.0%	Ex-Dividend Date:	12/29/23
% Fair Value:	103%	5 Year Valuation Multiple Estimate:	-0.6%	Dividend Payment Date:	01/12/24 ¹
Dividend Yield:	1.2%	5 Year Price Target	\$514	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 October 26th, 2023, Lennox International reported Q3 results for the period ending September 30th, 2023. The business earned \$5.37 in adjusted earnings-per-share in the quarter, which beat analysts' estimates by \$0.66, and was up 30% year-over-year. Core revenue, which excludes Lennox's European operations (for which the company has announced it is exploring new strategic options), was \$1.30 million, up 10% 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 adjusted earnings-per-share to be between \$17.25 to \$17.75 (up from \$15.50 to \$16.00 previously). We have utilized 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	\$17.50	\$25.71
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 decade, 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 \$17.50 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 ~\$25.71.

¹ Estimated dates based on past dividend dates.

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Over the past 10 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 15 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	20.6	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%	1.4%

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 is currently trading at a P/E of 20, which is not far from our fair estimate. 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

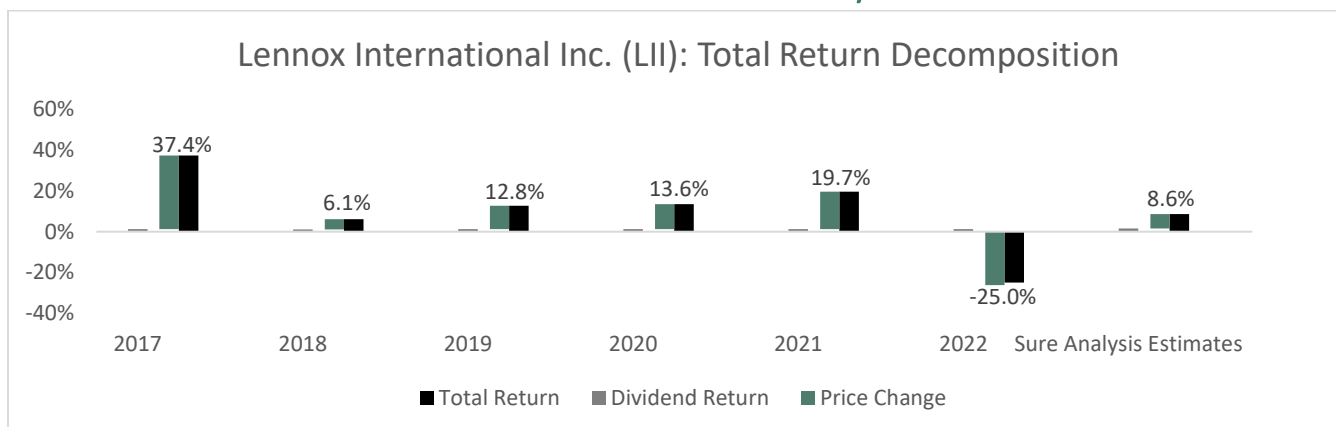
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	26%	27%	26%	23%	24%	26%	25%	31%	28%	29%	25%	29%

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 8.6% 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 0.6% 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.

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