Lennox International (LII)

Updated October 24th, 2024 by Nikolaos Sismanis

Key Metrics

Current Price:	$610	**5 Year CAGR Estimate:**	3.9%	**Market Cap:**	$21.7 B
Fair Value Price:	$459	**5 Year Growth Estimate:**	9.0%	**Ex-Dividend Date:**	12/27/24
% Fair Value:	133%	**5 Year Valuation Multiple Estimate:**	-5.5%	**Dividend Payment Date:**	01/15/25[1]
Dividend Yield:	0.8%	**5 Year Price Target**	$707	**Years Of Dividend Growth:**	16
Dividend Risk Score:	C	**Retirement Suitability Score:**	F	**Rating:**	Sell

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. 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.

On October 23rd, 2024, Lennox International reported Q3 results for the period ending September 30th, 2024. For the quarter, core revenue, which excludes Lennox's European operations (for which the company has announced it is exploring new strategic options), was $1.50 billion, up 15% year-over-year. Revenue growth was mainly driven by the Business Climate Solutions segment, which achieved 15% revenue growth, including organic growth of 9%.

Operating Income came in at $303 million, up 62% compared to last year, driven by a notable 650 bps operating margin expansion to 20.2%. Thus, the business earned $6.68 in adjusted earnings-per-share in the quarter, which beat analysts' estimates by $0.67 and was up 24% year-over-year.

For FY2024, management raised their outlook, projecting adjusted earnings-per-share to be between $20.75 and $21.00 (up from $19.50 to $20.25). We have utilized the midpoint of the updated range in our estimates.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	$4.28	$5.14	$6.95	$7.92	$9.42	$11.19	$9.94	$12.60	$14.18	$16.54	***$20.88***	***$32.13***
DPS	$1.14	$1.32	$1.58	$1.88	$2.43	$2.82	$3.08	$3.53	$4.10	$4.36	***$4.60***	***$7.75***
Shares	45	43	43	42	40	39	38	37	36	36	***36***	***34***

Over the past decade, Lennox International has seen adjusted earnings-per-share grow at an average annualized rate of 16.2%, and over the past five years, the business has seen the same metric grow at 11.5% annually. For the full fiscal year 2024, we expect the company to earn $20.88 in earnings-per-share. We forecast that the business will continue to grow earnings-per-share at 9% annually from 2024 to 2029, which guides our 2029 earnings-per-share estimate of $30.00.

Over the past ten years, the Lennox International has grown dividends at 16.1% annually, and over the past five years, the company has grown dividends at 9.3% 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 16 consecutive years.

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. Recent improvements in Lennox's distribution network should keep improving fill rates and costs, as seen in Q3's notable margin expansion.

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[1] Estimated dates based on past dividend dates.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	20.4	22.4	20.5	22.2	22.3	22.8	24.7	25.2	17.0	17.9	***29.2***	***22.0***
Avg. Yld.	1.3%	1.1%	1.1%	1.1%	1.2%	1.1%	1.3%	1.1%	1.7%	1.5%	***0.8%***	***1.1%***

Over the past five years, Lennox International has averaged a P/E ratio of 21.5. This is also the case for its past ten-year average, indicating rather stable valuation levels throughout its history. We have set our fair P/E ratio at 22.0 due to Lennox continuing to grow earnings-per-share at a fast clip balanced with rather elevated interest rates currently. Shares are currently trading at a P/E of 29.2, implying a notable premium. The stock offers a low dividend yield of about 0.8%, but investors might be more interested in this business's expected earnings and dividend growth.

Safety, Quality, Competitive Advantage, & Recession Resiliency

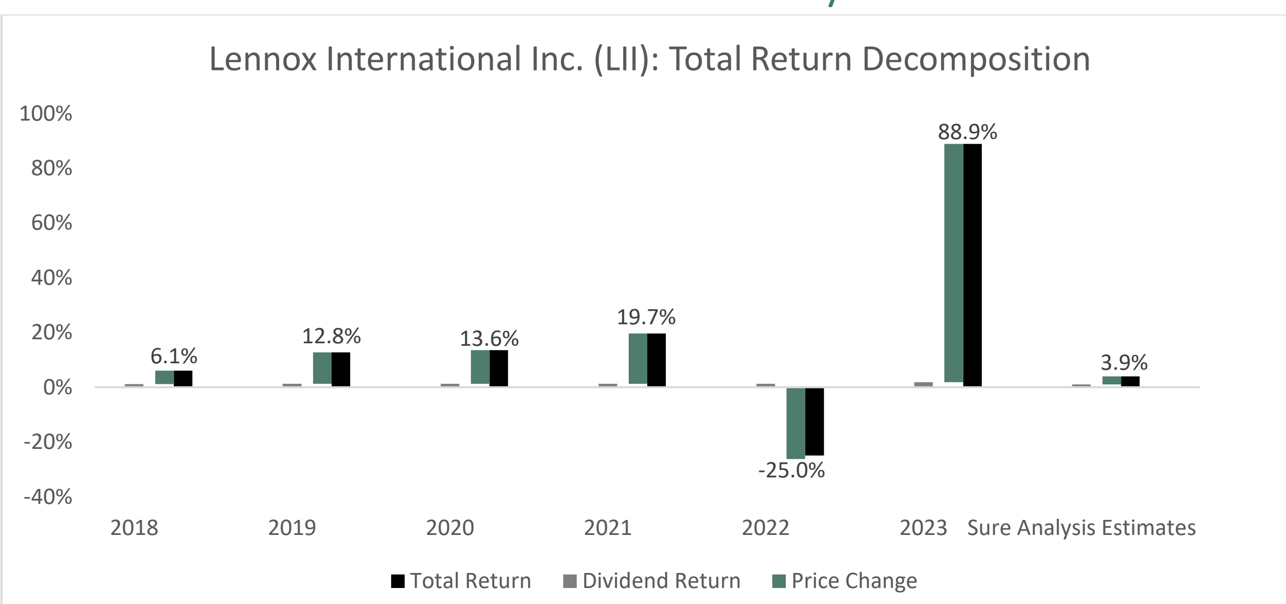
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	27%	26%	23%	24%	26%	25%	31%	28%	29%	26%	***22%***	***24%***

The business has averaged a very low payout ratio of 26% since 2014. 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 in demand. At today's price, we rate the stock as a sell because total return prospects come in at 3.9% annually through 2029. Total return prospects are derived from earnings-per-share growth of 9% annually and the 0.8% yield, offset by a 5.5% annual valuation headwind.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	3,367	3,467	3,642	3,840	3,884	3,807	3,634	4,194	4,718	4,982
Gross Profit	903	947	1,077	1,125	1,111	1,080	1,040	1,188	1,285	1,548
Gross Margin	26.8%	27.3%	29.6%	29.3%	28.6%	28.4%	28.6%	28.3%	27.2%	31.1%
SG&A Exp.	574	581	621	638	608	586	556	599	627	706
D&A Exp.	61	63	58	65	66	71	73	72	78	86
Operating Profit	330	364	455	487	503	496	486	591	686	844
Op. Margin	9.8%	10.5%	12.5%	12.7%	13.0%	13.0%	13.4%	14.1%	14.5%	16.9%
Net Profit	206	187	278	306	359	409	356	464	497	590
Net Margin	6.1%	5.4%	7.6%	8.0%	9.2%	10.7%	9.8%	11.1%	10.5%	11.8%
Free Cash Flow	96	284	290	227	400	291	534	409	201	486
Income Tax	110	95	124	157	108	99	88	96	119	147

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	1,764	1,677	1,760	1,892	1,817	2,035	2,033	2,172	2,568	2,798
Cash & Equivalents	38	39	50	68	46	37	124	31	53	61
Acc. Receivable	421	423	470	507	473	478	448	508	609	595
Inventories	463	419	419	484	510	544	439	511	753	699
Goodwill & Int.	233	201	202	201	187	187	187	187	186	222
Total Liabilities	1,755	1,576	1,722	1,841	1,967	2,205	2,050	2,441	2,771	2,513
Accounts Payable	324	320	361	349	433	372	340	402	427	375
Long-Term Debt	909	741	852	989	1,022	1,138	941	1,198	1,485	1,260
Total Equity	8	101	38	50	(150)	(170)	(17)	(269)	(203)	285
LTD/E Ratio	108.2	7.32	22.67	19.74	(6.83)	(6.68)	(55.0)	(4.45)	(7.31)	4.42

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	12.1%	10.8%	16.2%	16.7%	19.4%	21.2%	17.5%	22.1%	21.0%	22.0%
Return on Equity	83.4%	341%	400%	697%	---	---	---	---	---	1440%
ROIC	23.0%	21.2%	32.1%	31.7%	37.6%	44.4%	37.7%	50.1%	45.0%	41.7%
Shares Out.	45	43	43	42	40	39	38	37	35.8	35.7
Revenue/Share	69.29	76.04	82.76	89.71	94.50	96.63	94.15	111.84	131.80	139.55
FCF/Share	1.98	6.22	6.58	5.30	9.74	7.37	13.83	10.90	5.62	13.61

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

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