

LENNOX INTERNATIONAL INC
Form 10-Q
April 23, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED March 31, 2018
Commission file number 001-15149

LENNOX INTERNATIONAL INC.
Incorporated pursuant to the laws of the State of Delaware

Internal Revenue Service Employer Identification No. 42-0991521
2140 LAKE PARK BLVD., RICHARDSON, TEXAS, 75080
(972-497-5000)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer

Non-Accelerated Filer Smaller Reporting Company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

As of April 13, 2018, the number of shares outstanding of the registrant's common stock, par value \$.01 per share, was 41,242,755.

LENNOX INTERNATIONAL INC.
FORM 10-Q
For the three months ended March 31, 2018

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Part I - Financial Information

Item 1. Financial Statements

LENNOX INTERNATIONAL INC. AND SUBSIDIARIES

Consolidated Balance Sheets

| (Amounts in millions, except shares and par values) | As of March 31, 2018 (unaudited) | As of December 31, 2017 |
|---|---|-------------------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 57.1 | \$ 68.2 |
| Accounts and notes receivable, net of allowances of \$6.0 and \$5.9 in 2018 and 2017, respectively | 528.5 | 506.5 |
| Inventories, net | 561.5 | 484.2 |
| Assets held for sale | 93.3 | — |
| Other assets | 106.4 | 78.4 |
| Total current assets | 1,346.8 | 1,137.3 |
| Property, plant and equipment, net of accumulated depreciation of \$763.9 and \$774.2 in 2018 and 2017, respectively | 390.1 | 397.8 |
| Goodwill | 190.3 | 200.5 |
| Deferred income taxes | 94.0 | 94.4 |
| Other assets, net | 64.9 | 61.5 |
| Total assets | \$ 2,086.1 | \$ 1,891.5 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Short-term debt | \$ 0.9 | \$ 0.9 |
| Current maturities of long-term debt | 29.9 | 32.6 |
| Accounts payable | 405.6 | 348.6 |
| Accrued expenses | 226.0 | 270.3 |
| Liabilities held for sale | 28.7 | — |
| Income taxes payable | 21.7 | 2.1 |
| Total current liabilities | 712.8 | 654.5 |
| Long-term debt | 1,258.3 | 970.5 |
| Post-retirement benefits, other than pensions | 2.5 | 2.6 |
| Pensions | 85.9 | 84.5 |
| Other liabilities | 129.2 | 129.3 |
| Total liabilities | 2,188.7 | 1,841.4 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, \$.01 par value, 25,000,000 shares authorized, no shares issued or outstanding | — | — |
| Common stock, \$.01 par value, 200,000,000 shares authorized, 87,170,197 shares issued | 0.9 | 0.9 |
| Additional paid-in capital | 1,036.7 | 1,061.5 |
| Retained earnings | 1,609.6 | 1,575.9 |
| Accumulated other comprehensive loss | (181.3) | (157.4) |
| Treasury stock, at cost, 45,852,186 shares and 45,361,145 shares as of March 31, 2018 and December 31, 2017, respectively | (2,568.5) | (2,430.8) |
| Total stockholders' equity | (102.6) | 50.1 |

Total liabilities and stockholders' equity \$ 2,086.1 \$ 1,891.5

The accompanying notes are an integral part of these consolidated financial statements.

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LENNOX INTERNATIONAL INC. AND SUBSIDIARIES
Consolidated Statements of Operations
(Unaudited)

| (Amounts in millions, except per share data) | For the Three Months Ended March 31, | |
|---|--|---------|
| | 2018 | 2017 |
| Net sales | \$834.8 | \$793.4 |
| Cost of goods sold | 611.6 | 582.5 |
| Gross profit | 223.2 | 210.9 |
| Operating Expenses: | | |
| Selling, general and administrative expenses | 155.2 | 152.4 |
| Losses and other expenses, net | 7.3 | 3.1 |
| Restructuring charges | 0.9 | 0.1 |
| Loss on assets held for sale | 10.3 | — |
| Income from equity method investments | (3.5) | (5.5) |
| Operating income | 53.0 | 60.8 |
| Interest expense, net | 8.4 | 7.4 |
| Other expense, net | 0.6 | — |
| Income from continuing operations before income taxes | 44.0 | 53.4 |
| Provision for income taxes | 6.1 | 9.9 |
| Income from continuing operations | 37.9 | 43.5 |
| Discontinued Operations: | | |
| Loss from discontinued operations before income taxes | — | — |
| Benefit from income taxes | — | — |
| Loss from discontinued operations | — | — |
| Net income | \$37.9 | \$43.5 |
| Earnings per share – Basic: | | |
| Income from continuing operations | \$0.91 | \$1.02 |
| Loss from discontinued operations | — | — |
| Net income | \$0.91 | \$1.02 |
| Earnings per share – Diluted: | | |
| Income from continuing operations | \$0.90 | \$1.00 |
| Loss from discontinued operations | — | — |
| Net income | \$0.90 | \$1.00 |
| Weighted Average Number of Shares Outstanding - Basic | 41.5 | 42.8 |
| Weighted Average Number of Shares Outstanding - Diluted | 42.1 | 43.5 |
| Cash dividends declared per share | \$0.51 | \$0.43 |

The accompanying notes are an integral part of these consolidated financial statements.

LENNOX INTERNATIONAL INC. AND SUBSIDIARIES
 Consolidated Statements of Comprehensive Income
 (Unaudited)

| (Amounts in millions) | For the Three Months Ended March 31, | |
|--|--|--------|
| | 2018 | 2017 |
| Net income | \$37.9 | \$43.5 |
| Other comprehensive income: | | |
| Foreign currency translation adjustments | 7.9 | 15.9 |
| Net change in pension and post-retirement liabilities | (2.3) | (2.3) |
| Reclassification of pension and post-retirement benefit losses into earnings | 2.3 | 1.9 |
| Change in available-for-sale marketable equity securities | (1.8) | 0.8 |
| Net change in fair value of cash flow hedges | (4.3) | 6.4 |
| Reclassification of cash flow hedge gains into earnings | (4.6) | (3.0) |
| Other comprehensive income before income taxes | (2.8) | 19.7 |
| Income tax expense | (21.1) | (1.1) |
| Other comprehensive (loss) income, net of tax | (23.9) | 18.6 |
| Comprehensive income | \$14.0 | \$62.1 |

The accompanying notes are an integral part of these consolidated financial statements.

LENNOX INTERNATIONAL INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Unaudited)

| (Amounts in millions) | For the Three Months Ended March 31, | |
|---|--|---------|
| | 2018 | 2017 |
| Cash flows from operating activities: | | |
| Net income | \$37.9 | \$43.5 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Income from equity method investments | (3.5) | (5.5) |
| Loss on assets held for sale | 10.3 | — |
| Restructuring charges, net of cash paid | 0.6 | — |
| Provision for bad debts | 1.9 | 1.1 |
| Unrealized gains on derivative contracts | (0.1) | (0.5) |
| Stock-based compensation expense | 4.8 | 4.9 |
| Depreciation and amortization | 16.6 | 15.7 |
| Deferred income taxes | (2.1) | (1.1) |
| Pension expense | 2.1 | 1.9 |
| Pension contributions | (0.7) | (1.1) |
| Other items, net | 0.1 | 0.1 |
| Changes in assets and liabilities, net of effects of divestitures: | | |
| Accounts and notes receivable | (44.5) | (40.9) |
| Inventories | (124.3) | (101.2) |
| Other current assets | (0.7) | (4.3) |
| Accounts payable | 77.5 | 47.3 |
| Accrued expenses | (35.2) | (41.7) |
| Income taxes payable and receivable | (22.3) | (28.0) |
| Other | (1.9) | 2.2 |
| Net cash used in operating activities | (83.5) | (107.6) |
| Cash flows from investing activities: | | |
| Proceeds from the disposal of property, plant and equipment | 0.1 | 0.1 |
| Purchases of property, plant and equipment | (22.7) | (24.9) |
| Net cash used in investing activities | (22.6) | (24.8) |
| Cash flows from financing activities: | | |
| Short-term borrowings, net | (0.1) | (0.8) |
| Asset securitization borrowings | — | 150.0 |
| Asset securitization payments | (51.0) | — |
| Long-term debt payments | (10.2) | (0.2) |
| Borrowings from credit facility | 790.0 | 583.0 |
| Payments on credit facility | (444.1) | (497.5) |
| Proceeds from employee stock purchases | 0.8 | 0.7 |
| Repurchases of common stock | (150.0) | (75.0) |
| Repurchases of common stock to satisfy employee withholding tax obligations | (18.1) | (13.3) |
| Cash dividends paid | (21.3) | (18.5) |
| Net cash provided by financing activities | 96.0 | 128.4 |
| Increase in cash and cash equivalents | (10.1) | (4.0) |
| Effect of exchange rates on cash and cash equivalents | (1.0) | 2.6 |

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| | | |
|--|--------|--------|
| Cash and cash equivalents, beginning of period | 68.2 | 50.2 |
| Cash and cash equivalents, end of period | \$57.1 | \$48.8 |

Supplemental disclosures of cash flow information:

| | | |
|------------------------------------|--------|--------|
| Interest paid | \$6.0 | \$2.4 |
| Income taxes paid (net of refunds) | \$32.7 | \$36.7 |

The accompanying notes are an integral part of these consolidated financial statements.

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LENNOX INTERNATIONAL INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. General:

References in this Quarterly Report on Form 10-Q to "we," "our," "us," "LII," or the "Company" refer to Lennox International Inc. and its subsidiaries, unless the context requires otherwise.

Basis of Presentation

The accompanying unaudited Consolidated Balance Sheet as of March 31, 2018, the accompanying unaudited Consolidated Statements of Operations for the three months ended March 31, 2018 and 2017, the accompanying unaudited Consolidated Statements of Comprehensive Income for the three months ended March 31, 2018 and 2017, and the accompanying unaudited Consolidated Statements of Cash Flows for the three months ended March 31, 2018 and 2017 should be read in conjunction with our audited consolidated financial statements and footnotes included in our Annual Report on Form 10-K for the year ended December 31, 2017. The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The accompanying consolidated financial statements contain all material adjustments, consisting principally of normal recurring adjustments, necessary for a fair presentation of our financial position, results of operations and cash flows. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to applicable rules and regulations, although we believe that the disclosures herein are adequate to make the information presented not misleading. The operating results for the interim periods are not necessarily indicative of the results that may be expected for a full year.

Our fiscal quarterly periods are comprised of approximately 13 weeks, but the number of days per quarter may vary year-over-year. Our quarterly reporting periods usually end on the Saturday closest to the last day of March, June and September. Our fourth quarter and fiscal year ends on December 31, regardless of the day of the week on which December 31 falls.

Use of Estimates

The preparation of financial statements requires us to make estimates and assumptions about future events. These estimates and the underlying assumptions affect the amounts of assets and liabilities reported, disclosures about contingent assets and liabilities, and reported amounts of revenues and expenses. Such estimates include the valuation of accounts receivable, inventories, goodwill, intangible assets and other long-lived assets, contingencies, guarantee obligations, indemnifications, and assumptions used in the calculation of income taxes, pension and post-retirement medical benefits, and stock-based compensation, among others. These estimates and assumptions are based on our best estimates and judgment.

We evaluate these estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment. We believe these estimates and assumptions to be reasonable under the circumstances and will adjust such estimates and assumptions when facts and circumstances dictate. Volatile equity, foreign currency and commodity markets combine to increase the uncertainty inherent in such estimates and assumptions. Future events and their effects cannot be determined with precision and actual results could differ significantly from these estimates. Changes in these estimates will be reflected in the financial statements in future periods.

Reclassifications

Certain amounts have been reclassified from the prior year presentation to conform to the current year presentation.

Recently Adopted Accounting Guidance

In August 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-15, Classification of Certain Cash Receipts and Cash Payments. The amendments in this ASU clarify the classification for eight different types of activities, including debt prepayment and extinguishment costs, proceeds from insurance claims and distributions from equity method investees. For public business entities, the standard is effective for financial statements issued for fiscal years beginning after December 15, 2017. This standard did not have a material impact on our consolidated financial statements.

We also adopted other new accounting standards during the first quarter of 2018. The impact of these additional standards are discussed in their respective Notes to the Consolidated Financial Statements.

Recent Accounting Pronouncements

On February 25, 2016, the FASB issued ASU No. 2016-02, Leases (ASC 842). Lessees will need to recognize almost all leases on their balance sheet as a right-of-use asset and a lease liability. It will be critical to identify leases embedded in a contract to avoid misstating the lessee's balance sheet. For income statement purposes, the FASB retained a dual model, requiring leases to be classified as either operating or finance. Classification will be based on criteria that are largely similar to those applied in current lease accounting, but without explicit bright lines. ASU 2016-02 is effective for public companies for annual reporting periods beginning after December 15, 2018, and interim periods within those fiscal years. We will adopt the standard using the prospective approach and are still determining the effect of the standard on our ongoing financial reporting. As a result of the new standard, all of our leases greater than one year in duration will be recognized in our Consolidated Balance Sheets as both operating lease liabilities and right-of-use assets upon adoption of the standard.

2. Revenue Recognition:

On January 1, 2018, we adopted the new accounting standard Accounting Standards Codification ("ASC") 606, Revenue from Contracts with Customers and all the related amendments ("the new revenue standard") and applied it to all contracts using the modified retrospective method. We recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of retained earnings. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. We expect the impact of the adoption of the new standard to be immaterial to our net income on an ongoing basis.

The cumulative effect of the changes made to our consolidated January 1, 2018 balance sheet for the adoption of the new revenue standard was as follows (in millions):

| BALANCE SHEET | Balance at December 31, 2017 | Adjustments Due to ASC 606 | Balance at January 1, 2018 |
|---|------------------------------------|----------------------------------|-------------------------------------|
| ASSETS | | | |
| Accounts and notes receivable, net | \$ 506.5 | \$ 8.3 | \$ 514.8 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Accounts payable | 348.6 | 9.3 | 357.9 |
| Retained earnings | 1,575.9 | (1.0) | 1,574.9 |

In accordance with the new revenue standard requirements, the disclosure of the impact of adoption on our Consolidated Balance Sheet and Consolidated Statement of Operations was as follows (in millions):

| | March 31, 2018 | |
|----------------------|--------------------------------------|---------------------------------------|
| | Balances | |
| As Reported | Without Adoption of ASC 606 | Effect of Change Higher/(Lower) |
| BALANCE SHEET | | |
| ASSETS | | |