

Industrials/Multi-Industry

LII read across for TT and CARR: 4Q resi volumes down, risk of more destock in '24

Industry Overview

Resi volumes down, but price and mix offset

HVAC manufacturer Lennox (Ticker: LII, not covered) reported 4Q23 results on 1/31. LII results are a read across for CARR (Carrier) and TT's (Trane Technologies) NA residential and light commercial businesses. Lennox reported resi segment (Home Comfort Solutions) revenue grew 1% in the Q, as the segment benefited from a favorable mix of higher-efficiency products and effective pricing execution, offsetting volume declines. Unit sales volumes through independent distributors declined more than 20%, driven by industry destocking, but direct-to-contractor sales volumes remained stable. LII's reported volumes raise concerns about CARR and TT's resi volumes in 4Q23. Volumes down over 20% is consistent with what we heard at AHR ([see note here](#)). For LII's commercial segment (Building Climate Solutions), volumes continue to be impacted by constrained factory output, but revenue grew 19% overall with a large benefit from pricing (up 11%) as LII made price corrections. This compares to 4Q22 when revenue grew 19% with price/mix up 17%. Strength in the commercial business is consistent with our expectations for CARR and TT's light commercial businesses for 4Q23.

'24 resi volumes to be flat with price driving growth

For '24, LII guided for resi volumes being flat with price up MSD to offset. Independent distributor destocking was more than LII was expecting in 4Q, and mgmt. expects some destocking to bleed into Q1. We view this commentary as negative for CARR and TT, both of which have noted expectations that destocking would dissipate after YE23.

Commercial; pent up demand but projects pushed out

For 2024, LII guided for volumes up low-single digits and price/mix up mid-single digits in its commercial business. When asked about the outlook, management commented that backlog remains solid in the short term, but they are seeing some project delays, creating some caution for LII. After talking to key accounts, LII noted a lot of enthusiasm for the R454b product and are concerned some customers may wait for the new refrigerant product to hit the market rather than order now. During the AHR conference we heard similar concerns about potential destocking in 2H. We see potential light commercial destocking as a risk for CARR and TT, both of which had strong light commercial growth in 2023 and will be facing tougher comps in 2024.

Potential M&A

JCI (Johnson Controls) noted on its 1/30 earnings call that it was "in the early stages of pursuing strategic alternatives of our non-commercial product lines". This followed a 1/26 Bloomberg report that JCI was exploring the sale of its residential and light commercial business. When LII was asked about other participants in the market potentially selling assets, LII responded "Lennox has been very clear that if there is an industry consolidation opportunity, Lennox will like to participate". LII followed the comment, saying it does not have make acquisitions, as it was confident in its standalone strategy. Further in the call it said it didn't "want to make any specific comments and rule anything in or out at this stage, but we will look at those things as how does it benefit our shareholders".

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Equity
Americas
Industrials/Multi-Industry

Andrew Obin
Research Analyst
BofAS
+1 646 855 1817
andrew.obin@bofa.com

David Ridley-Lane, CFA
Research Analyst
BofAS
+1 646 855 2907
david.ridleylane@bofa.com

Sabrina Abrams
Research Analyst
BofAS
+1 646 556 3520
sabrina.abrams@bofa.com

Devin Leonard
Research Analyst
BofAS
+1 646 855 3698
devin.leonard@bofa.com

HVAC: heating, ventilation, and air conditioning

SEER: seasonal energy efficiency ratio

AHR: Air condition, Heating, Refrigeration Expo

MSD: mid-single digits

Concerns for consumers and refrigerant transition

For residential, Lennox is watching consumer sentiment, as the health of consumer spending remains a significant driver of demand. However, it has yet to see a meaningful shift from replacement to repair. For 2024, LII also flagged there would still be a carryover mix benefit from the SEER transition in 1Q and 2Q. We see the carryover benefit as a positive for TT and CARR, as it may help offset anticipated volume weakness. For the refrigerant transition, LII is not expecting much pre-buying due to inventory fatigue in the channel and the increased cost of carrying inventories.

Our ratings and rationales for CARR, TT, and JCI

Our Neutral rating for TT balances resi destocking and light commercial slowdown with TT's outperformance. Our Underperform rating on Carrier reflects our concerns about European heat pump demand and the US light commercial HVAC market. Our Neutral on JCI reflects positive end-market exposure offsetting near-term execution challenges.

Price objective basis & risk

Carrier Global Corp. (CARR, \$56.33, B-3-7))

We base our \$55 price objective on 11x EV/EBITDA of our 2025 estimates. Our 11x target multiple is at a discount to peers, trading at 12x on 2024 estimates. We believe that the discount is warranted given the potential for destocking across res and non-res.

Upside risks to our price objective are: 1) continued solid execution in 2023, 2) non-residential markets take longer to crack than our thesis, and 3) price increases offset impact of destocking cycle.

Downside risks to our price objective are: 1) slower-than-expected macro recovery, 2) inability to execute on announced cost savings plan, and 3) lost market share to competitors.

Johnson Controls International PLC (JCI, \$54.49, B-2-7)

We base our \$60 price objective on 10x EV/EBITDA of our 2025 estimates. Our 10x target multiple is below the peer group average trading at 14x on 2024 estimates. We think the discount valuation is warranted given risk from slowdown in the non-residential cycle.

Downside risks to our price objective are 1) potential loss of market share to peer and building automation competitors, 2) execution risks, particularly on the cost takeout plan, and 3) risks from the aqueous film forming foam litigation.

Trane Technologies PLC (TT, \$257.75, B-2-7)

We base our \$265 price objective on 17x 2025E EV/EBITDA. Our 17x target multiple is above the peer group average trading at 13x on 2024 estimates. We believe the premium is warranted given above-average performance.

Downside risks are 1) slower-than-expected macro recovery, 2) lower-than-expected productivity improvement and cost synergies, 3) loss of market share to competitors. Upside risks are 1) continued solid execution in 2023, 2) non-residential markets take longer to crack than our thesis, and 3) price increases offset impact of destocking cycle.

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US - Multi-Industrials/Engineering and Construction Coverage Cluster

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BUY				
	APi Group	APG	APG US	Andrew Obin
	AspenTech	AZPN	AZPN US	Andrew Obin
	Atmus Filtration	ATMU	ATMU US	Andrew Obin
	Dover Corp	DOV	DOV US	Andrew Obin
	Eaton Corp PLC	ETN	ETN US	Andrew Obin
	Emerson Electric Co	EMR	EMR US	Andrew Obin
	Flowserve	FLS	FLS US	Andrew Obin
	General Electric Company	GE	GE US	Andrew Obin
	Honeywell International Inc.	HON	HON US	Andrew Obin
	ITT Inc.	ITT	ITT US	Andrew Obin
	Montrose Environmental Group, Inc.	MEG	MEG US	Andrew Obin
	Parker Hannifin Corporation	PH	PH US	Andrew Obin
	PTC Inc.	PTC	PTC US	Andrew Obin
	Rush	RUSHA	RUSHA US	Andrew Obin
	Vertiv	VRT	VRT US	Andrew Obin
	Vontier	VNT	VNT US	Andrew Obin
NEUTRAL				
	3M Company	MMM	MMM US	Andrew Obin
	AMETEK Inc	AME	AME US	Andrew Obin
	Fortive Corporation	FTV	FTV US	Andrew Obin
	Johnson Controls International PLC	JCI	JCI US	Andrew Obin
	Pentair plc	PNR	PNR US	Andrew Obin
	Rockwell	ROK	ROK US	Andrew Obin
	Trane Technologies PLC	TT	TT US	Andrew Obin
UNDERPERFORM				
	Allegion	ALLE	ALLE US	Andrew Obin
	Carrier Global Corp.	CARR	CARR US	Andrew Obin
	Core & Main	CNM	CNM US	Andrew Obin
	Illinois Tool Works	ITW	ITW US	Andrew Obin
	John Bean Technologies	JBT	JBT US	Andrew Obin
	Keysight	KEYS	KEYS US	David Ridley-Lane, CFA

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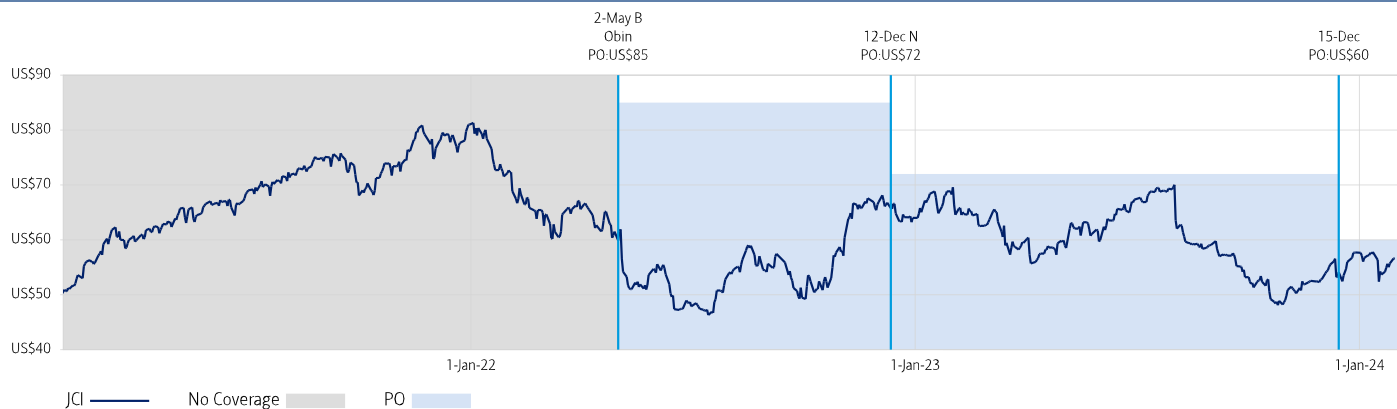
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Carrier (CARR) Price Chart



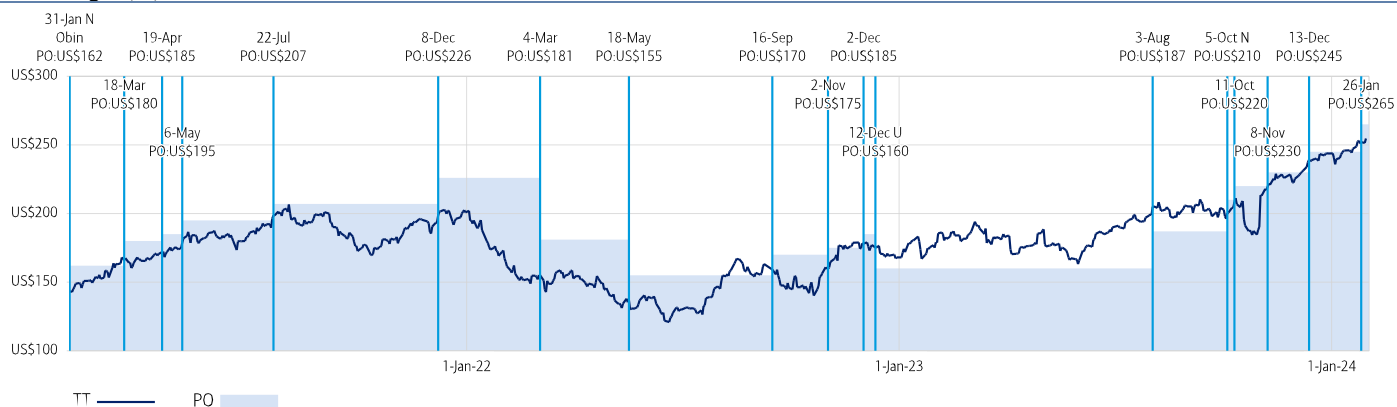
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Johnson Controls Int (JCI) Price Chart

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Trane Technologies (TT) Price Chart

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Equity Investment Rating Distribution: Industrials/Multi-Industry Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	45	50.56%	Buy	25	55.56%
Hold	26	29.21%	Hold	13	50.00%
Sell	18	20.22%	Sell	7	38.89%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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