Event Brief of Q1 2018 Lennox International Inc Earnings Call - Final

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OVERVIEW

Co. reported 1Q18 GAAP revenue of $835m, GAAP operating income of $53m and GAAP EPS from continuing operations of $0.90. Expects 2018 adjusted revenue growth guidance to be 4-8%, GAAP EPS from continuing operations to be $8.79-9.39 and adjusted EPS from continuing operations to be $9.75-10.35.

FINANCIAL DATA

1. 1Q18 GAAP revenue = $835m.

2. 1Q18 adjusted revenue = $788m.

3. 1Q18 GAAP operating income = $53m.

4. 1Q18 GAAP EPS from continuing operations = $0.90.

5. 1Q18 adjusted EPS from continuing operations = $1.13.

6. 1Q18 YoverY GAAP revenue growth = 5%.

7. 1Q18 YoverY adjusted revenue growth = 6%.

8. 1Q18 CapEx = $23m.

9. Cash and cash equivalents (at March-end) = $57m.

10. 1Q18-end total debt = $1.29b.

11. 1Q18 stock repurchases = $150m.

12. 2018 adjusted revenue growth guidance = 4-8%.

13. 2018 GAAP EPS from continuing operations guidance = $8.79-9.39.

14. 2018 adjusted EPS from continuing operations guidance = $9.75-10.35.

PRESENTATION SUMMARY -

Annotation (S.H.)

1. Note:

1. All comparisons are against prior-year period, unless otherwise noted.

1Q18 Review (T.B.)

1. Highlights:

1. Posted strong revenue and profit growth.

1. This set new 1Q highs for:

1. Revenue.

2. Total segment margin and profit.

3. Adjusted EPS from continuing operations.

2. GAAP revenue $835m; 1Q record.

1. Up 5%.

2. Adjusted revenue, excluding non-core refrigeration businesses in Australia, Asia and South America that Co. is in process of divesting, was up 6% to record $788m.

3. At constant currency, revenue in both cases was up 4%.

3. GAAP operating income was $53m, including $13m in pretax charges for write-down of assets and divestiture costs associated with Australia and Asia transaction.

4. GAAP EPS from continuing operations was $0.90, including $0.30 in charges for write-down of assets and divestiture costs associated with Australia and Asia transaction.

5. On adjusted basis, total segment profit rose 12% to 1Q record $69m.

1. Total segment margin expanded 50 BP for 1Q record 8.8%.

6. Adjusted EPS from continuing operations rose 33% to a 1Q record $1.13.

2. Residential:

1. Established new 1Q highs for:

1. Revenue.

2. Segment margin.

3. Profit.

2. Revenue was up 8%.

1. Replacement business up high-single digits.

2. New construction up mid-single digits.

3. Residential had strong price performance and [richer] mix than a year ago, with replacement business growing faster than new construction.

4. Segment profit rose 21%.

5. Segment margin expanded 120 BP to 11.3%.

3. Commercial:

1. Revenue and profit hit new 1Q highs.

2. Revenue up 3% at constant currency.

3. Segment profit up 2%.

4. Segment margin of 9.5% was off 30 BP from record 1Q level a year ago.

5. In North America, commercial equipment revenue up low-single digits.

6. Replacement revenue up mid-single digits.

7. New construction revenue down mid-single digits.

8. Looking at equipment business in other way, national account revenue was flat and regional and local revenue was up mid-single digits.

9. On service side, national account service revenue was up strong mid-20% rate.

10. In Europe, commercial HVAC revenue was down mid-teens at constant currency.

4. Refrigeration:

1. In core refrigeration business, revenue was down 5% at constant currency.

2. In North America, refrigeration system revenue was relatively flat.

1. Refrigerated display case revenue was down high-teens from a year ago.

3. In Europe, revenue was up mid-teens at constant currency on strength in food and non-food refrigeration business.

4. Segment profit was down 14%.

5. Segment margin was down 100 BP to 7.4%.

6. (inaudible) sale of non-core refrigeration businesses, as announced in March Co. signed a binding agreement for sale of Australia and Asia business to Beijer Ref.

1. Expects sale to close in 2Q18.

7. In 1Q, had $13m in pretax charge or $0.30 to GAAP EPS for write-down of assets and divestiture costs associated with transaction.

8. In April, signed binding agreement for sale of South American business to Elgin, a privately-held Brazilian co.

1. Expects sale to close later this year.

2. Subject to Brazilian anti-trust approval in 2Q, expects to take approx. $30m in non-cash charges associated with transaction, which is approx. $0.73 factored in to GAAP EPS guidance.

9. Co. is in process of selling real estate in Sydney metro area that was formerly related to Australia operations.

1. Expects that to be concluded before year-end.

2. Given low book value of property in strong Sydney real estate market, expects a sizable gain on the sale.

10. Broadly estimating total net proceeds from aforementioned transactions of approx. $110m, which Co. expects to receive over course of the year as sales are closed.

11. Excited about streamlining refrigeration portfolio to focus on strong market position in North America and Europe and market opportunities in these regions.

5. Summary:

1. Overall for Co. in 2018, will continue to invest in core businesses, grow dividend and repurchase stock.

2. Directed $150m to stock repurchases.

1. Has announced plans for total of $350m of stock repurchases for full year.

3. 1Q was a record start to the year.

1. As Co. enters largest seasonal period, continues to expect strong growth and profitability on its way to another record year in 2018.

1Q18 Financials (J.R.)

1. Residential Heating & Cooling:

1. Revenue was 1Q record $454m.

1. Up 8%.

2. Volume up 5%.

3. Price up 2%.

4. Mix up 1%.

5. FX was neutral to revenue.

6. Profit was 1Q record $51m.

1. Up 21%.

7. Segment margin was 1Q record 11.3%.

1. Up 120 BP.

8. Segment profit was positively impacted by higher volume and factory productivity, favorable price and mix and sourcing and engineering-led cost reductions.

1. Partial offsets included higher commodity and freight costs, higher SG&A and distribution investments.

2. Commercial Heating & Cooling:

1. Revenue was 1Q record $206m.

1. Up 5%.

2. Volume up 3%.

3. Price up 1%.

4. Mix down 1%.

5. FX had positive 2% impact on revenue.

6. North America commercial HVAC equipment revenue up low-single digits.

7. National account services revenue up at mid-20% rate.

8. European commercial HVAC revenue down low-single digits.

9. Segment profit was 1Q record $20m.

1. Up 2%.

10. Segment profit margin was 9.5%.

1. Off 30 BP from 1Q record level a year ago.

11. Segment profit was positively impacted by higher volume, higher price, sourcing and engineering-led cost reductions, lower other product costs and lower SG&A.

1. Partial offsets included unfavorable mix, higher commodity and freight costs and distribution investments.

3. Refrigeration:

1. In refrigeration segment, which now excludes non-core businesses in Australia, Asia and South America that Co. is divesting, revenue was $129m.

1. Down 2%.

2. Volume down 6%.

3. Price up 1%.

4. Mix was flat.

5. FX had positive 3% impact on revenue.

6. By region at actual currency on reported basis:

1. North America down high-single digits.

2. Europe up 30%.

7. Segment profit $10m.

1. Down 14%.

8. Segment margin 7.4%.

1. Down 100 BP.

9. Segment profit was impacted by lower volume and factory absorption and higher commodity costs.

1. Partial offsets included higher price, sourcing and engineering-led cost reductions, lower other products costs and lower SG&A.

4. Other Financials:

1. On adjusted basis, 1Q had net after-tax charges of $9.4m.

1. This included:

1. $10.3m for asset write-down.

2. $1.9m charge for divestiture costs associated with Australia and Asia transaction.

3. $1.5m for asbestos-related litigation.

4. Net total of $1.3m for various other items.

2. As partial offsets, had:

1. Benefit of $4.3m for excess tax benefits from share-based compensation.

2. Profit of $1.3m for non-core business results.

2. Corporate expenses $11m.

1. Flat with 1Q17.

3. Overall SG&A $155m, or 18.6% of revenue.

1. Down from 19.2% in 1Q17.

4. Net cash used in operations $83m.

1. 1Q17 $108m.

5. CapEx $23m.

1. 1Q17 $25m.

6. Free cash flow:

1. Used approx. $106m vs. use of $132m in 1Q17.

2. Due to seasonal nature of business, Co. uses cash in 1H of the year and generates cash in 2H of the year.

7. Continues to target $395m of free cash flow for 2018 overall.

8. 1Q-end total debt $1.29b.

1. Ended March with debt-to-EBITDA ratio of 2.2.

9. Cash and cash equivalents were $57m at March-end.

10. Paid approx. $21m in dividends and $150m for share repurchases.

5. 2018 Outlook:

1. Market assumptions for 2018 are unchanged.

2. For industry overall, expects:

1. North American residential HVAC shipments to be up mid-single digits.

2. North America commercial unitary shipments to be up low-single digits.

3. North America refrigeration shipments to be up low-single digits.

3. Based on this underlying market environment and targets for market share gains, adjusted revenue growth guidance for Co. is 4-8%, including positive 1% benefit from FX.

1. Prior guidance was 3-7% growth, with minimal impact from FX.

4. GAAP EPS guidance from continuing operations moves from $9.75-10.35 to new range of $8.79-9.39, after incorporating 1Q results and expected 2Q charges associated with divestiture of South American business.

5. Expects sizable gain on sale of Sydney real estate.

1. This is not factored into GAAP guidance for the year.

6. For adjusted EPS from continuing operations guidance for 2018, reiterating range of $9.75-10.35.

7. Key points in guidance assumptions and puts and takes for 2018:

1. Expects $50m of headwind from commodities in 2018, which includes Section 232 tariff impact on steel and aluminum.

1. Confident in offsetting that with $50m of price increases for the year.

2. Continues to expect $35m in savings from sourcing and engineering-led cost reduction programs.

3. Still sees $7m in savings from residential factories, as Co. focuses on automation [on] US plants and other productivity initiatives.

4. Continues to expect $5m benefit from FX for full year.

5. Investments and distribution will still be $10m headwind this year.

6. SG&A growth will be another $10m headwind.

8. Other guidance points:

1. Corporate expenses are still targeted at $85m.

2. Net interest expense is expected to be approx. $35m.

1. Up from prior guidance of $32m.

3. Tax rate guidance remains 22-24% on adjusted basis.

4. Planning for CapEx of approx. $100m.

5. Expected avg. diluted share count is still expected to be 41-42m shares, which includes plans to repurchase $350m of stock this year.

6. $395m in free cash flow is still targeted for full year.

QUESTIONS AND ANSWERS

OPERATOR: (Operator Instructions) First on the line, we have Jeff Hammond with KeyBanc Capital Markets.

JEFFREY DAVID HAMMOND, MD & EQUITY RESEARCH ANALYST, KEYBANC CAPITAL MARKETS INC., RESEARCH DIVISION: So just on price. It sounds like you guys are -- as it moves up, you're covering it. We heard chatter in the channel about June price increases. Is that something you're contemplating? Would that be additive? Maybe just a little more color there.

TODD M. BLUEDORN, CHAIRMAN & CEO, LENNOX INTERNATIONAL INC.: Yes. I mean, first, let me just reiterate the fact, Jeff, that -- maybe we said it in the script, but I'll just reiterate it. We got $11 million of price in the first quarter. 2% of revenue of price in residential, where you get price the earliest, and 1.5% for LII overall. And I think that's the strongest I've seen since I've been here. We had $9 million of commodity headwind in Q1. For the full year, we're confident we're going to get $50 million of price to offset the $50 million of commodity, maybe even better given the traction that we got in first quarter. And as you know, it's both the announcing of price increases, but it's the yield you get on what you announce. So we watch what our competitors do in terms of announcing an official next price increase. But sort of the clear message is we're getting price in the marketplace. We're going to continue to get price in the marketplace. If commodity costs were to move up again, we would get additional price to offset that.

JEFFREY DAVID HAMMOND: Okay. And then refrigeration, I think you're still saying the market's low single digit, but you did come out of the gate here weak, and it seems like more on the display side. Just what gives you confidence that you start to see better trends there? And then just maybe update us on margin traction, expectations for refrigeration, just given that you started the year in the hole.

TODD M. BLUEDORN: The North America refrigeration market, we expect the industry -- I think we're a little bit more conservative than what you said. We expect to be up low single digits, and we expect our business to be up a little bit better than that. The softness in Kysor/Warren is just a reflection of the lumpiness of the grocery business, which is a large part of what they do on the display case side and there is some lumpiness that had impact, both on factory absorption and the volume impact. In terms of margins, we've driven nice margin improvement in refrigeration the last couple of years, and there's more to come in 2018. And 2016 margins were up a couple hundred basis points. In the last year, they were up about 50 basis points. And while we sort of had -- we're down in the first quarter, we're still expecting our margins to be up 50 to 100 basis points full year within our Refrigeration segment. Again, adjusted for the businesses that we're disposing of, sort of an apples-to-apples, we think it's going to be up 50 to 100 basis points.

OPERATOR: Our next question is from Steve Tusa with JPMorgan.

CHARLES STEPHEN TUSA, MD, JP MORGAN CHASE & CO, RESEARCH DIVISION: To further delve into the price cost hysteria out there, but on the Refrigeration side specifically, did you guys say what price cost would be there?

TODD M. BLUEDORN: I'm just looking at some notes to make sure. We offset commodities with price in the first quarter in all 3 segments, including Refrigeration.

CHARLES STEPHEN TUSA: Okay. So going forward here, over the course of the year, you're optimistic you can get price in that channel?

TODD M. BLUEDORN: Yes is the short answer.

CHARLES STEPHEN TUSA: Okay. And are you seeing -- on the resi side, are you seeing everybody behave relatively well? Any holdouts so far? I know there have been -- as Jeff said, a few of your peers have kind of gone out with letters. But maybe there's a couple of guys missing there. Is that -- have you seen everybody kind of move forward?

TODD M. BLUEDORN: I think I'd answer it this way: I'd say we had strong revenue growth in the quarter. I think we outpaced the market and we got price. So that means we gained share raising price that implies, in an industry structure, others are doing the same thing. And then as I've always said, our competitors have the same cost structure we do and they hedge the same way we do and they got a pass on commodities just like we do. So at any given point, if I talk to the sales guys, there's a city where somebody's being irrational on pricing, but across the board, the industry structure is a good one and we all know we have to go get price.

CHARLES STEPHEN TUSA: Okay, that's fair. And then one last thing. What are you -- I know aluminum has kind of moved up here recently. Have you -- what -- when you look at your commodity cost estimates, I assume that reflects kind of like what you know as of April 23 as opposed to March 31.

TODD M. BLUEDORN: Correct. It's our best bet right now. And again, I mean, look, 50 is a pretty round number, so it's plus or minus that to be totally sincere. But 50 is sort of the number. And if it goes up or down a material amount, then we'll update it. But we feel -- I think the high-level message I'd deliver and what -- and I know there's concern about this in the marketplace is we're confident we're going to offset commodities with price, and we had a very good first quarter and demonstrated it, at least for one quarter that we're doing it.

CHARLES STEPHEN TUSA: Right. How are -- just curious, how are April volumes kind of starting off here in resi?

TODD M. BLUEDORN: Anytime the Cubs and the Mets are being snowed out, it's not a good sign for air-conditioning sales. So the honest answer is that April started cooler than last year, but it's very early in the quarter. 80% of the quarter is in May and June and we have plenty of time for the weather to warm up. But it's been cold the first couple of weeks of April and that's had -- and last year, you may recall, it got hot early. So we were hot in April and then cooled off at the end of the quarter. So we still have plenty of time for the heat to come. But it's off to a little bit of a slow start.

CHARLES STEPHEN TUSA: Yes. They always say, sticking your head out the window is not fundamental analysis. So the weather is what it is.

TODD M. BLUEDORN: Exactly, right.

OPERATOR: The next question is from Tim Wojs with Baird.

TIMOTHY RONALD WOJS, SENIOR RESEARCH ANALYST, ROBERT W. BAIRD & CO. INCORPORATED, RESEARCH DIVISION: Maybe just thinking about residential and maybe the business more broadly too, but how are you guys thinking about mix in the context of just some of the price increases that you're seeing in residential? Anything that you've seen? I know the summer selling season is kind of ahead of us. But any context around -- any sort of trade-down or anything like that you're seeing from a mix perspective or expecting?

TODD M. BLUEDORN: No. I mean, we had positive mix in the quarter in resi in part because add-on and replacement was up more than what new construction was and that leads to it. But even within our add-on replacement, we continue to see mix up, and that's all part of the strategy around iComfort and what we're doing with our Dave Lennox Signature Series. So no. Again, we sort of talked about this. At the end consumer level, 2% of price, based on something they bought 15 years ago, where the equipment's half the cost and labor installation's the other half, is to be unnoticeable. And so once you get it past the contractor, dealer to accept it, the homeowner is going to take the price increase.

TIMOTHY RONALD WOJS: Okay. Okay, great. And then just in terms of the use of the cash proceeds on some of the refrigeration sales, is that incorporated into your guidance at this point? Or how would be kind of think about offsetting some of the dilution as you work through '18?

TODD M. BLUEDORN: I think it's not explicitly incorporated into the guidance if you're sort of asking the question of is -- are we anticipating a share buyback that we haven't announced to lower the share count to get to the GAAP -- or to get to the EPS guidance. That's not incorporated. But sort of the mantra's consistent of we'll be disciplined, we'll invest in the core business, we've sort of said what CapEx is going to be. We're going to have dividends grow with earnings. And then what's left, we're going to do share buyback with.

OPERATOR: Next, we'll go to Julian Mitchell with Barclays.

JULIAN C.H. MITCHELL, RESEARCH ANALYST, BARCLAYS BANK PLC, RESEARCH DIVISION: Just a question maybe, you talked a lot about commodity costs thus far, I just wondered on the freight costs. You called those out as headwinds in the residential and commercial businesses. Maybe any kind of sizing of how big a headwind that was in the quarter and how you're thinking about the subsequent impact over the balance of the year from freight costs in the guidance?

TODD M. BLUEDORN: Yes. For the quarter, it was a couple million, $2 million or $3 million. And we've been able to offset that through distribution and transportation productivity in other areas as well as sort of broadly managing the cost of the business. And again, it's -- I would broadly say, take that, multiply it times 3.5, 4, and I think you'd sort of get the full year impact of it. But again, we're offsetting it on other elements of cost on the P&L.

JULIAN C.H. MITCHELL: Very helpful. And then my follow-up would be around the commercial segment. In particular, how quickly do you think we should see margins start to move up year-on-year, whether that's in the second quarter or we have to wait until the second half? And also whether you saw much impact from weather in the first quarter in terms of any kind of activity, push-outs or project delays, that kind of thing.

TODD M. BLUEDORN: No, there wasn't much -- there's always sort of push-outs at the end of the quarter, so there wasn't anything weather driven. What we saw in first quarter for our commercial business is just the lumpiness of national account revenue. And national account revenue is more profitable for us than our regional and local business. And our regional and local business grew faster than national accounts, and that caused the mix down. We're focused on driving margin expansion in commercial. And again, that's sort of -- we had a strong fourth quarter. We had margins decrease in first quarter. But we're committed to having them grow for the balance of the year.

OPERATOR: Our next question is from Gautam Khanna from Cowen and Company.

GAUTAM J. KHANNA, MD AND SENIOR ANALYST, COWEN AND COMPANY, LLC, RESEARCH DIVISION: So a couple of questions. First, now with the refrigeration exits announced, are there any assets in that space you'd like to add to the portfolio to the remaining refrigeration business to help shore it up? Or do you sort of have what you need and not really -- that's not really a focus of M&A from here?

TODD M. BLUEDORN: I think there could be some opportunities, both in North America now that we've parsed our business back, and I -- not in the display case business, but sort of in our more core traditional refrigeration business, there may be opportunities. And we talked more broadly in Europe, both HVAC and refrigeration, there's opportunities. But I wouldn't expect us to pull the trigger on refrigeration in the near term. I think we still have organic opportunities, both for growth and to continue to grow margins to get to our 3-year target. So if we use something on refrigeration, I would love for that to be sometime next year or later.

GAUTAM J. KHANNA: Okay. And then just as a follow-up, when you look at the industry landscape, it all seems pretty rational and everything. But are there any combinations out there that would, you think, pose a threat to Lennox? Because you've heard a little bit about UTX may be splitting up their company eventually, and who knows what happens with JCI post the separation of the auto battery business. Are there any combinations? Like, would that combination be a threat or change the landscape significantly from where you guys sit?

TODD M. BLUEDORN: No.

GAUTAM J. KHANNA: Anything out there that scares you?

TODD M. BLUEDORN: No. I mean, short answer is no. I said it 3 times. But I guess I'll underline it and say where we play North America residential and North America light commercial or unitary, where -- 3 in our end markets and we're at critical mass and scale. And so if 2 of these other sort of large applied companies that also have residential businesses and then certainly in JCI's case, almost an afterthought, sort of combined, that doesn't bother us at all. And again, I, without being too snarky about it, haven't spent a lot of time on UTC. When these conglomerates combine, people worry about that they're still going to have a corner office and are they going to still have the VIP parking pass rather than customers. And so it doesn't bother me when sort of the combination -- actually, I think we gain a lot of share if that happened. Now that, I guess, is the snarky answer. The more constructive answer is, I do think there can be value created through combinations in this industry, and I think we've demonstrated that we're pretty good operators here. And if something comes available, I think we can create value if we were part of the combination.

OPERATOR: The next question is from Jeff Sprague with Vertical Research.

JEFFREY TODD SPRAGUE, FOUNDER AND MANAGING PARTNER, VERTICAL RESEARCH PARTNERS, LLC: The good news is aluminum is down 8% this morning on a little Russia relief. But I've got a question about China, if you don't mind. You had made a point, Todd, historically about outsourcing significantly to China and highlighted that in the Investor Day. As you know, there's a lot of motors and compressors on that list that came out a couple of weeks ago. Can you give us a little color on how you might deal with that? Can you shift back to the U.S.? Is there anything preliminary that you are doing? Or do you just need to wait and see how these cards fall?

TODD M. BLUEDORN: I think I'll answer the latter part of the question first. We have to wait and see how the cards fall. I've learned, we've all learned, you've got to sort of see how it plays out. You can't react to the tweets or sort of to the early pronouncements. And this is obviously more than a tweet. They've put it in -- on paper. But we've just got to see how it plays out. The answer is we have options. We have options both to move it back to North America, to move it to other places in Asia. So we'll wait and see how it plays out. But we have multiple suppliers and flexibility on almost all the components, including the motors, and we'll just see how it plays out and react.

JEFFREY TODD SPRAGUE: Can you give us a sense of how much of your sourcing is still in the U.S. on motors and compressors?

TODD M. BLUEDORN: We do over half our compressors in the U.S. We have a joint venture from decades ago with Emerson that we do. We have a baseload of our scroll compressors come from there. And then some of the premium motors, we still source in the U.S. But even our U.S. suppliers of motors make a lot of those in Asia and source them for us from there. So compressors, more than 50% in the U.S.; motors, more than 50% outside the U.S.

JEFFREY TODD SPRAGUE: And I just wanted some help thinking about incrementals too. Obviously, you're targeting kind of 35%. But as you know, the way the arithmetic works, right, if you're getting price offsetting cost dollar for dollar, that actually erodes margin, right, works against the conversion rate, so to speak. Do you still see a path to drive to 35% incrementals, maybe a little color on how you get there?

TODD M. BLUEDORN: I'll parse it a little bit and just say I think it's closer to 30% than 35%. At least that's what we're attempting to do with our guide this year and longer term. So I think it's more 30% is what we should see the drop through on the model. Yes, we're still pretty confident that we can do it. I mean, we're -- prices are offsetting commodities. But we got SG&A productivity for the quarter and we'll get SG&A productivity for the year. We're offsetting freight and distribution productivity, and we still have the $7 million of factory productivity we're getting in North America. So we still feel pretty good as long as we get the volume on the 30% incrementals that we talked about.

JEFFREY TODD SPRAGUE: Right. And just one final point of clarification. Is the freight of 2 to 3 in addition to the commodities of 9 that you felt in the quarter, or it's inclusive?

TODD M. BLUEDORN: Yes, yes, yes.

OPERATOR: Our next question is from Robert Barry with Susquehanna.

ROBERT D. BARRY, SENIOR ANALYST, SUSQUEHANNA FINANCIAL GROUP, LLLP, RESEARCH DIVISION: Thanks for the more detailed color this quarter on the price versus the mix breakout; appreciate that. But I did actually have a question on a couple of those metrics. That 2% of price in resi kind of expressed as a growth rate, how you would expect that to track as the year progresses?

TODD M. BLUEDORN: I think in resi, it will be relatively consistent. And I think on the commercial and refrigeration, we'll see it uptick a little bit. And I think there will be some lapping maybe in the fourth quarter because we took sort of some preliminary actions going into the year to -- as commodities spiked up second half of the year. So I think maybe -- I'm answering your question real time. I think maybe the 2% tails it out for resi a little bit second half of the year, while commercial and refrigeration tails -- or starts to climb as we're able to get national accounts to some of our larger customers with pricing.

ROBERT D. BARRY: Yes. I mean, maybe there's some rounding there, but it does look like you're off to a pretty solid start on that front.

TODD M. BLUEDORN: Yes, I mean, state the obvious. If we do the math of it, if we do 1.5% all year on $3.9 billion of sales or whatever you sort of have in your model, we're going to do better than what we've said, but that would be good.

ROBERT D. BARRY: Yes. And that mix component of the guide, that 5%, is that just resi?

TODD M. BLUEDORN: It's primarily -- I mean, I don't think it was -- yes, primarily resi. The guide that we give is specifically resi, yes.

ROBERT D. BARRY: Yes. I mean, similar question, 1% in the quarter is almost 5% just in this quarter? I mean, is that just conservatism or do you see some offsets there as we go?

TODD M. BLUEDORN: It's conservatism. I mean, it's, quite frankly, just not -- well, let me give a more thoughtful answer. A part of that mix in the quarter was add-on replacement outgrowing RNC for the quarter, residential new construction. That happens on a full year basis. We'll probably do better on mix than what we guided. If RNC sort of kicks back in, if it's growing at double digits and add-on replacement is more like high single digits, then we have negative mix the other way that we have to offset. I think that's sort of the math of it.

ROBERT D. BARRY: Got it. Fair enough.

TODD M. BLUEDORN: In our models, we still think residential new construction on a full year basis will grow faster.

ROBERT D. BARRY: Got it. What was the kind of the net-net bottom line on how weather impacted resi growth in the quarter, do you think?

TODD M. BLUEDORN: The degree of heating days were up year-over-year. So I mean, it was colder in the first quarter than it was a year ago. So I think net-net it helped. It helped early and it helped sort of on spare parts and supplies. But as we said before, when it's been warm in the first quarter -- the weather in the first quarter isn't near as impactful as it is second, third quarter. So maybe 1 or 2 points, 1% or 2% of revenue.

ROBERT D. BARRY: Got it. Just quick last one for me. In your cash flow guide of $395 million, do you contemplate any material kind of working capital headwind or tailwind in that number?

TODD M. BLUEDORN: The tailwind we incorporated was last year. Recall at the end of the year, we had a disappointing end of the year on cash flow and we pointed at payables and, to a lesser degree, receivables as the reason, and we said that would flow into 2018. And so we added about $30 million to our initial cash flow guide to reflect that working capital tailwind. And then there's sort of nothing other than sort of normal working capital performance that's baked in other than that.

ROBERT D. BARRY: Got it. And that normal would be some modest incremental, just need given the -- right, yes, got it, okay.

TODD M. BLUEDORN: Yes. So the core working capital metrics, for good or for bad, when cost of capital just is slow, we'll spend working capital to drive revenue.

OPERATOR: Next, we will go to Ryan Merkel with William Blair.

RYAN JAMES MERKEL, RESEARCH ANALYST, WILLIAM BLAIR & COMPANY L.L.C., RESEARCH DIVISION: So first question, just back on residential new construction, why was it slower in the quarter? And it sounds like you think it'll still be strong for the year. But just what did you hear and why do you think it's going to pick up?

TODD M. BLUEDORN: I think it's mainly weather driven. The flip side of it being colder this year rather than last year is job sites don't get started and projects don't -- or houses don't get finished. And so I just think it's the reverse of the weather. I don't -- at least so far, when we talk to our -- and I think continuing, when we talked to our builders, big builders, they remain confident. They're not intimidated by the interest rates. They are sort of more constrained by making sure they have the property and the trades, and we still think it's going to be an up year.

RYAN JAMES MERKEL: That makes sense. That's helpful. And then just a follow-up on the commercial margins. It sounds like you think the national account mix is going to improve going forward and that's going to be the big driver of why we should see margins starting to improve year-over-year. But is it also secondary that you should gain a little more price as the year goes on? I think you said that, so price cost actually starts to improve a little bit as well?

TODD M. BLUEDORN: Yes, exactly.

OPERATOR: The next question is from Robert McCarthy with Stifel.

ROBERT PAUL MCCARTHY, MD & SENIOR ANALYST, STIFEL, NICOLAUS & COMPANY, INCORPORATED, RESEARCH DIVISION: Three quick questions, and I'll try to keep it on point just so you don't go from snarky to snide with me. But in any event -- because I know it's a slippery slope with me in particular. So in any event, number one, can we just talk about maybe the hurricane impact in terms of anecdotal, what you could see in terms in the rebuild activity? And then maybe just the second part of that question is, just level set us for the compare and the disruption in the third quarter as we kind of address our models as we're making the turn here?

TODD M. BLUEDORN: The -- when you talk to the team in Houston or to the team in Florida, what they'll tell you is we saw a spike in spare parts right after each of those events, and we saw it for a quarter. And then I think the variable that's unaccounted for that we just have to see how it plays out is, those are places that it's hot year-round so they had to repair their units. And the question is will they replace them when we get into the summer selling season if there's another issue on the unit. So I think it's still yet to be seen and -- but I think quite frankly, it's on the round. And then I'll have to double check, Robert, what we said last year. I don't think we complained -- look, we had a weaker third quarter. We were down low single digits and with -- part of the impact of that were the hurricanes. But as I recall from memory, it was much more about the weather in third quarter than it was that. So I don't think we blamed it when it happened. And then I don't think we were as bullish as others have been about how it's going to bounce back. I think it's on the round both times.

ROBERT PAUL MCCARTHY: Moving around just national accounts, definitely strong growth, obviously, on a bit about shoulder quarter. But I mean, could you talk maybe a little bit about -- was there any compare benefit? Or as you're kind of weathering kind of the retail Armageddon, maybe in terms of trends overall, how should we think about the national account growth playing out for the year?

TODD M. BLUEDORN: I think it continues to be a good story for us, and I think as we've -- as you know, Robert, we've made explicit efforts to diversify away from retail. And increasingly, our mix of business is less retail and more -- when you look at new accounts we won in the last 2 or 3 years, a higher percentage of them are non-retail than retail. And so we're working our way around. And then the other point, as you've heard me talk about is some of our customers are figuring how to compete and have a business model that works, whether it's Home Depot, whether it's Lowe's, whether it's Best Buy and continue to compete against Amazon. And so there's going to continue to be brick-and-mortar, and a lot of those have rooftops that we put on place during the last big bubble of new construction in retail, which mirrored the housing construction a decade ago. Those units are now aging and have to be replaced. Our business model is now a replacement model, 2/3 rather than a new construction model, which used to be 2/3 of our business.

ROBERT PAUL MCCARTHY: Final question is just PartsPlus, any update there on the trajectory of store ads? And any trends, positive or negative, in terms of deployment and traction?

TODD M. BLUEDORN: Yes, we -- our focus, as you know, in 2018 was to not open the same 25 to 30 stores you've opened the last few years, that have it be like 5 or 6. I forgot the exact number. We opened 1 in the first quarter. But we increasingly were talking about the need to drive parts and supplies as a mix of the sales. And we had a nice -- again, weather helped us, because it was cold. But we had a nice growth in parts and supplies. We outgrew our total revenue growth in resi. Parts and supplies grew double digits rather than the high single digits overall. And so parts and supplies had a nice quarter. One quarter doesn't make a trend. But sort of our increased focus appears to be paying off and we look forward to a good year in parts and supplies.

OPERATOR: Next, we will go to Chris Belfiore with UBS.

CHRISTOPHER BELFIORE, EQUITY RESEARCH ASSOCIATE ANALYST OF INDUSTRIALS, UBS INVESTMENT BANK, RESEARCH DIVISION: So in terms of residential, replacement picked up sequentially again, pretty tough comp from last year. So do you think that you guys are seeing any prebuy ahead of like price increase being fully baked in? And with regards to that, are you seeing any channel inventory levels? Are they normal or higher than last year?

TODD M. BLUEDORN: No, the price increases were effective at the end of the year. And so if we pulled anything in, we pulled it in the first -- or fourth quarter last year. The other is, and I know you know it, Chris, but I'll mention for others, I mean, it's tough to do the year-over-year against the hard comp point because last year, we were up significantly because we had more days in first quarter. The number of days versus last year this year, a difference of 1, so it's on the round, where last year, it was up by 4 or 5 days from the prior year. So it's hard to look at the percentages year-over-year and say it was up on a tough comp. But the answer, I think what you're trying to probe is we think it was real demand, underlying homeowner confidence to replace units when they break, demand, and that foreshadows even with the weather being a little cool right now, confidence as we go into the second quarter, both for us and for our contract.

CHRISTOPHER BELFIORE: Right. Yes, great. And then just on the -- you called out factory absorption negatively affecting profitability for the year -- or, for the quarter. Was that only in refrigeration? And how should we expect that to kind of continue to go through the year? Or is this kind of largely behind them at this point?

TODD M. BLUEDORN: It's only refrigeration, and we think it's largely behind us. Again, we sort of communicated that we think we're going to be able to -- while the margins in refrigeration were down 100 basis points for the quarter, we're still confident that we're going to have margins up full year, 50 to 100 basis points, and we look to grow margins in the second quarter.

CHRISTOPHER BELFIORE: Okay. And then just one last kind of on the commercial side in terms of mix. I think last quarter, you guys talked about some mix improving there and trying to potentially gain some more share on the emergency replacement side of things, with your product there. So just any color there in terms of what you're seeing or any trends there?

TODD M. BLUEDORN: No. I mean, we continue to focus on growing not only our national accounts business but our local and regional business. And as I spoke about, we had a pretty good first quarter in our regional national account business, which actually grew quicker than our national accounts business. So there's sort of focus on regional and locals working out and we're focused on growing it.

OPERATOR: And we will go to the Rich Kwas with Wells Fargo Securities.

RICHARD MICHAEL KWAS, MD & SENIOR EQUITY RESEARCH ANALYST, WELLS FARGO SECURITIES, LLC, RESEARCH DIVISION: Just a couple ones. On that local regional piece, is that better margin than national accounts?

TODD M. BLUEDORN: National accounts is actually better margin, believe it or not. And so that's why we felt margin pressure in part. We had mix down in the quarter from that part of the business growing faster than national accounts. And again, you know this, Rich, but for the broader audience, it's counterintuitive when you think about who our customers are on national accounts, but it's also our most expensive, most premium energy-efficient product is who we sell -- who we sell them -- or, the product we sell to them.

RICHARD MICHAEL KWAS: Okay, great. And then on mix for resi, so 1 point benefit in the first quarter. My recollection was last year, you faced stronger growth on the construction side. So you're confident against that, that replacement is a little bit weaker. So should we expect this mix of, say, 100 bps, is that going to continue next couple or 3 quarters?

TODD M. BLUEDORN: Steve asked the question or someone asked the question earlier, and I said popped all the way around and I -- the short answer is if -- we are mixing up and always sort of mix up at add-on and replacement. And so that's been the trend for the last 2 or 3 years. We expect that to be the trend this year. The variable that's offset it over the last couple of years is this residential new construction has grown faster than add-on and replacement has built, there's some market in our sales. And so if the rest of the year looks like first quarter, which is our add-on and replacement business grows faster than residential new construction, we're going to have a nice mix tailwind. We don't think that's going to be the case. In our internal models, we think residential new construction was impacted by cooler weather in the quarter. And for the balance of the year, it will -- the market will probably outpace add-on and replacement.

RICHARD MICHAEL KWAS: Okay. So that's potential upside when it's all said and done?

TODD M. BLUEDORN: Correct. I mean, it's upside on mix but maybe less volume. So we like both of them to be up strong.

RICHARD MICHAEL KWAS: Right, of course. And then SG&A, should we still think about half of sales growth?

TODD M. BLUEDORN: Yes. Although we're off to a good start, but, yes, that's how I would model it.

OPERATOR: With no further questions, I'll turn it back to the company for closing comments.

TODD M. BLUEDORN: Great. Thanks again everyone for joining us. To wrap up, first quarter was a record start to the year. We entered our largest seasonal period. We continue to expect strong growth, profitability and cash generation for another record year in 2018. Again, thanks, everyone for joining us.

OPERATOR: Ladies and gentlemen, that does conclude your conference for today. Thank you for your participation. You may now disconnect.

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