Q1 2018 Lennox International Inc Earnings Call - Final

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OPERATOR: Ladies and gentlemen, thank you for standing by. Welcome to the Lennox International First Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this call is being recorded.

I would now like to turn the conference over to Steve Harrison, Vice President of Investor Relations. Please go ahead.

STEVE L. HARRISON, VP OF IR, LENNOX INTERNATIONAL INC.: Good morning. Thank you for joining us for this review of Lennox International's financial performance for the first quarter of 2018. I'm here today with Chairman and CEO, Todd Bluedorn; and CFO, Joe Reitmeier. Todd will review key points for the quarter and Joe will take you through the company's financial performance and outlook. (Operator Instructions)

In the earnings release we issued this morning, we have included the necessary reconciliation of the non-GAAP financial measures that will be discussed to GAAP measures. All comparisons mentioned today are against the prior year period unless otherwise noted. You can find a direct link to the webcast to today's conference call on our website at www.lennoxinternational.com. The webcast also will be archived on that site for replay.

I would like to remind everyone that in the course of this call, to give you a better understanding of our operations, we will be making certain forward-looking statements. These statements are subject to numerous risks and uncertainties that could cause actual results to differ materially from such statements.

For information concerning these risks and uncertainties, see Lennox International's publicly available filings with the SEC. The company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Now let me turn the call over to Chairman and CEO, Todd Bluedorn.

TODD M. BLUEDORN, CHAIRMAN & CEO, LENNOX INTERNATIONAL INC.: Thanks, Steve. Good morning, everyone, and thanks for joining us. In the first quarter of 2018, Lennox International posted strong revenue and profit growth that set new first quarter highs for revenue, total segment margin and profit and adjusted EPS from continuing operations.

Revenue on a GAAP basis was a first quarter record $835 million, up 5%. On an adjusted basis excluding noncore Refrigeration businesses in Australia, Asia and South America that we are in the process of divesting, as previously announced, revenue was up 6% to a record $788 million. At constant currency, revenue in both cases was up 4%.

On a GAAP basis, operating income was $53 million in the first quarter, including $13 million in pretax charges for the write-down of assets and divestiture of costs associated with Australia and Asia transaction. GAAP EPS from continuing operations was $0.90, including $0.30 in charges for the write-down of assets and divestiture cost associated with the Australia and Asia transaction.

On an adjusted basis, total segment profit rose 12% to a first quarter record $69 million. Total segment margin expanded 50 basis points for a first quarter record of 8.8%, and adjusted EPS from continuing operations rose 33% to a first quarter record of $1.13.

Turning to the key points on our business segments for the first quarter. Residential established new first quarter highs for revenue, segment margin and profit. Revenue was up 8%, with replacement business up high single digits and new construction up mid-single digits. Residential had strong price performance and a richer mix than a year ago, with the replacement business growing faster than new construction. Residential segment profit rose 21% and segment margin expanded 120 basis points to 11.3%.

Turning to Commercial in the first quarter. Revenue and profit hit new first quarter highs. Revenue was up 3% at constant currency and segment profit was up 2%. Segment margin of 9.5% was off 30 basis points from the record first quarter level a year ago. In North America, commercial equipment revenue was up low single digits for the quarter, replacement revenue was up mid-single digits and new construction revenue was down mid-single digits.

Looking at the equipment business another way. National revenue was flat in the -- national account revenue was flat in the quarter and regional and local revenue was up mid-single digits. On the service side, National Account Service revenue was up a strong mid-20% rate. In Europe, Commercial HVAC revenue was down mid-teens at constant currency.

In our core Refrigeration business, revenue was down 5% at constant currency. In North America, Refrigeration system revenue was relatively flat. Refrigerated display case revenue was down high teens from a year ago. In Europe, revenue was up mid-teens at constant currency on strength in both food and nonfood Refrigeration business. Refrigeration segment profit was down 14% and segment margin was down 100 basis points, to 7.4%.

Talk to you on the sale of our noncore Refrigeration businesses. As announced in March, we signed a binding agreement for the sale of our Australia and Asia business to Beijer Ref. We expect the sale to close in the second quarter. As I mentioned earlier, in the first quarter, we had a $13 million pretax charge or $0.30 to GAAP EPS for the write-down of assets and divestiture costs associated with the transaction.

In April, we signed a binding agreement for the sale of our South America business to Elgin, a privately held Brazilian company. We expect the sale to close later this year. Subject to Brazilian antitrust approval, in the second quarter we expect to take approximately $30 million in noncash charges associated with the transaction, which is approximately $0.73 factored in to GAAP EPS guidance.

We're also in the process of selling real estate in the Sydney metro area that was formerly related to Australia operations, and we'll expect that to be concluded before the end of the year. Given a low book value of the property in the strong Sydney real estate market, we would expect a sizable gain on the sale.

As previously announced, we are broadly estimating total net proceeds from these transactions of approximately USD 110 million, which we expect to receive over the course of the year as the sales are closed. We are excited about the streamlining of our Refrigeration portfolio to focus on our strong market position in North America and Europe and the market opportunities in these regions.

Overall for the company in 2018, we will continue to invest in our core businesses, grow the dividend and repurchase stock. We directed $150 million of stock repurchases in the first quarter and have announced plans for a total of $350 million of stock repurchases for the full year. The first quarter was a record start to the year. And as we enter our largest seasonal period, we continue to expect strong growth and profitability on our way to another record year in 2018.

Now I'll turn it over to Joe.

JOSEPH WILLIAM REITMEIER, EXECUTIVE VP & CFO, LENNOX INTERNATIONAL INC.: Thank you, Todd, and good morning, everyone. I'll provide some additional comments and financial details on the business segments for the quarter, starting with Residential Heating & Cooling. In the first quarter, revenue from Residential Heating & Cooling was a first quarter record $454 million, up 8%. Volume was up 5%, price was up 2% and mix was up 1%. Foreign exchange was neutral to revenue.

Residential profit was first quarter record $51 million, up 21%. Segment margin was a first quarter record 11.3%, up 120 basis points. Segment profit was positively impacted by higher volume and factory productivity, favorable price and mix and sourcing and engineering-led cost reductions. Partial offsets include higher commodity and freight cost, higher SG&A and distribution investments.

Now turning to our Commercial Heating & Cooling business. Commercial revenue was a first quarter record $206 million, up 5%. Volume was up 3%, price was up 1% and mix was down 1%. Foreign exchange had a positive 2% impact on revenue.

North America Commercial HVAC equipment revenue was up low single digits. National Account Services revenue was up at a mid-20% rate. European Commercial HVAC revenue was down low single digits.

Commercial segment profit was a first quarter record $20 million, up 2%. Segment profit margin was 9.5%, off 30 basis points from the first quarter record level a year ago. Segment profit was positively impacted by higher volume, higher price, sourcing and engineering-led cost reductions, lower other product costs and lower SG&A. Partial offsets included unfavorable mix, higher commodity and freight costs and distribution investments.

In our Refrigeration segment, which now excludes the noncore businesses in Australia, Asia and South America that we are divesting, revenue in the first quarter was $129 million, down 2%. Volume was down 6%, price was up 1% and mix was flat. Foreign exchange had a positive 3% impact on revenue.

By region, at actual currency, on a reported basis, North America was down high single digits and Europe was up 30%. Refrigeration segment profit was $10 million, down 14%. Segment margin was 7.4%, down 100 basis points. Segment profit was impacted by lower volume and factory absorption and higher commodity costs. Partial offsets include higher price, sourcing and engineering-led cost reductions and lower other product costs and lower SG&A.

Overall for the company on an adjusted basis, the first quarter had net after-tax charges of $9.4 million. This included $10.3 million for the asset write-down and a $1.9 million charge for the divestiture cost associated with the Australia and Asia transaction, $1.5 million for asbestos-related litigation and a net total of $1.3 million for various other items.

As partial offsets, we had a benefit of $4.3 million for excess tax benefits from share-based compensation and profit of $1.3 million for noncore business results. Corporate expenses were $11 million in the first quarter, flat with the prior year quarter. Overall, SG&A was $155 million or 18.6% of revenue, down from 19.2% in the prior year quarter.

Net cash used in operations in the first quarter was $83 million compared to $108 million in the first quarter a year ago. Capital spending was $23 million compared to $25 million in the prior year quarter.

With respect to free cash flow, we used approximately $106 million in the first quarter compared to a use of $132 million in the prior year quarter. Due to the seasonal nature of our business, the company uses cash in the first half of the year and generates cash in the second half of the year. We continue to target $395 million of free cash flow for 2018 overall.

Total debt was $1.29 billion at the end of the first quarter and we ended March with a debt-to-EBITDA ratio of 2.2. Cash and cash equivalents were $57 million at the end of March and the company paid approximately $21 million in dividends and $150 million for share repurchases in the first quarter.

Before I turn it over to Q&A, I'll review our outlook for 2018. Our market assumptions for 2018 are unchanged. For the industry overall, we expect North American Residential HVAC shipments to be up mid-single digits. We expect North America commercial unitary shipments to be up low single digits, and we expect North America refrigeration shipments to be up low single digits.

Based on this underlying market environment and our targets for market share gains, adjusted revenue growth guidance for Lennox International is 4% to 8%, including a positive 1% benefit from foreign exchange. Our prior guidance was 3% to 7% growth, with a minimal impact from foreign exchange.

GAAP EPS guidance from continuing operations for 2018 moves from a range of $9.75 to $10.35 to a new range of $8.79 to $9.39 after incorporating first quarter results and the expected second quarter charges associated with the divestiture of the South American business.

As Todd mentioned, we expect a sizable gain on the sale of our Sydney real estate and this is not factored into our GAAP guidance for the year. For adjusted EPS from continuing operations guidance for 2018, we are reiterating our range of $9.75 to $10.35.

Now let me run through some of the other key points in our guidance assumptions and the puts and takes for 2018. We continue to expect $50 million of headwind from commodities in 2018, which includes Section 232 tariff impact on steel and aluminum, and are confident in offsetting that with $50 million of price increases for the year.

We continue to expect $35 million in savings from our sourcing and engineering-led cost reduction programs. We still see $7 million in savings from our residential factories as we focus on automation on our U.S. plants and other productivity initiatives. We continue to expect a $5 million benefit from foreign exchange for the full year, and investments in distribution will still be a $10 million headwind this year and SG&A growth will be another $10 million headwind.

Now just a few more guidance points. Corporate expenses are still targeted at $85 million for this year. Net interest expense is now expected to be approximately $35 million for the full year, up from prior guidance of $32 million. Tax rate guidance remains 22% to 24% on an adjusted basis for the full year.

We are planning for capital expenditures of approximately $100 million for 2018 and the expected average diluted share count for the full year is still expected to be 41 million to 42 million shares, which includes our plans to repurchase $350 million of stock this year. And $395 million in free cash flow is still targeted for the full year.

And with that, let's go to Q&A.

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: 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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