

LENNOX INTERNATIONAL INC

Form 10-Q

April 26, 2011

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549  
FORM 10-Q**

(MARK ONE)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2011**  
**OR**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 001-15149  
LENNOX INTERNATIONAL INC.**

Incorporated pursuant to the Laws of the State of DELAWARE

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Securities Exchange Act of 1934.

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).

Yes  No

As of April 21, 2011, the number of shares outstanding of the registrant's common stock, par value \$.01 per share, was 53,329,436.



**LENNOX INTERNATIONAL INC.**  
**FORM 10-Q**  
**For the Three Months Ended March 31, 2011**  
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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements.**

**LENNOX INTERNATIONAL INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(In millions, except share and per share data)

	As of March 31, 2011 (unaudited)	As of December 31, 2010
<b>ASSETS</b>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 55.2	\$ 160.0
Restricted cash	10.5	12.2
Accounts and notes receivable, net of allowances of \$16.4 and \$12.8 in 2011 and 2010, respectively	404.6	384.8
Inventories, net	453.2	286.2
Deferred income taxes	41.2	36.7
Other assets	82.3	67.0
Total current assets	1,047.0	946.9
PROPERTY, PLANT AND EQUIPMENT, net of accumulated depreciation of \$596.3 and \$584.7 in 2011 and 2010, respectively	348.4	324.3
GOODWILL	321.3	271.8
DEFERRED INCOME TAXES	88.6	87.2
OTHER ASSETS, net	95.1	61.8
TOTAL ASSETS	\$ 1,900.4	\$ 1,692.0
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
CURRENT LIABILITIES:		
Short-term debt	\$ 2.7	\$ 1.4
Asset securitization borrowings	50.0	
Current maturities of long-term debt	0.4	0.6
Accounts payable	340.8	273.8
Accrued expenses	281.8	334.5
Income taxes payable	0.9	5.3
Total current liabilities	676.6	615.6
LONG-TERM DEBT	488.5	317.0
POSTRETIREMENT BENEFITS, OTHER THAN PENSIONS	15.8	15.9
PENSIONS	88.7	88.1
OTHER LIABILITIES	64.4	65.7
Total liabilities	1,334.0	1,102.3
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY:		

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Preferred stock, \$.01 par value, 25,000,000 shares authorized, no shares issued or outstanding		
Common stock, \$.01 par value, 200,000,000 shares authorized, 86,594,374 shares and 86,480,816 shares issued for 2011 and 2010, respectively	0.9	0.9
Additional paid-in capital	870.6	863.5
Retained earnings	625.4	642.2
Accumulated other comprehensive income	41.4	30.2
Treasury stock, at cost, 33,274,352 shares and 32,784,503 shares for 2011 and 2010, respectively	(971.9)	(947.1)
Total stockholders' equity	566.4	589.7
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 1,900.4</b>	<b>\$ 1,692.0</b>

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

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**LENNOX INTERNATIONAL INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited, in millions, except per share data)

	<b>For the</b>	
	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2011</b>	<b>2010</b>
NET SALES	\$ 687.8	\$ 644.1
COST OF GOODS SOLD	522.6	469.8
Gross profit	165.2	174.3
<b>OPERATING EXPENSES:</b>		
Selling, general and administrative expenses	173.9	168.9
Gains and other expenses, net	(0.3)	(0.3)
Restructuring charges	1.2	7.2
Income from equity method investments	(2.6)	(2.0)
Operational (loss) income from continuing operations	(7.0)	0.5
INTEREST EXPENSE, net	4.1	2.5
Loss from continuing operations before income taxes	(11.1)	(2.0)
BENEFIT FROM INCOME TAXES	(3.9)	(0.7)
Loss from continuing operations	(7.2)	(1.3)
<b>DISCONTINUED OPERATIONS:</b>		
Operational loss from discontinued operations		0.4
Benefit from income taxes		(0.1)
Loss from discontinued operations		0.3
Net loss	\$ (7.2)	\$ (1.6)
<b>LOSS PER SHARE BASIC AND DILUTED:</b>		
Loss from continuing operations	\$ (0.13)	\$ (0.02)
Loss from discontinued operations		(0.01)
Net loss	\$ (0.13)	\$ (0.03)
AVERAGE SHARES OUTSTANDING BASIC AND DILUTED	53.6	56.0
CASH DIVIDENDS DECLARED PER SHARE	\$ 0.18	\$ 0.15

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

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**LENNOX INTERNATIONAL INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Three Months Ended March 31, 2011 and 2010**  
**(Unaudited, in millions)**

	<b>2011</b>	<b>2010</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (7.2)	\$ (1.6)
Adjustments to reconcile net loss to net cash used in operating activities:		
Income from equity method investments	(2.6)	(2.0)
Restructuring expenses, net of cash paid	(1.8)	(0.8)
Provision for bad debts	0.8	2.1
Unrealized loss on derivative contracts	1.2	0.1
Stock-based compensation expense	4.9	4.3
Depreciation and amortization	14.8	12.9
Deferred income taxes	(0.8)	2.2
Other items, net	1.2	9.7
Changes in assets and liabilities, net of effects of acquisitions and divestitures:		
Accounts and notes receivable	15.9	4.3
Inventories	(136.3)	(85.6)
Other current assets	(1.3)	(4.8)
Accounts payable	50.9	48.7
Accrued expenses	(60.9)	(28.7)
Income taxes payable and receivable	(25.9)	(5.7)
Other	(1.2)	4.6
Net cash used in operating activities	(148.3)	(40.3)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of property, plant and equipment	(8.2)	(10.7)
Proceeds from sale of property, plant and equipment	0.7	
Proceeds from sale of businesses		3.2
Acquisition of business	(144.2)	(6.7)
Restricted cash	1.6	(25.1)
Net cash used in investing activities	(150.1)	(39.3)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Short-term borrowings, net	1.2	2.1
Asset securitization borrowings, net	50.0	
Long-term payments	(0.2)	(35.1)
Revolver long-term borrowings, net	171.5	93.0
Proceeds from stock option exercises	0.9	1.0
Repurchases of common stock	(24.7)	(39.4)
Excess tax benefits related to share-based payments	1.2	2.1
Cash dividends paid	(8.1)	(7.9)
Net cash provided by financing activities	191.8	15.8



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DECREASE IN CASH AND CASH EQUIVALENTS	(106.6)	(63.8)
EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS	1.8	2.5
CASH AND CASH EQUIVALENTS, beginning of period	160.0	124.3
CASH AND CASH EQUIVALENTS, end of period	\$ 55.2	\$ 63.0

Supplementary disclosures of cash flow information:

Cash paid during the year for:

Interest	\$ 1.6	\$ 2.7
Income taxes (net of refunds)	\$ 21.5	\$ 0.5

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

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

**1. General:**

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

***Basis of Presentation***

The accompanying unaudited Consolidated Balance Sheet as of March 31, 2011, the accompanying unaudited Consolidated Statements of Operations for the three months ended March 31, 2011 and 2010, and the accompanying unaudited Consolidated Statements of Cash Flows for the three months ended March 31, 2011 and 2010 should be read in conjunction with our audited consolidated financial statements and footnotes included in our Annual Report on Form 10-K for the year ended December 31, 2010. The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The accompanying consolidated financial statements contain all material adjustments, consisting principally of normal recurring adjustments, necessary for a fair presentation of our financial position, results of operations and cash flows. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to applicable rules and regulations, although we believe that the disclosures herein are adequate to make the information presented not misleading. The operating results for the interim periods are not necessarily indicative of the results that may be expected for a full year.

Our fiscal year ends on December 31 and our quarters are each comprised of 13 weeks. For convenience, throughout these financial statements, the 13 weeks comprising each quarterly period are denoted by the last day of the respective calendar quarter.

***Use of Estimates***

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

We evaluate these estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment. We believe these estimates and assumptions to be reasonable under the circumstances and adjust such estimates and assumptions when facts and circumstances dictate.

**2. Inventories:**

Components of inventories are as follows (in millions):

	<b>As of March 31, 2011</b>	<b>As of December 31, 2010</b>
Finished goods	\$ 324.9	\$ 213.7
Work in process	17.6	6.5
Raw materials and repair parts	182.1	137.0
	524.6	357.2
Excess of current cost over last-in, first-out cost	(71.4)	(71.0)
Total inventories, net	\$ 453.2	\$ 286.2



**Table of Contents****3. Acquisition:**

On January 14, 2011, we acquired substantially all the assets of the Kysor/Warren business from The Manitowoc Company. Kysor/Warren is a leading manufacturer of refrigerated systems and display cases for supermarkets throughout North America and will be included in our Refrigeration Segment. The total consideration for the acquisition was \$144.2 million, including post-closing purchase price working capital adjustments. In connection with this acquisition, we recorded goodwill of \$43.3 million and intangible assets of \$33.4 million. The intangible assets consisted of the following: trade names of \$5.0 million with indefinite lives, customer relationships of \$26.2 million with 11 to 12 year lives, and other intangibles of \$2.2 million with lives ranging from one to eight years. We paid more than the fair value of the underlying net assets as a result of expected operational synergies. The entire \$43.3 million of goodwill is expected to be deductible for tax purposes. The initial accounting for this acquisition is substantially complete with the exception of additional minor adjustments as allowed under the purchase agreement. Overall, the acquisition would not have had a significant impact on our historical results.

**4. Goodwill:**

The changes in the carrying amount of goodwill for the first quarter of 2011, in total and by segment, are as follows (in millions):

<b>Segment:</b>	<b>Balance at December 31, 2010 Goodwill</b>	<b>Acquisitions/ (Dispositions) (2)</b>	<b>Other<sup>(3)</sup></b>	<b>Balance at March 31, 2011 Goodwill</b>
Residential Heating & Cooling	\$ 33.7	\$	\$	\$ 33.7
Commercial Heating & Cooling.	30.0		1.2	31.2
Service Experts <sup>(1)</sup>	116.6		3.7	120.3
Refrigeration	91.5	43.3	1.3	136.1
	\$ 271.8	\$ 43.3	\$ 6.2	\$ 321.3

(1) Service Experts goodwill was reduced for accumulated impairment losses of \$208.0 million from prior periods.

(2) During 2011, our Refrigeration segment acquired Kysor/Warren which resulted in additional goodwill of \$43.3 million.

(3) Other consists primarily of changes in foreign currency translation rates.

We performed our annual goodwill impairment test in the first quarter of 2011. Based on this test, our fair values exceeded the carrying values for each of our reporting units; therefore, we recognized no goodwill impairment for any of our reporting units.

**5. Derivatives:***Objectives and Strategies for Using Derivative Instruments***Commodity Price Risk**

We utilize a cash flow hedging program to mitigate our exposure to volatility in the prices of metal commodities we use in our production processes. The hedging program includes the use of futures contracts, and we enter into these contracts based on our hedging strategy. We use a dollar cost averaging strategy for our hedge program. As part of this strategy, a higher percentage of commodity price exposures are hedged near term with lower percentages hedged at future dates. This strategy provides us with protection against near-term price volatility caused by market speculators and market forces, such as supply variation, while allowing us to adjust to market price movements over time. Upon entering into futures contracts, we lock in prices and are subject to derivative losses should the metal commodity prices decrease and gains should the price increase.

Interest Rate Risk

A portion of our debt bears interest at variable interest rates and therefore, we are subject to variability in the cash paid for interest expense. In order to mitigate a portion of the risk, we use a hedging strategy to eliminate the variability of cash flows in the interest payments associated with the first \$100 million of the total variable-rate debt outstanding under our revolving credit facility that is solely due to changes in the benchmark interest rate. This strategy allows us to fix a portion of our interest payments.

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Foreign currency exchange rate movements create a degree of risk by affecting the U.S. dollar value of assets and liabilities arising in foreign currencies. Our objective for entering into foreign currency forward contracts is to mitigate the impact of short-term currency exchange rate movements on certain short-term intercompany transactions. In order to meet that objective, we periodically enter into foreign currency forward contracts that act as economic hedges against changes in foreign currency exchange rates. These forward contracts are not designated as hedges and generally expire during the quarter.

***Cash Flow Hedges***

We include gains or losses in accumulated other comprehensive income ( AOCI ) from our commodity cash flow hedges. The gains or losses related to commodity price hedges are expected to be reclassified into earnings based on the prices of the commodities at the settlement dates. Assuming that commodity prices remain constant, \$6.8 million of derivative gains are expected to be reclassified into earnings within the next 12 months. Commodity futures contracts that are designated as cash flow hedges and are in place as of March 31, 2011 are scheduled to mature through July 2012.

We also include gains or losses in AOCI from our \$100 million pay-fixed, receive-variable interest rate swap with a financial institution at a fixed interest rate of 2.66%. The variable portion of the interest rate swap is tied to the 1-Month LIBOR (the benchmark interest rate). The interest rates under both the interest rate swap and the underlying debt are reset, the swap is settled with the counterparty, and interest is paid, on a monthly basis. Assuming that the interest rate environment remains constant, \$1.4 million of derivative losses are expected to be reclassified into earnings within the next 12 months. The interest rate swap expires October 12, 2012.

We recorded the following amounts related to our cash flow hedges (in millions):

	<b>As of March 31, 2011</b>	<b>As of December 31, 2010</b>
Commodity Price Hedges:		
Gains included in AOCI, net of tax	\$ (6.9)	\$ (11.7)
Provision for income taxes	3.9	6.7
Interest Rate Swap:		
Losses included in AOCI, net of tax	\$ 2.0	\$ 2.3
Benefit from income taxes	(1.1)	(1.3)

We had the following outstanding commodity futures contracts designated as cash flow hedges (in millions):

	<b>As of March 31, 2011</b>	<b>As of December 31, 2010</b>
Copper	(pounds) 20.1	(pounds) 18.5

***Derivatives not Designated as Cash Flow Hedges***

For commodity derivatives not designated as cash flow hedges, we follow the same hedging strategy as for derivatives designated as cash flow hedges. We elect not to designate these derivatives as cash flow hedges at the inception of the arrangement. We had the following outstanding commodity futures contracts not designated as cash flow hedges (in millions):

<b>As of March 31,</b>	<b>As of December 31,</b>
--------------------------------	-----------------------------------

	<b>2011</b>	<b>2010</b>
	(pounds)	(pounds)
Copper	1.7	1.4
Aluminum	2.3	1.4

We had the following outstanding foreign currency forward contracts not designated as cash flow hedges (in millions):

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	<b>As of March 31, 2011</b>	<b>As of December 31, 2010</b>
Notional amounts:		
Brazilian Real	5.6	5.6
Mexican Peso	119.0	138.0
Euros	15.6	15.6
British Pounds	2.0	2.0

*Information About the Location and Amounts of Derivative Instruments*

The following table provides the location and amounts of derivative fair values in the Consolidated Balance Sheets and derivative gains and losses in the Consolidated Statements of Operations (in millions):

	<b>Fair Values of Derivative Instruments<sup>(1)</sup></b>			
	<b>Derivatives Designated as Hedging Instruments</b>		<b>Derivatives Not Designated as Hedging Instruments</b>	
	<b>As of March 31, 2011</b>	<b>As of December 31, 2010</b>	<b>As of March 31, 2011</b>	<b>As of December 31, 2010</b>
<b>Current Assets:</b>				
Other Assets				
Commodity futures contracts	\$ 10.9	\$ 17.4	\$ 0.9	\$ 1.4
Foreign currency forward contracts				0.2
<b>Non-Current Assets:</b>				
Other Assets, net				
Commodity futures contracts	0.2	1.3		0.1
<b>Total Assets</b>	<b>\$ 11.1</b>	<b>\$ 18.7</b>	<b>\$ 0.9</b>	<b>\$ 1.7</b>
<b>Current Liabilities:</b>				
Accrued Expenses				
Interest rate swap	\$ 2.2	\$ 2.2	\$	\$
Foreign currency forward contracts			0.3	
<b>Non-Current Liabilities:</b>				
Other Liabilities				
Interest rate swap	0.9	1.4		
<b>Total Liabilities</b>	<b>\$ 3.1</b>	<b>\$ 3.6</b>	<b>\$ 0.3</b>	<b>\$</b>

(1) All our derivative instruments are classified as Level 2 within the fair value hierarchy. For more information on other fair value measurements, see Note 15.





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- (1) The loss (gain) is recorded in Cost of Goods Sold in the accompanying Consolidated Statements of Operations.
- (2) The loss (gain) is recorded in Interest Expense, net in the accompanying Consolidated Statements of Operations.
- (3) The loss (gain) is recorded in Gains and Other Expenses, net in the accompanying Consolidated Statements of Operations.

**6. Income Taxes:**

As of March 31, 2011, we had approximately \$1.1 million in total gross unrecognized tax benefits. Of this amount, \$0.7 million (net of federal benefit on state issues), if recognized, would be recorded through the Consolidated Statement of Operations. As of March 31, 2011, we recognized \$0.1 million (net of federal tax benefits) in interest and penalties in income tax expense in accordance with Financial Accounting Standards Board ( FASB ) Accounting Standards Codification ( ASC ) Topic 740.

We are currently under examination for our U.S. federal income taxes for 2011, 2010, 2009 and 2008 and are subject to examination by numerous other taxing authorities in the U.S. and in jurisdictions such as Australia, Belgium, France, Canada, and Germany. We are generally no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by taxing authorities for years before 2005.

Since January 1, 2011, numerous states including Arizona and Illinois have enacted legislation effective for tax years beginning on or after January 1, 2011, including changes to rates and changes to apportionment methods. We believe any adjustments will be immaterial.

**7. Commitments and Contingencies:**

We are subject to contingencies that arise in the normal course of business, including product warranties and other product related contingencies, pending litigation, environmental matters and other guarantees or claims.

We use a combination of third-party insurance and self-insurance plans (large deductible or captive) to provide protection against claims relating to contingencies such as workers' compensation, general liability, product liability, property damage, aviation liability, directors' and officers' liability, auto liability, physical damage and other exposures. Self-insurance expense and liabilities are actuarially determined based on our historical claims information, as well as industry factors and trends and because we have a captive insurance company, we are required to maintain specified levels of liquid assets from which we must pay claims. The majority of our self-insured risks (excluding auto liability and physical damage) will be paid over an extended period of time. There have been no material changes since our latest fiscal year-end. We also maintain third-party insurance coverage for risks not retained within our large deductible or captive insurance plans. The self-insurance liabilities recorded in Accrued expenses in the accompanying Consolidated Balance Sheets were \$64.8 million and \$61.3 million as of March 31, 2011 and December 31, 2010, respectively.

***Product Warranties and Product Related Contingencies***

Total liabilities for estimated warranty are included in the following captions on the accompanying Consolidated Balance Sheets (in millions):

	<b>As of March 31, 2011</b>	<b>As of December 31, 2010</b>
Accrued expenses	\$ 32.8	\$ 31.2
Other liabilities	43.5	44.3
	<b>\$ 76.3</b>	<b>\$ 75.5</b>



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The changes in the total warranty liabilities for the first quarter of 2011 were as follows (in millions):

Total warranty liability as of December 31, 2010	\$ 75.5
Payments made in 2011	(6.5)
Changes resulting from issuance of new warranties	5.6
Changes in estimates associated with pre-existing liabilities	0.2
Changes in foreign currency translation rates and other	1.5
 Total warranty liability as of March 31, 2011	 \$ 76.3

At the end of each accounting period, we evaluate our warranty liabilities and during the second quarter of each year, we perform a complete reevaluation of our heating, ventilation and air conditioning ( HVAC ) warranty liabilities.

We incur the risk of liability claims for the installation and service of heating and air conditioning products, and we maintain liabilities for those claims that we self-insure. We are involved in various claims and lawsuits related to our products. Our product liability insurance policies have limits that, if exceeded, may result in substantial costs that could have an adverse effect on our results of operations. In addition, warranty claims are not covered by our product liability insurance and certain product liability claims also may not be covered by our product liability insurance. There have been no material changes in the circumstances since our latest fiscal year-end.

We may also incur costs related to our products that may not be covered under our warranties and are not covered by insurance, and we may, from time to time, repair or replace installed products experiencing quality issues in order to satisfy our customers and to protect our brand. These product quality issues may be caused by vendor-supplied components that fail to meet required specifications.

In addition to normal product warranty, we have identified a product quality issue in a heating and cooling product line produced in 2006 and 2007 that we believe results from a vendor-supplied materials quality issue. The expense for this product quality issue, and the related liability, is not included in the tables related to our estimated warranty liabilities. The expense related to this product quality issue was classified in Cost of Goods Sold in the Consolidated Statements of Operations and the related liability is included in Accrued Expenses in the accompanying Consolidated Balance Sheets. We may incur additional charges in the future as more information becomes available. The changes in the accrued product quality issue for the first quarter of 2011 were as follows (in millions):

Total accrued product quality issue as of December 31, 2010	\$ 16.0
Product quality claims	(2.0)
 Total accrued product quality issue as of March 31, 2011	 \$ 14.0

We estimate the costs to settle pending litigation based on experience involving similar claims and specific facts known. We do not believe that any current or pending or threatened litigation will have a material adverse effect on our financial position. Litigation and arbitration, however, involve uncertainties and it is possible that the eventual outcome of litigation could adversely affect our results of operations for a particular period. We are the defendant in a class action lawsuit related to certain hearth products we produced and sold that claims such products are hazardous and that consumers were not adequately warned. On August, 23, 2010, the Company and plaintiffs entered into a binding Memorandum of Understanding ( MOU ) and reached tentative terms for settlement of the case. At the parties request, the court stayed the lawsuit shortly after the MOU was signed. On January 11, 2011, the court granted preliminary approval of the settlement. The court set June 2, 2011 as the date for the final approval hearing. We had \$9.3 million in expenses to date related to this matter with no additional charges during the first quarter of 2011.

Our obligations under the Lake Park Lease are secured by a pledge of our interest in the leased property and are also guaranteed by us and certain of our subsidiaries. The Lake Park Lease, as amended, contains restrictive covenants that are consistent with those of our domestic revolving credit facility. We were in compliance with these financial covenants as of March 31, 2011.

**8. Lines of Credit and Financing Arrangements:**

The following tables summarize our outstanding debt obligations and the classification in the accompanying Consolidated Balance Sheets (in millions):

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	<b>As of March 31, 2011</b>	<b>As of December 31, 2010</b>
<b>Short-Term Debt:</b>		
Foreign obligations	\$ 2.7	\$ 1.4
Asset securitization	50.0	
Total short-term debt	\$ 52.7	\$ 1.4
<b>Current maturities of long-term debt:</b>	\$ 0.4	\$ 0.6
<b>Long-Term Debt:</b>		
Capital lease obligations	17.0	17.0
Domestic revolving credit facility	271.5	100.0
Senior unsecured notes	200.0	200.0
Total long-term debt	\$ 488.5	\$ 317.0
Total debt	\$ 541.6	\$ 319.0

**Short-Term Debt***Foreign Obligations*

Through several of our foreign subsidiaries, we have \$10.9 million in committed combined foreign facilities to assist in financing seasonal borrowing needs for our foreign locations. We had \$10.9 million and \$10.1 million of available capacity as of March 31, 2011 and December 31, 2010, respectively. Our foreign obligations of \$2.7 million represented borrowings under non-committed facilities.

*Asset Securitization*

Under a revolving period asset securitization arrangement ( ASA ), we are eligible to sell beneficial interests in a portion of our trade accounts receivable to participating financial institutions for cash. The arrangement is subject to renewal and contains a provision whereby we retained the right to repurchase all of the outstanding beneficial interests transferred. Our continued involvement with the transferred assets includes servicing, collection and administration of the transferred beneficial interests. The sale of the beneficial interests in our trade accounts receivable are reflected as secured borrowings in the accompanying Consolidated Balance Sheets and proceeds received are included in cash flows from financing activities in the accompanying Consolidated Statements of Cash Flows. The ASA provides for a maximum securitization amount of \$100.0 million or 100% of the net pool balance as defined by the ASA. However, eligibility for securitization is limited based on the amount and quality of the qualifying accounts receivable and is calculated monthly. The beneficial interest sold cannot exceed the maximum amount even if our qualifying accounts receivable is greater than the maximum amount at any point in time. In the first quarter of 2011, we sold a beneficial interest in \$50.0 million of our trade accounts receivable under the ASA. Because the ASA matures in November 2011, we classified the related debt as short-term on the Consolidated Balance Sheet. The eligible amounts available and beneficial interests sold were as follows (in millions):

<b>As of March 31,</b>	<b>As of December 31,</b>
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	<b>2011</b>	<b>2010</b>
Eligible amount available under the ASA on qualified accounts receivable	\$ 94.0	\$ 100.0
Beneficial interest sold	50.0	
Remaining amount available	\$ 44.0	\$ 100.0

Under the ASA, we pay certain discount fees to use the program and have the facility available to us. These fees relate to both the used and unused portions of the securitization. The used fee is based on the beneficial interest sold and calculated on the average floating commercial paper rate determined by the purchaser of the beneficial interest, plus a program fee of 0.75%. The rate as of March 31, 2011 and December 31, 2010 was 1.06% for both periods. The unused fee is based on 102% of the maximum available amount less the beneficial interest sold and calculated at a 0.375% fixed rate throughout the term of the agreement. We recorded these fees in Selling, General and Administrative Expenses in the accompanying Consolidated Statements of Operations. The amounts recorded were as follows (in millions):

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	<b>For the Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Discount fees	\$ 0.1	\$ 0.1

The ASA contains certain restrictive covenants relating to the quality of our accounts receivable and cross-default provisions with our domestic revolving credit facility and senior unsecured notes. The administrative agent under the ASA is also a participant in our domestic revolving credit facility. The participating financial institution has an investment grade credit rating. We continue to evaluate its credit rating and have no reason to believe it will not perform under the ASA. As of March 31, 2011, we were in compliance with all covenant requirements.

**Long-Term Debt***Domestic Revolving Credit Facility*

Under the \$650 million domestic revolving credit facility, we had outstanding borrowings of \$271.5 million and \$69.5 million committed to standby letters of credit as of March 31, 2011. Subject to covenant limitations, \$309.0 million was available for future borrowings. Included in this facility is a subfacility for swingline loans of up to \$50 million and provides for the issuance of letters of credit for the full amount of the credit facility. The subfacility is fully drawn and is included in our outstanding borrowings. This domestic revolving credit facility matures in October 2012.

Our weighted average borrowing rate on the facility was as follows:

	<b>As of March 31, 2011</b>	<b>As of December 31, 2010</b>
Weighted average borrowing rate	1.05%	0.96%

Our domestic revolving credit facility contains financial covenants relating to leverage and interest coverage. Other covenants contained in the domestic revolving credit facility restrict, among other things, mergers, asset dispositions, guarantees, debt, liens, acquisitions, investments, affiliate transactions and our ability to make restricted payments. The financial covenants require us to maintain a defined Consolidated Indebtedness to Adjusted EBITDA Ratio and a Cash Flow (defined as EBITDA minus capital expenditures) to Net Interest Expense Ratio. The required ratios under our domestic revolving credit facility as of March 31, 2011 are detailed below:

Consolidated Indebtedness to Adjusted EBITDA Ratio no greater than	3.5 : 1.0
Cash Flow to Net Interest Expense Ratio no less than	3.0 : 1.0

Our domestic revolving credit facility contains customary events of default. These events of default include nonpayment of principal or interest, breach of covenants or other restrictions or requirements, default on certain other indebtedness or receivables securitizations (cross default), and bankruptcy. A cross default under our revolving credit facility could occur if:

We fail to pay any principal or interest when due on any other indebtedness or receivables securitization of at least \$40.0 million; or

We are in default in the performance of, or compliance with any term of any other indebtedness or receivables securitization in an aggregate principal amount of at least \$40.0 million, or any other condition exists which would give the holders the right to declare such indebtedness due and payable prior to its stated maturity.

Each of our major debt agreements contains provisions by which a default under one agreement causes a default in the others (a cross default). If a cross default under the revolving credit facility, our senior unsecured notes, or our revolving period asset securitization program were to occur, it could have a wider impact on our liquidity than might otherwise occur from a default of a single debt instrument or lease commitment.



If any event of default occurs and is continuing, lenders with a majority of the aggregate commitments may require the administrative agent to terminate our right to borrow under our domestic revolving credit facility and accelerate amounts due under our domestic revolving credit facility (except for a bankruptcy event of default, in which case such amounts will automatically become due and payable and the lenders' commitments will automatically terminate). As of March 31, 2011, we were in compliance with all covenant requirements.

*Senior Unsecured Notes*

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We issued \$200.0 million of senior unsecured notes in May 2010 through a public offering. Interest is paid semiannually on May 15 and November 15 at a fixed interest rate of 4.90% per annum. These notes mature on May 15, 2017.

The notes are guaranteed, on a senior unsecured basis, by each of our domestic subsidiaries that guarantee payment by us of any indebtedness under our domestic revolving credit facility. The indenture governing the notes contains covenants that, among other things, limit our ability and the ability of the subsidiary guarantors to: create or incur certain liens; enter into certain sale and leaseback transactions; enter into certain mergers, consolidations and transfers of substantially all of our assets; and transfer certain properties. The indenture also contains a cross default provision which is triggered if we default on other debt of at least \$75 million in principal which is then accelerated, and such acceleration is not rescinded within 30 days of the notice date. As of March 31, 2011, we were in compliance with all covenant requirements and these covenants have not changed from December 31, 2010.

**Credit Rating**

At March 31, 2011, our senior credit ratings were Baa3, with a stable outlook, and BBB-, with a stable outlook by Moody's and Standard & Poor's Rating Group (S&P), respectively.

**Other Financing Arrangements**

In the first quarter 2010, our captive insurance subsidiary entered into an agreement in which cash was placed into a trust for the benefit of a third-party insurance provider. The purpose of the trust is to pay workers compensation claims for policy years 2003-2009 until the liabilities are fully extinguished. These policies were written by the third-party insurance provider, and then reinsured by our captive insurance subsidiary. As of March 31, 2011 and December 31, 2010, we had \$10.5 million and \$12.2 million in Restricted Cash on the accompanying Consolidated Balance Sheets to pay these claims.

**9. Pension and Postretirement Benefit Plans:**

The components of net periodic benefit cost were as follows (in millions):

	For the Three Months Ended March 31,			
	2011	2010	2011	2010
	Pension Benefits		Other Benefits	
Service cost	\$ 1.4	\$ 1.2	\$ 0.2	\$ 0.2
Interest cost	4.5	4.4	0.2	0.2
Expected return on plan assets	(4.8)	(4.8)		
Amortization of prior service cost	0.1	0.1	(0.5)	(0.5)
Amortization of net loss	1.7	2.2	0.3	0.3
Settlements or curtailments	1.5			
Total net periodic pension cost	\$ 4.4	\$ 3.1	\$ 0.2	\$ 0.2

**10. Comprehensive Income:**

The changes in the components of other comprehensive income, net of taxes, were as follows (in millions):

	For the Three Months Ended March 31,	
	2011	2010
Net loss	\$ (7.2)	\$ (1.6)
Foreign currency translation adjustments, net	16.2	8.4
Derivatives, net of tax benefit of \$2.6 and \$0.1 in 2011 and 2010, respectively	(5.0)	(0.5)
Comprehensive income	\$ 4.0	\$ 6.3

**11. Stock-Based Compensation:**

The Lennox International Inc. 2010 Incentive Plan, as amended and restated provides for various long-term incentive awards, which include stock options, performance share units, restricted stock units and stock appreciation rights. Net stock-based compensation expense recognized was as follows (in millions):

	<b>For the Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Net stock-based compensation expense	\$ 4.9	\$ 4.3

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These expenses are included in Selling, General and Administrative Expenses in the accompanying Consolidated Statements of Operations.

**12. Restructuring Charges:**

As part of our strategic priorities of manufacturing and sourcing excellence and expense reduction, we initiated various manufacturing rationalization actions designed to lower our cost structure. We expanded these expense reductions across the organization by initiating a number of activities to rationalize and reorganize various support and administrative functions. Restructuring charges are not included in our calculation of segment (loss) profit, see Note 14 for further discussion. Detailed below are the restructuring activities that we anticipate incurring additional expense in 2011.

**2010 Plans***Refrigeration*

We began to exit certain Refrigeration manufacturing operations in Milperra, Australia in 2010, specifically our contract coil and OEM coil manufacturing. In the first quarter of 2010, we began to exit the OEM coil manufacturing with total restructuring charges of \$5.8 million composed of \$4.4 million in severance, \$1.2 million in asset impairment charges, and \$0.2 million in other charges. This activity was substantially complete in 2010. We initiated the restructuring activities related to exiting contract coil manufacturing in the third quarter of 2010. The total restructuring charges related to this activity were \$4.2 million composed of \$3.1 million in severance, \$0.4 million in asset impairment and accelerated depreciation, and \$0.7 million in other charges. In the first quarter of 2011, we recognized \$0.5 million in other plant closure costs related to these restructuring activities.

*Service Experts*

We began to reorganize certain administrative functions and the management structure of our Service Experts business in 2010. We initiated two actions in 2010. The first action, started in the second quarter of 2010, was to reorganize the administrative operations of an acquired company. This project was completed in 2010. The second action, initiated in the fourth quarter of 2010, was to reorganize the management structure of our Service Experts business. Expected restructuring charges for this project are \$1.5 million and consist principally of severance charges. We anticipate this action to complete in the third quarter of 2011. We recognized \$0.3 million in lease termination and other costs in the first quarter of 2011.

**2009 and Prior Plans***Refrigeration*

In the fourth quarter of 2009, we began to consolidate certain Refrigeration manufacturing operations located in Parets, Spain into our existing operations in Genas, France. This activity had total restructuring charges of \$8.5 million, consisting of \$6.1 million in severance, \$1.2 million in asset impairment and equipment moves, and \$1.1 million in other charges, and was substantially complete by the fourth quarter of 2010.

*Commercial Heating & Cooling*

We completed the consolidation of certain manufacturing operations from Mions, France into our Longvic, France operations in the first quarter of 2010. This activity had total restructuring charges of \$6.3 million which consist primarily of severance charges. We reversed \$0.1 million in severance charges in the first quarter of 2011 to adjust estimated charges to actual. Additionally, included in our 2009 and Prior Plans was a reorganization of various administration functions for the Commercial Heating & Cooling Segment.

*Residential Heating & Cooling*

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Included in our 2009 and Prior Plans was a consolidation of our manufacturing operations from Blackville, South Carolina into our Orangeburg, South Carolina and Saltillo, Mexico operations. The consolidation is expected to be complete by the fourth quarter of 2011 with expected total restructuring charges of \$14.2 million. These charges consist of \$3.1 million in severance, \$6.0 million in asset impairment and accelerated depreciation, and \$5.2 million in other costs. We recognized \$0.3 million in restructuring charges in the first quarter of 2011 related to other plant closure costs.

**Regional Distribution Network**

In the fourth quarter of 2008, we commenced the transition of activities performed at our North American Parts Center in Des Moines, Iowa to other locations, including our North American Distribution Center in Marshalltown, Iowa. To date, we incurred \$3.2 million, primarily severance costs, and we expect the total cost to be \$3.6 million. The total costs of this project include \$2.7 million in severance costs, \$0.3 million in moving costs, and \$0.3 million in other costs. The transition is expected to complete by the fourth quarter of 2011.

**Total Restructuring**

Information regarding the restructuring charges for all plans is as follows (in millions):

	<b>Charges Incurred in 2011</b>	<b>Charges Incurred to Date</b>	<b>Total Charges Expected to be Incurred</b>
Severance and related expense	\$ 0.1	\$ 50.6	\$ 51.0
Asset write-offs and accelerated depreciation		11.1	11.1
Equipment moves		1.2	2.1
Lease termination		2.5	2.5
Other	1.1	5.9	8.5
Total	\$ 1.2	\$ 71.3	\$ 75.2

Information regarding the restructuring charges by segment is as follows (in millions):

	<b>Charges Incurred in 2011</b>	<b>Charges Incurred to Date</b>	<b>Total Charges Expected to be Incurred</b>
Residential Heating & Cooling	\$ 0.3	\$ 16.0	\$ 18.9
Commercial Heating & Cooling		10.4	10.6
Service Experts	0.3	3.6	3.6
Refrigeration	0.6	29.8	30.6
Corporate & Other		11.5	11.5
Total	\$ 1.2	\$ 71.3	\$ 75.2

Restructuring reserves are included in Accrued Expenses in the accompanying Consolidated Balance Sheets. The table below details activity within the restructuring reserves for the first quarter of 2011 (in millions):

**Charged**

**Non-Cash**

<b>Description of Reserves</b>	<b>Balance as of December 31, 2010</b>	<b>to Earnings</b>	<b>Cash Utilization</b>	<b>Utilization and Other</b>	<b>Balance as of March 31, 2011</b>
Severance and related expense	\$ 6.2	\$ 0.2	\$ (2.0)	\$ 0.1	\$ 4.5
Asset write-offs and accelerated depreciation					
Equipment moves		0.1	(0.1)		
Lease termination	0.3				0.3
Other	0.7	0.9	(0.9)	0.1	0.8
Total restructuring reserves	\$ 7.2	\$ 1.2	\$ (3.0)	\$ 0.2	\$ 5.6

**13. Loss Per Share:**

Due to the net losses recorded in the first quarters of 2011 and 2010, both basic and diluted net loss per share are computed by dividing net loss by the weighted-average number of common shares outstanding during the period.

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The computations of basic and diluted loss per share for Loss from Continuing Operations were as follows (in millions, except per share data):

	<b>For the Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Net loss	\$ (7.2)	\$ (1.6)
Add: Loss from discontinued operations		0.3
Loss from continuing operations	\$ (7.2)	\$ (1.3)
Weighted-average shares outstanding basic and diluted	53.6	56.0
Loss per share from continuing operations basic and diluted	\$ (0.13)	\$ (0.02)

Not included in the 2011 and 2010 computations of diluted loss per share were 1,128,847 and 1,274,529 shares, respectively, of potentially dilutive securities, including stock options, stock appreciation rights, restricted stock units and performance share units as these shares would be anti-dilutive. These shares were anti-dilutive due to the loss position in both periods.

Additionally, stock appreciation rights were outstanding, but not included in the diluted loss per share calculation because the assumed exercise of such rights would be anti-dilutive. The details are as follows:

	<b>For the Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Number of shares	464,314	555,628
Price per share	\$ 46.78	\$ 36.94

**14. Reportable Business Segments:**

We operate in four reportable business segments of the heating, ventilation, air conditioning and refrigeration (HVACR) industry. Our segments are organized primarily by the nature of the products and services provided. The table below details the nature of the operations for each reportable segment:

<b>Segment</b>	<b>Product or Services</b>	<b>Markets Served</b>	<b>Geographic Areas</b>
<i>Residential Heating &amp; Cooling</i>	Heating	Residential Replacement	United States
	Air Conditioning	Residential New	Canada
	Hearth Products	Construction	
<i>Commercial Heating &amp; Cooling</i>	Rooftop Products	Light Commercial	United States
	Chillers		Canada
	Air Handlers		Europe
<i>Service Experts</i>	Equipment Sales	Residential	United States
	Installation	Light Commercial	Canada
	Maintenance		
	Repair		

<i>Refrigeration</i>	Unit Coolers	Light Commercial	United States
	Condensing Units	Food Preservation and	Canada
	Other Commercial	Non-Food/Industrial	Europe
	Refrigeration Products		Asia Pacific
	Display Cases and Systems		South America

Transactions between segments, such as products sold to Service Experts by the Residential Heating & Cooling segment, are recorded on an arm's-length basis using the market price for these products. The eliminations of these intercompany sales and any associated profit are noted in the reconciliation of segment results to the income from continuing operations before income taxes below.

We use segment profit or loss as the primary measure of profitability to evaluate operating performance and to allocate capital resources. We define segment profit or loss as a segment's income or loss from continuing operations before income taxes included in the accompanying Consolidated Statements of Operations:



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## Excluding:

Gains and/or losses and other expenses, net except for gains and/or losses on the sale of fixed assets

Restructuring charges

Goodwill and equity method investment impairments

Interest expense, net

Other expense, net

Less amounts included in Gains and Other Expenses, net:

Realized gains and/or losses on settled futures contracts

Foreign currency exchange gains and/or losses

Our corporate costs include those costs related to corporate functions such as legal, internal audit, treasury, human resources, tax compliance and senior executive staff. Corporate costs also include the long-term share-based incentive awards provided to employees throughout LII. We recorded these share-based awards as Corporate costs as they are determined at the discretion of the Board of Directors and based on the historical practice of doing so for internal reporting purposes.

Net sales and segment (loss) profit by business segment, along with a reconciliation of segment (loss) profit to Loss from Continuing Operations Before Income Taxes are shown below (in millions):

	<b>For the Three Months Ended March, 31</b>	
	<b>2011</b>	<b>2010</b>
<i>Net Sales</i>		
Residential Heating & Cooling	\$ 272.0	\$ 284.2
Commercial Heating & Cooling	138.8	119.7
Service Experts	116.5	127.1
Refrigeration	175.1	131.4
Eliminations (1)	(14.6)	(18.3)
	\$ 687.8	\$ 644.1
<i>Segment (Loss) Profit(2)</i>		
Residential Heating & Cooling	\$ (1.2)	\$ 7.1
Commercial Heating & Cooling	5.9	3.4
Service Experts	(8.2)	(4.6)
Refrigeration	13.5	14.9
Corporate and other	(14.5)	(13.2)
Eliminations (1)	(0.4)	0.2
Subtotal that includes segment (loss) profit and eliminations	(4.9)	7.8
Reconciliation to loss from continuing operations before income taxes:		
Items in gains and other expenses, net that are excluded from segment (loss) profit (3)	0.9	0.1
Restructuring charges	1.2	7.2
Interest expense, net	4.1	2.5

Loss from continuing operations before income taxes	\$ (11.1)	\$ (2.0)
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- (1) Eliminations consist of intercompany sales between business segments, such as products sold to Service Experts by the Residential Heating & Cooling segment.

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- (2) The Company defines segment profit and loss as a segment's income or loss from continuing operations before income taxes included in the accompanying Consolidated Statements of Operations:

Excluding:

Special product quality adjustments.

Items within Gains and/or losses and other expenses, net that are noted in <sup>(3)</sup>.

Restructuring charges.

Goodwill and equity method investment impairments.

Interest expense, net.

Other expense, net.

- (3) Items in Gains and/or losses and other expenses, net that are excluded from segment profit or loss are net change in unrealized gains and/or losses on open future contracts, discount fee on accounts sold, realized gains and/or losses on marketable securities, special legal contingency charge, and other items.

Total assets by business segment are shown below (in millions). The assets in the Corporate segment are primarily comprised of cash and deferred tax assets. Assets recorded in the operating segments represent those assets directly associated with those segments.

	<b>As of March 31, 2011</b>	<b>As of December 31, 2010</b>
<i>Total Assets</i>		
Residential Heating & Cooling	\$ 606.4	\$ 519.8
Commercial Heating & Cooling	270.5	252.7
Service Experts	184.1	186.2
Refrigeration <sup>(2)</sup>	577.2	389.7
Corporate and other	271.1	354.9
Eliminations <sup>(1)</sup>	(8.9)	(11.3)
Total assets	\$ 1,900.4	\$ 1,692.0

- (1) Eliminations consist of net intercompany receivables and intercompany profit included in inventory from products sold between business segments, such as products sold to Service Experts by the Residential Heating & Cooling segment.
- (2) The increase in Total assets for the Refrigeration segment is primarily related to the Kysor/Warren acquisition. See Note 3 for more information on this acquisition.

**15. Fair Value Measurements:*****Assets and Liabilities Measured at Fair Value on a Recurring Basis***

The following table presents the fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis (in millions):

	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	
	<b>As of March 31, 2011</b>	<b>As of December 31, 2010</b>
<b>Assets:</b>		
Investment in marketable equity securities <sup>(1)</sup>	\$ 17.0	\$ 18.0

(1) Investment in marketable equity securities is recorded in Other Assets, net in the accompanying Consolidated Balance Sheets.

***Other Fair Value Measurements***

The carrying amounts of cash and cash equivalents, accounts and notes receivable, net, accounts payable and other current liabilities approximate fair value due to the short maturities of these instruments. The fair values of each of our long-term debt instruments are based on the quoted market prices for the same issues or on the amount of future cash flows associated with each instrument using current market rates for debt instruments of similar maturities and credit risk. The fair values presented are estimates and are not necessarily indicative of

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amounts for which we could settle such instruments currently or indicative of our intent or ability to dispose of or liquidate them. The estimated fair value of our debt was as follows (in millions):

	As of March 31, 2011	As of December 31, 2010
Long-term debt <sup>(1)</sup>	\$ 283.4	\$ 114.6
Senior unsecured notes	210.7	203.0

(1) Long-term debt includes our domestic revolving credit facility, capital lease obligations, foreign obligations and any related current maturities.

**16. Condensed Consolidating Financial Statements**

The Company's senior unsecured notes are unconditionally guaranteed by certain of the Company's subsidiaries (the Guarantor Subsidiaries) while they are not by other subsidiaries (the Non-Guarantor Subsidiaries). As a result of the guarantee arrangements, we are required to present the following condensed consolidating financial statements.

During the first quarter of 2011, our guarantor and non-guarantor subsidiary structure changed as required by our credit facility due to the Kysor/Warren acquisition. Three subsidiaries previously classified as non-guarantor subsidiaries as of December 31, 2010 are now classified as guarantor subsidiaries as of March 31, 2011. These changes will be reflected in the condensed consolidating financial statements for periods after December 31, 2010.

The condensed consolidating financial statements reflect the investments in subsidiaries of the Company using the equity method of accounting. Intercompany account balances have been included in Accounts and Notes Receivable, Other (Current) Assets, Other Assets, net, Short-Term Debt, Accounts Payable, and Long-Term Debt line items of the Parent, Guarantor and Non-Guarantor balance sheets. The principal elimination entries eliminate investments in subsidiaries and intercompany balances and transactions.

Condensed consolidating financial statements of the Company, its Guarantor Subsidiaries and Non-Guarantor Subsidiaries as of March 31, 2011 and December 31, 2010 and for the three months ended March 31, 2011 and 2010 are shown below:

**Condensed Consolidating Balance Sheets****As of March 31, 2011****(In millions)**

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>					
<b>CURRENT ASSETS:</b>					
Cash and cash equivalents	\$	\$ 13.8	\$ 41.4	\$	\$ 55.2
Restricted cash			10.5		10.5
Accounts and notes receivable, net	(886.2)	942.2	347.4	1.2	404.6
Inventories, net		336.2	122.2	(5.2)	453.2
Deferred income taxes	4.4	30.7	9.2	(3.1)	41.2
Other assets	12.0	24.5	137.5	(91.7)	82.3
Total current assets	(869.8)	1,347.4	668.2	(98.8)	1,047.0
<b>PROPERTY, PLANT AND EQUIPMENT, net</b>					
		265.5	82.9		348.4
<b>GOODWILL</b>					
		110.6	210.7		321.3
<b>DEFERRED INCOME TAXES</b>					
	(1.5)	78.8	24.1	(12.8)	88.6
<b>OTHER ASSETS, net</b>					
	2,062.6	410.4	37.6	(2,415.5)	95.1

TOTAL ASSETS	\$ 1,191.3	\$ 2,212.7	\$ 1,023.5	\$ (2,527.1)	\$ 1,900.4
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**LIABILITIES AND STOCKHOLDERS EQUITY**

**CURRENT LIABILITIES:**

Short-term debt	\$ 35.0	\$	\$ 3.0	\$ (35.3)	\$ 2.7
Asset securitization borrowings			50.0		50.0
Current maturities of long-term debt		0.4			0.4
Accounts payable	10.0	221.2	97.5	12.1	340.8
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Accrued expenses	9.6	238.5	95.2	(61.5)	281.8
Income taxes payable	17.5	(17.3)	(0.5)	1.2	0.9
Total current liabilities	72.1	442.8	245.2	(83.5)	676.6
LONG-TERM DEBT	471.5	21.9	127.5	(132.4)	488.5
POSTRETIREMENT BENEFITS, OTHER THAN PENSIONS		15.8			15.8
PENSIONS		78.0	10.6	0.1	88.7
OTHER LIABILITIES	5.1	55.4	16.8	(12.9)	64.4
Total liabilities	548.7	613.9	400.1	(228.7)	1,334.0
COMMITMENTS AND CONTINGENCIES					
TOTAL STOCKHOLDERS EQUITY	642.6	1,598.8	623.4	(2,298.4)	566.4
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 1,191.3	\$ 2,212.7	\$ 1,023.5	\$ (2,527.1)	\$ 1,900.4

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**Condensed Consolidating Statements of Operations**  
**For the Three Months Ended March 31, 2011**  
(In millions)

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
NET SALES	\$	\$ 515.9	\$ 216.5	\$ (44.6)	\$ 687.8
COST OF GOODS SOLD		402.8	165.4	(45.6)	522.6
Gross profit		113.1	51.1	1.0	165.2
OPERATING EXPENSES:					
Selling, general and administrative expenses		127.7	46.1	0.1	173.9
Losses (gains) and other expenses, net	0.9	(0.9)	(0.2)	(0.1)	(0.3)
Restructuring charges		0.7	0.5		1.2
Loss (income) from equity method investments	6.2	1.1	(2.3)	(7.6)	(2.6)
Operational (loss) income from continuing operations	(7.1)	(15.5)	7.0	8.6	(7.0)
INTEREST EXPENSE (INCOME), net	4.0	(0.8)	1.0	(0.1)	4.1
(Loss) income from continuing operations before income taxes	(11.1)	(14.7)	6.0	8.7	(11.1)
(BENEFIT FROM) PROVISIONS FOR INCOME TAXES	(1.8)	(5.0)	2.6	0.3	(3.9)
(Loss) income from continuing operations	(9.3)	(9.7)	3.4	8.4	(7.2)
Loss from discontinued operations					
Net (loss) income	\$ (9.3)	\$ (9.7)	\$ 3.4	\$ 8.4	\$ (7.2)



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**Condensed Consolidating Balance Sheets**  
**As of December 31, 2010**  
(In millions)

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>ASSETS</b>					
<b>CURRENT ASSETS:</b>					
Cash and cash equivalents	\$ 81.1	\$ 14.7	\$ 64.2	\$	\$ 160.0
Restricted cash			12.2		12.2
Accounts and notes receivable, net	(1,169.7)	933.3	613.2	8.0	384.8
Inventories, net		163.7	128.7	(6.2)	286.2
Deferred income taxes		27.6	12.1	(3.0)	36.7
Other assets	19.3	21.0	121.2	(94.5)	67.0
<b>Total current assets</b>	<b>(1,069.3)</b>	<b>1,160.3</b>	<b>951.6</b>	<b>(95.7)</b>	<b>946.9</b>
<b>PROPERTY, PLANT AND EQUIPMENT, net</b>		<b>202.8</b>	<b>121.6</b>	<b>(0.1)</b>	<b>324.3</b>
<b>GOODWILL</b>		<b>50.8</b>	<b>225.8</b>	<b>(4.8)</b>	<b>271.8</b>
<b>DEFERRED INCOME TAXES</b>		<b>77.3</b>	<b>22.6</b>	<b>(12.7)</b>	<b>87.2</b>
<b>OTHER ASSETS, net</b>	<b>2,068.3</b>	<b>415.6</b>	<b>51.8</b>	<b>(2,473.9)</b>	<b>61.8</b>
<b>TOTAL ASSETS</b>	<b>\$ 999.0</b>	<b>\$ 1,906.8</b>	<b>\$ 1,373.4</b>	<b>\$ (2,587.2)</b>	<b>\$ 1,692.0</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>					
<b>CURRENT LIABILITIES:</b>					
Short-term debt	\$ 31.1	\$	\$ 1.8	\$ (31.5)	\$ 1.4
Current maturities of long-term debt		0.2	0.4		0.6
Accounts payable	8.1	133.1	131.0	1.6	273.8
Accrued expenses	6.6	262.0	115.5	(49.6)	334.5
Income taxes payable	(36.1)	30.6	28.3	(17.5)	5.3
<b>Total current liabilities</b>	<b>9.7</b>	<b>425.9</b>	<b>277.0</b>	<b>(97.0)</b>	<b>615.6</b>
<b>LONG-TERM DEBT</b>	<b>300.0</b>	<b>5.4</b>	<b>139.6</b>	<b>(128.0)</b>	<b>317.0</b>
<b>POSTRETIREMENT BENEFITS, OTHER THAN PENSIONS</b>		<b>15.9</b>			<b>15.9</b>
<b>PENSIONS</b>		<b>77.4</b>	<b>10.7</b>		<b>88.1</b>
<b>OTHER LIABILITIES</b>	<b>5.8</b>	<b>46.8</b>	<b>25.9</b>	<b>(12.8)</b>	<b>65.7</b>
<b>Total liabilities</b>	<b>315.5</b>	<b>571.4</b>	<b>453.2</b>	<b>(237.8)</b>	<b>1,102.3</b>
<b>COMMITMENTS AND CONTINGENCIES</b>					
<b>TOTAL STOCKHOLDERS EQUITY</b>	<b>683.5</b>	<b>1,335.4</b>	<b>920.2</b>	<b>(2,349.4)</b>	<b>589.7</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 999.0</b>	<b>\$ 1,906.8</b>	<b>\$ 1,373.4</b>	<b>\$ (2,587.2)</b>	<b>\$ 1,692.0</b>



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**Condensed Consolidating Statements of Operations**  
**For the Three Months Ended March 31, 2010**  
(In millions)

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
NET SALES	\$	\$ 429.4	\$ 274.2	\$ (59.5)	\$ 644.1
COST OF GOODS SOLD		322.7	206.5	(59.4)	469.8
Gross profit		106.7	67.7	(0.1)	174.3
OPERATING EXPENSES:					
Selling, general and administrative expenses		116.4	52.6	(0.1)	168.9
(Gains) losses and other expenses, net	(0.2)	(0.1)			(0.3)
Restructuring charges		2.0	5.1	0.1	7.2
Loss (Income) from equity method investments	4.8	2.9	(2.0)	(7.7)	(2.0)
Operational (loss) income from continuing operations	(4.6)	(14.5)	12.0	7.6	0.5
INTEREST (INCOME) EXPENSE, net	(0.3)	1.9	0.9		2.5
(Loss) income from continuing operations before income taxes	(4.3)	(16.4)	11.1	7.6	(2.0)
PROVISIONS FOR (BENEFIT FROM) INCOME TAXES	0.2	(5.0)	4.1		(0.7)
(Loss) income from continuing operations	(4.5)	(11.4)	7.0	7.6	(1.3)
Loss from discontinued operations			0.3		0.3
Net (loss) income	\$ (4.5)	\$ (11.4)	\$ 6.7	\$ 7.6	\$ (1.6)

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**Condensed Consolidating Statements of Cash Flows**  
**For the Three Months Ended March 31, 2011**  
(In millions)

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net cash provided by (used in) operating activities	\$ 59.7	\$ (131.0)	\$ (77.0)	\$	\$ (148.3)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>					
Proceeds from the disposal of property, plant and equipment		0.7			0.7
Purchases of property, plant and equipment		(7.4)	(0.8)		(8.2)
Acquisition of business		(136.3)	(7.9)		(144.2)
Restricted cash			1.6		1.6
Net cash used in investing activities		(143.0)	(7.1)		(150.1)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>					
Short-term borrowings, net			1.2		1.2
Asset securitization borrowings			50.0		50.0
Long-term payments		(0.2)			(0.2)
Revolver long-term borrowings, net	171.5				171.5
Proceeds from stock option exercises	0.9				0.9
Repurchases of common stock	(24.7)				(24.7)
Excess tax benefits related to share-based payments	1.2				1.2
Intercompany debt	1.8	(2.3)	0.5		
Intercompany financing activity	(283.4)	275.6	7.8		
Cash dividends paid	(8.1)				(8.1)
Net cash (used in) provided by financing activities	(140.8)	273.1	59.5		191.8
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(81.1)	(0.9)	(24.6)		(106.6)
<b>EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS</b>			1.8		1.8
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	81.1	14.7	64.2		160.0
<b>CASH AND CASH EQUIVALENTS, end of year</b>	\$	\$ 13.8	\$ 41.4	\$	\$ 55.2

**Condensed Consolidating Statements of Cash Flows**  
**For the Three Months Ended March 31, 2010**  
(In millions)

	<b>Parent</b>	<b>Guarantor Subsidiaries</b>	<b>Non- Guarantor Subsidiaries</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net cash provided by (used in) operating activities	\$ (53.0)	\$ 32.4	\$ (19.7)	\$	\$ (40.3)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>					
Purchases of property, plant and equipment		(2.1)	(8.6)		(10.7)
		25			

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Proceeds from sale of business		0.1	3.1	3.2
Acquisition of business		(6.7)		(6.7)
Restricted cash			(25.1)	(25.1)
Net cash used in investing activities		(8.7)	(30.6)	(39.3)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>				
Short-term borrowings, net			2.1	2.1
Long-term payments	(35.0)		(0.1)	(35.1)
Revolver long-term payments, net	93.0			93.0
Proceeds from stock option exercises	1.0			1.0
Repurchases of common stock	(39.4)			(39.4)
Excess tax benefits related to share-based payments	2.1			2.1
Intercompany debt	(0.8)	5.2	(4.4)	
Intercompany financing activity	38.5	(27.5)	(11.0)	
Intercompany investments	(7.9)		7.9	
Intercompany dividends	9.0		(9.0)	
Cash dividends paid	(7.9)			(7.9)
Net cash (used in) provided by financing activities	52.6	(22.3)	(14.5)	15.8
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(0.4)	1.4	(64.8)	(63.8)
<b>EFFECT OF EXCHANGE RATES ON CASH AND CASH EQUIVALENTS</b>			2.5	2.5
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	0.8	6.6	116.9	124.3
<b>CASH AND CASH EQUIVALENTS, end of year</b>	\$ 0.4	\$ 8.0	\$ 54.6	\$ 63.0

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that are based on information currently available to management as well as management's assumptions and beliefs. All statements, other than statements of historical fact, included in this Quarterly Report on Form 10-Q constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including but not limited to statements identified by the words may, will, should, plan, predict, anticipate, believe, and expect and similar expressions. Such statements reflect our current views with respect to future events, based on what we believe are reasonable assumptions; however, such statements are subject to certain risks and uncertainties. In addition to the specific uncertainties discussed elsewhere in this Quarterly Report on Form 10-Q, the risk factors set forth in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010, and those set forth in Part II, Item 1A. Risk Factors of this report, if any, may affect our performance and results of operations. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may differ materially from those in the forward-looking statements. We disclaim any intention or obligation to update or review any forward-looking statements or information, whether as a result of new information, future events or otherwise.

**Overview**

We operate in four reportable business segments of the HVACR industry. Our reportable segments consist of Residential Heating & Cooling, Commercial Heating & Cooling, Service Experts and Refrigeration. For more detailed information regarding our reportable segments, see Note 14 in the Notes to our Consolidated Financial Statements.

Our products and services are sold through a combination of distributors, independent and company-owned dealer service centers, other installing contractors, wholesalers, manufacturers' representatives, original equipment manufacturers and to national accounts. The demand for our products and services is seasonal and dependent on the weather. Warmer than normal summer temperatures generate strong demand for replacement air conditioning and refrigeration products and services and colder than normal winter temperatures have the same effect on heating products and services. Conversely, cooler than normal summers and warmer than normal winters depress the demand for HVACR products and services. In addition to weather, demand for our products and services is influenced by national and regional economic and demographic factors, such as interest rates, the availability of financing, regional population and employment trends, new construction, general economic conditions and consumer spending habits and confidence.

The principal elements of cost of goods sold in our manufacturing operations are components, raw materials, factory overhead, labor and estimated costs of warranty expense. The principal raw materials used in our manufacturing processes are steel, copper and aluminum. In recent years, increased prices for these commodities and related components have challenged us and the HVACR industry in general. We seek to mitigate the impact of higher commodity prices through a combination of price increases for our products and services, commodity contracts, improved production efficiency and cost reduction initiatives. We also seek to mitigate volatility in the prices of these commodities by entering into futures contracts and fixed forward contracts. In our Service Experts segment, the principal components of cost of goods sold are equipment, parts and supplies and labor.

A substantial portion of the sales in each of our business segments is attributable to replacement business, with the balance comprised of new construction business.

The Residential Heating & Cooling business was impacted in the first quarter of 2011 by pull-forward of demand in the fourth quarter of 2010 ahead of announced price increases. These items combined for a 10% volume decline in net sales for this business when compared to the prior year quarter. We were able to offset the sales volume decline with a 5% increase in price and mix. The Service Experts business also experienced a sales volume decline in our seasonally lightest quarter. Our Commercial Heating & Cooling business showed strong growth in the quarter with 16% revenue growth, largely driven by volume. The Refrigeration segment experienced a 33% increase in net sales. We had organic growth of 3%, excluding a 5% impact of foreign currency exchange rates, with the remainder of the growth from the acquisition of the Kysor/Warren business in January 2011.





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We will continue to execute on our strategic priorities to win new business and capture opportunities through innovative product and system solutions and lower our cost structure through manufacturing and sourcing excellence and expense reduction efforts. As we move into the strongest seasonal quarters of the year, we believe we are well-positioned across all our businesses.

*Key Financial Statistics*

Net sales for first quarter of 2011 increased to \$687.8 million as compared to \$644.1 million in 2010. The Kysor/Warren acquisition contributed 5% to the net sales growth with the remainder of the increase due to favorable foreign currency exchange rates.

Operational income for first quarter of 2011 declined to a \$7.0 million loss as compared to operational income of \$0.5 million in 2010. The decline to an operational loss in 2011 was primarily due to gross profit compression from commodity headwinds and an increase in freight costs.

Net loss for the first quarter of 2011 was \$7.2 million compared to a net loss of \$1.6 million in 2010. Basic and diluted loss per share from continuing operations were \$0.13 in the first quarter of 2011 compared to basic and diluted loss per share from continuing operations of \$0.02 in 2010.

Cash of \$148.3 million was used in operating activities for first quarter of 2011 compared to cash used in operating activities of \$40.3 million in the first quarter of 2010. Cash used in operating activities was higher primarily due to the increased build of inventory levels in the first quarter of 2011.

During the first quarter of 2011, we returned \$31.8 million to shareholders through share repurchases and dividends. Our dividends increased in the first quarter of 2011 to \$0.15 per share from \$0.14 per share in 2010.

*Results of Operations*

The following table provides a summary of our financial results, including information presented as a percentage of net sales (dollars in millions):

	<i>Three Months Ended March 31,</i>				
	<i>Dollars</i>		<i>Percent</i>	<i>Percent Sales</i>	
	<i>2011</i>	<i>2010</i>	<i>Change</i>	<i>2011</i>	<i>2010</i>
			<i>Fav/(Unfav)</i>		
Net sales	\$ 687.8	\$ 644.1	6.8%	100.0%	100.0%
Cost of goods sold	522.6	469.8	(11.2)	76.0	72.9
Gross profit	165.2	174.3	(5.2)	24.0	27.1
Selling, general and administrative expenses	173.9	168.9	(3.0)	25.2	26.2
Gains and other expenses, net	(0.3)	(0.3)		N.M	N.M
Restructuring charges	1.2	7.2	83.3	0.2	1.1
Income from equity method investments	(2.6)	(2.0)	30.0	(0.4)	(0.3)
Operational (loss) income	\$ (7.0)	\$ 0.5	(1,500.0)%	(1.0)%	0.1%
Net loss	\$ (7.2)	\$ (1.6)	(350.0)%	(1.0)%	(0.2)%

*First Quarter of 2011 Compared to First Quarter of 2010 Consolidated Results**Net Sales*

Net sales increased 7% in the first quarter of 2011 compared to the first quarter of 2010. The Kysor/Warren acquisition added 5% to our net sales. Our price and mix were up 3% in the comparable period; however, our sales volume was down 1%. The decline in volume was predominantly in our residential segment partially offset by volume growth in our commercial and refrigeration segments. Changes in foreign currency exchange rates favorably impacted net sales by 2%.

**Table of Contents***Gross Profit*

Gross profit margins declined 310 basis points to 24.0% for the first quarter of 2011 when compared to gross profit margins of 27.1% in 2010. Commodity headwinds contributed approximately 180 basis points to the decline which was partially offset by improved price and mix of 110 basis points. Contributing to the decline in gross profit margins were other cost changes contributing 50 basis points and foreign currency translation rates 110 basis points. The other costs changes decline was primarily due to an increase in freight charges primarily from rate increases and fuel surcharges.

*Selling, General and Administrative Expenses*

Selling, general and administrative ( SG&A ) expenses increased by \$5 million in the first quarter of 2011 compared to 2010; however, as a percentage of net sales, SG&A expenses declined to 25% in 2011 from 26% in 2010. SG&A expenses excluding the Kysor/Warren acquisition were relatively flat. The impact of changes in foreign exchange rates increased SG&A expenses by \$2 million. Offsetting the effects of foreign currency exchange rates were \$1 million in favorable bad debt experience and \$1 million in lower commissions primarily due to lower sales in our residential segment.

*Gains and Other Expenses, Net*

Gains and other expenses, net for the first quarters of 2011 and 2010 included the following (in millions):

	<b>Three Months Ended March</b>	
	<b>31,</b>	
	<b>2011</b>	<b>2010</b>
Realized gains losses on settled futures contracts	\$ (0.6)	\$ (0.3)
Unrealized loss on unsettled futures contracts not designated as cash flow hedges	0.7	
Foreign currency exchange loss (gains)	0.1	(0.2)
Acquisition expenses	0.2	
Other items, net	(0.7)	0.2
Gains and other expenses, net	\$ (0.3)	\$ (0.3)

The change in gains and losses on futures contracts was primarily due to increases in commodity prices relative to our futures contract prices during 2011 as compared to 2010 for the contracts that settled during the period. Conversely, the change in unrealized losses related to unsettled futures contracts not designated as cash flow hedges was primarily due to higher commodity prices relative to the futures contract prices for those contracts. For more information, see Note 5 in the Notes to the Consolidated Financial Statements.

*Restructuring Charges*

Restructuring charges declined from \$7.2 million in the first quarter of 2010 to \$1.2 million in the first quarter of 2011. As we didn't initiate any new projects in the first quarter of 2011, the charges in this period related to minor charges from various open projects initiated in prior years. The restructuring charges from the first quarter of 2010 were primarily related to the exit of coil manufacturing in Milperra, Australia which was initiated in that quarter. This restructuring project resulted in \$5.8 million in restructuring charges consisting of \$4.4 million in severance, \$1.2 million in asset impairments, and \$0.2 million in other charges. The remaining restructuring charges from the first quarter of 2010 were minor charges from various open projects initiated in prior years.

*Results from Equity Method and Other Equity Investments*

Investments over which we do not exercise control but have significant influence are accounted for using the equity method of accounting. Income from equity method investments increased to \$2.6 million in the first quarter of 2011 from \$2.0 million in 2010, primarily from improved performance from our compressor manufacturing joint venture.

*Interest Expense, Net*

Interest expense, net, increased to \$4.1 million in 2011 from \$2.5 million in 2010. The increase in interest expense was primarily attributable to an increase in our weighted average interest rate as well as an increase in the average amounts borrowed in the first quarter of 2011 compared to 2010.

**Table of Contents***Benefit from Income Taxes*

The income tax benefits were \$3.9 million in the first quarter of 2011 compared \$0.7 million in 2010. The effective tax rate was 35.1% for 2011 and 35.0% in 2010. Our effective rates differ from the statutory federal rate of 35% for certain items, such as state and local taxes, non-deductible expenses, foreign operating losses for which no tax benefits have been recognized and foreign taxes at rates other than 35%. In the first quarters of 2011 and 2010, these items effectively offset each other and did not affect our effective tax rates.

**First Quarter of 2011 Compared to First Quarter of 2010 Results by Segment***Residential Heating & Cooling*

The following table summarizes our Residential Heating & Cooling segment's net sales and (loss) profit for the first quarters of 2011 and 2010 (dollars in millions):

	<b>Three Months Ended March 31,</b>			%
	<b>2011</b>	<b>2010</b>	<b>Difference</b>	<b>Change</b>
Net sales	\$ 272.0	\$ 284.2	\$ (12.2)	(4.3)%
(Loss) profit	(1.2)	7.1	(8.3)	(116.9)%
% of net sales	(0.4)%	2.5%		

The decrease in sales was impacted by the pull-forward of demand into the fourth quarter of 2010 ahead of announced price increases. Sales volumes declined by almost 10% in 2011 as compared to 2010. Partially offsetting the decline in sales volume was higher price and mix of 5% and foreign currency exchange rates of 1%.

Segment profit decreased \$8 million due to \$11 million in lower sales volumes and \$8 million in higher freight charges. Commodity headwinds of \$8 million were more than offset by \$12 million in favorable price and mix. Other product cost savings of \$5 million, primarily from material savings and lower SG&A expense of \$2 million, partially offset the decline in segment profit. The lower SG&A expenses were the result of \$1 million in favorable bad debt experience and \$1 million in lower commissions due to the decline in net sales.

*Commercial Heating & Cooling*

The following table summarizes our Commercial Heating & Cooling segment's net sales and profit for the first quarters of 2011 and 2010 (dollars in millions):

	<b>Three Months Ended March 31,</b>			%
	<b>2011</b>	<b>2010</b>	<b>Difference</b>	<b>Change</b>
Net sales	\$ 138.8	\$ 119.7	\$ 19.1	16.0%
Profit	5.9	3.4	2.5	73.5
% of net sales	4.3%	2.8%		

Our Commercial Heating & Cooling business experienced 16% in higher net sales in the first quarter of 2011 compared to 2010 primarily due to an increase in both our commercial new construction and replacement businesses which resulted in a 15% increase in sales volume. Changes in foreign currency exchange rates favorably impacted sales by 1%.

Segment profit for the first quarter of 2011 increased almost \$3 million from the first quarter of 2010. Segment profit increased from the impact of higher sales volume of \$5 million. Partially offsetting our higher sales were commodity headwinds of \$2 million and freight charges of \$1 million. The increase in freight charges is primarily related to an increase in fuel surcharges.

*Service Experts*

The following table summarizes our Service Experts segment's net sales and loss for the first quarters of 2011 and 2010 (dollars in millions):



**Table of Contents****Three Months Ended  
March 31,**

	<b>2011</b>	<b>2010</b>	<b>Difference</b>	<b>% Change</b>
Net sales	\$ 116.5	\$ 127.1	\$ (10.6)	(8.3)%
Loss	(8.2)	(4.6)	(3.6)	78.3
% of net sales	(7.0)%	(3.6)%		

In total, sales volumes declined 11% which was partially offset by a 2% increase in price and mix. Foreign currency exchange rates increased net sales by 1%.

In the seasonally lightest quarter, segment loss increased \$4 million due to the impact of the volume decline in net sales. Partially offsetting the volume decline was an SG&A expense improvement of \$2 million due to \$1 million in favorable bad debt experience and \$1 million in lower commissions due to the decline in net sales.

*Refrigeration*

The following table summarizes our Refrigeration segment's net sales and profit for the first quarters of 2011 and 2010 (dollars in millions):

**Three Months  
Ended  
March 31,**

	<b>2011</b>	<b>2010</b>	<b>Difference</b>	<b>% Change</b>
Net sales	\$ 175.1	\$ 131.4	\$ 43.7	33.3%
Profit	13.5	14.9	(1.4)	(9.4)
% of net sales	7.7%	11.3%		

Net sales, excluding Kysor/Warren, increased 3% due to higher sales volumes. Price and mix were relatively flat. Foreign exchange rates increased net sales by an additional 4%. The Kysor/Warren acquisition contributed 26% to the increase in net sales.

Segment profit decreased by \$1 million from commodity headwinds and \$1 million in increased freight charges. The increase in freight charges was due to an increase in rates and fuel surcharges. Offsetting these decreases to segment profit was a favorable impact from foreign currency exchange rates of \$1 million.

*Corporate and Other*

Corporate and other expenses were \$15 million in the first quarter of 2011, up from \$13 million in 2010. The increase was primarily driven by a \$1 million pension settlement and a \$1 million increase in stock-based and incentive compensation plans.

**Liquidity and Capital Resources**

Our working capital and capital expenditure requirements are generally met through internally generated funds, bank lines of credit and a revolving period asset securitization arrangement. Working capital needs are generally greater in the first and second quarters due to the seasonal nature of our business cycle.

*Statement of Cash Flows*

The following table summarizes our cash activity for the quarters ended March 31, 2011 and 2010 (in millions):

	<b>Three Months Ended March 31,</b>	
	<b>2011</b>	<b>2010</b>
Net cash used in operating activities	\$ (148.3)	\$ (40.3)
Net cash used in investing activities	(150.1)	(39.3)
Net cash provided by financing activities	191.8	15.8





**Table of Contents****Net Cash Used in by Operating Activities**

Operating activities resulted in a higher use of cash in 2011 compared to 2010. This increased use was primarily due to higher working capital requirements in 2011 and a higher incentive payout in 2011 from improved operating results in 2010. Our working capital requirements resulted in a \$69.5 million use of cash in the first quarter of 2011 compared to a \$32.6 million use of cash in 2010. The increase in working capital requirements is primarily due to a larger increase in inventory of \$136.3 million in the first quarter of 2011 compared to \$85.6 million in 2010. As we prepare for the peak cooling season, we carry higher than average inventory balances in the first and second quarters. Our increases in inventory in the first quarter of 2011 were larger than 2010 primarily due to anticipated sales growth across all business segments in 2011.

**Net Cash Used in Investing Activities**

Net cash used in investing activities for the first quarter of 2011 included \$144.2 million for the acquisition of the Kysor/Warren business from The Manitowoc Company. Kysor/Warren is a leading manufacturer of refrigerated systems and display cases for supermarkets throughout North America and will be included in our Refrigeration Segment.

Capital expenditures in the first quarter of 2011 were \$8.2 million, which was slightly lower than the \$10.7 million in the first quarter of 2010. Capital expenditures in the quarter were primarily related to maintenance capital expenditures.

In addition to the \$10.7 million in capital expenditures, net cash used in investing activities for the first quarter of 2010 included \$25.1 million placed in a trust for our captive insurance subsidiary and \$6.7 million for business acquisitions. Offsetting these uses were \$3.2 million in proceeds from the sale of businesses.

**Net Cash Provided by Financing Activities**

Net cash provided by financing activities increased by \$176.0 million in the first quarter of 2011 compared to the first quarter of 2010. This increase was primarily related to an increase in net borrowings to support the Kysor/Warren acquisition and the increase in working capital needs in the first quarter of 2011. Additionally, we had lower share repurchase activity in the first quarter of 2011 of \$23.7 million compared to \$34.7 million in the first quarter of 2010 which contributed to the increase in net cash provided by financing activities. Offsetting these increases was an increase in our cash dividend from \$0.14 per share in the first quarter of 2010 to \$0.15 per share in the first quarter of 2011.

***Debt Position and Financial Leverage***

The following table details our lines of credit and financing arrangements as of March 31, 2011:

	<b>Maximum Capacity</b>	<b>Outstanding Borrowings</b>	<b>Available for Future Borrowings</b>
<b>Short-Term Debt:</b>			
Foreign Obligations			
Committed	\$ 10.9	\$	\$ 10.9
Non-committed	2.7	\$ 2.7	
Asset Securitization (1)	94.0	50.0	44.0
Total short-term debt	\$ 107.6	\$ 52.7	\$ 54.9
<b>Long-Term Debt:</b>			
Capital lease obligations	\$ 17.4	17.4	
Domestic revolving credit facility (2)	650.0	271.5	309.0
Senior unsecured notes	200.0	200.0	
Total long-term debt	\$ 867.4	\$ 488.9	309.0
Total	\$ 975.0	\$ 541.6	\$ 363.9

- (1) The maximum capacity under the asset securitization arrangement ( ASA ) is the lesser of \$100.0 million or 100% of the net pool balance defined under the ASA.
- (2) The available future borrowings on our domestic revolving credit facility exclude \$69.5 million in standby letters of credit.

As discussed above, we utilized our domestic revolving credit facility ( credit facility ) and ASA to support the acquisition of the Kysor/Warren business and the increase in working capital needs in the first quarter of 2011.

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As our peak season arrives, we typically pay down debt. We believe our available future borrowings combined with our cash of \$55.2 million and anticipated cash from operations in the latter half of the year will be more than sufficient to fund our operations, capital expenditures, share repurchases, dividends and other needs in the foreseeable future. Our expected capital expenditures are \$65 million for 2011.

Our debt-to-total-capital ratio increased to 48.9% at March 31, 2011 compared to 35.1% at December 31, 2010. Lower stockholders' equity was primarily due to the repurchase of approximately 0.5 million shares of our common stock for \$23.7 million since December 31, 2010 under our current share repurchase plan. The increase in debt since December 31, 2010 was principally due to the acquisition of the Kysor/Warren business as well as our increase in working capital needs.

Covenants on our outstanding debt did not change in the first quarter of 2011 and we were in compliance with all of our debt covenants as of March 31, 2011. For a more detailed discussion of our debt, see Note 8 in the Notes to the Consolidated Financial Statements set forth in Part I, Item I of this Quarterly Report on Form 10-Q.

We periodically review our capital structure, including our primary bank facility, to ensure that it has adequate liquidity. Our ASA expires on November 18, 2011 and our credit facility matures in October 2012. We expect to amend, renew or replace these facilities prior to or upon their expiration. We also periodically consider various other financing alternatives and may, from time to time, seek to take advantage of favorable interest rate environments or other market conditions, which may include accessing the capital markets. We filed a shelf registration statement with the SEC that became effective on December 1, 2008, which allows us to offer and sell an indeterminate number or amount of debt securities, common shares, preferred shares, subscription rights, warrants, depositary shares and units.

On March 11, 2011, we announced that our Board of Directors approved a 20% increase in our quarterly dividend on common stock from \$0.15 to \$0.18 effective with the April dividend payment. Dividend payments are expected to be approximately \$35 million in 2011. We also continue to increase shareholder value through our share repurchase program. During the quarter we returned \$23.7 million to our investors through share repurchases. We are targeting in excess of \$100.0 million in share repurchases in 2011.

### **Off-Balance Sheet Arrangements**

In addition to the credit facilities and promissory notes described above, we also lease real estate and machinery and equipment pursuant to operating leases that are not capitalized on the balance sheet, including high-turnover equipment such as autos and service vehicles and short-lived equipment such as personal computers.

### **Commitments, Contingencies and Guarantees**

For a detailed discussion of commitments, contingencies and guarantees, see Note 7 in the Notes to the Consolidated Financial Statements.

The estimate of our liability for future warranty costs requires us to make significant assumptions about the amount, timing and nature of the costs we will incur in the future. We review the assumptions used to determine the liability periodically and we adjust our assumptions based upon factors such as actual failure rates and cost experience. Numerous factors could affect actual failure rates and cost experience, including the amount and timing of new product introductions, changes in manufacturing techniques or locations, components or suppliers used. In recent years, changes in the warranty liability as the result of the issuance of new warranties and the payments made have remained relatively stable. Should actual warranty costs differ from our estimates, we may be required to record adjustments to accruals and expense in the future. At the end of each accounting period, we evaluate our warranty liabilities and during the second quarter of each year, we perform a complete reevaluation of our warranty liabilities.

We also may incur costs related to our products that may not be covered under our warranties and are not covered by insurance, and we may, from time to time, repair or replace installed products experiencing quality

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issues in order to satisfy our customers and to protect our brand. These product quality issues may be caused by vendor-supplied components that fail to meet required specifications. We have identified a product quality issue in a heating and cooling product line produced in 2006 and 2007 period that we believe results from a vendor-supplied materials quality issue. To date, we recorded an expense of \$24.4 million for the portion of the issue that is probable and can be reasonably estimated. No material charges were recorded for this matter in the first quarter of 2011. As of March 31, 2011, we had \$14.0 million accrued for this matter. We may incur additional charges in the future as more information becomes available.

We estimate the costs to settle pending litigation based on experience involving similar claims and specific facts known. We do not believe that any current or pending or threatened litigation will have a material adverse effect on our financial position. Litigation and arbitration, however, involve uncertainties and it is possible that the eventual outcome of litigation could adversely affect our results of operations for a particular period. We are the defendant in a class action lawsuit related to certain hearth products we produced and sold that claims such products are hazardous and that consumers were not adequately warned. On August 23, 2010, the Company and the plaintiffs entered into a binding Memorandum of Understanding (MOU) and have reached tentative terms for settlement of the case. On January 11, 2011, the court granted preliminary approval of the settlement. At the parties' request, the court stayed the lawsuit shortly after the MOU was signed. The court set June 2, 2011 as the date for the final approval hearing. We had \$9.3 million in expenses to date related to this matter with no additional charges during the first quarter of 2011.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.***Commodity Price Risk*

We enter into commodity futures contracts to stabilize prices expected to be paid for raw materials and parts containing high copper and aluminum content. These contracts are for quantities equal to or less than quantities expected to be consumed in future production.

Fluctuations in metal commodity prices impact the value of the derivative instruments that we hold. When metal commodity prices rise, the fair value of our futures contracts increases and conversely, when commodity prices fall, the fair value of our futures contracts decreases.

Information about our exposure to market risks related to metal commodity prices and a sensitivity analysis related to our metal commodity hedges is presented below (in millions):

Notional amount (pounds)	24.1
Carrying amount and fair value of asset	\$ 12.0
Change in fair value from 10% change in forward prices	\$ 1.2

*Interest Rate Risk*

Our results of operations can be affected by changes in interest rates due to variable rates of interest on our revolving credit facilities, cash, cash equivalents and short-term investments.

In order to partially mitigate interest rate risk, we use a hedging strategy to eliminate the variability of cash flows in the interest payments for the first \$100 million of the total variable-rate debt outstanding under the domestic revolving credit facility that is solely due to changes in the benchmark interest rate. This strategy allows us to fix a portion of our interest payments while also taking advantage of historically low interest rates.

On June 12, 2009, we entered into a \$100 million pay-fixed, receive-variable interest rate swap with a large financial institution at a fixed interest rate of 2.66%. The variable portion of the interest rate swap is tied to 1-Month LIBOR (the benchmark interest rate). The interest rates under both the interest rate swap and the underlying debt are reset, the swap is settled with the counterparty, and interest is paid, on a monthly basis. The interest rate swap expires October 12, 2012. We account for the interest rate swap as a cash flow hedge.

Information about our exposure to interest rate risk and a sensitivity analysis related to our interest rate swap is presented below (in millions):

Notional amount	\$ 100.0
Impact of a 100 basis point change in the benchmark interest rate:	
Carrying amount and fair value of liability	\$ 1.7

Interest expense

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\$ 1.3

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*Foreign Currency Exchange Rate Risk*

Our results of operations can be affected by changes in exchange rates. Net sales and expenses in foreign currencies are translated into U.S. dollars for financial reporting purposes based on the average exchange rate for the period. For the first quarters of 2011 and 2010, net sales from outside the U.S. represented 30.5% and 30.0%, respectively, of our total net sales. Historically, foreign currency transaction gains (losses) have not had a material effect on our overall operations. As of March 31, 2011, the impact to net income of a 10% change in exchange rates is estimated to be approximately \$0.3 million.

**Item 4. Controls and Procedures.**

*Disclosure Controls and Procedures*

As required by Rule 13a-15 under the Securities Exchange Act of 1934, we carried out an evaluation, under the supervision and with the participation of our current management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of March 31, 2011, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the applicable rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

*Changes in Internal Control Over Financial Reporting*

During the quarter ended March 31, 2011, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II OTHER INFORMATION****Item 1. Legal Proceedings.**

On February 6, 2008, a class action lawsuit was filed against us in the U.S. District Court for the Northern District of California styled *Keilholtz v. Lennox Hearth Products, Lennox Industries and Lennox International, Inc.* The lawsuit, which involves no personal injury claims, alleges that certain of our single-pane, glass-front, gas fireplaces are hazardous and that consumers were not adequately warned, and seeks economic damages. On February 16, 2010, the court issued an order certifying a nationwide class of plaintiffs.

On August 23, 2010, the Company and the plaintiffs entered into a binding Memorandum of Understanding in this case and have reached tentative terms for settlement of the case. At the parties' request, the court stayed the lawsuit shortly after the MOU was signed. On January 11, 2011, the court granted preliminary approval of the settlement. The court set June 2, 2011 as the date for the final approval hearing.

Other than the lawsuit described above, there have been no significant changes concerning our legal proceedings since December 31, 2010. See Note 7 in the Notes to the Consolidated Financial Statements set forth in Part I, Item 1, of this Quarterly Report on Form 10-Q for additional discussion regarding legal proceedings.

**Item 1A. Risk Factors.**

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the risk factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010, which could materially affect our business, financial condition or results of operations. There have been no material changes to our risk factors from those disclosed in our 2010 Annual Report on Form 10-K.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

In June 2008 our Board of Directors approved a new share repurchase plan for \$300 million, pursuant to which we are authorized to repurchase shares of our common stock through open market purchases (the 2008 Share Repurchase Plan). The 2008 Share Repurchase Program has no stated expiration date. In the first quarter of 2011, we repurchased shares of our common stock as follows:

<b>Period</b>	<b>Total Number of Shares Purchased<sup>(1)</sup></b>	<b>Average Price Paid per Share (including fees)</b>	<b>Total Number of Shares Purchased As Part of Publicly Announced Plans or Programs</b>	<b>Approximate Dollar Value of Shares that may yet be Purchased Under the Plans or Programs (in millions)</b>
January 1 through January 31	2,097	\$ 49.32		\$ 141.0
February 1 through February 28	408,295	\$ 50.85	391,500	\$ 121.1
March 1 through March 31	79,457	\$ 48.72	77,800	\$ 117.3
	489,849	\$ 50.50	469,300	

- (1) This column reflects the repurchases of 469,300 shares under the 2008 Share Repurchase Plan and the surrender to LII of 20,549 shares of common stock to satisfy tax-withholding obligations in connection with the vesting of restricted stock and performance share units.



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**Item 6. Exhibits.**

- 3.1 Restated Certificate of Incorporation of Lennox International Inc. ( LII ) (filed as Exhibit 3.1 to LII s Registration Statement on Form S-1 (Registration Statement No. 333-75725) filed on April 6, 1999 and incorporated herein by reference).
- 3.2 Amended and Restated Bylaws of LII (filed as Exhibit 3.1 to LII s Current Report on Form 8-K filed on March 15, 2010 and incorporated herein by reference).
- 4.1 Specimen Stock Certificate for the Common Stock, par value \$.01 per share, of LII (filed as Exhibit 4.1 to LII s Amendment to Registration Statement on Form S-1/A (Registration No. 333-75725) filed on June 16, 1999 and incorporated herein by reference).
- 4.2 Indenture, dated as of May 3, 2010, between LII and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.3 to LII s Post-Effective Amendment No. 1 to Registration Statement on S-3 (Registration No. 333-155796)).
- 4.3 Form of First Supplemental Indenture among LII, the guarantors party thereto and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.11 to LII s Post-Effective Amendment No. 1 to Registration Statement on S-3 (Registration No. 333-155796)).
- 4.4 Second Supplemental Indenture dated as of March 28, 2011, among Heatcraft Inc., a Mississippi corporation, Heatcraft Refrigeration Products LLC, a Delaware limited liability company and Advanced Distributor Products LLC, a Delaware limited liability company (the Guarantors ), LII, and each other then existing Guarantor under the Indenture dated as of May 3, 2010, and U.S. Bank National Association as Trustee (filed herewith).
- 4.5 Form of 4.900% Note due 2017 (filed as Exhibit 4.3 to LII s Current Report on Form 8-K and incorporated herein by reference).
- 10.1 Subsidiary Joinder Agreement dated as of March 28, 2011, executed by Advanced Distributor Products LLC, a Delaware LLC, for the benefit of Bank of America, N.A. in its capacity as administrative agent ( Administrative Agent ) for the lenders party to the Third Amended and Restated Credit Agreement, dated October 12, 2007, among the Administrative Agent, LII (the Borrower ), the lenders party thereto, JPMorgan Chase Bank, N.A. and Wachovia Bank, National Association, as Co-Syndication Agents, The Bank of Tokyo-Mitsubishi UFJ, Ltd, and Wells Fargo Bank, N.A., as Co-Documentation Agents, and U.S. Bank National Association and The Bank of Nova Scotia, as Co-Managing Agents and Banc of America Securities LLC and J.P. Morgan Securities, Inc. as Joint Lead Arrangers and Joint Book Managers (as amended, the Credit Agreement) (filed herewith).
- 10.2 Subsidiary Joinder Agreement dated as of March 28, 2011, executed by Heatcraft Inc., a Mississippi corporation, for the benefit of Bank of America, N.A. in its capacity as administrative agent for the lenders party to the Credit Agreement (filed herewith).
- 10.3 Subsidiary Joinder Agreement dated as of March 28, 2011, executed by Heatcraft Refrigeration Products LLC, a Delaware LLC, for the benefit of Bank of America, N.A. in its capacity as administrative agent for the lenders party to the Credit Agreement (filed herewith).

- 31.1 Certification of the principal executive officer (filed herewith).
  - 31.2 Certification of the principal financial officer (filed herewith).
  - 32.1 Certification of the principal executive officer and the principal financial officer pursuant to 18 U.S.C. Section 1350 (filed herewith).
- Exhibit No. (101).INS\* XBRL Instance Document
- Exhibit No. (101).SCH\* XBRL Taxonomy Extension Schema Document
- Exhibit No. (101).CAL\* XBRL Taxonomy Extension Calculation Linkbase Document
- Exhibit No. (101).LAB\* XBRL Taxonomy Extension Label Linkbase Document
- Exhibit No. (101).PRE\* XBRL Taxonomy Extension Presentation Linkbase Document

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LENNOX INTERNATIONAL INC.

Date: April 26, 2011

/s/ Robert W. Hau  
Robert W. Hau  
Chief Financial Officer  
(on behalf of registrant and as principal  
financial officer)

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