CMS ENERGY CORP
Form 10-Q
July 24, 2014
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **For the quarterly period ended June 30, 2014**
	OR
o	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	Registrant; State of Incorporation; Address; and Telephone Number	IRS Employer Identification No.
1-9513	**CMS ENERGY CORPORATION** (A Michigan Corporation) One Energy Plaza, Jackson, Michigan 49201 (517) 788-0550	38-2726431
1-5611	**CONSUMERS ENERGY COMPANY** (A Michigan Corporation) One Energy Plaza, Jackson, Michigan 49201 (517) 788-0550	38-0442310

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.

CMS Energy Corporation: Yes x No o **Consumers Energy Company**: Yes x No o

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).

CMS Energy Corporation: Yes x No o **Consumers Energy Company**: Yes x No o

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 Exchange Act.

CMS Energy Corporation:

Large accelerated filer x Accelerated filer o Non-Accelerated filer o Smaller reporting company o

(Do not check if a smaller reporting company)

Consumers Energy Company:

Large accelerated filer o   Accelerated filer o   Non-Accelerated filer x   Smaller reporting company o

(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 Exchange Act).

CMS Energy Corporation: Yes o   No x   **Consumers Energy Company**: Yes o   No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock at July 7, 2014:

CMS Energy Corporation:

CMS Energy Common Stock, $0.01 par value (including 1,091,320 shares owned by Consumers Energy Company)	276,062,395
Consumers Energy Company:	
Consumers Common Stock, $10 par value, privately held by CMS Energy Corporation	84,108,789

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CMS Energy Corporation

Consumers Energy Company

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June 30, 2014

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GLOSSARY

Certain terms used in the text and financial statements are defined below.

2008 Energy Law	Comprehensive energy reform package enacted in Michigan in 2008
2013 Form 10-K	Each of CMS Energy s and Consumers Annual Report on Form 10-K for the year ended December 31, 2013
ABATE	Association of Businesses Advocating Tariff Equity
ASU	Financial Accounting Standards Board Accounting Standards Update
Bay Harbor	A residential/commercial real estate area located near Petoskey, Michigan, in which CMS Energy sold its interest in 2002
bcf	Billion cubic feet
Big Rock	Big Rock Point nuclear power plant, formerly owned by Consumers
CAIR	The Clean Air Interstate Rule
Cantera Gas Company	Cantera Gas Company LLC, a non-affiliated company, formerly known as CMS Field Services
Cantera Natural Gas, Inc.	Cantera Natural Gas, Inc., a non-affiliated company that purchased CMS Field Services
CCR	Coal combustion residual
CEO	Chief Executive Officer
CERCLA	Comprehensive Environmental Response, Compensation, and Liability Act of 1980
CFO	Chief Financial Officer
Clean Air Act	Federal Clean Air Act of 1963, as amended
Clean Water Act	Federal Water Pollution Control Act of 1972, as amended
CMS Capital	CMS Capital, L.L.C., a wholly owned subsidiary of CMS Energy
CMS Energy	CMS Energy Corporation, the parent of Consumers and CMS Enterprises
CMS Enterprises	CMS Enterprises Company, a wholly owned subsidiary of CMS Energy

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CMS ERM	CMS Energy Resource Management Company, formerly known as CMS MST, a wholly owned subsidiary of CMS Enterprises
CMS Field Services	CMS Field Services, Inc., a former wholly owned subsidiary of CMS Gas Transmission
CMS Gas Transmission	CMS Gas Transmission Company, a wholly owned subsidiary of CMS Enterprises
CMS Land	CMS Land Company, a wholly owned subsidiary of CMS Capital
CMS MST	CMS Marketing, Services and Trading Company, a wholly owned subsidiary of CMS Enterprises, whose name was changed to CMS ERM in 2004
Consumers	Consumers Energy Company, a wholly owned subsidiary of CMS Energy
Consumers 2014 Securitization Funding	Consumers 2014 Securitization Funding LLC, a wholly owned consolidated bankruptcy-remote subsidiary of Consumers and special-purpose entity organized for the sole purpose of purchasing and owning Securitization property, issuing Securitization bonds, and pledging its interest in Securitization property to a trustee to collateralize the Securitization bonds
CSAPR	The Cross-State Air Pollution Rule
DB SERP	Defined Benefit Supplemental Executive Retirement Plan
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
DOE	U.S. Department of Energy
EBITDA	Earnings before interest, taxes, depreciation, and amortization
EnerBank	EnerBank USA, a wholly owned subsidiary of CMS Capital
Entergy	Entergy Corporation, a non-affiliated company
Environmental Mitigation Projects	Environmentally beneficial projects that a party agrees to undertake as part of the settlement of an enforcement action, but which the party is not otherwise legally required to perform
EPA	U.S. Environmental Protection Agency
EPS	Earnings per share

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Exchange Act	Securities Exchange Act of 1934, as amended
FDIC	Federal Deposit Insurance Corporation
FERC	The Federal Energy Regulatory Commission
fine particulate matter	Particulate matter that is 2.5 microns or less in diameter
FMB	First mortgage bond
FOV	Finding of Violation
FTR	Financial transmission right
GAAP	U.S. Generally Accepted Accounting Principles
GCR	Gas cost recovery
Health Care Acts	Comprehensive health care reform enacted in March 2010, comprising the Patient Protection and Affordable Care Act and the related Health Care and Education Reconciliation Act
kWh	Kilowatt-hour, a unit of energy equal to one thousand watt-hours
Ludington	Ludington pumped-storage plant, jointly owned by Consumers and DTE Electric Company, a non-affiliated company
MACT	Maximum Achievable Control Technology, which is the emission control that is achieved in practice by the best-controlled similar source
MATS	Mercury and Air Toxics Standards, which limit mercury, acid gases, and other toxic pollution from coal-fueled and oil-fueled power plants
MD&A	Management s Discussion and Analysis of Financial Condition and Results of Operations
MDEQ	Michigan Department of Environmental Quality
MDL	A pending multi-district litigation case in Nevada arising out of several consolidated cases
MGP	Manufactured gas plant
MISO	Midcontinent Independent System Operator, Inc.

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mothball	To place a generating unit into a state of extended reserve shutdown in which the unit is inactive and unavailable for service for a specified period, during which the unit can be brought back into service after receiving appropriate notification and completing any necessary maintenance or other work; generation owners in MISO must request approval to mothball a unit, and MISO then evaluates the request for reliability impacts
MPSC	Michigan Public Service Commission
MW	Megawatt, a unit of power equal to one million watts
NAV	Net asset value
NERC	The North American Electric Reliability Corporation, a non-affiliated company responsible for developing and enforcing reliability standards, monitoring the bulk power system, and educating and certifying industry personnel
NOV	Notice of Violation
NPDES	National Pollutant Discharge Elimination System, a permit system for regulating point sources of pollution under the Clean Water Act
NREPA	Part 201 of the Michigan Natural Resources and Environmental Protection Act, a statute that covers environmental activities including remediation
NSR	New Source Review, a construction-permitting program under the Clean Air Act
NYMEX	The New York Mercantile Exchange
OPEB	Other Post-Employment Benefits
OPEB Plan	Defined benefit postretirement health-care and life insurance plans of CMS Energy, Consumers, and Panhandle
Palisades	Palisades nuclear power plant, sold by Consumers to Entergy in 2007
Panhandle	Panhandle Eastern Pipe Line Company, a former wholly owned subsidiary of CMS Gas Transmission
PCB	Polychlorinated biphenyl
PSCR	Power supply cost recovery
PSD	Prevention of Significant Deterioration
REC	Renewable energy credit established under the 2008 Energy Law

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ReliabilityFirst Corporation	ReliabilityFirst Corporation, a non-affiliated company responsible for the preservation and enhancement of bulk power system reliability and security
Renewable Operating Permit	Michigan s Title V permitting program under the Clean Air Act
Resource Conservation and Recovery Act	Federal Resource Conservation and Recovery Act of 1976
RMRR	Routine maintenance, repair, and replacement
ROA	Retail Open Access, which allows electric generation customers to choose alternative electric suppliers pursuant to a Michigan statute enacted in 2000
SEC	U.S. Securities and Exchange Commission
Securitization	A financing method authorized by statute and approved by the MPSC which allows a utility to sell its right to receive a portion of the rate payments received from its customers for the repayment of securitization bonds issued by a special-purpose entity affiliated with such utility
Sherman Act	Sherman Antitrust Act of 1890
Smart Energy	Consumers Smart Energy grid modernization project, which includes the installation of smart meters that transmit and receive data, a two-way communications network, and modifications to Consumers existing information technology system to manage the data and enable changes to key business processes
Title V	A federal program under the Clean Air Act designed to standardize air quality permits and the permitting process for major sources of emissions across the U.S.
Trunkline	Trunkline Gas Company, LLC, a non-affiliated company and wholly owned subsidiary of Panhandle

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FILING FORMAT

This combined Form 10-Q is separately filed by CMS Energy and Consumers. Information in this combined Form 10-Q relating to each individual registrant is filed by such registrant on its own behalf. Consumers makes no representation regarding information relating to any other companies affiliated with CMS Energy other than its own subsidiaries. None of CMS Energy, CMS Enterprises, nor any of CMS Energy s other subsidiaries (other than Consumers) has any obligation in respect of Consumers debt securities and holders of such debt securities should not consider the financial resources or results of operations of CMS Energy, CMS Enterprises, nor any of CMS Energy s other subsidiaries (other than Consumers and its own subsidiaries (in relevant circumstances)) in making a decision with respect to Consumers debt securities. Similarly, none of Consumers nor any other subsidiary of CMS Energy has any obligation in respect of debt securities of CMS Energy.

This report should be read in its entirety. No one section of this report deals with all aspects of the subject matter of this report. This report should be read in conjunction with the consolidated financial statements and related notes and with MD&A included in the 2013 Form 10-K.

FORWARD-LOOKING STATEMENTS AND INFORMATION

This Form 10-Q and other written and oral statements that CMS Energy and Consumers make may contain forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. The use of might, may, could, should, anticipates, believes, estimates, intends, plans, projects, forecasts, predicts, assumes, and other similar words is intended to identify forward-looking statements that invol and uncertainty. This discussion of potential risks and uncertainties is designed to highlight important factors that may impact CMS Energy s and Consumers businesses and financial outlook. CMS Energy and Consumers have no obligation to update or revise forward-looking statements regardless of whether new information, future events, or any other factors affect the information contained in the statements. These forward-looking statements are subject to various factors that could cause CMS Energy s and Consumers actual results to differ materially from the results anticipated in these statements. These factors include, but are not limited to, the following, all of which are potentially significant:

- the impact of new regulation by the MPSC or FERC and other applicable governmental proceedings and regulations, including any associated impact on electric or gas rates or rate structures;

- potentially adverse regulatory treatment or failure to receive timely regulatory orders affecting Consumers that are or could come before the MPSC, FERC, or other governmental authorities;

- changes in the performance of or regulations applicable to MISO, Michigan Electric Transmission Company, pipelines, railroads, vessels, or other service providers that CMS Energy, Consumers, or any of their affiliates rely on to serve their customers;

- the adoption of federal or state laws or regulations or changes in applicable laws, rules, regulations, principles, or practices, or in their interpretation, including those related to energy policy and ROA, gas pipeline safety, the environment, regulation or deregulation, health care reforms (including the Health Care Acts), taxes, accounting matters, and other business issues that could have an impact on CMS Energy s or Consumers businesses or financial results, including laws or regulations regarding climate change and air emissions and potential effects of the Dodd-Frank Act and related regulations on CMS Energy, Consumers, or any of their affiliates;

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- potentially adverse regulatory or legal interpretations or decisions regarding environmental matters, or delayed regulatory treatment or permitting decisions that are or could come before the MDEQ, EPA, and/or U.S. Army Corps of Engineers, and potential environmental remediation costs associated with these interpretations or decisions, including those that may affect Bay Harbor or Consumers RMRR classification under NSR regulations;

- changes in energy markets, including availability and price of electric capacity and the timing and extent of changes in commodity prices and availability and deliverability of coal, natural gas, natural gas liquids, electricity, oil, and certain related products;

- the price of CMS Energy common stock, the credit ratings of CMS Energy and Consumers, capital and financial market conditions, and the effect of these market conditions on CMS Energy s and Consumers interest costs and access to the capital markets, including availability of financing to CMS Energy, Consumers, or any of their affiliates;

- the investment performance of the assets of CMS Energy s and Consumers pension and benefit plans and the discount rates used in calculating the plans obligations, and the resulting impact on future funding requirements;

- the impact of the economy, particularly in Michigan, and potential future volatility in the financial and credit markets on CMS Energy s, Consumers , or any of their affiliates revenues, ability to collect accounts receivable from customers, or cost and availability of capital;

- changes in the economic and financial viability of CMS Energy s and Consumers suppliers, customers, and other counterparties and the continued ability of these third parties, including third parties in bankruptcy, to meet their obligations to CMS Energy and Consumers;

- population changes in the geographic areas where CMS Energy and Consumers conduct business;

- national, regional, and local economic, competitive, and regulatory policies, conditions, and developments, including municipal bankruptcy filings;

- loss of customer demand for electric generation supply to alternative energy suppliers or to increased use of distributed generation;

- federal regulation of electric sales and transmission of electricity, including periodic re-examination by federal regulators of CMS Energy s and Consumers market-based sales authorizations in wholesale power markets without price restrictions;

- the impact of credit markets, economic conditions, and any new banking regulations on EnerBank;

- the availability, cost, coverage, and terms of insurance, the stability of insurance providers, and the ability of Consumers to recover the costs of any insurance from customers;

- the effectiveness of CMS Energy s and Consumers risk management policies, procedures, and strategies, including strategies to hedge risk related to future prices of electricity, natural gas, and other energy-related commodities;

- factors affecting development of electric generation projects and gas and electric distribution infrastructure replacement and expansion projects, including those related to project site identification, construction material pricing, schedule delays, availability of qualified construction personnel, permitting, and government approvals;

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- factors affecting operations, such as costs and availability of personnel, equipment, and materials, unusual weather conditions, catastrophic weather-related damage, scheduled or unscheduled equipment outages, maintenance or repairs, environmental incidents, equipment failures, and electric transmission and distribution or gas pipeline system constraints;

- potential disruption to, interruption of, or other impacts on facilities, utility infrastructure, or operations due to accidents, explosions, physical disasters, war, or terrorism, and the ability to obtain or maintain insurance coverage for these events;

- changes or disruption in fuel supply, including but not limited to rail or vessel transport of coal and pipeline transport of natural gas;

- potential costs, lost revenues, or other consequences resulting from misappropriation of assets or sensitive information, corruption of data, or operational disruption in connection with a cyber attack or other cyber incident;

- technological developments in energy production, storage, delivery, usage, and metering, including Smart Energy and the success of its implementation;

- the impact of CMS Energy s and Consumers integrated business software system and its operation on their activities, including utility customer billing and collections;

- adverse consequences resulting from any past or future assertion of indemnity or warranty claims associated with assets and businesses previously owned by CMS Energy or Consumers, including claims resulting from attempts by foreign or domestic governments to assess taxes on past operations or transactions;

- the outcome, cost, and other effects of any legal or administrative proceedings, settlements, investigations, or claims;

- the impact of operational incidents, violations of corporate compliance policies, regulatory violations, and other events on CMS Energy s and Consumers reputations;

- restrictions imposed by various financing arrangements and regulatory requirements on the ability of Consumers and other subsidiaries of CMS Energy to transfer funds to CMS Energy in the form of cash dividends, loans, or advances;

- earnings volatility resulting from the application of fair value accounting to certain energy commodity contracts or interest rate contracts;

- changes in financial or regulatory accounting principles or policies, including a possible future requirement to comply with International Financial Reporting Standards, which differ from GAAP in various ways, including the present lack of special accounting treatment for regulated activities; and

- other matters that may be disclosed from time to time in CMS Energy s and Consumers SEC filings, or in other publicly issued documents.

All forward-looking statements should be considered in the context of the risk and other factors described above and as detailed from time to time in CMS Energy s and Consumers SEC filings. For additional details regarding these and other uncertainties, see Part I Item 1. Consolidated Financial Statements (Unaudited) Notes to the Unaudited Consolidated Financial Statements Note 2, Regulatory Matters and Note 3, Contingencies and Commitments; Part I Item 2. MD&A Outlook; and Part II Item 1A. Risk Factors.

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CMS Energy Corporation

Consumers Energy Company

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This MD&A is a combined report of CMS Energy and Consumers.

EXECUTIVE OVERVIEW

CMS Energy is an energy company operating primarily in Michigan. It is the parent holding company of several subsidiaries, including Consumers, an electric and gas utility, and CMS Enterprises, primarily a domestic independent power producer. Consumers electric utility operations include the generation, purchase, distribution, and sale of electricity, and Consumers gas utility operations include the purchase, transmission, storage, distribution, and sale of natural gas. Consumers customer base consists of a mix of residential, commercial, and diversified industrial customers. CMS Enterprises, through its subsidiaries and equity investments, owns and operates power generation facilities.

CMS Energy and Consumers manage their businesses by the nature of services each provides. CMS Energy operates principally in three business segments: electric utility; gas utility; and enterprises, its non-utility operations and investments. Consumers operates principally in two business segments: electric utility and gas utility.

CMS Energy and Consumers earn revenue and generate cash from operations by providing electric and natural gas utility services; electric distribution and generation; gas transmission, storage, and distribution; and other energy-related services. Their businesses are affected primarily by:

- regulation and regulatory matters;
- economic conditions;
- weather;
- energy commodity prices;
- interest rates; and

- CMS Energy s and Consumers securities credit ratings.

CMS Energy s and Consumers business strategy emphasizes the key elements depicted below:

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Accountability is part of CMS Energy s and Consumers corporate culture. CMS Energy and Consumers are committed to making the right choices to serve their customers safely and affordably and to acting responsibly as corporate citizens. CMS Energy and Consumers hold themselves accountable to the highest standards of safety, operational performance, and ethical behavior, and work diligently to comply with all laws, rules, and regulations that govern the electric and gas industry.

In October 2013, Consumers released its first-ever accountability report. The report provides an overview of Consumers efforts to continue meeting Michigan s energy needs safely and efficiently, and highlights Consumers commitment to Michigan businesses, its corporate citizenship, and its role in reducing the state s air emissions.

Safe, Excellent Operations

The safety of employees, customers, and the general public remains a priority of CMS Energy and Consumers. Accordingly, CMS Energy and Consumers have worked to integrate a set of safety principles into their business operations and culture. These principles include complying with applicable safety, health, and security regulations and implementing programs and processes aimed at continually improving safety and security conditions. From 2006 through 2013, Consumers achieved a 72 percent reduction in the annual number of recordable safety incidents.

Customer Value

Consumers is undertaking a number of initiatives that reflect its intensified customer focus. Consumers planned investments in reliability are aimed at improving safety, reducing customer outage frequency, reducing repetitive outages, and increasing customer satisfaction. Also, in order to minimize increases in customer base rates, Consumers has undertaken several additional initiatives to reduce costs through voluntary separation plans, accelerated pension funding, employee and retiree health-care cost sharing, negotiated labor agreements, information system efficiencies, and productivity improvements. Consumers has also received approval from the MPSC to issue Securitization bonds and to accelerate the recognition of certain tax benefits, both of which will result in cost savings for customers. These initiatives, together with Consumers plans to accelerate further cost reductions, should allow Consumers to avoid increasing electric and gas base rates through 2014.

Utility Investment

Consumers expects to make capital investments of about $7 billion from 2014 through 2018. Consumers has limited its capital investment program to those investments it believes are needed to provide safe, reliable, and efficient service to its customers. Consumers capital investment program is expected to result in annual rate base growth of five to seven percent while allowing Consumers to maintain sustainable customer base rate increases (excluding PSCR and GCR charges) at or below the rate of inflation.

Among the key components of Consumers investment program are projects that will enhance customer value. Consumers planned base capital investments of $3.5 billion represent projects to maintain Consumers system and comprise $2.1 billion at the electric utility to preserve reliability and capacity and $1.4 billion at the gas utility to sustain deliverability and enhance pipeline integrity. An additional $1.9 billion of planned reliability investments at Consumers are aimed at reducing outages and improving customer satisfaction; these investments comprise $1.0 billion at the electric utility to strengthen circuits and substations, replace poles, and upgrade the Ludington pumped-storage plant and $0.9 billion at the gas utility to replace mains and enhance transmission and storage systems. Consumers also expects to spend $0.9 billion on environmental investments needed to comply with state and federal laws and regulations.

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Consumers Smart Energy program, with an estimated total project capital cost of $0.8 billion, also represents a major capital investment. The full-scale deployment of advanced metering infrastructure began in 2012 and is planned to continue through 2017. Consumers has spent $0.3 billion through 2013 on its Smart Energy program, and expects to spend an additional $0.5 billion, following a phased approach, from 2014 through 2017.

Renewable energy projects are another major component of Consumers planned capital investments. Consumers expects to spend $0.2 billion on renewable energy investments, under an MPSC-approved renewable energy plan, from 2014 through 2018. The 2008 Energy Law requires that at least ten percent of Consumers electric sales volume come from renewable energy sources by 2015, and it includes requirements for specific capacity additions. Consumers has historically included renewable resources as part of its portfolio, with about eight percent of its present power supply coming from such renewable sources as hydropower, landfill gas, biomass, wind, anaerobic digestion, and solar.

In December 2013, Consumers signed an agreement to purchase a 540-MW gas-fueled electric generating plant located in Jackson, Michigan for $155 million. In January 2014, as a result of this planned purchase, Consumers announced plans to defer the development of its proposed 700-MW gas-fueled electric generating plant at its Thetford complex in Genesee County, Michigan.

REGULATION

Regulatory matters are a key aspect of CMS Energy s and Consumers businesses, particularly Consumers rate cases and regulatory proceedings before the MPSC. Important regulatory events and developments are summarized below.

- ***Gas Rate Case:*** In July 2014, Consumers filed an application with the MPSC seeking an annual rate increase of $88 million, based on a 10.7 percent authorized return on equity. The filing requested authority to recover new investments that will allow Consumers to improve system reliability, comply with regulations, and enhance technology. Costs associated with these investments represent an annual rate increase of $144 million; this amount is offset partially by reductions in the revenue requirement associated with working capital and other cost reductions. This would be Consumers first gas base rate increase since 2012.

The filing also seeks approval of two rate adjustment mechanisms: a mechanism that would reconcile annually Consumers actual nonfuel revenues with the revenues approved by the MPSC, and a mechanism that would allow recovery of an additional $92 million associated with investments in the period January 2016 through December 2017, subject to reconciliation.

- ***Securitization Financing Order:*** In July 2014, Consumers, through its subsidiary Consumers 2014 Securitization Funding, issued $378 million of Securitization bonds with tenors of six, 11, and 15 years, maturing from 2020 to 2029. These bonds will finance the recovery of the remaining book value of seven smaller coal-fueled electric generating units and three smaller gas-fueled electric generating units that Consumers plans to retire by April 2016. The MPSC approved the issuance of these bonds in its December 2013 Securitization financing order, and authorized Consumers to collect from its retail electric customers, with some exceptions, Securitization charges to cover the principal and interest on the bonds as well as certain other qualified costs.

The 2008 Energy Law limits alternative electric supply to ten percent of Consumers weather-adjusted retail sales of the preceding calendar year. At June 30, 2014, Consumers electric deliveries under the ROA program were at the ten-percent limit. Bills have been introduced to the Michigan House of Representatives and the Michigan Senate to raise or remove the ROA limit. The House bill also proposes to deregulate electric generation service in Michigan within two years. Consumers is unable to predict the outcome of these legislative proposals. In addition, the Michigan legislature has conducted hearings

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on the subject of energy competition. If the ROA limit were increased or if electric generation service in Michigan were deregulated, it could have a material adverse effect on Consumers   financial results and operations.

Environmental regulation is another area of importance for CMS Energy and Consumers, and they are monitoring numerous legislative and regulatory initiatives, including initiatives to regulate greenhouse gases, and related litigation. CMS Energy and Consumers believe that environmental laws and regulations related to their operations will continue to become more stringent and require them to make additional significant capital expenditures for emissions control equipment, CCR disposal, cooling water intake equipment, effluent treatment, and PCB remediation. Present and reasonably anticipated state and federal environmental statutes and regulations, including but not limited to the Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act, and CERCLA, will continue to have a material effect on CMS Energy and Consumers.

Financial Performance

For the six months ended June 30, 2014, CMS Energy   s net income available to common stockholders was $287 million, and diluted EPS were $1.05. This compares with net income available to common stockholders of $224 million and diluted EPS of $0.83 for the six months ended June 30, 2013. Among the factors contributing to CMS Energy   s improved performance in 2014 were increased gas and electric deliveries due to colder weather and benefits from an electric rate increase.

Consumers   utility operations are seasonal. The consumption of electric energy typically increases in the summer months, due primarily to the use of air conditioners and other cooling equipment, while peak demand for natural gas occurs in the winter due to colder temperatures and the resulting use of natural gas as heating fuel. In addition, Consumers   electric rates, which follow a seasonal rate design, are higher in the summer months than in the remaining months of the year. A more detailed discussion of the factors affecting CMS Energy   s and Consumers   performance can be found in the Results of Operations section that follows this Executive Overview.

CMS Energy and Consumers believe that economic conditions in Michigan are improving. Consumers expects its electric deliveries to increase annually by up to 0.5 percent on average through 2018, driven largely by the continued rise in industrial production. Excluding the impacts of energy efficiency programs, Consumers expects its electric deliveries to increase by about 1.0 to 1.5 percent annually through 2018. Consumers is projecting that its gas deliveries will remain relatively stable through 2018. This outlook reflects growth in gas demand offset by energy efficiency and conservation.

As Consumers seeks to continue to receive fair and timely regulatory treatment, delivering customer value will remain a key strategic priority. In order to minimize increases in customer base rates, Consumers has set goals to achieve further annual productivity improvements. Additionally, Consumers will strive to give priority to capital investments that increase customer value or lower costs.

Consumers expects to continue to have sufficient capacity to fund its investment-based growth plans. CMS Energy also expects its sources of liquidity to remain sufficient to meet its cash requirements. CMS Energy and Consumers will continue to monitor developments in the financial and credit markets, as well as government policy responses to those developments, for potential implications for their businesses and their future financial needs.

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RESULTS OF OPERATIONS

CMS ENERGY CONSOLIDATED RESULTS OF OPERATIONS

In Millions, Except Per Share Amounts

June 30	Three Months Ended 2014	2013	Change	Six Months Ended 2014	2013	Change
Net Income Available to Common Stockholders	$ 83	$ 80	$ 3	$ 287	$ 224	$ 63
Basic Earnings Per Share	$ 0.31	$ 0.30	$ 0.01	$ 1.07	$ 0.85	$ 0.22
Diluted Earnings Per Share	$ 0.30	$ 0.29	$ 0.01	$ 1.05	$ 0.83	$ 0.22

In Millions

June 30	2014	2013	Change	2014	40.0
Asset securitization payments	(20.0)	(40.0)			
Long-term debt payments	(30.9)	(23.5)			
Borrowings from credit facility	1,715.0	1,401.0			
Payments on credit facility	(1,493.0)	(1,385.0)			
Payments of deferred financing costs	(0.9)	—			
Proceeds from employee stock purchases	1.9	1.8			
Repurchases of common stock	(300.0)	—			
Repurchases of common stock to satisfy employee withholding tax obligations	(26.3)	(23.5)			
Excess tax benefits related to share-based payments	20.0	18.6			
Cash dividends paid	(50.5)	(43.1)			
Net cash used in financing activities	(41.8)	(52.9)			
Increase in cash and cash equivalents	5.7	7.0			
Effect of exchange rates on cash and cash equivalents	3.2	(9.4)			
Cash and cash equivalents, beginning of period	38.9	37.5			
Cash and cash equivalents, end of period	$ 47.8	$ 35.1			
Supplemental disclosures of cash flow information:					
Interest paid	$ 17.0	$ 15.9			
Income taxes paid (net of refunds)	$ 120.9	$ 73.4			

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 September 30, 2016, the accompanying unaudited Consolidated Statements of Operations for the three and nine months ended September 30, 2016 and 2015, the accompanying unaudited Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2016 and 2015, and the accompanying unaudited Consolidated Statements of Cash Flows for the nine months ended September 30, 2016 and 2015 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, 2015. 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 each quarter is comprised of approximately13 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 post-retirement medical benefits, and stock-based compensation, among others. These estimates and assumptions are based on our best estimates and judgment.

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

Reclassifications

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

2. Inventories:

The components of inventories are as follows (in millions):

	As of September 30, 2016	As of December 31, 2015
Finished goods	$ 335.5	$ 300.0
Work in process	6.8	4.2
Raw materials and parts	193.8	178.3
Subtotal	536.1	482.5
Excess of current cost over last-in, first-out cost	(62.1)	(63.7)
Total inventories, net	$ 474.0	$ 418.8

3. Goodwill:

The changes in the carrying amount of goodwill for the first nine months of 2016, in total and by segment, are summarized in the table below (in millions):

	Balance at December 31, 2015	Acquisitions / (Dispositions)	Other [1]	Balance at September 30, 2016
Residential Heating & Cooling	$ 26.1	$ —	$ —	$ 26.1
Commercial Heating & Cooling	60.6	—	0.5	61.1
Refrigeration	108.4	—	2.9	111.3
Total Goodwill	$ 195.1	$ —	$ 3.4	$ 198.5

[1] Other consists of changes in foreign currency translation rates.

We performed our annual goodwill impairment test in the fourth quarter of 2015 and recorded a $5.5 million goodwill impairment charge. We continue to monitor our reporting units for indicators of impairment throughout the year to determine if a change in facts or circumstances warrants a re-evaluation of our goodwill. We will perform our annual goodwill assessment in the fourth quarter of 2016.

4. 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 used in our production processes. Our hedging program includes the use of futures contracts to lock in prices, and as a result, we are subject to derivative losses should the metal commodity prices decrease and gains should the prices increase. We utilize a dollar cost averaging strategy so that a higher percentage of commodity price exposures are hedged near-term and lower percentages hedged at future dates. This strategy allows for protection against near-term price volatility while allowing us to adjust to market price movements over time.

Interest Rate Risk - A portion of our debt bears interest at variable rates, and as a result, we are subject to variability in the cash paid for interest. To mitigate a portion of that risk, we may choose to engage in an interest rate swap hedging strategy to eliminate the variability of interest payment cash flows. We are not currently hedged against interest rate risk.

Foreign Currency Risk - 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. We seek to mitigate the impact of currency exchange rate movements on certain short-term transactions by periodically entering into foreign currency forward contracts.

Our forward contracts are generally not designated as hedges, but on occasion we have entered into forward contracts that are designated as cash flow hedges. By entering into forward contracts, we lock in exchange rates that would otherwise cause losses should the U.S. dollar appreciate and gains should the U.S. dollar depreciate.

Cash Flow Hedges

We have commodity futures contracts and foreign exchange forward contracts designated as cash flow hedges that are scheduled to mature through February 2018. Unrealized gains or losses from our cash flow hedges are included in Accumulated Other

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Comprehensive Loss ("AOCL") and are expected to be reclassified into earnings within the next 18 months based on the prices of the commodities and foreign currencies at the settlement dates. We recorded the following amounts in AOCL related to our cash flow hedges (in millions):

	As of September 30, 2016	As of December 31, 2015
Unrealized losses on unsettled futures contracts	$ 1.2	$ 13.2
Income tax benefit	(0.4)	(4.8)
Losses included in AOCL, net of tax [1]	$ 0.8	$ 8.4

[1] Assuming commodity and foreign currency prices remain constant, we expect to reclassify $1.4 million of derivative losses into earnings within the next 12 months.

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

	As of September 30, 2016	As of December 31, 2015
Copper	31.6	34.7

We had the following outstanding foreign exchange forward contracts designated as cash flow hedges (in millions):

	As of September 30, 2016	As of December 31, 2015
Notional Amounts (in local currency):		
Mexican Peso	230.6	201.4
Canadian Dollar	16.4	—

Derivatives not Designated as Cash Flow Hedges

For commodity derivatives not designated as cash flow hedges, we follow the same hedging strategy as derivatives designated as cash flow hedges, except that we elect not to designate them 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 of pounds):

	As of September 30, 2016	As of December 31, 2015
Copper	2.6	3.3
Aluminum	3.1	3.2

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

	As of September 30, 2016	As of December 31, 2015
Notional Amounts (in local currency):		
Mexican Peso	34.7	53.0
Indian Rupee	218.5	30.8
Euro	51.1	3.2
Chinese Yuan	14.0	—

Polish Zloty	—	25.4
Great Britain Pound	1.9	—
New Zealand Dollar	3.0	—
Australian Dollar	28.0	—

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Information about the Locations and Amounts of Derivative Instruments

The following tables provide the locations and amounts of derivative fair values in the Consolidated Balance Sheets and derivative gains and losses in the Consolidated Statements of Operations (in millions):

	Fair Values of Derivative Instruments [1]			
	Derivatives Designated as Hedging Instruments		Derivatives Not Designated as Hedging Instruments	
	As of September 30, 2016	As of December 31, 2015	As of September 30, 2016	As of December 31, 2015
Current Assets:				
Other Assets				
Commodity futures contracts	$ 1.1	$ —	$ 0.1	$ —
Foreign currency forward contracts	—	—	0.4	0.2
Non-Current Assets:				
Other Assets, net				
Commodity futures contracts	0.6	—	0.1	—
Total Assets	$ 1.7	$ —	$ 0.6	$ 0.2
Current Liabilities:				
Accrued Expenses				
Commodity futures contracts	$ 2.0	$ 12.5	$ 0.2	$ 1.5
Foreign currency forward contracts	0.4	0.4	0.1	—
Non-Current Liabilities:				
Other Liabilities				
Commodity futures contracts	0.1	0.4	—	—
Foreign currency forward contracts	—	—	—	—
Total Liabilities	$ 2.5	$ 13.3	$ 0.3	$ 1.5

[1] All derivative instruments are classified as Level 2 within the fair value hierarchy. See Note 15 for more information.

Derivatives Designated as Cash Flow Hedges	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Amount of Loss reclassified from AOCL into Income (effective portion) [1]	$ 2.4	$ 3.2	$ 10.6	$ 9.4
Amount of Loss recognized in Net income (ineffective portion) [2]	$ (0.5)	$ —	$ (0.4)	$ —

Derivatives Not Designated as Hedging Instruments	For the Three Months Ended September 30,	For the Nine Months Ended September 30,

	2016	2015	2016	2015
Amount of Loss (Gain) Recognized in Net Income:				
Commodity futures contracts [2]	$(0.3)	$1.4	$(0.2)	$2.2
Foreign currency forward contracts [2]	0.4	—	0.3	0.2
	$0.1	$1.4	$0.1	$2.4

[1] The loss was recorded in Cost of goods sold in the accompanying Consolidated Statements of Operations.
[2] The loss was recorded in Losses and other expenses, net in the accompanying Consolidated Statements of Operations.

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5. Income Taxes:

As of September 30, 2016, we had approximately$0.8 million in total gross unrecognized tax benefits. Of this amount,$0.8 million, if recognized, would be recorded through the Consolidated Statement of Operations.

We are currently under examination for our U.S. federal income taxes under the Internal Revenue Service's Compliance Assurance Program for 2016 and 2015 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 prior to 2010.

Since January 1, 2016, numerous states, including Delaware, North Carolina and the District of Columbia, have enacted legislation effective for tax years beginning on or after January 1, 2016, including changes to apportionment methodologies and tax rates. The impact of these changes is immaterial.

6. Commitments and Contingencies:

Product Warranties and Product Related Contingencies

We offer warranties to customers for some of our products and record liabilities for estimated future warranty-related costs based on failure rates, cost experience and other factors. We periodically review the assumptions used to determine the product warranty liabilities and will adjust the liabilities in future periods for changes in assumptions, as necessary.

Liabilities for estimated product warranty costs related to continuing operations are included in the following captions on the accompanying Consolidated Balance Sheets (in millions):

	As of September 30, 2016	As of December 31, 2015
Accrued expenses	$ 30.3	$ 26.7
Other liabilities	69.9	65.6
Total warranty liability	$ 100.2	$ 92.3

The changes in product warranty liabilities related to continuing operations for the nine months ended September 30, 2016 were as follows (in millions):

Total warranty liability as of December 31, 2015	$92.3
Warranty claims paid	(20.4)
Changes resulting from issuance of new warranties	31.6
Changes in estimates associated with pre-existing liabilities	(3.9)
Changes in foreign currency translation rates and other	0.6
Total warranty liability as of September 30, 2016	$100.2

We have incurred, and will likely continue to incur, product costs not covered by insurance or our suppliers' warranties, which is not included in the estimated warranty liabilities tables immediately above. Also, to satisfy our customers and protect our brands, we have repaired or replaced installed products experiencing quality-related issues, and will likely continue such repairs and replacements. We currently estimate our probable liability for a certain supplier quality issue within a range of $1.9 million and $9.1 million with all amounts in that range equally likely. We have accrued a $1.9 million liability in Accrued expenses on the Consolidated Balance Sheet at September 30, 2016. The supplier is reimbursing the majority of costs related to this liability.

Litigation

We are involved in a number of claims and lawsuits incident to the operation of our businesses. Insurance coverages are maintained and estimated costs are recorded for such claims and lawsuits, including costs to settle claims and lawsuits, based on experience involving similar matters and specific facts known.

Some of these claims and lawsuits allege personal injury or health problems resulting from exposure to asbestos that was integrated into certain of our products. We have never manufactured asbestos and have not incorporated asbestos-containing components into our products for several decades. A substantial majority of asbestos-related claims have been covered by insurance or other forms of indemnity or have been dismissed without payment. The remainder of our closed cases have been resolved for amounts that are not material, individually or in the aggregate. Our defense costs for asbestos-related claims are generally covered by insurance; however, our insurance coverage for settlements and judgments for asbestos-related claims varies depending on several factors and is subject to policy limits. As a result, we may have greater financial exposure for future settlements and judgments. For the nine months ended September 30, 2016, and 2015, expense for asbestos-related litigation was $2.3 million, and $1.0 million, net of insurance recoveries, respectively.

It is management's opinion that none of these claims or lawsuits or any threatened litigation will have a material adverse effect on our financial condition, results of operations or cash flows. Claims and lawsuits, however, involve uncertainties and it is possible that their eventual outcome could adversely affect our results of operations for a particular period.

7. Lines of Credit and Financing Arrangements:

The following table summarizes our outstanding debt obligations and their classification in the accompanying Consolidated Balance Sheets (in millions):

	As of September 30, 2016	As of December 31, 2015
Short-Term Debt:		
Asset Securitization Program	$ 325.0	$ 200.0
Foreign obligations	2.8	4.1
Total short-term debt	$ 327.8	$ 204.1
Current maturities of long-term debt:		
Capital lease obligations	$ 0.9	$ 1.2
Domestic credit facility	15.0	30.0
Senior unsecured notes	200.0	—
Debt issuance costs	(0.3)	(0.2)
Total current maturities of long-term debt	$ 215.6	$ 31.0
Long-Term Debt:		
Capital lease obligations	$ 15.1	$ 15.6
Domestic credit facility	500.0	293.0
Senior unsecured notes	—	200.0
Debt issuance costs	(2.6)	(2.6)
Total long-term debt	$ 512.5	$ 506.0
Total debt	$ 1,055.9	$ 741.1

In April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. We adopted this guidance in the first quarter of 2016 and have reclassified the unamortized debt issuance costs into the debt liability as shown in the table above.
Short-Term Debt

Foreign Obligations

Through several of our foreign subsidiaries, we have facilities available to assist in financing seasonal borrowing needs for our foreign locations. We had $2.8 million and $4.1 million of foreign obligations as of September 30, 2016 and December 31, 2015, respectively, that were primarily borrowings under non-committed facilities. Proceeds on these facilities were $28.2 million and $63.6 million during the nine months ended September 30, 2016 and 2015, respectively. Repayments on the facilities were $30.3 million and $61.7 million during the nine months ended September 30, 2016 and 2015, respectively.

Asset Securitization Program

Under the Asset Securitization Program (“ASP”), we are eligible to sell beneficial interests in a portion of our trade accounts receivable to participating financial institutions for cash. The ASP matures in November 2017 and contains a provision whereby we retain 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 accounts receivable securitized under the ASP are high-quality domestic customer accounts that have not aged significantly. The receivables represented by the retained interest that we service are exposed to risk of loss for any uncollectible amounts in the pool of receivables sold under the ASP. The fair values assigned to the retained and transferred interests are based on the sold accounts receivable carrying value given the short term to maturity and low credit risk. The sale of the beneficial interests in our trade accounts receivable are reflected as short-term 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.

Prior to the amendment in July 2016, the ASP provided for a maximum securitization amount ranging from $180.0 million to $220.0 million, depending on the period. The ASP was amended effective as of July 5, 2016 to increase the maximum securitization range from $200.0 million to $325.0 million, depending on the period. The maximum capacity under the ASP is the lesser of the maximum securitization amount or 100% of the net pool balance less allowances, as defined by the ASP. Eligibility for securitization is limited based on the amount and quality of the qualifying accounts receivable and is calculated monthly. The eligible amounts available and beneficial interests sold were as follows (in millions):

	As of September 30, 2016	As of December 31, 2015
Eligible amount available under the ASP on qualified accounts receivable	$ 325.0	$ 220.0
Beneficial interest sold	325.0	200.0
Remaining amount available	$ —	$ 20.0

We pay certain discount fees to use the ASP and to 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 0.65%. The average rate for September 30, 2016 and December 31, 2015 was 1.49% and 1.06% respectively. The unused fee is based on 102% of the maximum available amount less the beneficial interest sold and is calculated at a 0.33% fixed rate throughout the term of the agreement. In addition, a 0.05% unused fee is charged on incremental available amounts above $200 million during certain months of the year. We recorded these fees in Interest expense, net in the accompanying Consolidated Statements of Operations.

The ASP contains certain restrictive qualifications relating to the quality of our accounts receivable and certain cross-default provisions with our Sixth Amended and Restated Credit Facility Agreement ("Domestic Credit Facility"), senior unsecured notes and any other indebtedness we may have over $75.0 million. The administrative agent under the ASP is also a participant in our Domestic Credit Facility. The participating financial institutions have investment grade credit ratings. We continue to evaluate their credit ratings and have no reason to believe they will not perform under the ASP. As of September 30, 2016, we believe we were in compliance with all covenant requirements.

Long-Term Debt

Domestic Credit Facility

On August 30, 2016, we replaced an earlier $950.0 million credit facility with a $900.0 million credit facility (the "Domestic Credit Facility"), which consisted of a $650.0 million unsecured revolving credit facility and a $250.0 million unsecured term loan and matures in August 2021 (the "Maturity Date"). Under our Domestic Credit Facility, we had outstanding borrowings of $515.0 million, of which $250.0 million was the term loan balance, as well as $4.4 million committed to standby letters of credit as of September 30, 2016. Subject to covenant limitations, $380.6 million was available for future borrowings. The unsecured term loan also matures on the Maturity Date and requires quarterly principal repayments of $7.5 million beginning in March 2017. The revolving credit facility allows up to $100.0 million of letters of credit to be issued and also includes a subfacility for swingline loans of up to $65.0 million. Additionally, at our request and subject to certain conditions, the commitments under the Domestic Credit Facility may be increased by a maximum of $350.0 million as long as existing or new lenders agree to provide such additional commitments.

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

	As of September 30, 2016	As of December 31, 2015
Weighted average borrowing rate	1.70 %	1.90 %

Our Domestic Credit Facility is guaranteed by certain of our subsidiaries and contains financial covenants relating to leverage and interest coverage. Other covenants contained in the Domestic Credit Facility restrict, among other things, certain mergers, asset dispositions, guarantees, debt, liens, and affiliate transactions. 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 Credit Facility 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 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 Domestic 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 $75.0 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 $75.0 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 Domestic Credit Facility, our senior unsecured notes, our lease of our corporate headquarters in Richardson, Texas (recorded as an operating lease), or our ASP 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 Credit Facility and accelerate amounts due under our Domestic 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 September 30, 2016, we believe we were in compliance with all covenant requirements.

Senior Unsecured Notes

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 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 $75.0 million in principal which is then accelerated, and such acceleration is not rescinded within 30 days of the notice date. As of September 30, 2016, we believe we were in compliance with all covenant requirements.

8. Pension and Post-retirement Benefit Plans:

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

	For the Three Months Ended September 30,			
	2016	2015	2016	2015
	Pension Benefits		Other Benefits	
Service cost	$1.1	$1.2	$—	$—
Interest cost	3.8	4.3	—	0.1
Expected return on plan assets	(5.4)	(5.3)	—	—
Amortization of prior service cost	0.1	—	(0.8)	(0.8)
Recognized actuarial loss	1.9	2.4	0.4	0.4
Settlements and curtailments	0.2	—	—	—
Net periodic benefit cost [1]	$1.7	$2.6	$(0.4)	$(0.3)

	For the Nine Months Ended September 30,			
	2016	2015	2016	2015
	Pension Benefits		Other Benefits	
Service cost	$3.3	$3.6	$—	$—
Interest cost	11.5	12.9	0.1	0.2
Expected return on plan assets	(16.2)	(16.0)	—	—
Amortization of prior service cost	0.2	—	(2.3)	(2.4)
Recognized actuarial loss	5.7	7.2	1.1	1.2
Settlements and curtailments	0.2	0.4	—	—
Net periodic benefit cost [1]	$4.7	$8.1	$(1.1)	$(1.0)

[1] All net periodic benefit cost for the three and nine months ended September 30, 2016 and 2015 related to continuing operations.

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9. Stock-Based Compensation:

We issue various long-term incentive awards, including performance share units, restricted stock units and stock appreciation rights under the Lennox International Inc. 2010 Incentive Plan, as amended and restated. Stock-based compensation expense related to continuing operations is included in Selling, general and administrative expenses in the accompanying Consolidated Statements of Operations as follows (in millions):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Stock-based compensation expense [(1)]	$9.9	$7.7	$24.8	$18.5

[(1)] All expense was recorded in our Corporate and other business segment.

10. Stock Repurchases:

Our Board of Directors has authorized a total of $1.4 billion towards the repurchase of shares of our common stock (collectively referred to as the "Share Repurchase Plans"). The Share Repurchase Plans authorize open market repurchase transactions and do not have an expiration date. There were no additional share repurchase authorizations in the first nine months of 2016. As of September 30, 2016, $96.2 million of shares may yet be repurchased under the Share Repurchase Plans.

On February 10, 2016, the Company entered into a Fixed Dollar Accelerated Share Repurchase Transaction (the “First ASR Agreement”) with Merrill Lynch International (“Merrill Lynch”), acting through its agent, Merrill Lynch, Pierce, Fenner and Smith Incorporated to effect an accelerated stock buyback of the Company’s common stock (the “Common Stock”).

Under the First ASR Agreement, on February 10, 2016, the Company paid Merrill Lynch an initial purchase price of $200 million, and Merrill Lynch delivered to the Company a total of 1.3 million shares of Common Stock, representing approximately 75% of the shares expected to be purchased under the ASR Agreement. The First ASR Agreement was completed in the third quarter and Merrill Lynch delivered an additional 0.2 million shares of Common Stock to the Company.

On August 1, 2016, the Company entered into another Fixed Dollar ASR Agreement (the "Second ASR Agreement) with Wells Fargo to effect an accelerated stock buyback of Common Stock.

Under the Second ASR Agreement, on August 1, 2016, the Company paid Wells Fargo an initial purchase price of $100 million, and Wells Fargo delivered to the Company a total of 0.5 million shares of Common Stock, representing approximately 75% of the shares expected to be purchased under the Second ASR Agreement. The Second ASR Agreement will be completed in the fourth quarter.

We also repurchased 0.2 million shares for $26.3 million for the nine months ended September 30, 2016 from employees who surrendered their shares to satisfy minimum tax withholding obligations upon the exercise of long-term incentive awards.

11. Comprehensive Income:

The following table provides information on items not reclassified in their entirety from AOCL to Net income in the accompanying Consolidated Statements of Operations (in millions):

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	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		Affected Line Item(s) in the Consolidated Statements of Operations
	2016	2015	2016	2015	
(Losses)/Gains on cash flow hedges:					
Commodity futures contracts	$(2.4)	$(3.2)	$(10.6)	$(9.4)	Cost of goods sold
Income tax benefit	0.8	1.2	3.7	3.2	Provision for income taxes
Net of tax	$(1.6)	$(2.0)	$(6.9)	$(6.2)	
Defined Benefit Plan items:					
Pension and post-retirement benefit costs	$(1.6)	$(2.0)	$(4.8)	$(6.1)	Cost of goods sold; Selling, general and administrative expenses
Income tax benefit	0.6	0.7	1.7	2.2	Provision for income taxes
Net of tax	$(1.0)	$(1.3)	$(3.1)	$(3.9)	
Total reclassifications from AOCL	$(2.6)	$(3.3)	$(10.0)	$(10.1)	

The following table provides information on changes in AOCL, by component (net of tax), for the nine months ended September 30, 2016 (in millions):

	(Losses) Gains on Cash Flow Hedges	Unrealized Gains (Losses) on Available-for-Sale Securities	Defined Benefit Pension Plan Items	Foreign Currency Translation Adjustments	Total AOCL
Balance as of December 31, 2015	$ (8.4)	$ 4.4	$(139.3)	$ (61.4)	$(204.7)
Other comprehensive (loss) income before reclassifications	0.8	(1.8)	(2.6)	11.3	7.7
Amounts reclassified from AOCL	6.9	—	3.1	—	10.0
Net other comprehensive (loss) income	7.7	(1.8)	0.5	11.3	17.7
Balance as of September 30, 2016	$ (0.7)	$ 2.6	$(138.8)	$ (50.1)	$(187.0)

12. Restructuring Charges:

We record restructuring charges associated with management-approved restructuring plans when we reorganize or remove duplicative headcount and infrastructure within our businesses. Restructuring charges include severance costs to eliminate a specified number of employees, infrastructure charges to vacate facilities and consolidate operations, contract cancellation costs and other related activities. The timing of associated cash payments is dependent upon the type of restructuring charge and can extend over a multi-year period. Restructuring charges are not included in our calculation of segment profit (loss), as more fully explained in Note 14.

Restructuring Activities in 2016

Information regarding the restructuring charges for all ongoing activities is presented in the following table (in millions):

	Charges Incurred in 2016	Charges Incurred to Date	Total Charges Expected to be Incurred
Severance and related (gains) expense	$ (0.3)	$ 9.2	$ 9.2
Asset write-offs and accelerated depreciation	0.2	2.3	2.3
Equipment moves	—	—	—
Lease termination	—	0.2	0.2
Other	1.3	3.3	4.1
Total restructuring charges	$ 1.2	$ 15.0	$ 15.8

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While restructuring charges are excluded from our calculation of segment profit (loss), the table below presents the restructuring charges associated with each segment (in millions):

	Charges Incurred in 2016	Charges Incurred to Date	Total Charges Expected to be Incurred
Residential Heating & Cooling	$ —	$ 0.9	$ 0.9
Commercial Heating & Cooling	—	0.9	0.9
Refrigeration	(0.2)	11.8	11.8
Corporate & Other	1.4	1.4	2.2
Total restructuring charges	$ 1.2	$ 15.0	$ 15.8

Restructuring accruals are included in Accrued expenses in the accompanying Consolidated Balance Sheets. The table below details the activity in 2016 within the restructuring accruals (in millions):

	Balance as of December 31, 2015	Included in Earnings	Cash Utilization	Non-Cash Utilization and Other	Balance as of September 30, 2016
Severance and related expense	$ 0.7	$ (0.3)	$ (0.4)	$ 0.1	$ 0.1
Asset write-offs and accelerated depreciation	—	0.2	(0.1)	(0.1)	—
Equipment moves	—	—	—	—	—
Lease termination	0.2	—	—		0.2
Other	—	1.3	(1.5)	—	(0.2)
Total restructuring accruals	$ 0.9	$ 1.2	$ (2.0)	$ —	$ 0.1

13. Earnings Per Share:

Basic earnings per share are computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per share are computed by dividing net income by the sum of the weighted-average number of shares and the number of equivalent shares assumed outstanding, if dilutive, under our stock-based compensation plans.

The computations of basic and diluted earnings per share for Net income were as follows (in millions, except per share data):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	$101.7	$80.3	$237.3	$175.3
Add: Loss from discontinued operations	—	—	0.6	0.5
Income from continuing operations	$101.7	$80.3	$237.9	$175.8
Weighted-average shares outstanding – basic	43.2	45.0	43.6	44.9
Add: Potential effect of dilutive securities attributable to stock-based payments	0.5	0.6	0.6	0.7
Weighted-average shares outstanding – diluted	43.7	45.6	44.2	45.6
Earnings per share – Basic:				
Income from continuing operations	$2.35	$1.78	$5.46	$3.92
Loss from discontinued operations	—	—	(0.01)	(0.01)
Net income	$2.35	$1.78	$5.45	$3.91
Earnings per share – Diluted:				
Income from continuing operations	$2.33	$1.76	$5.39	$3.86
Loss from discontinued operations	—	—	(0.01)	(0.01)
Net income	$2.33	$1.76	$5.38	$3.85

The following stock appreciation rights and restricted stock units were outstanding but not included in the diluted earnings per share calculation because the assumed exercise of such rights would have been anti-dilutive (in millions, except for per share data):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Weighted-average number of shares	—	—	0.2	0.2
Price range per share	$ —	$ —	$124.97-$131.94	$92.64

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14. Reportable Business Segments:

We operate in three 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 we provide. The following table describes each segment:

Segment	Product or Services	Markets Served	Geographic Areas
Residential Heating & Cooling	Furnaces, air conditioners, heat pumps, packaged heating and cooling systems, indoor air quality equipment, comfort control products, replacement parts	Residential Replacement; Residential New Construction	United States Canada
Commercial Heating & Cooling	Unitary heating and air conditioning equipment, applied systems, controls, installation and service of commercial heating and cooling equipment	Light Commercial	United States Canada Europe
Refrigeration	Condensing units, unit coolers, fluid coolers, air cooled condensers, air handlers, process chillers, controls, compressorized racks, supermarket display cases and systems	Light Commercial; Food Preservation; Non-Food/Industrial	United States Canada Europe Asia Pacific South America

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, excluding certain items. The reconciliation in the table below details the items excluded.

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 because they are determined at the discretion of the Board of Directors and based on the historical practice of doing so for internal reporting purposes.

As they arise, transactions between segments are recorded on an arm's-length basis using the relevant market prices. Any intercompany sales and associated profit (and any other intercompany items) are eliminated from segment results. There were no significant intercompany eliminations for the periods presented.

Segment Data

Net sales and segment profit (loss) for each segment, along with a reconciliation of segment profit (loss) to Operating income, are shown below (in millions):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Net sales				
Residential Heating & Cooling	$572.7	$517.9	$1,524.5	$1,435.6
Commercial Heating & Cooling	251.4	246.8	674.7	660.3
Refrigeration	185.9	190.3	545.2	537.4
	$1,010.0	$955.0	$2,744.4	$2,633.3
Segment profit (loss) [1]				
Residential Heating & Cooling	$112.7	$90.1	$266.9	$221.3
Commercial Heating & Cooling	48.9	44.8	110.6	95.5
Refrigeration	22.9	20.3	53.2	37.5
Corporate and other	(27.3)	(24.0)	(65.7)	(57.4)
Total segment profit	157.2	131.2	365.0	296.9
Reconciliation to Operating income:				
Special product quality adjustments	—	0.7	(0.4)	(0.6)
Items in Losses (gains) and other expenses, net that are excluded from segment profit (loss) (1)	(0.3)	3.9	2.9	10.8
Restructuring charges (gains)	0.6	(0.4)	1.2	1.8
Operating income	$156.9	$127.0	$361.3	$284.9

[1] The Company defines segment profit and loss as a segment's operating income included in the accompanying Consolidated Statements of Operations, excluding:

- Special product quality adjustments;
- The following items in Losses (gains) and other expenses, net:
  Net change in unrealized gains and/or losses on unsettled futures contracts,
  Special legal contingency charges,
  Asbestos-related litigation,
  Contractor tax payments,
  Environmental liabilities, and
  Other items, net;
- Restructuring charges; and
- Goodwill, long-lived asset, and equity method investment impairments.

Total Assets by Segment

Except for the seasonal increase in total assets across all reportable segments, there have not been any material changes in the composition of total assets by segment since December 31, 2015.

15. Fair Value Measurements:

Fair Value Hierarchy

The methodologies used to determine the fair value of our financial assets and liabilities at September 30, 2016 were the same as those used at December 31, 2015.

Assets and Liabilities Carried at Fair Value on a Recurring Basis

Derivatives

Derivatives were classified as Level 2 and primarily valued using estimated future cash flows based on observed prices from exchange-traded derivatives. We also considered the counterparty's creditworthiness, or our own creditworthiness, as appropriate. Adjustments were recorded to reflect the risk of credit default, however, they were insignificant to the overall value of the derivatives. Refer to Note 4 for more information related to our derivative instruments.

Marketable Equity Securities

The following table presents the fair values of an investment in marketable equity securities, classified as Level 1 and related to publicly traded stock of a non-U.S. company, recorded in Other assets, net in the accompanying Consolidated Balance Sheets (in millions):

	As of September 30, 2016	As of December 31, 2015
Investment in marketable equity securities	$ 4.6	$ 6.5

Other Fair Value Disclosures

The carrying amounts of Cash and cash equivalents, Accounts and notes receivable, net, Accounts payable, and Short-term debt approximate fair value due to the short maturities of these instruments. The carrying amount of our Domestic Credit Facility in Long-term debt also approximates fair value due to its variable-rate characteristics.

The fair value of our senior unsecured notes in Long-term debt, classified as Level 2, was based on the amount of future cash flows using current market rates for debt instruments of similar maturities and credit risk. The following table presents their fair value (in millions):

	As of September 30, 2016	As of December 31, 2015
Senior unsecured notes	$ 207.2	$ 207.3

16. Condensed Consolidating Financial Statements:

The Company’s senior unsecured notes are unconditionally guaranteed by certain of the Company’s subsidiaries (the “Guarantor Subsidiaries”) and are not guaranteed by our other subsidiaries (the “Non-Guarantor Subsidiaries”). The Guarantor Subsidiaries are 100% owned, all guarantees are full and unconditional, and all guarantees are joint and several. As a result of the guarantee arrangements, we are required to present the following condensed consolidating financial statements.

The condensed consolidating financial statements reflect the investments in subsidiaries of the Company using the equity method of accounting. 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 September 30, 2016 and December 31, 2015 and for the three and nine months ended September 30, 2016 and 2015 are shown on the following pages.

Lennox International Inc. and Subsidiaries
Condensed Consolidating Balance Sheets
As of September 30, 2016

(Amounts in millions)	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Current Assets:					
Cash and cash equivalents	$4.5	$ 15.9	$ 27.4	$—	$ 47.8
Accounts and notes receivable, net	—	42.4	528.0	—	570.4
Inventories, net	—	361.3	119.3	(6.6)	474.0
Other assets	4.8	50.5	80.1	(61.1)	74.3
Total current assets	9.3	470.1	754.8	(67.7)	1,166.5
Property, plant and equipment, net	—	269.0	77.2	—	346.2
Goodwill	—	134.9	63.6	—	198.5
Investment in subsidiaries	1,137.6	308.6	(0.6)	(1,445.6)	—
Deferred income taxes	5.0	129.0	28.5	(15.1)	147.4
Other assets, net	2.1	38.6	28.8	(1.5)	68.0
Intercompany receivables (payables), net	(450.8)	439.0	85.1	(73.3)	—
Total assets	$703.2	$ 1,789.2	$ 1,037.4	$ (1,603.2)	$ 1,926.6
LIABILITIES AND STOCKHOLDERS’ EQUITY					
Current liabilities:					
Short-term debt	$—	$ —	$ 327.8	$—	$ 327.8
Current maturities of long-term debt	214.7	0.6	0.3	—	215.6
Accounts payable	18.5	283.0	70.2	—	371.7
Accrued expenses	6.1	208.3	57.8	—	272.2
Income taxes payable	(58.4)	79.3	57.4	(77.5)	0.8
Total current liabilities	180.9	571.2	513.5	(77.5)	1,188.1
Long-term debt	497.6	14.6	0.3	—	512.5
Post-retirement benefits, other than pensions	—	2.2	—	—	2.2
Pensions	—	64.7	8.2	—	72.9
Other liabilities	0.5	120.2	10.7	(4.7)	126.7
Total liabilities	679.0	772.9	532.7	(82.2)	1,902.4
Commitments and contingencies					
Total stockholders' equity	24.2	1,016.3	504.7	(1,521.0)	24.2
Total liabilities and stockholders' equity	$703.2	$ 1,789.2	$ 1,037.4	$ (1,603.2)	$ 1,926.6

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Lennox International Inc. and Subsidiaries
Condensed Consolidating Balance Sheets
As of December 31, 2015

(Amounts in millions)	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
Current Assets:					
Cash and cash equivalents	$0.5	$ 7.8	$ 30.6	$—	$ 38.9
Accounts and notes receivable, net	—	25.9	396.9	—	422.8
Inventories, net	—	324.3	98.9	(4.4)	418.8
Other assets	3.3	46.9	67.4	(59.9)	57.7
Total current assets	3.8	404.9	593.8	(64.3)	938.2
Property, plant and equipment, net	—	261.8	77.8	—	339.6
Goodwill	—	134.9	60.2	—	195.1
Investment in subsidiaries	879.0	337.6	(0.6)	(1,216.0)	—
Deferred income taxes	5.4	126.6	28.4	(14.7)	145.7
Other assets, net	1.5	38.2	20.6	(1.5)	58.8
Intercompany (payables) receivables, net	(278.6)	253.3	25.3	—	—
Total assets	$611.1	$ 1,557.3	$ 805.5	$ (1,296.5)	$ 1,677.4
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities:					
Short-term debt	$—	$ —	$ 204.1	$—	$ 204.1
Current maturities of long-term debt	29.8	0.8	0.4	—	31.0
Accounts payable	16.1	237.9	66.1	—	320.1
Accrued expenses	15.8	176.7	50.1	—	242.6
Income taxes (receivable) payable	(43.0)	106.6	37.9	(75.5)	26.0
Total current liabilities	18.7	522.0	358.6	(75.5)	823.8
Long-term debt	490.4	15.1	0.5	—	506.0
Post-retirement benefits, other than pensions	—	4.1	—	—	4.1
Pensions	—	111.9	8.9	—	120.8
Other liabilities	0.4	114.4	10.5	(4.2)	121.1
Total liabilities	509.5	767.5	378.5	(79.7)	1,575.8
Commitments and contingencies					
Total stockholders' equity	101.6	789.8	427.0	(1,216.8)	101.6
Total liabilities and stockholders' equity	$611.1	$ 1,557.3	$ 805.5	$ (1,296.5)	$ 1,677.4

Lennox International Inc. and Subsidiaries
Condensed Consolidating Statements of Operations and Comprehensive Income
For the Three Months Ended September 30, 2016

(Amounts in millions)	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net Sales	$—	$ 870.5	$ 186.9	$ (47.4)	$ 1,010.0
Cost of goods sold	—	603.4	143.7	(47.4)	699.7
Gross profit	—	267.1	43.2	—	310.3
Operating expenses:					
Selling, general and administrative expenses	—	135.9	20.6	—	156.5
Losses (gains) and other expenses, net	(1.1)	1.1	0.7	—	0.7
Restructuring charges	—	0.5	0.1	—	0.6
Income from equity method investments	(105.0)	(10.0)	(3.2)	113.8	(4.4)
Operating income	106.1	139.6	25.0	(113.8)	156.9
Interest expense, net	6.1	(0.5)	1.4	—	7.0
Other expense, net	—	—	—	—	—
Income from continuing operations before income taxes	100.0	140.1	23.6	(113.8)	149.9
Provision for income taxes	(1.7)	42.3	7.6	—	48.2
Income from continuing operations	101.7	97.8	16.0	(113.8)	101.7
Loss from discontinued operations	—	—	—	—	—
Net income	$101.7	$ 97.8	$ 16.0	$ (113.8)	$ 101.7
Other comprehensive income (loss), net of tax	2.7	(0.4)	(2.3)	(0.4)	(0.4)
Comprehensive income	$104.4	$ 97.4	$ 13.7	$ (114.2)	$ 101.3

Lennox International Inc. and Subsidiaries
Condensed Consolidating Statements of Operations and Comprehensive Income
For the Nine Months Ended September 30, 2016

(Amounts in millions)	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net Sales	$—	$ 2,368.8	$ 514.1	$ (138.5)	$ 2,744.4
Cost of goods sold	—	1,675.6	396.3	(136.4)	1,935.5
Gross profit	—	693.2	117.8	(2.1)	808.9
Operating expenses:					
Selling, general and administrative expenses	—	394.6	61.6	—	456.2
Losses (gains) and other expenses, net	(1.7)	4.3	3.0	(0.1)	5.5
Restructuring charges	—	1.5	(0.3)	—	1.2
Income from equity method investments	(248.5)	(19.5)	(12.4)	265.1	(15.3)
Operating income	250.2	312.3	65.9	(267.1)	361.3
Interest expense, net	17.7	(1.5)	3.4	—	19.6
Other expense, net	—	—	(0.2)	—	(0.2)
Income from continuing operations before income taxes	232.5	313.8	62.7	(267.1)	341.9
Provision for income taxes	(4.9)	89.1	20.5	(0.7)	104.0
Income from continuing operations	237.4	224.7	42.2	(266.4)	237.9
Loss from discontinued operations	—	—	0.6	—	0.6
Net income	$237.4	$ 224.7	$ 41.6	$ (266.4)	$ 237.3
Other comprehensive income (loss), net of tax	7.7	2.0	6.7	1.3	17.7
Comprehensive income	$245.1	$ 226.7	$ 48.3	$ (265.1)	$ 255.0

Lennox International Inc. and Subsidiaries
Condensed Consolidating Statements of Operations and Comprehensive Income
For the Three Months Ended September 30, 2015

(Amounts in millions)	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net Sales	$—	$ 827.9	$ 185.2	$ (58.1)	$ 955.0
Cost of goods sold	—	589.9	150.2	(58.5)	681.6
Gross profit	—	238.0	35.0	0.4	273.4
Operating expenses:					
Selling, general and administrative expenses	—	124.0	19.8	—	143.8
Losses and other expenses, net	0.6	2.7	2.7	—	6.0
Restructuring gains	—	(0.2)	(0.2)	—	(0.4)
Income from equity method investments	(84.2)	(2.7)	(2.1)	86.0	(3.0)
Operating income	83.6	114.2	14.8	(85.6)	127.0
Interest expense, net	5.4	(0.4)	0.7	—	5.7
Other expense, net	—	—	(0.7)	—	(0.7)
Income from continuing operations before income taxes	78.2	114.6	14.8	(85.6)	122.0
Provision for income taxes	(2.1)	39.0	4.6	0.2	41.7
Income from continuing operations	80.3	75.6	10.2	(85.8)	80.3
Loss from discontinued operations	—	—	—	—	—
Net income	$80.3	$ 75.6	$ 10.2	$ (85.8)	$ 80.3
Other comprehensive loss, net of tax	(4.3)	(8.6)	(16.2)	(1.8)	(30.9)
Comprehensive income (loss)	$76.0	$ 67.0	$ (6.0)	$ (87.6)	$ 49.4

Lennox International Inc. and Subsidiaries
Condensed Consolidating Statements of Operations and Comprehensive Income
For the Nine Months Ended September 30, 2015

(Amounts in millions)	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net Sales	$—	$ 2,268.6	$ 520.7	$ (156.0)	$ 2,633.3
Cost of goods sold	—	1,650.7	418.2	(155.4)	1,913.5
Gross profit	—	617.9	102.5	(0.6)	719.8
Operating expenses:					
Selling, general and administrative expenses	—	362.0	68.0	—	430.0
Losses and other expenses, net	1.1	7.7	6.2	(0.1)	14.9
Restructuring charges	—	(0.5)	2.3	—	1.8
Income from equity method investments	(187.2)	(0.3)	(9.3)	185.0	(11.8)
Operating income	186.1	249.0	35.3	(185.5)	284.9
Interest expense, net	17.1	(1.5)	2.3	—	17.9
Other expense, net	—	—	(0.7)	—	(0.7)
Income from continuing operations before income taxes	169.0	250.5	33.7	(185.5)	267.7
Provision for income taxes	(6.3)	87.2	11.2	(0.2)	91.9
Income from continuing operations	175.3	163.3	22.5	(185.3)	175.8
Loss from discontinued operations	—	—	(0.5)	—	(0.5)
Net income	$175.3	$ 163.3	$ 22.0	$ (185.3)	$ 175.3
Other comprehensive income (loss), net of tax	(2.9)	(13.8)	(36.4)	(3.2)	(56.3)
Comprehensive income	$172.4	$ 149.5	$ (14.4)	$ (188.5)	$ 119.0

Lennox International Inc. and Subsidiaries
Condensed Consolidating Statements of Cash Flows
For the Nine Months Ended September 30, 2016

(Amounts in millions)	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows from operating activities	$ (4.5)	$ 262.2	$ (150.8)	$ —	$ 106.9
Cash flows from investing activities:					
Purchases of property, plant and equipment	—	(52.4)	(7.0)	—	(59.4)
Net cash used in investing activities	—	(52.4)	(7.0)	—	(59.4)
Cash flows from financing activities:					
Short-term borrowings, net	—	—	(2.1)	—	(2.1)
Asset securitization borrowings	—	—	145.0	—	145.0
Asset securitization payments	—	—	(20.0)	—	(20.0)
Long-term debt payments	(30.0)	(0.6)	(0.3)	—	(30.9)
Borrowings from credit facility	1,715.0	—	—	—	1,715.0
Payments on credit facility	(1,493.0)	—	—	—	(1,493.0)
Proceeds from employee stock purchases	1.9	—	—	—	1.9
Payments of deferred financing costs	(0.9)	—	—	—	(0.9)
Repurchases of common stock	(300.0)	—	—	—	(300.0)
Repurchases of common stock to satisfy employee withholding tax obligations	(26.3)	—	—	—	(26.3)
Excess tax benefits related to share-based payments	20.0	—	—	—	20.0
Intercompany debt	(6.6)	(5.1)	11.7	—	—
Intercompany financing activity	178.9	(196.0)	17.1	—	—
Cash dividends paid	(50.5)	—	—	—	(50.5)
Net cash provided by financing activities	8.5	(201.7)	151.4	—	(41.8)
Increase in cash and cash equivalents	4.0	8.1	(6.4)	—	5.7
Effect of exchange rates on cash and cash equivalents	—	—	3.2	—	3.2
Cash and cash equivalents, beginning of period	0.5	7.8	30.6	—	38.9
Cash and cash equivalents, end of period	$ 4.5	$ 15.9	$ 27.4	$ —	$ 47.8

Lennox International Inc. and Subsidiaries
Condensed Consolidating Statements of Cash Flows
For the Nine Months Ended September 30, 2015

(Amounts in millions)	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows from operating activities	$ (27.3)	$ 138.2	$ (4.0)	$ —	$ 106.9
Cash flows from investing activities:					
Purchases of property, plant and equipment	—	(40.3)	(6.7)	—	(47.0)
Net cash used in investing activities	—	(40.3)	(6.7)	—	(47.0)
Cash flows from financing activities:					
Short-term borrowings, net	—	—	0.8	—	0.8
Asset securitization borrowings	—	—	40.0	—	40.0
Asset securitization payments	—	—	(40.0)	—	(40.0)
Long-term debt payments	(22.5)	(0.8)	(0.2)	—	(23.5)
Borrowings from revolving credit facility	1,401.0	—	—	—	1,401.0
Payments on revolving credit facility	(1,385.0)	—	—	—	(1,385.0)
Proceeds from employee stock purchases	1.8	—	—	—	1.8
Repurchases of common stock to satisfy employee withholding tax obligations	(23.5)	—	—	—	(23.5)
Payments of deferred financing costs	—	—	—	—	—
Excess tax benefits related to share-based payments	18.6	—	—	—	18.6
Intercompany financing activity	(37.7)	10.2	27.5	—	—
Intercompany investments	118.0	(106.3)	(11.7)	—	—
Cash dividends paid	(43.1)	—	—	—	(43.1)
Net cash provided by financing activities	27.6	(96.9)	16.4	—	(52.9)
Increase in cash and cash equivalents	0.3	1.0	5.7	—	7.0
Effect of exchange rates on cash and cash equivalents	—	—	(9.4)	—	(9.4)
Cash and cash equivalents, beginning of period	1.0	11.5	25.0	—	37.5
Cash and cash equivalents, end of period	$ 1.3	$ 12.5	$ 21.3	$ —	$ 35.1

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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 as of the date such statements were made. All statements, other than statements of historical fact, included in this Quarterly Report on Form 10-Q constitute forward-looking statements, including but not limited to statements identified by forward-looking terminology, such as the words “may,” “will,” “should,” “plan,” “anticipate,” “believe,” “intend,” “estimate” a “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, 2015, 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, except as required by law.

Business Overview

We operate in three reportable business segments of the heating, ventilation, air conditioning and refrigeration (“HVACR”) industry. Our reportable segments are Residential Heating & Cooling, Commercial Heating & Cooling, and Refrigeration. For additional information regarding our reportable segments, see Note 14 in the Notes to the Consolidated Financial Statements.

Our fiscal year ends on December 31 and our interim fiscal quarters are each comprised of approximately 13 weeks. For convenience, throughout this Management’s Discussion and Analysis of Financial Condition and Results of Operations, the 13-week periods comprising each fiscal quarter are denoted by the last day of the respective calendar quarter.

We sell our products and services through a combination of direct sales, distributors and company-owned parts and supplies stores. The demand for our products and services is seasonal and significantly impacted by the weather. Warmer than normal summer temperatures generate demand for replacement air conditioning and refrigeration products and services, and colder than normal winter temperatures have a similar 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. 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 principal elements of cost of goods sold are components, raw materials, factory overhead, labor, estimated warranty costs, and freight and distribution costs. The principal raw materials used in our manufacturing processes are steel, copper and aluminum. In recent years, pricing volatility for these commodities and related components have impacted us and the HVACR industry in general. We seek to mitigate the impact of volatility in commodity prices through a combination of price increases, commodity contracts, improved production efficiency and cost reduction initiatives. We also partially mitigate volatility in the prices of these commodities by entering into futures contracts and fixed forward contracts.

Financial Overview

In the third quarter of 2016, the Residential Heating & Cooling segment continued to lead our overall operational performance with a 11% increase in net sales and a $23 million increase in segment profit compared to the third quarter of 2015. The primary growth drivers for this segment were volume gains and lower material cost. Our Commercial Heating & Cooling segment also performed well in the third quarter of 2016 with a 2% increase in net sales and $4 million in increased segment profit compared to the third quarter of 2015. This segment's profits were up largely due to lower material cost. While sales in our Refrigeration segment were down 2%, the segment profit increased $3 million compared to the third quarter of 2015. For this segment, lower sales volume was offset by lower material cost.

On a consolidated basis, our product profit margins improved quarter over quarter primarily due to lower material costs and higher productivity. We continue to manage our cost structure by utilizing a combination of commodity hedging and controllable product cost management initiatives.

Financial Highlights

- Net sales increased $55 million, or 6%, to $1,010 million in the third quarter of 2016 compared to $955 million in the third quarter of 2015.
- Operating income in the third quarter of 2016 increased $30 million to $157 million from $127 million in the third quarter of 2015.
- Net income for the third quarter of 2016 increased $22 million to $102 million from $80 million in the third quarter of 2015.
- Diluted earnings per share from continuing operations were $2.33 per share in the third quarter of 2016 compared to $1.76 per share in the third quarter of 2015.
- During the third quarter of 2016, we returned $19 million to shareholders through dividend payments.
- Cash provided by operating activities was flat at $107 million in the first nine months of 2016 and 2015, although we made a discretionary $50 million pension contribution into our U.S. qualified plan in the third quarter of 2016.

Third Quarter of 2016 Compared to Third Quarter of 2015 - Consolidated Results

The following table provides a summary of our financial results, including information presented as a percentage of net sales:

	For the Three Months Ended September 30,				
	Dollars (in millions)		Percent Change	Percent of Sales	
	2016	2015	Fav/(Unfav)	2016	2015
Net sales	$1,010.0	$955.0	5.8 %	100.0 %	100.0 %
Cost of goods sold	699.7	681.6	(2.7)	69.3	71.4
Gross profit	310.3	273.4	13.5	30.7	28.6
Selling, general and administrative expenses	156.5	143.8	(8.8)	15.5	15.1
Losses and other expenses, net	0.7	6.0	88.3	0.1	0.6
Restructuring charges	0.6	(0.4)	(250.0)	0.1	—
Income from equity method investments	(4.4)	(3.0)	46.7	(0.4)	(0.3)
Operating income	$156.9	$127.0	23.5 %	15.5 %	13.3 %

Net Sales

Net sales increased 6% in the third quarter of 2016 compared to the third quarter of 2015, primarily from 5% higher sales volumes and 1% from price and mix. The Residential Heating & Cooling segment delivered higher volume by capturing additional replacement and new construction business and the Commercial Heating & Cooling segment delivered higher volume from our North American Service business.

Gross Profit

Gross profit margin in the third quarter of 2016 increased 210 basis points ("bps") to 30.7% compared to the third quarter of 2015. Our profit margin increased 270 bps from lower material costs. Offsetting this increase were decreases of 10 bps for unfavorable mix and price, 20 bps from combined freight and distribution, and 30 bps from other product costs.

Selling, General and Administrative Expenses

Selling, general and administrative expenses, or SG&A, was $157 million in the third quarter of 2016 compared to $144 million in the third quarter of 2015, and as a percentage of net sales increased 40 bps to 15.5%. SG&A expenses increased due to higher long-term incentive compensation costs, wage inflation, and increased investment in information technology and research and development.

Losses and Other Expenses, Net

Losses and other expenses, net for the third quarter of 2016 and 2015 included the following (in millions):

	For the Three Months Ended September 30,	
	2016	2015
Realized losses on settled future contracts	$0.3	$0.6
Foreign currency exchange losses	0.5	1.4
Loss on disposal of fixed assets	0.2	0.1
Net change in unrealized (gains) losses on unsettled futures contracts	(1.2)	0.8
Special legal contingency charges	0.5	1.3
Asbestos-related litigation	0.4	0.4
Contractor tax payments	—	0.8
Environmental liabilities	—	0.3
Other items, net	—	0.3
Losses and other expenses, net (pre-tax)	$0.7	$6.0

The net change in unrealized (gains) losses on unsettled futures contracts was due to lower commodity prices relative to the unsettled futures contract prices. For more information on our futures contracts, see Note 4 in the Notes to the Consolidated Financial Statements. The change in the special legal contingency charges resulted from higher estimated liabilities related to settled claims. For more information on special legal contingency charges and asbestos-related litigation, see Note 6 in the Notes to the Consolidated Financial Statements.

Restructuring Charges

Restructuring charges during the third quarter of 2016 relate to the demolition of a facility relating to a previous restructuring activity. The restructuring charges in the third quarter of 2015 relate to the restructuring of our Australian operations in the Refrigeration segment. For additional information on our restructuring activities, refer to Note 12 in the Notes to the Consolidated Financial Statements.

Income from Equity Method Investments

We participate in two joint ventures that are engaged in the manufacture and sale of compressors, unit coolers and condensing units. We exert significant influence over these affiliates based upon our ownerships, but do not control them due to venture partner participation. Accordingly, these joint ventures have been accounted for under the equity method and their financial position and results of operations are not consolidated. Income from equity method investments of $4 million in the third quarter of 2016 increased from $3 million in the third quarter of 2015.

Interest Expense, net

Interest expense, net of $7 million in the third quarter of 2016 was up from $6 million as compared to the third quarter of 2015.

Income Taxes

We expect our annual effective tax rate to be 31% in 2016 and subsequent years to be approximately 32% due to sustainable benefits from reorganization of our international subsidiaries that will enable us to utilize foreign tax credits and other benefits that drives our effective tax rate down by approximately 250 basis points. The tax benefit resulting from a repatriation of earnings in 2016 was recognized in the second quarter.

The effective tax rate was 32.2% for the third quarter of 2016 compared to 34.2% for the third quarter of 2015.

Third Quarter of 2016 Compared to Third Quarter of 2015 - Results by Segment

Residential Heating & Cooling

The following table presents our Residential Heating & Cooling segment's net sales and profit for the third quarter of 2016 and 2015 (dollars in millions):

	For the Three Months Ended September 30,			
	2016	2015	Difference	% Change
Net sales	$572.7	$517.9	$ 54.8	10.6 %
Profit	$112.7	$90.1	$ 22.6	25.1 %
% of net sales	19.7 %	17.4 %		

Net sales increased by 11% in the third quarter of 2016 compared to the third quarter of 2015. Sales volumes increased by 10% and price and mix combined increased sales by 1%.

Segment profit for the third quarter of 2016 increased $23 million due to $13 million in higher sales volumes, $13 million in lower material cost and $4 million from factory productivity, which includes the addition of a second factory in Mexico, and $1 million from price and mix combined. Partially offsetting these increases was $1 million of SG&A expenses primarily for information technology and research and development investments, $4 million in distribution investments, and $3 million from increases in other product costs.

Commercial Heating & Cooling

The following table presents our Commercial Heating & Cooling segment's net sales and profit for the third quarter of 2016 and 2015 (dollars in millions):

	For the Three Months Ended September 30,			
	2016	2015	Difference	% Change
Net sales	$251.4	$246.8	$ 4.6	1.9 %
Profit	$48.9	$44.8	$ 4.1	9.2 %
% of net sales	19.5 %	18.2 %		

Net sales increased by 2% in the third quarter of 2016 compared to the third quarter of 2015. Sales volumes increased by 2% primarily the result of growth in our North American Service and VRF businesses.

Segment profit in the third quarter of 2016 increased $4 million compared to the third quarter of 2015 due to $6 million in lower material cost, $1 million from higher sales volumes, and $1 million in lower freight expenses. Partially offsetting these increases was $2 million in SG&A expenses, $1 million in lower factory productivity, and $1 million in other product costs.

Refrigeration

The following table presents our Refrigeration segment's net sales and profit for the third quarter of 2016 and 2015 (dollars in millions):

	For the Three Months Ended September 30,			
	2016	2015	Difference	% Change
Net sales	$185.9	$190.3	$ (4.4)	(2.3)%
Profit	$22.9	$20.3	$ 2.6	12.8 %
% of net sales	12.3 %	10.7 %		

Net sales decreased 2% in the third quarter of 2016 compared to the third quarter of 2015. Sales volume decreased by 1% and price and mix combined decreased sales by 1%.

Segment profit for the third quarter of 2016 increased $3 million compared to the third quarter of 2015 due to $7 million from lower material costs and $2 million from lower depreciation and amortization due to the impairment of our Kysor Warren business recorded in the fourth quarter of 2015. Partially offsetting these increases was $4 million in higher SG&A expenses, $1 million from combined price and mix and $1 million in lower sales volumes.

Corporate and Other

Corporate and other expenses increased $4 million in the third quarter of 2016 compared to the third quarter of 2015 primarily due to $5 million of higher incentive compensation and general wage inflation and $2 million in investments in research and development and consulting. Partially offsetting these increases was $3 million in lower health care expenses.

Year-to-Date through September 30, 2016 Compared to Year-to-Date through September 30, 2015 - Consolidated Results

The following table provides a summary of our financial results, including information presented as a percentage of net sales:

	For the Nine Months Ended September 30,				
	Dollars (in millions)		Percent	Percent of Sales	
	2016	2015	Change Fav/(Unfav)	2016	2015
Net sales	$2,744.4	$2,633.3	4.2	100.0 %	100.0 %
Cost of goods sold	1,935.5	1,913.5	(1.1)	70.5	72.7
Gross profit	808.9	719.8	12.4	29.5	27.3
Selling, general and administrative expenses	456.2	430.0	(6.1)	16.6	16.3
Losses and other expenses, net	5.5	14.9	63.1	0.2	0.6
Restructuring charges	1.2	1.8	33.3	—	0.1
Income from equity method investments	(15.3)	(11.8)	29.7	(0.6)	(0.4)
Operating income	$361.3	$284.9	26.8	13.2 %	10.8 %

Net Sales

Net sales increased 4% in the first nine months of 2016 compared to the first nine months of 2015, with sales volumes up 4% and a 1% increase from price and mix combined. The volume increases were driven by our Residential Heating & Cooling, Commercial Heating & Cooling and Refrigeration segments all capturing additional replacement and new construction business. Partially offsetting these increases was a 1% decrease from unfavorable foreign currency exchange rates.

Gross Profit

Gross profit margins in the first nine months of 2016 increased 220 bps to 29.5% compared to the first nine months of 2015. Our profit margin increased 290 bps from material cost savings and 30 bps from factory productivity. Offsetting these increases were decreases of 40 bps for unfavorable mix and price, 20 bps from unfavorable foreign currency exchange rates, 10 bps from freight and distribution, and 30 bps from other product costs.

Selling, General and Administrative Expenses

SG&A was $456 million for the first nine months of 2016 compared to $430 million for the first nine months of 2015, and as a percentage of net sales, increased 30 bps to 16.6% from 16.3%. SG&A expenses increased due to higher long-term incentive compensation costs, wage inflation, and increased investment in information technology and research and development.

Losses and Other Expenses, Net

Losses and other expenses, net for the first nine months of 2016 and 2015 included the following (in millions):

	For the Nine Months Ended September 30,	
	2016	2015
Realized losses on settled future contracts	$1.2	$1.3
Foreign currency exchange losses	1.1	2.7
Loss on disposal of fixed assets	0.3	0.1
Net change in unrealized (gains) losses on unsettled futures contracts	(1.9)	0.9
Special legal contingency charges	0.5	5.5
Asbestos-related litigation	2.3	1.0
Environmental liabilities	1.1	0.7
Contractor tax payments	0.5	2.4
Acquisition costs	0.4	—
Other items, net	—	0.3
Losses and other expenses, net (pre-tax)	$5.5	$14.9

The net change in unrealized gains on unsettled futures contracts was due to lower commodity prices relative to the unsettled futures contract prices. For more information on our futures contracts, see Note 4 in the Notes to the Consolidated Financial Statements. For more information on special legal contingency charges and asbestos-related litigation, see Note 6 in the Notes to the Consolidated Financial Statements. Contractor tax payments relate to a charge for underpaid contractor taxes at one of our non-U.S. subsidiaries.

Restructuring Charges

Restructuring charges during the first nine months of 2016 relate to the demolition of a facility relating to a previous restructuring activity. The restructuring charges in the first nine months of 2015 relate to the restructuring of our Australian operations in the Refrigeration segment. For additional information on our restructuring activities, refer to Note 12 in the Notes to the Consolidated Financial Statements.

Income from Equity Method Investments

We participate in two joint ventures that are engaged in the manufacture and sale of compressors, unit coolers and condensing units. We exert significant influence over these affiliates based upon our ownerships, but do not control them due to venture partner participation. Accordingly, these joint ventures have been accounted for under the equity method and their financial position and results of operations are not consolidated. Income from equity method investments increased to $15 million in the first nine months of 2016 as compared to $12 million in the first nine months of 2015.

Interest Expense, net

Interest expense, net of $20 million in the first nine months of 2016 increased from $18 million in the first nine months of 2015 due to an increase in our average net borrowings.

Income Taxes

We expect our annual effective tax rate to be 31% in 2016 and subsequent years to be approximately 32% due to sustainable benefits from reorganization of our international subsidiaries that will enable us to utilize foreign tax credits and other benefits that drives our effective tax rate down by approximately 250 basis points. The tax benefit resulting from a repatriation of earnings in 2016 was recognized in the second quarter.

The effective tax rate was 30.4% for the first nine months of 2016 compared to 34.3% for the first nine months of 2015.

Year-to-Date through September 30, 2016 Compared to Year-to-Date through September 30, 2015 - Results by Segment

Residential Heating & Cooling

The following table presents our Residential Heating & Cooling segment's net sales and profit for the first nine months of 2016 and 2015 (dollars in millions):

	For the Nine Months Ended September 30,			
	2016	2015	Difference	% Change
Net sales	$1,524.5	$1,435.6	$ 88.9	6.2 %
Profit	$266.9	$221.3	$ 45.6	20.6 %
% of net sales	17.5 %	15.4 %		

Net sales increased by 6% in the first nine months of 2016 compared to the first nine months of 2015. Sales volumes increased net sales by 5% due to industry growth and market share gains and the benefits of favorable price and mix contributed 1%.

Segment profit for the first nine months of 2016 increased $46 million due to $45 million in lower material costs, $22 million from higher sales volume and $9 million from favorable factory productivity which includes the addition of a second factory in Mexico. Partially offsetting these increases was $9 million from unfavorable price and mix combined, $4 million of unfavorable foreign currency exchange rates, $6 million in distribution investments, $7 million of SG&A expenses to support wage inflation and investments in information technology and research and development, and $4 million of other product costs.

Commercial Heating & Cooling

The following table presents our Commercial Heating & Cooling segment's net sales and profit for the first nine months of 2016 and 2015 (dollars in millions):

	For the Nine Months Ended September 30,			
	2016	2015	Difference	% Change
Net sales	$674.7	$660.3	$ 14.4	2.2 %
Profit	$110.6	$95.5	$ 15.1	15.8 %
% of net sales	16.4 %	14.5 %		

Commercial Heating & Cooling net sales increased by 2% in the first nine months of 2016 compared to the first nine months of 2015. Sales volumes increased net sales by 2%, price and mix increased sales by 1% and changes in foreign currency exchange rates unfavorably impacted net sales by 1%.

Segment profit in the first nine months of 2016 increased $15 million compared to the first nine months of 2015. The benefits of $4 million from incremental volume, $15 million from lower material costs, $4 million from price and mix and $2 million from lower freight and distribution expenses were partially offset by $5 million in lower factory productivity and other product costs, $3 million of higher SG&A expenses, $1 million for investments in infrastructure for the North American Service business and $1 million from changes in foreign currency exchange rates.

Refrigeration

The following table presents our Refrigeration segment's net sales and profit for the first nine months of 2016 and 2015 (dollars in millions):

	For the Nine Months Ended September 30,			
	2016	2015	Difference	% Change
Net sales	$545.2	$537.4	$ 7.8	1.5 %
Profit	$53.2	$37.5	$ 15.7	41.9 %
% of net sales	9.8 %	7.0 %		

Refrigeration net sales increased 2% in the first nine months of 2016 compared to the first nine months of 2015 primarily due 4% volume growth led by our North American supermarket businesses. This volume increase was partially offset by a 1% impact from unfavorable foreign exchange rates and a 1% impact from price reductions.

Segment profit for the first nine months of 2016 increased $16 million compared to the first nine months of 2015 primarily due to $6 million from increased sales volumes, $16 million in lower material costs, $5 million from lower depreciation and amortization due to the impairment of our Kysor Warren business recorded in the fourth quarter of 2015 and $3 million in factory productivity and other product costs. Partially offsetting these increases were $7 million from unfavorable price and mix combined, $6 million from higher SG&A expenses and $1 million from changes in foreign currency exchange rates.

Corporate and Other

Corporate and other expenses increased $8 million in the first nine months of 2016 as compared to the first nine months of 2015 due primarily to $10 million in incentive compensation and wage inflation and $2 million of investments in research and development and consulting. Partially offsetting these increases was $4 million from lower health care and other miscellaneous costs.

Pensions

As part of our overall strategy to de-risk our pension plans, we have offered certain vested participants in our U.S. qualified plans the opportunity to take a one-time lump sum distribution in lieu of future monthly pension payments. These lump sum distributions will be paid from our retirement plan in the fourth quarter of 2016. As a result of these lump sum payments, our pension benefit obligation will be reduced by approximately $50 million, and we expect to recognize a pre-tax pension settlement charge in the fourth quarter of approximately $30 million.

Liquidity and Capital Resources

Our working capital and capital expenditure requirements are generally met through internally generated funds, bank lines of credit and an 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 flow activity for the nine months ended September 30, 2016 and 2015 (in millions):

	For the Nine Months Ended September 30,	
	2016	2015
Net cash provided by operating activities	$106.9	$106.9
Net cash used in investing activities	(59.4)	(47.0)
Net cash used in financing activities	(41.8)	(52.9)

Net Cash Provided by Operating Activities - The net cash provided by operating activities in the first nine months of 2016 and 2015 reflects the seasonal increase in working capital requirements and was flat year over year. Cash provided by operating activities was flat, the increase in net income in the first nine months of 2016 as compared to 2015 was offset by increases in cash paid for taxes and the fact we made a discretionary pension contribution of $50 million into our U.S. qualified pension plan during the third quarter of 2016.

Net Cash Used in Investing Activities - Capital expenditures were $59 million and $47 million in the first nine months of 2016 and 2015, respectively. Capital expenditures in 2016 were primarily related to investments in systems and software to support the overall enterprise, expansion of our manufacturing capacity, and continued investments in our distribution network.

Net Cash Used in Financing Activities - Net cash used in financing activities decreased to $42 million in the first nine months of 2016 primarily due to an increase in stock repurchases partially offset by increases in borrowings. Net borrowings were higher in 2016 to support the increased stock repurchases and dividend payments. Final settlement of the $200 million Accelerated Share Repurchase Plan executed in the first quarter of 2016 was in the third quarter of 2016. Final settlement of the $100 Million Accelerated Share Repurchase Plan executed in the third quarter of 2016 will be in the fourth quarter of 2016.

Debt Position

The following table details our lines of credit and financing arrangements as of September 30, 2016 (in millions):

	Outstanding Borrowings
Short-term debt:	
Foreign obligations	$ 2.8
Asset Securitization Program [1]	325.0
Total short-term debt	$ 327.8
Current maturities of long-term debt:	
Capital lease obligations	0.9
Domestic credit facility [2]	15.0
Senior unsecured notes	200.0
Debt issuance costs	(0.3)
Total current maturities of long-term debt	$ 215.6
Long-term debt:	
Capital lease obligations	15.1
Domestic credit facility [2]	500.0
Debt issuance costs	(2.6)
Total long-term debt	512.5
Total debt	$ 1,055.9

[1] The maximum securitization amount ranges from $200.0 million to $325.0 million, depending on the period, after consideration of the July 5, 2016 amendment. The maximum capacity of the ASP is the lesser of the maximum securitization amount or 100% of the net pool balance less reserves, as defined under the ASP.
[2] The available future borrowings on our domestic credit facility are $380.6 million after being reduced by the outstanding borrowings and $4.4 million in outstanding standby letters of credit. We also had $38.3 million in outstanding standby letters of credit outside of the domestic credit facility as of September 30, 2016.

Financial Leverage

We periodically review our capital structure to ensure the appropriate levels of leverage and liquidity. We may access the capital markets, as necessary, based on business needs and to take advantage of favorable interest rate environments or other market conditions. We also evaluate our debt-to-capital and debt-to-EBITDA ratios to determine, among other considerations, the appropriate targets for capital expenditures and share repurchases under our share repurchase programs. Our debt-to-total-capital ratio increased to 97.8% at September 30, 2016 from 87.9% at December 31, 2015.

As of September 30, 2016, our senior credit ratings were Baa3 with a stable outlook, and BBB with a stable outlook, by Moody's Investors Service, Inc. ("Moody's") and Standard & Poor's Rating Group ("S&P"), respectively. The security ratings are not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating agency. Each rating should be evaluated independently of any other rating. Our goal is to maintain investment grade ratings from Moody's and S&P to help ensure the capital markets remain available to us.

Liquidity

We believe our cash and cash equivalents of $48 million, future cash generated from operations and available future borrowings are sufficient to fund operations, planned capital expenditures, future contractual obligations, share repurchases, anticipated dividends and other needs in the foreseeable future. Included in our cash and cash equivalents of $48 million as of September 30, 2016 was $27.4 million of cash held in foreign locations. Our cash held in foreign locations is used for investing and operating activities in those locations, and we generally do not have the need or intent to repatriate those funds to the United States. If we were to repatriate foreign earnings, we would be required to accrue and pay taxes in the United States, less foreign tax credits, for the amounts that were repatriated. However, an additional benefit of the tax reorganization discussed previously is our ability to repatriate cash generated in prior periods in a tax efficient manner. We repatriated $42 million in cash from foreign subsidiaries and made a discretionary contribution of $50 million to our qualified pension plans in the third quarter of 2016.

Our expected capital expenditures for 2016 are $95 million. We also continue to increase shareholder value through dividend payments and our share repurchase programs, with the completion of our $200 million accelerated share repurchase program in 2016, the initiation of another $100 million stock repurchase program in the third quarter of 2016, and a target of between $65 million and $75 million of dividend payments in 2016.

Off Balance Sheet Arrangements

In addition to the credit facilities, promissory notes and leasing commitments 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. Our operating lease commitments have not materially changed since December 31, 2015.

Commitments, Contingencies and Guarantees

For information regarding our commitments, contingencies and guarantees, see Note 6 in the Notes to the Consolidated Financial Statements.

Recent Accounting Pronouncements

On May 28, 2014, the Financial Accounting Standard Board ("FASB") issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for us on January 1, 2018. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. We are evaluating the effect that ASU 2014-09 will have on our Consolidated Financial Statements and related disclosures. We will adopt the new standard using the modified retrospective approach and are still determining the effect of the standard on our ongoing financial reporting.

In January 2015, the FASB issued ASU No. 2015-01, Income Statement - Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items. ASU No. 2015-01 eliminates the concept of an extraordinary item from GAAP. As a result, an entity will no longer be required to separately present an extraordinary item on its statement of operations, net of tax, after income from continuing operations or to disclose income taxes and net income per share data applicable to an extraordinary item. However, ASU No. 2015-01 will still retain the presentation and disclosure guidance for items that are unusual in nature and occur infrequently. ASU No. 2015-01 is effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period, although early adoption is permitted. The adoption of this standard did not materially impact our Consolidated Financial Statements.

In February 2015, the FASB issued ASU 2015-02, Consolidation: Amendments to the Consolidation Analysis, or ASU 2015-02, which amends the criteria for determining which entities are considered variable interest entities (“VIEs”), amends the criteria for determining if a service provider possesses a variable interest in a VIE and ends the deferral granted to investment companies for application of the VIE consolidation model. This guidance is effective for annual and interim reporting periods of public entities beginning after December 15, 2015 and early adoption is permitted. The adoption of this standard did not materially impact our Consolidated Financial Statements.

In April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. This guidance is effective for annual and interim reporting periods of public entities beginning after December 15, 2015, and early adoption is permitted. The adoption of this standard did not materially impact our Consolidated Financial Statements.

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes (Topic 740) that simplifies the presentation of deferred taxes by requiring deferred tax assets and liabilities be classified as noncurrent on the

balance sheet. ASU 2015-17 is effective for public companies for annual reporting periods beginning after December 15, 2016, and interim periods within those fiscal years. We adopted this standard retrospectively as of December 31, 2015.
On February 25, 2016, the FASB issued ASU No. 2016-02, Leases (ASC 842). Lessees will need to recognize almost all leases on their balance sheet as a right-of-use asset and a lease liability. It will be critical to identify leases embedded in a contract to avoid misstating the lessee's balance sheet. For income statement purposes, the FASB retained a dual model, requiring leases to be classified as either operating or finance. Classification will be based on criteria that are largely similar to those applied in current lease accounting, but without explicit bright lines. ASU 2016-02 is effective for public companies for annual reporting periods beginning after December 15, 2018, and interim periods within those fiscal years. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing financial reporting.
On March 30, 2016, the FASB issued ASU No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The ASU includes multiple provisions intended to simplify various aspects of the accounting for share-based payments. Excess tax benefits for share-based payments will be recorded as a reduction of income taxes and reflected in operating cash flows upon the adoption of this ASU. Excess tax benefits are currently recorded in equity and as financing activity under the current rules. This guidance is effective for annual and interim reporting periods of public entities beginning after December 15, 2016.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about market risk affecting LII, see "Quantitative and Qualitative Disclosures About Market Risk" in Item 7A of Part II of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. Our exposure to market risk has not changed materially since December 31, 2015.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

As required by Rule 13a-15 under the Exchange Act, 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 September 30, 2016, 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 Exchange Act 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

There were no changes during the quarter ended September 30, 2016 in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II - Other Information

Item 1. Legal Proceedings

We are involved in a number of claims and lawsuits incident to the operation of our businesses. Insurance coverages are maintained and estimated costs are recorded for such claims and lawsuits. It is management's opinion that none of these claims or lawsuits will have a material adverse effect, individually or in the aggregate, on our financial position, results of operations or cash flows.

In October 2016, the Company self-reported to the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) an alleged payment in the amount of 30,000 rubles (approximately US $475) to a Russian customs broker or official. The Company, under the oversight of its Audit Committee, has initiated an investigation into this matter with the assistance of external legal counsel and external forensic accountants. The alleged payment was purportedly made to release a shipment of goods being held by Russian customs officials due to inaccurate paperwork. The value of the shipment was approximately €62,000 (approximately US $68,500). The allegations are related to the Company’s subsidiary in Russia, which had 2015 annual sales of approximately US $5 million and approximately US $3 million in sales for the nine months ended September 30, 2016. To date, the investigation has not resulted in any evidence of other potentially improper payments; however, the investigation has raised questions regarding possible irregularities with respect to other Russian customs documents. The investigation is ongoing. The Company intends to fully cooperate with the SEC and the DOJ regarding this matter. The Company does not anticipate any material adverse effect on its business or financial condition as a result of this matter.

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, 2015, 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 2015 Annual Report on Form 10-K.

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

In the third quarter of 2016, we purchased shares of our common stock as follows:

	Total Number of Shares Purchased (1)	Average Price Paid per Share (including fees)	Total Number of Shares Purchased As Part of Publicly Announced Plans	Approximate Dollar Value of Shares that may yet be Purchased under our Share Repurchase Plans (in millions) (2)
July 1 through July 23	200,803	$ 132.64	196,269	$ 196.2
July 24 through August 20	505,079	156.56	478,316	96.2
August 21 through September 30	1,268	158.59	—	96.2
	707,150		674,585	

(1) We repurchased 32,566 shares of common stock in July, August and September 2016 surrendered to LII to satisfy employee tax-withholding obligations in connection with the exercise of long-term incentive awards.

(2) After $200 million payment for Accelerated Share Repurchase Plan (ASR) executed in February 2016 and $100 million payment for ASR executed in August 2016. Final settlement of the February ASR occurred in the third quarter and the final settlement of the August ASR will be in the fourth quarter. The February and August ASRs were offered pursuant to a previously announced repurchase plan. See Footnote 10 for further details.

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 December 16, 2013 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 (filed as Exhibit 4.3 to LII’s Post-Effective Amendment No. 1 to Registration Statement on S-3 (Registration No. 333-155796) filed on May 3, 2010, and incorporated herein by reference).
4.3	Form of First Supplemental Indenture among LII, the guarantors party thereto and U.S. Bank National Association, as trustee (filed as Exhibit 4.11 to LII’s Post-Effective Amendment No. 1 to Registration Statement on S-3 (Registration No. 333-155796) filed on May 3, 2010, and incorporated herein by reference).
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 existing Guarantor under the Indenture dated as of May 3, 2010, and U.S. Bank National Association as Trustee (filed as Exhibit 4.4 to LII’s Quarterly Report on Form 10-Q filed on April 26, 2011, and incorporated herein by reference).
4.5	Fourth Supplemental Indenture, dated as of December 10, 2013 among Lennox National Account Services LLC, LGL Australia (US) Inc., Lennox International Inc., each other existing Guarantor under the Indenture, dated as of May 3, 2010, as subsequently supplemented, and U.S. Bank National Association (filed as Exhibit 4.5 to LII's Annual Report on Form 10-K filed on February 13, 2014 and incorporated herein by reference).
4.6	Fifth Supplemental Indenture, dated as of August 30, 2016 among LGL Europe Holding Co., each other existing Guarantor under the Indenture, dated as of May 3, 2010, as subsequently supplemented, and U.S. Bank National Association (filed herewith).
4.7	Form of 4.900% Note due 2017 (filed as Exhibit 4.3 to LII’s Current Report on Form 8-K filed on May 6, 2010 and incorporated herein by reference).
10.1	Amendment No. 5 to Amended and Restated Receivables Purchase Agreement, dated as of June 30, 2016, among LPAC Corp., as the Seller, Lennox Industries Inc., as the Master Servicer, Victory Receivables Corporation, as a Purchaser and The Bank of Tokyo-Mitsubishi UFJ, Ltd., New York Branch, as Administrative Agent for the Investors, the Purchaser Agent for the BTMU Purchaser Group and a BTMU Liquidity Bank (filed as Exhibit 10.1 to LII’s Current Report on Form 8-K filed on July 6, 2016 and incorporated herein by reference).
10.2	Sixth Amended and Restated Credit Facility Agreement dated as of August 30, 2016, among Lennox International Inc., a Delaware corporation, the Lenders party thereto, and JPMorgan Chase Bank, National Association, as Administrative Agent (filed as Exhibit 10.1 to LII’s Current Report on Form 8-K filed on September 2, 2016 and incorporated herein by reference).
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 (furnished 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
Exhibit No. (101).DEF XBRL Taxonomy Extension Definition Linkbase Document

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SIGNATURE

Pursuant to the requirements of Section 13 or 15(d) 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.

By: /s/ Joseph W. Reitmeier
Joseph W. Reitmeier
Chief Financial Officer
(on behalf of registrant and as principal financial officer)

Date: October 17, 2016