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LII - Q4 2018 Lennox International Inc Earnings Call

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OVERVIEW:

Co. reported 4Q18 GAAP revenue of $844m, GAAP operating income of $116m and GAAP EPS from continuing operations of $1.86. Expects 2019 revenue growth to be 3-7% and GAAP EPS from continuing operations to be $14.30-14.90.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Lennox International Fourth Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this call is being recorded. I would now like to turn the conference over to Steve Harrison, Vice President of Investor Relations. Please go ahead.

Steve L. Harrison - *Lennox International Inc. - VP of IR*

Good morning. Thank you for joining us for this review of Lennox International's financial performance for the fourth quarter and full year 2018. I'm here today with Chairman and CEO, Todd Bluedorn; and CFO, Joe Reitmeier. Todd will review key points for the quarter and year, and Joe will take you through the company's financial performance and outlook. (Operator Instructions)

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

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

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

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

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Thanks, Steve. Good morning, everyone, and thanks for joining us. Let me start with a review of 2018 overall and then discuss some fourth quarter highlights and then thoughts on 2019.

Lennox International posted another record year in 2018 as the company set new highs for revenue, operating margin, profit and cash generation while working through the challenges from the tornado damage at our manufacturing facility in Iowa and continuing to focus our business portfolio with the divestitures of our Australia, Asia and South America Refrigeration businesses.

The GAAP financials we discuss today have the impact from the divestitures in the numbers. Adjusted financials have the impact out of the numbers to present a clearer view on our remaining Refrigeration businesses in North America and Europe.

Company revenues for 2018 on a GAAP basis was a record $3.88 billion, up 1%, including the impact from the divestitures in the tornado. On an adjusted basis for 2018, revenue was up 4%. The tornado had a negative 3% impact on revenue growth for the full year.

GAAP operating income rose 3% to a record $510 million. GAAP EPS from continuing operations was up 22% to a record $8.77. On an adjusted basis, total segment profit rose 6% to a record $540 million, and total segment margin expanded 30 basis points to a new high of 14.2%. Adjusted EPS from continuing operations was up 20% to a record $9.42.

Turning to our business segments for the year. Residential established new highs for revenue, margin and profit. Segment revenue rose 4%, including a negative 6% impact from the tornado. Segment profit rose 7%, including a negative 11% net impact from the tornado. And segment margin expanded 50 basis points to 18%, including a negative 70 basis points of net impact from the tornado.

Our Commercial business set new records for revenue and profit for the year. Commercial revenue rose 7%, profit was up 1% and segment margin was down 90 basis points to 15.3%, impacted by labor inefficiencies and lower factory productivity as well as other product costs. We expect these factors to be largely behind us in the first quarter of 2019 and margins to expand in 2019. In North America, Commercial Equipment revenue was up high single digits. Replacement revenue was up high single digits and new construction was up mid-single digits at constant currency.

Looking at the business another way, revenue from regional and local business was up low double digits. National account equipment revenue was up mid-single digits for the year, and the company won 25 new national account customers across diverse verticals in 2018. On the service side, Lennox National Account Services revenue was up more than 20% for the year. In Europe, Commercial HVAC revenue was down low double digits at constant currency.

Turning to Refrigeration. Before I get into the financials, let me talk about the planned divestiture of our Kysor/Warren business. We are well along in the process and expect the sale to close in the first quarter of this year. As was the case with our other divestitures, this enables us to focus on Refrigeration businesses, where we have strong market positions and that fit our growth profiles.

The businesses that remain are our Heatcraft business in North America and our European Refrigeration businesses. In 2019, this segment will also include our Europe Commercial HVAC business as we manage that and the Europe Refrigeration business together in the region.

These are all strong businesses for us, and they're well positioned to capitalize on opportunities in respective markets. On our website, we have posted reclassified Commercial and Refrigeration segment revenue and profit for 2018 by quarter to reflect these changes so you can adjust your models accordingly.

Regarding Refrigeration financials. Adjusted revenue was up 1% for the year. Segment margin was down 30 basis points to 12% and profit was down 1%. Regionally, at constant currency, North America revenue was down low single digits. Revenue from Kysor/Warren, the business being divested, was down, while our Heatcraft business in North America was up mid-single digits. Europe Refrigeration revenue was up mid-teens for the year.

Turning to the fourth quarter. Company revenue on a GAAP and adjusted basis was $844 million. GAAP revenue at constant currency was down 4%, including the impact from divestitures in the tornado. Adjusted revenue, excluding the impact from divestitures, was up 1% at constant currency. The tornado had a negative 8% impact on revenue growth in the quarter.

GAAP operating income rose 12% to a fourth quarter record $116 million. GAAP EPS from continuing operations was up 82% to a fourth quarter record of $1.86. On an adjusted basis, total segment profit rose 7% to a fourth quarter record of $110 million. Total segment margin expanded 70 basis points to a new fourth quarter high of 13%. Adjusted EPS from continuing operations rose 18% to a fourth quarter record $1.93.

Looking at our business segments for the fourth quarter. Residential revenue was down 3%, including a negative 14% impact from the tornado. Segment profit rose 7%, including a negative 17% net impact from the tornado. And segment margin expanded 170 basis points to a fourth quarter record 17.7%, including a negative 10 basis points of net impact from the tornado.

In Commercial for the fourth quarter, revenue set a new fourth quarter record and was up 9% at constant currency on strong and broad growth in North America. Segment profit was down 7% as margins declined 240 basis points to 15% due to the timing of other product costs in the quarter as well as labor inefficiencies and lower factory productivity. North America Commercial equipment revenue was up high single digits. Replacement revenue was up high single digits. New construction was up low double digits at constant currency.

Looking at the business another way, revenue from regional and local business was up high single digits. National Account revenue was up low double digits in the quarter. On the service side, Lennox National Account Services revenue was up more than 20%. In Europe, Commercial HVAC revenue was down mid-single digits at constant currency.

In Refrigeration for the fourth quarter, revenue was up 1% at constant currency. Regionally, North America revenue was down low single digits with Kysor/Warren revenue down and Heatcraft revenue up high single digits.

Europe Refrigeration revenue was up mid-teens for the quarter at constant currency. Refrigeration profit was down 25% and segment margin declined 300 basis points to 9.2% in the quarter as we had some unfavorable mix in our Heatcraft and Europe businesses as well as the timing of certain expenses and other product costs in the quarter. We expect organic margin expansion to resume in 2019 and be up for the year.

Looking ahead for the company overall in 2019, we are reiterating our revenue and EPS guidance. The first quarter's off to a solid start and the cold weather certainly has helped. We remain on track to meet -- to either meet or exceed the tornado recovery plan discussed at our Investment Community Meeting in October. Across our 3 Residential factories, we're back to full production capability for cooling products as we enter 2019, and we expect to be there for heating products in the first quarter. We are working aggressively to fully refill our distribution channel and are taking back share that was borrowed from us last year.

Our current view on the tornado financial impact has not moved much from what we talked about in December, but let me provide an update for the fourth quarter actuals and what is currently expected for 2019.

First big picture. We now expect total insurance proceeds of approximately $356 million, up from $347 million previously. We received $124 million of that in 2018 and expect approximately $232 million in 2019. The noncore gain expected for the difference in book value and replacement value of assets is now $120 million compared to $132 million previously due to lower estimated construction costs.

From a core perspective in the fourth quarter, the tornado impact on revenue was $69 million, $4 million more than estimated, and the tornado impact on segment profit was $40 million, $2 million more than estimated, which we will recover from insurance in 2019.

From a core perspective for 2019, the negative tornado impact is still expected to be $85 million on revenue and the negative impact on profit is now expected to be $43 million, up from $35 million previously. Insurance recovery is now expected to be $83 million, up from $73 million, and the net profit is now expected to be $40 million, up from $38 million. A lot there.

Looking at the tornado impact by quarter in 2019. For the $85 million of revenue and $43 million of profit impact, we expect approximately 50% of that in the first quarter, 25% in the second quarter and 25% in the third quarter. We had posted a tornado financial update chart on our website with the details reflecting the prior estimates and the current view.

Now I'll turn it over to Joe.

Joseph William Reitmeier - *Lennox International Inc. - Executive VP & CFO*

Thank you, Todd, and good morning, everyone. I'll provide some additional comments and financial details on the business segments for the quarter and full year, starting with Residential Heating & Cooling.

In the fourth quarter, revenue from Residential Heating & Cooling was $461 million, down 3%. Volume was down 4%, price was up 3% and mix was down 2% with foreign exchange neutral to revenue. Residential profit was $82 million, up 7%. Segment margin was a fourth quarter record 17.7%, up 170 basis points.

Segment profit was favorably impacted by $27 million of tornado insurance proceeds for the third quarter lost profits, favorable price, sourcing and engineering-led cost reductions and factory productivity. Partial offsets included $40 million of negative tornado impact from the fourth quarter, lower volume, unfavorable mix, unfavorable foreign exchange, higher commodity, tariff, freight and other product costs, distribution investments and higher SG&A.

For the full year, Residential segment revenue was a record $2.23 billion, up 4%, volume was up 2%, price was up 2% and mix was flat. Foreign exchange was neutral to revenue. Residential profit was a record $399 million, up 7%. Segment margin was a record 18%, up 50 basis points.

Now turning to our Commercial Heating & Cooling business. Commercial revenue was a fourth quarter record $270 million, up 8%. Volume was up 4%, price was up 1% and mix was up 4%. Foreign exchange had a negative 1% impact on revenue.

Commercial segment profit was $41 million, down 7%. Segment margin was 15%, down 240 basis points. Segment profit was impacted by lower factory productivity and higher other product costs, higher commodity and freight costs and higher SG&A. Partial offsets included higher volume, favorable price and mix and sourcing and engineering-led cost reductions.

For the full year, Commercial revenue was a record $1.04 billion, up 7%. Volume was up 5%, price was up 1% and mix was up 1%. Foreign exchange was neutral to revenue. Segment profit was a record $160 million, up 1% and segment margin was 15.3%, down 90 basis points.

In our Refrigeration segment, revenue was flat in the fourth quarter at $113 million. Volume was up 3%, price was up 2% and mix was down 4%. Foreign exchange had a negative 1% impact on revenue. Refrigeration segment profit was $10 million, down 25%.

Segment margin was 9.2%, down 310 basis points. Segment profit was impacted by unfavorable mix, higher commodity, freight, distribution and other product costs, along with higher SG&A. Partial offsets included higher volume, favorable price and sourcing and engineering-led cost reductions.

For the full year, revenue was $545 million, up 1%. Volume was up 2%, price was up 1% and mix was down 3%. Foreign exchange had a positive 1% impact. Segment profit was $66 million, down 1% and segment profit margin was 12%, down 30 basis points.

Regarding special items in the fourth quarter. The company had net after-tax charges totaling $2.6 million, and they included a charge of $10.5 million for tax items related to divestitures, a net charge of $4.4 million for restructuring and various other items and a gain of $8.4 million from insurance recoveries net of losses incurred and a benefit of $3.9 million for excess tax benefits from share-based compensation.

For the full year, the company had net after-tax special charges of $25.6 million. This included a net loss of $26 million on the sale of businesses and related property, a net charge of $5.8 million for tax items related to divestitures, a net charge of $12.5 million for restructuring and various other items and a benefit of $10.5 million for excess tax benefits from share-based compensation and a gain of $8.2 million from insurance recoveries net of losses incurred.

Corporate expenses were $23 million in the fourth quarter and $84 million for the full year. Overall, SG&A was $142 million in the fourth quarter or 16.8% of revenue, down from 17.7% in the prior year quarter.

For 2018, overall, SG&A was $608 million or 15.7% of revenue, down from 16.6% in the prior year. For 2018, the company had cash from operations of $496 million compared to $325 million in the prior year. Capital expenditures were $95 million for the full year compared to $98 million in the prior year and free cash flow was $411 million for 2018 compared to $227 million in the prior year.

In 2018, the company paid $94 million in dividends and repurchased $450 million of company stock. Total debt was $1.04 billion at the end of the fourth quarter, and we ended the year with a debt-to-EBITDA ratio of 1.7. Cash and cash equivalents were $46 million at the end of the year.

Now before I turn it over to Q&A, I'll review our outlook for 2019. Our underlying market assumptions for the year are unchanged. For the industry overall, we expect North America and Residential HVAC shipments to be up mid-single digits, we expect North America Commercial unitary shipments to be up low single digits and we expect North America Refrigeration shipments to be relatively flat.

The company's guidance for 2019 remains the same that we presented at the December Investment Community Meeting. We continue to expect revenue growth of 3% to 7% with neutral foreign exchange. We still expect GAAP EPS from continuing operations in a range of $14.30 to $14.90, and we still expect adjusted EPS from continuing operations in a range of $12 to $12.60.

Now let me run through the other key points in our guidance assumptions and the puts and takes for 2019, all of which are unchanged. We expect to capture $80 million of additional price for the year. We are planning for a $25 million benefit from sourcing and engineering-led cost reductions and an $8 million benefit from Residential factory productivity.

We still expect a $30 million headwind from commodities, $15 million from freight and $10 million from tariffs. Other investments -- other headwinds include $15 million for distribution investments and $15 million from SG&A. Net interest expense is expected to be approximately $45 million, up from $38 million last year.

And a few other guidance points. Corporate expenses are targeted at $90 million for 2019. We expect an effective tax rate in the range of 22% to 23% on an adjusted basis for the full year. Capital expenditures are still planned to be approximately $215 million, including $115 million in 2019 to complete the reconstruction of the Iowa manufacturing facility funded by insurance proceeds. And finally, we continue to expect a weighted average diluted share count for the full year to be between 39 million and 40 million shares, which incorporates our plans to repurchase $350 million of stock this year.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) First on the line, we have Julian Mitchell with Barclays.

Julian C.H. Mitchell - *Barclays Bank PLC, Research Division - Research Analyst*

Maybe just a first question around the unchanged cost headwind guidance you talked about, the $30 million, $15 million and $10 million. There seems to be some different commentary from your peers about the phasing as they see it of the cost headwinds through this year, something they're level loaded, something they're very front half loaded. Maybe just characterize how you see those cost pieces as we look half-on-half or quarterly through this year.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

I think that way we see them right now, they're probably more front end loaded than back end loaded. And if I was going to do a model, I might do 60-40 between the front and the back end.

Julian C.H. Mitchell - *Barclays Bank PLC, Research Division - Research Analyst*

Understood. And price, fairly level loaded with volumes moving, I guess?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Correct.

Julian C.H. Mitchell - *Barclays Bank PLC, Research Division - Research Analyst*

And then my second question, maybe just give us a little bit of context around the Kysor/Warren divestment. Maybe just talk through a couple of points on why you're keeping what you're keeping in Refrigeration versus obviously what you're divesting, having owned the business for sort of 7 or 8 years.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. I mean, it's the same logic that we've had as we've looked at the other businesses that we've sold. We wanted to focus on the businesses where we had a strong market position and it fit our growth profile. And we just made the decision that the Kysor/Warren didn't fit that. The structure of the industry is a tough business. And so we made the decision to exit. And as I said on the call, we're well on the way of that transaction and expect to close by the end of first quarter. We like the businesses that we have left, and you never say never. But at least for right now, the team we have on the fields, our team, we like it. We think we have good growth profile, good growth potential and we are focused on it.

Operator

Next question from Tim Wojs with Baird.

Timothy Ronald Wojs - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Just wanted to focus a little bit on mix in resi. I think it was down 2% for the quarter. How much of that do you think was driven by the impact of the tornado? I'm just trying to understand, I don't think you're seeing any sort of a trade-down in the business. I just want to make sure that's the case.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes, I think it was exclusively the tornado. I mean, because where we were impacted -- as you know Tim -- I'm just saying it for the record of everybody else's, where we're impacted on the Marshalltown facility is where we make premium furnaces. And so we were able to -- [Rick] started to ramp it back up, but we didn't get to full production and certainly didn't get to full inventory levels. And so the mix down is due to the tornado impact.

Timothy Ronald Wojs - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay, okay. And then as you look at recovering the share, I mean, have you -- I know you're pretty close to your dealers. But I mean, have you talked to your dealers? Are there any sort of, I don't know, agreements that maybe we don't see that you guys see that give you confidence in that share recovery ramp?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

The direct answer is there aren't annual agreements that tie people in. I think what ties them in is the service, the capability, the digital support, the product, the relationships we have at the local level that we do business with thousands of very loyal Lennox dealers. And as we start to refill, we expect it to come back. We're confident as we go into 2019 on the operational side. We're either going to meet or exceed the tornado recovery plan that we discussed with investors back in December across 3 Residential factories. We're back in full production capability for cooling products as we enter 2019, and we expect to be there for heating products in first quarter. And we're working aggressively to fully refill our distribution channel. And we're taking back market share now that was borrowed from us last year. And we expect that share take-back to accelerate as we go through the year.

Timothy Ronald Wojs - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Great. And then just based on your intel, just kind of units plus price, what did you think the resi market grew in the fourth quarter?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

I think we have some AHRI data we're going to dig up and I'll give you a specific answer. It was high single digits, I want to say 8% or 9%, but I'll -- I'm turning to somebody what to say (inaudible)

Timothy Ronald Wojs - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

And I was going to say yes, we've got the units. I'm just curious what the price.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. We've got 2% of price. So I assume others got something similar. And so if units are up 8% and a couple of points of price, revenue was probably up 10% and I don't know what mix did.

Operator

Next on the line is Steve Tusa with JPMorgan.

Charles Stephen Tusa - *JP Morgan Chase & Co, Research Division - MD*

Just on the kind of segment changes, am I looking at that right, that basically, Europe HVAC, while kind of small, I guess, $150 million, something like that, is operating at kind of a very, very low single-digit margin type of number?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes, yes.

Charles Stephen Tusa - *JP Morgan Chase & Co, Research Division - MD*

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So is that -- are those businesses core? Or is that something that -- and I guess, you're going to kind of look to fix that, I would assume? That's kind of an unacceptable margin for you guys? What's kind of the longer-term strategic potential with kind of the new European structure?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

We had a tough year in HVAC in 2018, and we talked about it where revenue was down significantly because of regulatory change that added 15% cost to the rooftops, which is our primary product line. And that led to 2 or 3 quarters where revenue has been down double digits in that business, and that had significant impact on the profitability. If you go back a few years, we made not great money there, but not to our corporate average, but significantly better operating margins than what we had in 2018. So fundamentally, the business is better than what it showed in 2018. It doesn't mean there isn't a lot of work there, and that's where we're focused on about, expanding the product line, growing the top line to be able to absorb the fixed cost that we have there, and it's always [in your plan], creative ways to lower our cost. So yes, our Europe business is a keeper, we just need to find how to grow it and make it more profitable.

Charles Stephen Tusa - *JP Morgan Chase & Co, Research Division - MD*

And then just on Kysor, I didn't quite understand the footnote. Are you now stripping -- I mean, you said Kysor was going to be closed before the end of the first quarter. Can you just remind us of sales, EBITDA? And then I would assume that given the state of the industry right now that the multiples around these businesses can't be that great. Maybe you could just -- and then also, beyond that, what do you expect to do with the -- with whatever proceeds you're going to get? So just a little bit to help us on color around how much you're going to get and then what you're going to do with it and what you're losing?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. The order of magnitude, it's $150 million of revenue, and we lost $3 million of EBIT in 2018 because people are going to be -- you're going to be able to back that out, so that's sort of what it is. And we're in the process of selling it and we again expect to have it closed by end of first quarter. The proceeds -- so the normal mantra that you'd expect me to say around targeting at the debt to EBITDA, but in lieu of anything else, any acquisition or -- that for some reason, CapEx needs to go up, you'd expect it to flow into share buyback.

Charles Stephen Tusa - *JP Morgan Chase & Co, Research Division - MD*

Okay. So you are -- from here on out, you're going to basically, that business will obviously -- it's not part of guidance today essentially, the -- so logging 0 anyway?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes, I should be clear about that. Yes, it's not part of guidance and it won't be in the "adjusted core numbers."

Charles Stephen Tusa - *JP Morgan Chase & Co, Research Division - MD*

Okay. And then one last quick one for you. How exactly do you calculate the kind of 14% impact from tornado? Is that just what -- who bought from you last year and then who didn't buy from you this year? I mean, how do you actually get to that number in the fourth quarter on sales?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. I mean, we do it a couple of ways. One is we know what the market did, we know what our market share and gains have been historically and what our actual results were. And so the difference is the tornado impact. So high level, we're gaining 0.25 point or 0.5 point or 0.75 point, we sort of know what the market was up 8% units, we know what our actual unit volume did. And so that delta between where the market was and where we would have been versus where we were is the top level way we do it. And the way to come from the bottom is on a micro level, we can look at customers and we know who we turned off and who bought less and then we sort of add it up from the bottom and compare the 2 numbers, they're relatively the same number and that's what we talk about publicly and that's also what we are talking with insurance companies about.

Charles Stephen Tusa - *JP Morgan Chase & Co, Research Division - MD*

Right. And the impact in the third quarter of 25%, the lingering impact is not -- is basically just the wood you have to chop to kind of gain some of those guys back, even though your production will be up and running by the second quarter?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

I'm not sure I understood the 25%.

Charles Stephen Tusa - *JP Morgan Chase & Co, Research Division - MD*

Well, you said 25% of the impact is going to linger in the third quarter, but you sound like you're going to be fully operational by second quarter?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Correct, yes, exactly.

Operator

Next question is from Jeff Hammond with KeyBanc Capital Markets.

Jeffrey David Hammond - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Just back to the Europe HVAC business. Can you give us a sense of kind of where that business you think structurally can be from a margin perspective once you do some restructuring and maybe recover some of the regulatory? And then also just should we think of these 2021 targets for the segments any differently with the reclass? I guess, particularly Commercial seems a lot more profitable standalone.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. I'll answer the second one because that's a little easier to answer because that's straightforward. The Residential doesn't change. So we ended -- sort of ignoring the tornado, we ended -- which I wish I could do, ignore the tornado, but ignoring the tornado, we're about 18.5% operating margins and the 3-year target is 19% to 21%. Commercial, the new Commercial segment ended '18 at 17.5% and our new 3-year target is 19% to

21%. And then Refrigeration ended 2018, the new segment at 13.1% and the new target is 15% -- or the target is 15% to 17%. And overall, for the corporation, it's now $4.3 billion of revenue, which is a 16% -- or excuse me, a 6% CAGR off of where we ended '18 with that 18% EBIT margin, which is up 50 basis points from what we guided in December. So that's sort of the new 3-year targets. And in terms of Europe HVAC, just structurally, Europe, for most businesses, including HVAC, is structurally less profitable than it is in North America. I think this is a double-digit [ROS] business and if we're really high performing better than that. And obviously, we have a ways to go to get to that. But I think we clearly have line of sight to get it to double digits, and then we'll see what we have to do to get it higher than that.

Jeffrey David Hammond - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

Okay. And then just a housekeeping on the tornado, I don't know if I missed this. But do you know the insurance proceeds for 1Q at this point that would be included in that Residential op profit number?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. The way I would -- we talked about the impacts on the core of $85 million in revenue and $43 million of profit and we said 50% in Q1, 25% in Q2, 25% in Q3. And then for the $83 million of insurance proceeds that we're now expecting in 2019 to offset the $43 million in '19 plus the $40 million in Q4, which is, I think, what you're asking about. For modeling purposes, I would tell you that -- have the total proceeds of $83 million spread it equally over the 4 quarters in 2019. We're obviously working with the insurance company. We're confident we're going to get it all. The timing is still a bit questionable. So for modeling purposes, I'd take the $83 million and spread it out over the 4 quarters.

Operator

Next question is from John Walsh with Crédit Suisse.

John Fred Walsh - *Crédit Suisse AG, Research Division - Director*

So I guess, just kind of going back to recapturing the borrowed market share. Can you talk about the tools you're using to do that? I assume some of it's like joint marketing. And how some of those early campaigns are going, it seems to be pretty successful. And maybe just also, given how specific you are with numbers around who's been turned off, how should we expect you to communicate that going forward to us so that we know you're reclaiming that lost captured share? Would it be a dollar amount of the reclaimed or a percentage? Or will it just be -- we'll have to look at how you're outgrowing relative to the market? Any help on that would be appreciated.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

I think it's going to be the last answer. I mean, we'll see what clarity we have to bring. But I think we'll be clear when you have a quarter like we did in fourth quarter. And we're saying our revenue was down, but adjusting for the tornado, it would be up 14% more. That 14% will shrink, shrink, shrink and eventually go away. And then that way, you'll know that "we had no tornado impact" and then our revenue growth is greater than our -- the industry data or our competitors and you know we're gaining it back. I mean, high level, you'd expect that really to happen second half of the year. First half of the year, we had no tornado impact. Second half of the year, we had it. And so second half of the year is when we should start to outgrow the market in a significant way. That was the first -- second part of the question. Remind me the first part.

John Fred Walsh - *Crédit Suisse AG, Research Division - Director*

Just the tools you're using to win back that borrowed market share.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. The tools we're using, I think, are the things you'd expect us to do. Again, we have granular detail, we know who we have to go to, we know what we have to bring. We have sort of the full toolkit of the things we always have to do to sell to our customers, digitization, the marketing programs, the advertising programs, the equipment. And then we're incenting our sales guys to go get it. I was at our national sales meeting last week. And I'll tell you, I spent a lot of time talking about it, sales folks are fired up. And when sales folks get paid for something, they usually go do it and we're ready to go get it.

John Fred Walsh - *Crédit Suisse AG, Research Division - Director*

Yes. Maybe just a quick follow-up here on -- thinking about Commercial unitary market share. I mean, when we were down at AHR, clearly, there's a lot of new products being launched, particularly from the market leader in that space to kind of no longer give up market share. I mean, how do you think about your ability to kind of continue to take share in that Commercial unitary rooftop market?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

We have lots of confidence. I mean, I know there -- assume that's Carrier, but -- that you're talking about. So they're making investments in products. Although I think a lot of their investments has been skewed towards the applied segment, less that sort of unitary where we play sort of at the -- sort of entry-level stuff. And -- but we're aggressively focused on that. You saw our numbers were strong in the fourth quarter in Commercial. We talked about focusing on local and regional segment when we were with you in December, and we were up 20% or so in that segment. And so we're focused and we're confident that we'll continue to grow share.

Operator

Next, we'll go to Rich Kwas with Wells Fargo Securities.

Deepa Bhargavi Narasimhapuram Raghavan - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

This is Deepa Raghavan for Rich Kwas. A couple of quick details here. So the weather has been pretty choppy, at least in some parts of the U.S. here, just ranging from extreme cold to mid-50s on some days, in some parts at least. Just curious, is that enough to drive the strength in the quarter? Or is there a more than seasonal adjustment we should be thinking about this quarter?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes, the weather certainly helps. And when it's minus 20 in Chicago, we're selling furnaces, and so that's helpful. And so -- but it's -- 25% to 30% of the quarter revenue is in January and March can be as high as half the quarter. So it's still -- as we get into March, it's still going to be the transitioning to the cooling season, stocking dealers, preparing for the summer that's yet to come, so cold weather helps. Hot weather will allow you to make second quarter, cold weather very seldom allows you to make first quarter, and that's going to be the case.

Deepa Bhargavi Narasimhapuram Raghavan - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

Got it. My follow-up would be, you're -- so are you -- looks like you're expecting full recovery of that 3% sales last year to tornado. Is that contemplated at the midpoint of your 3% to 7% revenue growth outlook? And within that 3% to 7%, the second part of that is, what's sort of a housing slowdown? Or can you pin it to starts or something that you can consider? I mean, if you can give us something that we could pin it to, that would be pretty helpful.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

The -- our revenue guidance sort of anticipates what we're going to do in the Residential business, yes. In terms of new housing, the last 2 or 3 years, we sort of baked into our -- into our numbers as we started the year double digit, 10% or so new housing starts. In 2019, we're thinking it's more going to be mid-single digits, 5% or so is what we have baked into our internal models.

Deepa Bhargavi Narasimhapuram Raghavan - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

That's new construction housing starts -- based on housing starts?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. I mean, when we think about our new construction growth, we tie -- we sort of bake it, tie it to housing starts.

Deepa Bhargavi Narasimhapuram Raghavan - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

Okay, got it. So mid-single digit, some growth in new construction?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes.

Operator

And next, we go to Robert Barry with Buckingham Research.

Robert Douglas Barry - *The Buckingham Research Group Incorporated - Research Analyst*

Just a few follow-ups here. The inefficiencies you were highlighting in Commercial, is that what we had last quarter too? I think it was confined to Europe.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

The issues with margins in the quarter, I mentioned lower factory productivity. That was part of it, that was the lesser part of it. But the lower factory productivity we talked about, I think I talked about it in December was -- or on the last earnings call, was we're really tied to labor constraints and our Stuttgart, Arkansas factory not being able to hire enough workers and temporary workers and keeping the lines fully up and running and handling all the absentees that we were seeing. We've made some adjustments on how we're hiring and handling people. And I think to a large degree, that's now behind us. It takes a while for the good news to flow through the P&L given we do LIFO accounting, but we're pretty confident operationally it's behind us. The other issue for the quarter was just the timing of other costs. I hate to get into the accounting of things. But last year, we have good news in fourth quarter and this year, we had bad news around different elements. And so it was just sort of the timing of the other costs. But -- so the -- we're still confident we're going to have the right margin trajectory for Commercial in 2019. And direct answer to your question is, if I was anticipating your question, we think the factory issues are, to a large part, behind us at this point.

Robert Douglas Barry - *The Buckingham Research Group Incorporated - Research Analyst*

Got it, got it. I mean, should we just assume that the first half or the first quarter continues to be a little weaker there in terms of cadence?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes, because I -- given what I was saying, I was trying to shed that -- yes, I would sort of build my model second half clear margin expansion, first half a bit more choppy.

Robert Douglas Barry - *The Buckingham Research Group Incorporated - Research Analyst*

Got it. And following up on the pricing cadence, I mean, I think during '18, the pricing was building through the year. So on a year-over-year basis, I would think that you'd see much better contribution to growth from price in the first half. Is that accurate?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

I think that's broadly correct. I think our -- the only caveat would be sort of the -- we didn't get as much price as we would have most likely got in second half of this year, certainly fourth quarter this year in resi because of the tornado issues, right? And so when I think about our ability to sort of go out and really capture and stick the price increase, we'll get a better yield from the price increase we're doing this year second half than we did [this] year second half.

Robert Douglas Barry - *The Buckingham Research Group Incorporated - Research Analyst*

Got it, got it. Okay. Just finally, on commodities, I mean, I think copper has ticked up a little bit recently. But net-net, year-over-year, it's still I think down pretty nicely. I think you do start to hedge about 18 months out, so maybe too early to get into 2020. But just directionally, are you starting to kind of hedge in some nice tailwinds on the commodities front at this point for next year?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

For 2020?

Robert Douglas Barry - *The Buckingham Research Group Incorporated - Research Analyst*

Yes.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Man, my head was so full of the tornado numbers, Robert. [I be able to] -- I think the...

Robert Douglas Barry - *The Buckingham Research Group Incorporated - Research Analyst*

I think it's good news.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

The answer is we're hedging for 2020 and they're rolling in lower than the hedges that we're taking.

Operator

Next, we will go to Robert McCarthy with Stephens.

Robert Paul McCarthy - *Stephens Inc., Research Division - MD & Analyst*

In any event, obviously, math isn't my strong suit, so I'll ask 2 very high-level vanilla questions. First is just talking about the prevailing environment and what the macro headlines seen. Have you seen anything in your business in terms of your backlogs, in terms of -- on the retail side, in terms of anything across Commercial or Residential that gives you pause? And maybe you could just square the circle with some of the comments we've seen around the macro on the Commercial side. And then on the Residential side, what Watsco has referred to episodically over the past 6 months?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

I'll first talk about Commercial. The short answer is no. We had a strong fourth quarter, both in national accounts and in our local and regional businesses. Equipment business was up, service business was up 20%. I agree. If you watched MSNBC or Fox, you're petrified. But I think on the ground, that continues to be solid, if not strong. In terms of Florida, we talked about this in the past. I'll touch it again. Through the first 9 months of the year before we had any tornado impact, our Florida business was up 3 -- 2%, 3%, low single digits in unit volume. And so then with price and with mix, up mid-single digits. And so we haven't seen any -- and then obviously, we had the tornado impact, so it's hard to tell in the fourth quarter. We -- I don't think it's the canary in the mineshaft.

Robert Paul McCarthy - *Stephens Inc., Research Division - MD & Analyst*

Okay. No fair enough. And then just a follow-up. I know you love talking about technology investments, particularly in distribution. But I guess, in the context of the potential for share shift or share gain given one of your larger competitors might strategically have its eye off the ball. And we've talked about that on a high level in the past, right? But specifically, do you think there's an opportunity to just basically make some investments in channel or in technology at a time when maybe some of your competitors do have their eye off the ball and take some share or set yourself up for taking share? Or is it -- or is that just not how things work? Is that not how the real world works?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

I understand the question. I'll sort of ramble a little bit and then maybe answer it directly. I mean, the way we think about these investments is we do them in good times and bad. We do them -- we've been doing it for 5, 6 years, both the digitization of the interface with the distribution partner as well as automating our back offices to take out cost and drive efficiencies and effectiveness, and we're going to continue to do that. So the governor quite frankly doing it isn't sort of the -- that we can put on the accelerator in a year, do 3 years of work. I mean, it's about people and building the capability organizationally and quite frankly, knowing the right place to spend because technology is moving so fast. And so as you know, we've doubled our IT spend over the last 8 or 9 years. We now spend more on IT than we do R&D. That's going to continue. But I don't expect we're going to double it over the next 6 months because [UPC's] spinning off [CCS].

Operator

And we'll go to Gautam Khanna with Cowen.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

I was wondering if there was any dyssynergy to the remaining business from separating Kysor/Warren, either with, I don't know, do customers ever buy things in a bundled way or stranded cost, anything you could point to that would have some bleed over.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

I think just stranded -- certainly stranded cost, if you will, of corporate cost and segment cost that were being absorbed by that business, and we're doing the things you'd expect us to do. We're taking those costs out, just like we did when we sold the other businesses in the segment. In terms of customer synergies, it was part of our case when we bought it. And 7 years later, however long it's been, I have to hang my head and say no, there aren't many synergies that we're worried about.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

Okay. No, that's fair. I have to ask it because no one has. But just consolidation, what's your view? Do you think anything actually happens [this year of] size either with Lennox finding some methods to acquire of size in North America resi or elsewhere or among others?

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Yes. I mean, you know what I'm going to say, but I'll say it. These things are lumpy and they happen or they don't happen. We don't have to do a deal as you know because we're at scale, but we think we could create value and we think we're the right people to run something if it became available. But it's others people's calls, not ours. So we stand ready and would want to do something. But it's going to be up to what others want to do.

Gautam J. Khanna - *Cowen and Company, LLC, Research Division - MD and Senior Analyst*

But just to be -- to put a finer point on it, it's not like you're seeing much in terms of your M&A pipeline come up.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

Well, again, it's M&A pipeline of sort of -- the concept assumes lots of deals that you're talking about. They're -- this is the discrete number. I think we all know who they are. And I wouldn't comment on any activity whether it was happening or not, right? But it's a -- a concept really isn't a pipeline, it's whether something breaks loose or not.

Okay, thank you. I think that's the last question, operator.

Operator

That's correct, yes. Please go ahead.

Todd M. Bluedorn - *Lennox International Inc. - Chairman & CEO*

So to wrap up, 2018 was a record year for Lennox with new highs for revenue, margin, profit and cash generation. The first quarter has seen some cold weather, and we're off to a solid start for 2019 and continue to expect another year of strong growth and profitability. Thanks, everyone, for joining us today.

Operator

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