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LII - Q2 2019 Lennox International Inc Earnings Call

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OVERVIEW:

Co. reported 2Q19 GAAP revenue of $1.1b, adjusted revenue of $1.1b, GAAP EPS from continuing operations of $2.81 and adjusted EPS from continuing operations of $3.74. Expects 2019 adjusted revenue growth to be 2-5%, GAAP EPS from continuing operations to be $11.91-12.51 and adjusted EPS from continuing operations to be $11.30-11.90.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Lennox International Second Quarter 2019 Earnings Call. (Operator Instructions) As a reminder, this call is being recorded. I would now like to turn the conference call 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 second quarter of 2019. I'm here today with Chairman and CEO, Todd Bluedorn; and CFO, Joe Reitmeier. Todd will review key points for the quarter, and Joe will take you through the company's financial performance and outlook. (Operator Instructions)

In the earnings release we issued this morning, we have included the necessary reconciliation of the non-GAAP financial measures that will be discussed to GAAP measures. All comparisons mentioned today are against the prior year period. You can find a direct link to the webcast to today's conference call on our website at www.lennoxinternational.com. The webcast will 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 thank you for joining us. Let me start with an overview on the second quarter, which was significantly impacted by the adverse weather conditions. I will cover the key points on each of our businesses, our current view on the tornado impact and insurance proceeds and our reduced outlook for commercial and refrigeration end markets and then update 2019 guidance.

For the second quarter, GAAP and adjusted revenue was $1.1 billion. GAAP revenue was down 6%, including 8% of negative impact from the tornado, divestitures and foreign exchange. Excluding the impact from divestitures, adjusted revenue was down 1% or flat at constant currency, including a negative 3% impact from the tornado. GAAP operating income was $214 million, up 10%, and GAAP EPS from continuing operations was $2.81, down 17%, including a noncash pension settlement charge of $1.14.

On an adjusted basis, total segment profit was $202 million, down 2%, and total segment margin was relatively flat at 18.4%. Adjusted EPS from continuing operations was up 2% to $3.74. Residential revenue was down 3% at constant currency and down 4% on a reported basis, with volume down 6% and down 3% adjusted for the tornado impact. Residential profit was flat and segment margin expanded 80 basis points to 22.3%. Price performance was strong at 3.6% yield.

Our Residential business in the second quarter was negatively impacted by the significantly cooler temperatures and higher precipitation across the United States, especially in key Central regions where cooling degree days were down more than 30% and precipitation was up more than 60%, areas that account for approximately 40% of our revenue. We said over the years that a hot summer could add 10% to Residential growth and a cold summer could subtract 10%, which was the case in second quarter this year. Adjusted for the tornado, our Residential volume was down 3%. If you add 10% to that, you get a more normalized number, in line with the overall Residential market conditions.

Our Residential business had negative tornado impact of $28 million to revenue in the second quarter and $16 million to segment profit, offset by $18 million of insurance recovery. Adjusting for the net impact from the tornado and insurance proceeds, Residential revenue was flat, profit was down 1% and margin was down 30 basis points to 21.1%.

The adverse weather in the second quarter led to slower moving shipments in the industry, which slowed us in regaining market share following the tornado, and extends our recovery timeline to include the fourth quarter. We remain confident we will resume gaining share in 2020.

For 2019 overall, we now expect $99 million of negative tornado impact to Residential revenue, up from $70 million previously. We expect a negative $54 million impact to segment profit, up from $40 million previously. We expect insurance recovery for loss profits of $94 million, up from $80 million previously. The resulting $40 million of net benefit to Residential segment profit in 2019 is unchanged.

Of the remaining negative tornado impact for 2019, we expect to have an impact of approximately $22 million in revenue and $11 million in segment profit in the third quarter. For the fourth quarter, we expect an impact of approximately $14 million to revenue and $9 million to segment profit. For the remaining $36 million [of insurance recovery] in our core guidance, we expect that to be split evenly between the third and fourth quarters.

Taking a step back and looking at the big picture for both core and noncore related to the tornado, we now expect total insurance proceeds of approximately $372 million, up from $358 million previously. We had received $252 million of that as of the end of second quarter and expect the remainder by the end of 2019. The 2019 noncore gain expected for the difference in the book value and replacement value of assets remains approximately $91 million or a benefit of approximately $1.73 per share to GAAP EPS. We have posted a tornado financial update chart on our website, summarizing the guidance I just discussed.

Turning to Commercial in the second quarter. Revenue was a second quarter record $261 million, up 4%; commercial profit was a record $54 million, up 6%; and the segment margin expanded 50 basis points to a record 20.6%. Commercial revenue in the second quarter was led by high single-digit growth in national account equipment business. Regional and local equipment revenue was up low single digits at constant currency.

Breaking out the business another way, Commercial new construction revenue was up low single digits at constant currency and replacement revenue was up high single digits. Planned replacement was up low double digits and emergency replacement, which also was negatively impacted by cooler weather in the quarter, was down low single digits at constant currency.

Our VRF business was up high single digits in the second quarter. On the service side, Lennox National Account Services revenue was up low single digits.

In Refrigeration for the second quarter, adjusted revenue was up 5% at constant currency. Adjusted revenue profit was down 19% and adjusted segment margin was down 340 basis points to 12.8%. Profit was impacted by unfavorable mix as North America volume was down and Europe volume was up in the second quarter. In addition, profitability was negatively impacted by the timing on the sale of refrigerant allocations in Europe compared to the prior year quarter.

Before I turn it over to Joe, I'll review the latest of our outlook for 2019 and provide a few early thoughts on 2020. For the industry overall, we still expect North America residential HVAC shipments to be up mid-single digits. We are reducing the outlook for commercial and refrigeration end markets in North America. We now expect commercial shipments to be flat for the industry in 2019 and expect refrigeration shipments to be slightly down for the industry. That's for the market. We still expect our revenue to be up for both businesses in the second half of the year. We expect year-over-year commercial margin expansion to continue in the second half and refrigeration margin expansion to resume in the fourth quarter.

Looking ahead and thinking about 2020, we're still 6 months away, but the residential market continues to look robust, setting aside the second quarter weather. Commodity costs continue to trail down, and that is setting us up nicely for a more positive price/cost benefit in 2020 than we've had in 2019. And the investments we made in equipment, controls and distribution set us up well in 2020 as do the easier comps, post the tornado impact, to get us back on a share gain path.

Now let me 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, starting with Residential Heating & Cooling.

In the second quarter, revenue from Residential Heating & Cooling was $689 million, down 4%. Foreign exchange had a negative 1% impact on revenue. Volume was down 6% or down 3% adjusted for the tornado impact. Price was up 4% and mix was down 1%.

Residential profit was flat at $153 million. Segment margin expanded 80 basis points to 22.3%. Segment profit was favorably impacted by a net $2 million of benefit from insurance proceeds relative to the tornado impact in the quarter as well as favorable price, sourcing and engineering-led cost reductions and favorable warranty. Offsets included cooler and wetter weather, tornado impact, factory productivity, unfavorable mix, higher commodity, freight, tariff and other product costs as well as distribution and SG&A investments and unfavorable foreign exchange.

Turning to our Commercial Heating & Cooling business. Commercial revenue was a second quarter record $261 million, up 4%. Foreign exchange was neutral to revenue. Volume was up 2%, price was up 2% and mix was up 4% on the strength of national account growth.

Commercial segment profit was a record $54 million, up 6%. Segment margin was a record 20.6%, up 50 basis points. Segment profit was impacted by favorable price, favorable mix and sourcing and engineering-led cost reductions. Partial offsets included lower volume, higher commodity and other product costs, tariffs, freight and distribution and SG&A investments.

In the Refrigeration segment, adjusted revenue was $149 million, up 2% in the second quarter. Foreign exchange had a negative 3% impact on revenue, volume was up 1%, price was up 2% and mix was up 2%.

Adjusted segment profit was $19 million, down 19%. Adjusted segment margin was 12.8%, down 340 basis points. Profit was impacted by lower mix and the timing on the sale of our refrigerant allocations in Europe compared to the prior year quarter, higher commodity, freight, distribution and tariffs and other product costs and unfavorable foreign exchange. Partial offsets included higher volume, favorable price, sourcing and engineering-led cost reductions and lower SG&A expenses.

Regarding special items in the second quarter, the company had net after-tax charges totaling $36.6 million. This included a charge of $45.5 million for pension settlement, a net charge of $1.5 million for various other items and a gain of $10.4 million from insurance recoveries net of losses incurred.

Corporate expenses were $24 million in the second quarter compared to $23 million in the prior year quarter. Overall, SG&A on an adjusted basis was $152 million compared to $151 million in the prior year quarter.

Net cash from operations in the second quarter was $30 million compared to $49 million in the prior year quarter. Capital expenditures and purchases of short-term investments were $18 million compared to $21 million in the second quarter a year ago. We had proceeds for tornado damage to property and proceeds from the disposal of property, plant and equipment of $6 million in the second quarter this year. Free cash flow was $20 million compared to $28 million in the prior year quarter.

The company repurchased $150 million of stock and paid $25 million in dividends in the quarter. Total debt was $1.47 billion at the end of June, and we ended the quarter with a debt-to-EBITDA ratio of 2.3. Cash and cash equivalents were $36 million ending the quarter.

Now turning to our guidance for the company overall in 2019. We are updating guidance for adjusted revenue growth from a range of 3% to 7% to a new range of 2% to 5%. We are updating GAAP EPS from continuing operations from a range of $12.65 to $13.25 to a new range of $11.91 to $12.51. This incorporates special items in the first half of the year, including the $1.14 non-GAAP pension settlement charge in the second quarter.

As previously discussed, the pension settlement charge relates to an agreement that we entered into with Pacific Life Insurance Company in April to annuitize $106 million of our defined benefit pension obligation. As part of this transaction, we also transferred $100 million in pension assets to Pacific Life.

This event required a remeasurement of the pension plan and resulted in a noncash $45.5 million after-tax settlement charge in the second quarter to write off the related accumulated actuarial losses. And as Todd mentioned, we continue to expect a total 2019 pretax gain at $91 million related to factory construction costs and the associated gain from replacement value above book value.

For adjusted EPS from continuing operations in 2019, we are updating guidance from a range of $12 to $12.60 to a new range of $11.30 to $11.90.

Let me now run through the other key points of our guidance assumptions and the puts and takes for 2019. First, the guidance elements we are updating. We are lowering the headwinds expected from commodities for the full year from $30 million to $20 million. We are lowering the guidance for factory, residential factory productivity from a benefit of $8 million to being flat year-over-year due to the weather impact on production and the corresponding lower fixed cost absorption. We are updating guidance for 2019 capital expenditures from approximately $195 million to $155 million, as $40 million of capital to fully reconstruct the Iowa manufacturing facility damaged by the tornado has moved from 2019 to 2020.

We are updating 2019 guidance for free cash flow from approximately $420 million to $390 million for the full year. There are 3 moving pieces to the guidance. The 2 headwinds are lower earnings guidance and higher working capital, and the benefit is a reduction in capital expenditures due to the project timing in the Iowa factory reconstruction between 2019 and 2020.

For the guidance settlements that remain the same, we still expect to capture $80 million of price for the full year. We still expect a $25 million benefit from sourcing and engineering-led cost reductions. We still expect $15 million of a headwind from freight and $10 million from tariffs, and we continue to expect headwinds of $15 million for distribution investments and $15 million for SG&A.

Corporate expenses are still targeted at $90 million for 2019. Net interest expense is still expected to be approximately $45 million. And we still expect an effective tax rate in the range of 22% to 23% on an adjusted basis for the full year. And finally, we continue to expect the weighted average diluted share count for the full year to be between 39 million to 40 million shares, which incorporates our plans to repurchase $400 million of stock this year.

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

QUESTIONS AND ANSWERS

Operator

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

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

Maybe just the first question around Commercial and Refrigeration demand. You had talked about a temporary pause back in Q1, entered Q2 with good backlog growth in both pieces. So just wondered kind of what changed as you went through the second quarter and maybe how you're seeing -- get a start to Q3 across the 3 segments in terms of demand.

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

As you can see in -- we had a nice second quarter revenue wise in both segments, especially in Commercial, and we entered third quarter with solid backlog. Our Commercial backlog is flattish from a year ago and our Refrigeration backlog is up mid-single digits. And again, we expect the revenue to grow in both of those segments. But in some ways, we're just truing up what we're seeing. I mean when you look at ARI data for commercial through May, market's up 0.5%, 1%. We think it was down in June in part because of weather. And so we think calling flat, just sort of a more realistic assumption.

What we're seeing in Refrigeration is some of our larger customers sort of deferring given some of the macroeconomic uncertainty. But again, it is on the margins. We're going from being up low single digits market, call it, sort of slightly down. It should be flattish to slightly down. So it's sort of a toggle of a couple of points, if you will. But again, we still expect revenue in both those segments to be up second half of the year.

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

And then sort of tied to that, maybe just any thoughts on Residential, how that's trended the last couple of months, if you've seen any improvement in sell-through conditions recently.

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

It's certainly warmed up in July from where it was in June and so that's helped. So we're off to a solid start. Although I'd remind everybody, third quarter last year was warm. If you could recall, it was up, from memory, 25% above normal and 15% above the prior year. So last third quarter was pretty warm. So the comps aren't so easy, but Residential's sort of chugging along and we're off to a nice start.

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

And then my last question on that point would just be in terms of the market share, efforts at Residential. Maybe just walk through where you're thinking you're falling short or if it's really the external conditions of weather that has sort of held you back on that market share retake.

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

Again, we're gaining share back. We're just -- we didn't gain it back as fast as we had hoped in second quarter, and I think it was largely driven to the weather. I think it's just an old business truism, which I've always found to be true. It's harder to get share in a down market than in an up market. In some of our markets, the area that we're talking about, this sort of region in the center of the country, our revenue was down there, even greater than it was overall in the business. And it was just tough to gain back share when things are down. And so we think that's a majority, vast majority of the impact.

I think to be honest and straightforward about it, full transparency, there are some sort of smaller dealers who, quite frankly, we're probably not going to get back that we protected our most valuable customers. And those we didn't protect, when we get to the other side of it, if they had a good experience with their new vendor, some of them aren't coming back, but we're -- we've gotten back the majority of the share we think by -- and we've guided that as we go into 2020, we're confident we'll be back on the share gain track again.

Operator

Next, we'll move to Steve Tusa with JPMorgan.

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

Just on the Commercial side. I mean you had talked I think a bit about at a conference in early June about how you were seeing the order rates come back there at that stage. Did something kind of happen later in the quarter on this front to kind of tweak that lower for the year?

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

I -- again, I think I'm reflecting a guide on the industry rather than our share. So what I said is we had a nice second quarter in revenue, and we expect revenue to -- up the second half of the year. Our backlog chart was -- is flattish because we sort of delivered a lot in second quarter. So we're still optimistic on the segment overall, but we're halfway through the year and the industry is flat.

And I think -- I don't think it's going to -- I think the second half will sort of -- closer we get to election, the more of these macroeconomic uncertainties hang, the less likely we're going to see growth in the end market second half of the year.

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

Right. Okay. On the Resi side, do you guys -- started to disclose in your Qs the difference between externally sold sales and sell-through your own distribution. And I think that number was up -- the external sales were up pretty nicely in the first quarter. Your sell-through was, through your own stuff, was kind of down moderately.

I think if the Q's going to come out today, can you just talk about -- was that the similar trend here in the second quarter? And then how should we read into that? Is that just you guys kind of restocking the channel from tornado impacts? Or what's kind of the framework with which -- to kind of look at that around?

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

It's even more pronounced in the second quarter maybe than it was in first quarter. So of our direct business, our Lennox business, which is 80% of what we do, revenue wise, was down 6%. And our Allied and ADP businesses, which are direct, was up 3%. I think it's a couple of things. I think it's weather exposure.

Our Lennox historic -- well, our Lennox-branded business is more on the center of the country than our Allied business. I think that's part of it. I also think it's this issue that the independent distributors were able to hang on to their dealers because they had multiple brands, and so were able to juggle brands and sort of keep dealers happy. And then as we're able to reload our independent distributors with our product and they're able to sort of seamlessly move back the dealers that have product line. And so no one said it was turned off by the -- or up -- had a relationship turn them off, they were able to sort of seamlessly move it back in. So I think that's part of it. So it's a bit of the weather end, so the other issue I talked about, regaining share.

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

Okay. And then one last one. Are you at all considering monetizing some of your distribution? Or is it still a very core part of who Lennox is, having this much captive distribution?

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

Did Al ask you to ask that of me?

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

Well, he was just very -- he was very quick to compliment you guys on the conference call, which is -- it's warranted. I mean you guys have done a great job, but just curious.

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

(inaudible) I heard that compliment, and I thought it was a left. I kept my head up for the right. We absolutely notice -- [hard to get out] distribution. As you've heard me say multiple times, I think it's a differentiator today. It will increasingly be a differentiator, all the investments we've made in digitization. It's gone from a business where you needed local knowledge and sort of moving boxes to this business where you want be able to leverage investments. And then again, if I learned anything at business school, I want to have thousands -- tens of thousands of small customers rather than one large customer. So we have no desire to get out of it.

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

Got it. One last one for Resi. What was the actual -- was there any major difference in kind of parts versus equipment? Were parts up in the quarter? Like what -- were any difference there?

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

No. I mean the -- so the part of the business that was up the most was residential and new construction, less impacted by the weather. But parts and the add-on replacement trended the same direction, that the cool weather impacting them both, and parts and supplies maybe even a little bit more than equipment.

Operator

Next question is from Jeff Hammond with KeyBanc.

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

I already knew the answer to that distribution question.

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

I was just going to joke, and say I'd be shocked if Al asked you to ask a question, go ahead.

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

All right. Just going through the $0.70 cut, I mean I know you made adjustments to the Commercial piece but can you maybe break out how much of the -- how you break out that 70% (sic) [$0.70] cut? How much is it, this kind of soft 2Q Residential versus how much is it -- is the Commercial piece being softer? And then it looks like Refrigeration margins seem to be coming in lighter as well.

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

I think order of magnitude, the way I think about it, Jeff, is we passed on the second quarter miss to the full year guide. And then we had sort of lower second half of the year because of the push out of the share gain, but that's offset by insurance. And then the third piece would be sort of a lowering of the end markets and corresponding revenue of the Commercial and Refrigeration businesses.

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

Okay. That's helpful. And then could you just explain this Refrigeration allocation dynamic and how big it was? And I think you said Refrigeration, the margins, you'll get expansion in the fourth quarter, which would suggest that maybe margins are down in the third quarter. And so what's going on there?

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

The issue -- I'll do it in reverse order. The issue in third quarter is the mix -- and I refer to it as mix. It's just this dynamic that our business in Europe is growing quicker than our business in North America. I think part of that's market, part of it is we're -- sort of flattish share in North America, Refrigeration organic share in Europe and that hurts it.

The refrigerant issue was second quarter a year ago. We had about a $3 million gain on refrigerant. I'll come back to that in a second. And second quarter this year, we had about $1 million. So net-net, a $2 million difference year-over-year. And as you may recall, it's -- I'll simplify it as a cap and trade program in Europe for F-gases, fluorine-based gases, and we had an allocation. We were able to resell the -- parts of the allocation you don't use, and we were able to sell those again to a $3 million gain last year second quarter, a $1 million gain this year. So year-over-year, $2 million swing.

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

Okay. So the third quarter margin comment on Refrigeration is that this mix dynamic continues and then it normalizes in 4Q?

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

Correct. I would broaden the answer. Also self-help will kick in, in fourth quarter.

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

Okay. And then the last one on this, distribution growth versus direct decline in the first half of the year. How should we think about that impacting the second half of the year, just with kind of the prebuy dynamic?

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

Which prebuy dynamic are you talking about, the furnaces?

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

Yes.

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

I haven't quant -- the reason I paused is because I haven't quantified it yet in my own mind, so I'm going to real-time think. I think obviously, the way you asked the question, you're right, it will, on the direct side, we'll have more of a sell -- we'll be selling furnaces where indirect, we'd sort of stocked it already. Although I would tell you, because of the tornado impact, we didn't do as much pre-stocking of our distributors as our competitors have done. I also think there'll be normalization as we get away from the weather impacts, especially in second quarter.

Operator

Our next question is from Ryan Merkel with William Blair.

Ryan James Merkel - *William Blair & Company L.L.C., Research Division - Research Analyst*

So first question for me. I'm guessing you don't want to give numbers by geography, but I'd just like to get a better sense of how weak the Midwest was in the quarter.

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

I won't give the exact numbers as you suggested, but we do -- it was -- it's up about 40% of our revenue. And it was maybe 2 or 3 points down in revenue in the add-on and replacement versus the overall market. I would contrast that. I will give you -- I will give you exact numbers for something I want to say, which is, in a market like Florida where we had warm weather, our Lennox replacement revenue was up 12%. And so a market we had good weather, we did well. In large parts of the country where we didn't have good weather, we didn't do well.

Ryan James Merkel - *William Blair & Company L.L.C., Research Division - Research Analyst*

Okay. That's helpful. And then just a follow-up to a prior question. So it sounds like you didn't assume that would make up some of the 2Q Resi shortfall in the second half, am I hearing that right?

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

I think that's what the guide says, yes. So the short answer is yes, and that's what's in the guide. Now again, we -- I often don't like to talk about weather, but I almost have to now given everything we've said so far. But sort of the conventional wisdom that I also believe is true is sort of the weather that you want now is hot, cool, hot, cool, so they sort of sell out and then they -- cools down, they can -- better say that it gets hot.

Our dealers get really busy, sometimes a week or 2 weeks planned out. And then you want it cool so they can catch their breath, get caught up and ready to take on new business. And then it gets hot again, they get the business they order from you.

And then as we get into September, we want the weather to break and sort of stay cool, so we'll start loading up for furnaces. So it's not just a record heat now -- for now for the balance of the quarter. We're going to have to sort of have some things move. But it's hard to make up the miss we had in second quarter due to weather.

Ryan James Merkel - *William Blair & Company L.L.C., Research Division - Research Analyst*

Got it. Okay. Just lastly, Residential price yield up 3.6%. That's a little better than I was thinking. Is this just a function of a double price increase still helping and maybe you didn't discount equipment to try to sell through just given the lower shipments this quarter?

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

It's primarily the first point. It's just the double price increase. And so second quarter was a sweet spot where we were sort of getting peak -- a carryover at both of them, if you will. And the year -- [we with] full year, we're going to get 2 points, might be slightly better than that given the performance in second quarter, but the second quarter is sort of the high watermark of year-over-year price increases.

And look, we were competitive in the marketplace. And so it's not like we said, look, we're not going to do any pricing to protect -- to regain share. Just at some point, you realize that's not the lever to pull, so we tried to pull a lot of other levers instead.

Operator

And we'll go to Jeffrey Sprague with Vertical Research Partners.

Jeffrey Todd Sprague - *Vertical Research Partners, LLC - Founder and Managing Partner*

Just coming around to kind of cash flow and absorption. So of kind of those 3 pieces Joe mentioned, really, working capital's got to be a chunk. Inventory looks high. I guess I really have kind of 2 questions. Is -- was there some kind of absorption benefit in the quarter actually from building inventory?

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

There was kind of -- Jeff, there was some inventory build, but there's also some raw material that are -- at higher levels given the increased production between Marshalltown and Saltillo.

Jeffrey Todd Sprague - *Vertical Research Partners, LLC - Founder and Managing Partner*

And then conversely, I guess your guide would assume some under absorption in the back half as you're burning inventory down. Can you give me any context on the margin impact there if there is any?

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

Once again, I think the margin impact is de minimis, and we're going to continue to level [low] production to optimize the impact on absorption.

Jeffrey Todd Sprague - *Vertical Research Partners, LLC - Founder and Managing Partner*

And then just back to price, Todd or Joe, I mean can you see any indication anywhere that there is some pushback? We've heard that in some industrial channels. Watsco kind of mentioned it around some parts pricing. Obviously, raw mats are coming down, volume's maybe not as good as people thought.

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

No. We're -- we've seen price stick in marketplace obviously from the results we've had. And we, as always, plan on passing on an annual price increase. And commodities have trailed down a bit, but labor is extremely tight in North America and we've had to raise wages in our factories. Our suppliers have had to raise wages in their factories. The tariff situation is still not settled. Freight and transportation is still -- while down a little bit from last year, it's still high versus last couple of years. So there's still inflation in the system and the need for us to pass on pricing, and our competitors are doing the same thing.

Jeffrey Todd Sprague - *Vertical Research Partners, LLC - Founder and Managing Partner*

So would it be fair to assume the double dip was obviously a bit unusual but kind of normal year-end? Beginning of year, list price increases, should -- kind of rule the day again, into 2020?

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

Yes. I mean what we'll do going into 2020s. Just we -- I'll repeat what you just said. We'll be announcing a price increase at the end of 2019 and set us up for realizing the 2020, and that's historically how the industry did it. Not to bash Watsco, but when Watsco is talking about price, they may be talking to their supplier and letting them know what they want to hit with, what they want them to hear. But from our perspective, we're still getting price in the marketplace.

Operator

Our next question is from Robert McCarthy with Stephens.

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

Maybe since you broke hearts a little bit on 2020 for your outlook, Todd, I mean could you talk a little bit about just maybe the current environment? Are you seeing any chinks in the armor or the cycle? And how do you think about '20 and how do you think about your long-term targets from where you sit now just so we get some comfort because obviously, some investors think that this could [precede] something worse than just bad weather?

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

No. I think it's bad weather. I think it's 2 things. It's bad weather in terms of cool and wet weather and bad weather in terms of a tornado, but those are the dynamics. I mean from a residential viewpoint, the market's still robust. U.S. consumer's still strong. U.S. consumer's still spending. I think you sort of see that in all the surveys and macroeconomic data. And as we go into 2020, we expect that to continue.

We sort of toggled down just a bit the commercial and refrigeration end markets, and I think that just reflects reality. But we continue to gain share and expect our revenue to be up in those end markets. So we think 2020's end markets are going to be good. 2021, my crystal ball is a little less clear, but our 3-year targets still stand up even with this second quarter drop because of weather.

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

And then in terms of the Residential -- excuse me, in terms of the Refrigeration and Commercial lowering, you did answer to the fact that you do expect to grow and that there should be share increase. I mean do you think this is some conservatism that you're baking into the guide? Or do you think you're just calling the market as you see it?

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

Yes. I mean the guide is the guide is the way I sort of think about it. And I hope we're wrong and I hope it does better, but that's sort of our best call right now.

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

I'll spare you a question on your distribution and whether you want to sell it.

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

No matter what happens, you're going to write that down as we do not want to sell distribution.

Operator

Next, we'll go to Gautam Khanna with Cowen and Company.

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

A couple of questions. First, I was wondering, any change that you would expect in the competitive environment given the CCS [spin] or anything else, the climate, the Ingersoll breakup. It doesn't sound like you've seen anything, but what might you expect in an environment that's going to be unfolding over the next year?

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

I don't think I'd expect any change in Trane Co. or whatever the new business is going to be called. I mean the management, as I understand that, Lamach and the management team, at the parent company are going to go with Trane Co., right? And so I assume they're going to compete the same way they've competed now.

If Carrier Co., it's unclear exactly -- I think one way -- one thing I think about is sort of the distractions aren't going to stop because Carrier Co., in and of itself, is a multi-industrial conglomerate that probably needs to be broken up. And so I think there'll be continued internal discussions about what do they do with refrigeration, what do they do with some of their lower-profit international businesses, what do they do with security business because I think all of that will continue to be a distraction, and I think that's good for us.

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

Okay. That's helpful. And also just what are your latest thoughts on North American HVAC consolidation? Do you think it happens? Do you think there's -- if it happens, when does it happen?

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

Yes. I -- my answer, Gautam, you've heard me say a thousand times. I'll say it for people who are listening anew. We don't need to do anything. We're at scale, but I think value could be created. And if something would happen, we'd love to participate. And we think we'd be a good player to help drive the value.

I think over the long term, if there's value to be created, markets find -- the financial markets find a way to have assets be combined. But right now it's only a handful of assets. And someone who's in the business would have to decide they wanted to get out of business, and I can't really control that. That question's better asked to somebody else rather than me.

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

Fair. And then you mentioned you're not going to retain 100% of the customers that you lost in the -- related to the tornado. Can you quantify that? What's sort of a net -- of the dealers you -- or the customers you had previously, what percentage do you think they'll come back? Is there any way to quantify it so we can understand the hurdle you're overcoming as you do recover?

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

Again, with some degree of uncertainty, sort of the order of magnitude is we keep 90 -- we get back 90%, we lose 10%. And if you do some of the backward math on that, then that implies 1.5 points, 2 points of Resi revenue maybe 1 away at the end of the tornado versus closer to 10 points of Resi revenue that was totally impacted by it. And I think of that kind of revenue changes, 0.25 point or so of share, maybe 3/5 -- or yes, 0.3 points of a market share.

And that's why I'm comfortable, as we go into 2020, it's now -- we'll sort of pivot away from just flitting out this piece that we still haven't gotten to more broadly talking about our market share gain. So we gained 0.5 point or more of market share in Resi up to the tornado during the prior 5 or 6 years. And as we go into 2020, we'll do the same thing and this will be behind us.

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

And last one, sorry. Marshalltown, is it fully operational, fully up to speed, there's no lingering production interruption there?

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

No lingering production interruption, we're up to speed. I mean the pushout of the capital, no one's asked the question, but I'll anticipate it, pushout of the capital has nothing to do with sort of being up to speed on production. It's building sort of the admin wing of the factory, adding in parking lots. And so lesser priority things of what we needed to do to make it a full-time factory again, but production wise, we're where we need to be.

Operator

Next, we'll go to Deepa Raghavan with Wells Fargo Securities.

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

Could you talk about what's embedded in the high end and low end of your revenue or EPS guide? Is that now all just Resi weather playing out next few months because it looks like you've already factored in some weakness in Commercial end of duration?

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

It's that, it's also just sort of -- there's always a range around commodities. There's a range around freight and transportation. There's a range around some of our execution in the factories. And so I think it's sort of a stacking of the operational bell-shaped curve, the range of outcomes around lots of initiatives that we have in place. I think the most important thing is maybe the weather impacts and -- or more broadly [stating] overall residential market. But there's other things in that guide.

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

Okay. Got it. Can you comment on a few puts and takes to Q3? I mean how should we think about your EPS contribution versus prior years? Anything you think that's worthy of being called out just given all the noise this quarter and last year?

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

No. I mean as you know, we don't give quarterly guidance. I know -- I don't want to give you a number and you know that. I think as I said earlier, we're off to a solid start. I gave the backlog outlook sort of flat in Commercial, up mid-single digits in Refrigeration. I've talked about Residential. You can read a weather map, but you've also got to read a weather map from last year to sort of understand it's hot last year, it's hot this year. And operationally, we're executing. So I think that's sort of the color commentary I'd make.

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

Okay. Lastly for me, can you give us some color on what you're seeing in non-res. I mean some recent data points not very favorable. You gave us pretty good color on -- I mean you talked about market. I think you obviously talked about your growth. But generally, is there anything else on a broad basis that you'd like to talk about in terms of office versus retail versus institutional? And is that concerning to you? Just any viewpoints there, appreciate it.

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

No macro use that I would share that you couldn't get elsewhere. I mean again, it's sort of overall, calling the unitary markets flat, so no additional color. Thanks.

Operator

Our next question is from Joe Ritchie with Goldman Sachs.

Joseph Alfred Ritchie - *Goldman Sachs Group Inc., Research Division - VP & Lead Multi-Industry Analyst*

Can we just kind of dive a little bit deeper into this market share dynamic? So I just want to make sure I understand it. Your production was back and running in 4Q. It seems like the recovery was getting better than expected last quarter. I mean is the way to think about your Resi growth rate right now, just chalking it up to weather and where you guys are based regionally? Or is there more to it than that?

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

Well, I think it's -- the more to it is what we called out for the revenue tornado impact or the tornado revenue impact in the quarter, which is $28 million. So there's $28 million revenue impact in the second quarter associated with the tornado. And part of that was being in full production early in the quarter. And then part of it was, as I said earlier, that there's a portion of the share that left us that we haven't regained it all back yet, and so that's tied to the $28 million. The larger number in the quarter is weather and that's -- by definition, it's weather. It was 100% weather.

Joseph Alfred Ritchie - *Goldman Sachs Group Inc., Research Division - VP & Lead Multi-Industry Analyst*

Got it. Okay. And then so I guess as I'm kind of thinking about the portion you've discussed with the smaller dealers, there's a portion that you're not going to get back, I'm trying to understand, I guess, just -- and so the increase in the expenses related to the tornado is related to the portion that you're not going to recapture in terms of your share? Is that fair?

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

I'm not sure I understand the question. You mean the additional gain of insurance proceeds?

Joseph Alfred Ritchie - *Goldman Sachs Group Inc., Research Division - VP & Lead Multi-Industry Analyst*

Yes. The gain on the insurance proceeds and the impact to the insurance proceeds this quarter. So it was expected to go up by $14 million for the year. I guess what is that related to?

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

That's lost revenue associated with the tornado.

Joseph Alfred Ritchie - *Goldman Sachs Group Inc., Research Division - VP & Lead Multi-Industry Analyst*

Okay. And then I guess as we think through 2020 and just this concept that the whole business interruption insurance and how that's calculated, is there an expectation that there's going to be additional recovery in 2020? Or it -- do we get a clean slate in 2020 and we can just look at the core business and how the core business is doing in 2020?

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

That's a fair question. We're in the process of negotiating with all the insurance companies, and they've worked very closely with us and have been fair and we continue to sort of get back the money we expect to get back. Our current expectation now would be that we would wrap things up by the end of the year with some forward look maybe into 2020, but that will be a negotiation. But at some point, we're just going to collect the money and move on. And right now, the guide expects that to be in -- all happen in -- in 2019, but it may bleed over into 2020. But I understand the need to have clean numbers in -- or the desire to have clean numbers in 2020.

Operator

Next, we'll go to Nicole DeBlase with Deutsche Bank.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

So I just want to start on Europe. I think during the first quarter, you talked about low double-digit growth ex FX. A lot of that was driven by Commercial HVAC, and it sounded like Europe was kind of strong again this quarter. So if you could just give us a little bit of update on what you're seeing in the region?

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

In Europe, we were up mid-single digits. Our HVAC was sort of low end of that and our Commercial Refrigeration was at the high end, but sort of on average mid-single digits in Europe. And we're primarily in France, in Spain and in Germany. Those are our major end markets, and that's where we've seen our strength.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Okay. Got it. And then Commercial HVAC margins, I think when we got the last update in the first quarter, you had guided for flat to down in the second quarter, but we saw some improvement there. What was better? Was it the top line was a little bit better than you expected? Or was it that the operational improvement was the driver of the upside?

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

It was both. I'd say it's equally split between the 2. They were -- we did better in the factory and then we did a little bit better on revenue and mix than we had hoped or had guided.

Nicole Sheree DeBlase - *Deutsche Bank AG, Research Division - Director & Lead Analyst*

Understood. Okay. And then last one for me, just price costs. Impact on margins in the second quarter and then if you still expect to see improvement there in the second half?

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

Turning to folks to see if we have that in front of us. I got too many numbers in my head right now. We'll have to get back, I mean it -- the answer is we were positive. See if I'm turning it and I've got it right in front of me. For the quarter, we had $32 million in price and $15 million headwind of commodity [spread and] tariffs. So we were positive $17 million for the quarter, and that's obviously the high watermark for the year.

Operator

And we'll go to Robert Barry with Buckingham Research.

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

Off the ground covered, I just have a few things to follow up on. So I thought -- I think earlier in the quarter or late in the quarter in June, you had alluded to at a conference potentially price and also material costs tracking better, but saw that you kind of kept the guide for those 2 components the same. Any kind of reason for that?

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

I think we lowered commodities. So it went from a $30 million headwind to a $20 million headwind.

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

Sorry, the material costs? It was price, commodity and material costs?

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

I think maybe I tried to lump all those together just by saying that the total of the 3 would be better. I didn't mean to say each element would be better. And so the -- all 3 of them I think used to be $55 million and are now $45 million if I have the math right.

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

Got it. Got it. And then that number you gave for the replacement volume in Florida, that up 12%, is that -- like how same-store is that? Is that a same-store number? Are you adding stores in Florida contributing to that growth?

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

I don't know if we added -- I don't think we added any PartsPlus stores, if that's the question, because I don't think we added any in Florida. But I don't really think about it for our business quite that way, Robert. I mean it's -- I think we had more dealers than we did last year because that's how we gain market share. And so I just -- I don't view it as sort of same-store sales. I view it as did we gain share or not and we did. Or -- and the market was up.

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

Got it. Right. I guess just lastly, following up I think it was Joe's question about the wave of share recapture is included in the numbers. So that $28 million of revenue in this quarter is not just volume loss, it's -- net of what you've estimated is recaptured share, is that right?

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

Correct.

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

And I guess, too, same thing with the -- at the EBIT line?

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

Correct.

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

So the fact that the EBIT tracked a little bit better on insurance recoveries even though the revenue was -- or the share recapture was lower, is just kind of how to -- period items.

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

Correct. In some way -- and we gave rough guides last time but the $18 million of insurance proceeds in Q2, I would tie to the $18 million lost profits we had in Q1. So it sort of lagged, not sort of -- it lagged it by a quarter.

Operator

Next, we'll go to Josh Pokrzywinski with Morgan Stanley.

Joshua Charles Pokrzywinski - *Morgan Stanley, Research Division - Equity Analyst*

Todd, I wonder if you could calibrate something for me. It was kind of touched around a few of these elements with the prebuy around the furnace standard and some of the growth differential between the independents and the company owned. I guess how should we think about that into the second half? Do then the independents go the other direction? Like can you size up the magnitude of what you thought was maybe pre-bought there versus underlying?

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

I don't have the math in front of me, Josh. I'll -- we'll put it together. I -- the prebuy versus our competitors' was dramatically less just because we didn't have the factory capacity to be building the pre-regulatory furnaces like others may have done. And so I think that's part of it. But I think how I -- doing better or independent distributors doing better during the second quarter and -- was I think were more driven by the ability not to be impacted by the tornado to the same degree that the independent distributors were able to hang on to dealers with other brands, which our Lennox distribution, by definition, wasn't able to.

Joshua Charles Pokrzywinski - *Morgan Stanley, Research Division - Equity Analyst*

Got it. So the -- kind of where I was going with this is, obviously, your competitors who don't have substantial company distribution are able to fill the channel a little bit more -- I think Carrier was still taking prebuy orders through May. So does that mean then that it's not just a timing flip where they've already made the sale in the first half, they can't in the second half, through company-owned, you can make that in the second half? I guess in the absence of the big prebuy or the notion of that, maybe not as big of a flip into the second half is how I should read that?

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

I'm not sure I follow the question. I think if you're -- if you're a company like -- if you're a company like Carrier who's selling to independent distribution, the revenue first half of the year will be overinflated and the revenue second half of the year will be deflated by that fact. If you're a company-owned distribution like we are in Lennox brands, our revenue would have been -- versus competitors would have been understated during the first half of the year and overstated during the second half of the year.

The reason I haven't spent a lot of time talking about that is that's like a third order equation after the tornado, after the weather, but I think that's sort of a rounding issue of a couple of points here or there. And I think on Allied, again, there was a -- we got some tailwind from selling furnaces first half of the year, and that will be a headwind second half of the year. But I think the amplitude of that was less than our competitors because we didn't build as -- prebuild as much.

And that -- the greater driver of the disparity between our Lennox brands and our Allied brands during second quarter was driven more by this issue of regaining the lost share more seamlessly through independent distribution and company-owned distribution because independent distributors were able to avoid losing dealers by using alternative brands.

Joshua Charles Pokrzywinski - *Morgan Stanley, Research Division - Equity Analyst*

Got it. And then just one more point on this. I don't mean to belabor it. But thinking about the -- I'm trying to pull it out. You know what, we'll -- I'll follow up on it. It's a little overcomplicated. I'll leave it there.

Operator

And we'll go to John Walsh with Crédit Suisse.

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

Just a question around the strong price realization. I mean obviously, a lot of different things are going into price right now, whether it's general inflation, tariffs, right? But you mentioned earlier about consumer confidence. Wanting to kind of understand how much of that price is driven by maybe people mixing up to a higher SEER or going kind of beyond that, opening price point, any way you kind of want to articulate it would be helpful.

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

I think most of it's just straight price. I mean there's a little bit of mix in the quarter. But given the tornado impact, given the weather, the mix sort of wasn't on its normal trajectory. I mean that's just 2 price increases being passed on.

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

Got you. And then I guess I think in Refrigeration, you made this comment. You're seeing the customers defer some spending just kind of given the macro. Any more color around that? Is it -- which kind of vertical are you seeing that in? And if it's kind of we're pushing it 1 to 2 quarters or if it's kind of they're actually waiting to see if the capital project moves forward.

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

I think it's just on the margins, and I think it -- we're primarily exposed to grocery and cold storage. And the question is do you build new -- not so much on stores but on cold storage facilities, do you build new cold storage facilities, do you invest the capital? I think it's sort of the macro investment decisions we're seeing across sort of corporate or industrial America.

Operator

Our next question is from Nigel Coe with Wolfe Research.

Nigel Edward Coe - *Wolfe Research, LLC - MD & Senior Research Analyst*

Obviously covered a lot of ground here. Can we just -- I mean I hate to maybe betray my stupidity here, but just want to understand the market share dynamics in 2Q. Because you didn't actually lose any share in 2Q '18. So therefore, to be talking about regaining share seems like illogical. So I'm just wondering, are we talking here about dealers that went away in the second half of the year that haven't come back? Is that how you're measuring the market share loss in 2Q?

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

Yes, exactly. So the $28 million is in that number. And so dealers who we lost in fourth quarter, if we hadn't have gained them back, the impact in second quarter would have been significantly greater than $28 million.

Nigel Edward Coe - *Wolfe Research, LLC - MD & Senior Research Analyst*

Okay. That's great. And then the -- I think you called out a 40% exposure to the Central states, Midwest states. Would that include the Central Southwest as well, so we're talking here about Texas, Oklahoma, those states, or not just the classic Midwest?

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

Yes. I mean the swing regions, I'll call it out, is the traditional Midwest, which is -- the football fans out there, the Big Ten, so it's Illinois, Indiana, Michigan, Ohio, Wisconsin. The Central Plains, which is really Missouri, Iowa, Minnesota, Nebraska and obviously, to a much lesser degree, the Dakotas, and then South Central, to your direct question, Texas, Louisiana, Arkansas, Oklahoma.

Nigel Edward Coe - *Wolfe Research, LLC - MD & Senior Research Analyst*

Okay. That makes total sense. And then just 2 more quick ones to tick off here. Just -- you talked about the insurance negotiation to FY '20. I mean just -- I mean I understand this is somewhat a sensitive topic. But conceptually, do you get compensated for 1 full year of lost profits? Or is it not that simple?

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

It's not that simple. So we're in detailed negotiations where we're justifying everything, both sort of impact to the factory plus lost revenue. And then in some ways, I would call speculative lost revenue. And it all gets [stirred] up in a mixer and at the end of the day, we'll work out a number. And we've guided to sort of the best of our ability publicly of what that number is and how much -- we've said how much we've gained so far and what we expect that number to be. I'm looking around because I've got so many numbers. I think it's [$4.72 million], right?

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

[$3.72 million].

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

[$3.72 million]. Not a (inaudible)

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

And we've received [$2.52 million] to date. We still have [$1.20 million] to negotiate.

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

And that's our best estimate.

Nigel Edward Coe - *Wolfe Research, LLC - MD & Senior Research Analyst*

Okay. Great. And then just a quick one on pricing. We covered pricing in a fair amount of detail. There's been a little bit of chatter about dealer incentives picking up during 2Q, towards the end of 2Q. Have you seen that? And is that a risk in any dimension for the back half of the year?

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

It's not a risk for the back half of the year. It's when the weather is that cool and the volume is that soft and people start spiffing to try and move volume. And quite frankly, we did the same thing.

Operator

Our final question will be from Damian Harris (sic) [Karas] with UBS.

Damian Karas - *UBS Investment Bank, Research Division - Associate Director and Equity Research Associate of Electric Equipment & Multi-Industry*

Appreciate you fitting us in here. Just a clarification on client capacity. So you had shifted some additional production down to Mexico as a result of the tornado. Where exactly do things stand now with respect to the production split across your 3 facilities, comparing to that before the tornado in Marshalltown? And is there still some shifting that you'll be looking to do in the future?

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

We're always looking to shift in the future. So that's still out there and that continues to be out there, and we'll continue to look at our footprint to try and drive the lowest cost.

In terms of the shift of the volume for the tornado, we moved capability both to South Carolina and to Mexico. That capability still remains there. But we're up and running all the products in Marshalltown that we were producing prior to the tornado also.

Damian Karas - *UBS Investment Bank, Research Division - Associate Director and Equity Research Associate of Electric Equipment & Multi-Industry*

Got it. And just curious, have you felt any pushback from customers on having some of that Dave Lennox Signature branded product coming out of Mexico now?

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

Zero pushback. I mean we've been building a Mexican facility for almost a decade now, and many of our largest dealers have visited the facility. They know how the quality is and they don't care where -- whether it's made in Mexico or whether it's made in the U.S., it's the exact same quality.

Operator

And with that, I'll turn it back to the company for any closing comments.

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

Thanks a lot, operator. To wrap up, we've [reset] guidance after a significantly adverse weather in the second quarter and have reduced the outlook on commercial and refrigeration end markets in North America for the year. Looking ahead, weather aside, the residential market continues to look robust, commodity costs are trending down with more price/cost benefit moving forward, and the investments we have made in products and distribution set us up well for 2020 and for the second half of 2019. Thank you all for joining us today.

Operator

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