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LII - Q4 2019 Lennox International Inc Earnings Call

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OVERVIEW:

Co. reported 2019 GAAP revenues of $3.81b, GAAP operating income of $657m, and GAAP EPS from continuing operations of $10.38. 4Q19 GAAP revenue was $885m, GAAP operating income was $192m, and GAAP EPS from continuing operations was $2.92. Expects 2020 adjusted revenue growth to be 4-8% and GAAP and adjusted EPS from operations guidance to be $11.30-11.90.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to Lennox International Fourth Quarter 2019 Earnings Call. (Operator Instructions) As a reminder, this call is being recorded.

I'd 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 2019. 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 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 a quick review of 2019 overall and then discuss some fourth quarter highlights.

For 2019, the company reported record adjusted revenue, margin and profit and had strong cash generation. As we talked about over the course of the year, weather was a significant headwind to growth in the second, third and finally fourth quarters. GAAP revenue overall for the company was $3.81 billion for the year, down 2%, including a negative 5% impact from divestitures. GAAP operating income rose 29% to a record $657 million. GAAP EPS from continuing operations rose 18% to $10.38. On an adjusted basis for 2019, excluding the impact from divestitures, revenue was up 3% to a record $3.77 billion. Total segment profit rose 12% to a record $610 million, and total segment margin expanded 140 basis points to a record 16.2%. Adjusted EPS from continuing operations increased 18% to a record $11.19.

Of note in 2019, we completed the divestitures of our noncore Refrigeration businesses. We operationally recovered from the tornado and resumed capturing share in the market, and we introduced new products and continue to make investments for future growth and profitability that position the company well for 2020 and beyond.

Turning to our business segments for the year. Residential reported new record highs for revenue, margin and profit. Residential revenue rose 3% on comparable growth in both replacement and new construction business. Residential profit rose 16%, and segment margin expanded 230 basis points to 20.3%. For the year, Residential had negative tornado impact of $109 million to revenue and $59 million to segment profit, offset by $99 million of insurance recovery for a net benefit of $40 million to segment profit.

Our Commercial business set new records for profit and margin for the year. Commercial revenue and profit rose 5%. Segment margin was flat with prior year's record level of 17.5%. Commercial equipment revenue was up mid-single digits for the year with both replacement and new construction up mid-single digits. Looking at the business another way, revenue from regional and local business was up low single digits. National account equipment revenue was up high single digits for the year. On the new business front, the company won 25 new national account customers across diverse vertical markets in 2019.

On the service side, Lennox National Account Service revenue was up high single digits for the year. In the Refrigeration segment, on an adjusted basis that excludes impact from divestitures, revenue is up 1% at constant currency and down 1% on a reported basis. Segment profit was down 12%, and margins were down 140 basis points to 11.7%. At constant currency, North America revenue was up low single digits, Europe Refrigeration was down mid-single digits and Europe Commercial HVAC was up high single digits.

Turning to the fourth quarter. Company revenue on a GAAP and adjusted basis was $885 million. GAAP revenue was up 5%. Adjusted revenue, excluding the impact from divestitures, was up 8% to a new fourth quarter high. GAAP operating income rose 64% to a fourth quarter record $192 million. GAAP EPS from continuing operations is up 57% to fourth quarter record $2.92. On an adjusted basis, total segment profit rose 19% to fourth quarter record of $133 million, and total segment margin expanded 140 basis points to A fourth quarter high of 15.1%. Adjusted EPS from continuing operations rose 24% to fourth quarter record of $2.45.

Looking at our business segments for the fourth quarter. Residential reported new fourth quarter records for revenue, profit and margin. Revenue -- Residential revenue was up 8% on a high single-digit growth in replacement business and a mid-single-digit growth in new construction business. Segment profit was up 20%, and segment margin expanded 190 basis points to 19.6%. And as provided in December, the Residential business had a negative tornado impact of $23 million to revenue and $13 million to segment profit in the fourth quarter, offset by $25 million of insurance recovery for a net benefit of $12 million to segment profit.

In Commercial, revenue, profit and margin were all new fourth quarter records. Commercial revenue was up 12% and profit rose 24%. Segment margin expanded 180 basis points to 19%. Commercial equipment revenue was up low double digits in the quarter. New construction revenue was up mid-teens, and replacement revenue was up high single digits.

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 (inaudible) revenue was up mid-teens.

In Refrigeration for the fourth quarter, revenue was relatively flat at constant currency. Refrigeration profit rose 5%, and segment margin expanded 70 basis points to 11.1%. At constant currency, North America revenue was up low single digits, Europe Refrigeration was down high single digits and Europe Commercial HVAC was up low single digits.

Looking ahead for the company overall in 2020, we are reiterating guidance. We expect adjusted revenue growth of 4% to 8% this year and GAAP and adjusted EPS from continuing operations to be $11.30 to $11.90 for the full year. The company has a strong cash generation profile including $371 million of free cash flow in 2019. Beyond our investments for the future performance of the business, we plan to continue to grow the dividend and repurchase stock, including $400 million this year.

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 a fourth quarter record $499 million, up 8%. Volume was up 3%. Price was up 2% and mix was up 3%. Foreign exchange was neutral to revenue.

Residential profit was a fourth quarter record $98 million, up 20%. Segment margin was a fourth quarter record 19.6%, up 190 basis points. Segment profit was favorably impacted by the benefit from insurance and tornado recovery year-over-year, higher volume, price and mix and lower material, tariff and warranty costs. Partial offsets included lower factory efficiency, higher distribution, freight and other product costs. For the full year, Residential segment revenue was a record $2.29 billion, up 3%. Volume was up 1%, price was up 2% and mix was flat. Foreign exchange was neutral to revenue. Residential profit was a record $465 million, up 16%. And segment margin was a record 20.3%, up 230 basis points.

Turning to our Commercial Heating & Cooling business. Commercial revenue was a fourth quarter record $260 million, up 12%. Volume was up 12%, price and mix were flat and foreign exchange was neutral to revenue. Commercial segment profit was a fourth quarter record $49 million, up 24%. Segment margin was a fourth quarter record 19%, up 180 basis points. Segment profit was favorably impacted by higher volume and price, lower material and other product costs and lower SG&A. Partial offsets included unfavorable mix, lower factory efficiency and higher distribution, warranty and tariff costs. For the full year, Commercial revenue was $947 million, up 5%. Volume was up 2%, price was up 1% and mix was up 2%. Foreign exchange was neutral to revenue. Segment profit was a record $165 million, up 5%. Segment margin was 17.5%, flat with last year's record level.

In Refrigeration, on an adjusted basis, fourth quarter revenue was $127 million, down 2%. Volume was up 2%, price was up 1% and mix was up 1%. Foreign exchange had a negative 2% impact on revenue. Refrigeration segment profit was $14 million in the fourth quarter, up 5%. Segment margin was 11.1%, up 70 basis points. Segment profit was favorably impacted by price and mix, lower material, distribution and tariff costs and higher joint venture income. Partial offsets include lower volume and factory efficiency, higher warranty and other product costs, higher SG&A and unfavorable foreign exchange. For the full year, Refrigeration revenue was $534 million, down 1%. Volume was flat, price was up 1% and mix was flat. Foreign exchange had a negative 2% impact. Segment profit was $62 million, down 12%. Segment profit was -- segment profit margin was 11.7%, down 140 basis points.

Regarding special items in the fourth quarter, the company had a net after-tax gain totaling $18.7 million. This included a gain of $51 million for insurance recoveries received for property damage incurred from the natural disaster, a benefit of $4 million for excess tax benefits from share-based compensation, a charge of $28.9 million for pension settlements and a total charge of $7.4 million for various other items net. For the full year, the company had net after-tax special charges totaling $31.1 million. This included a charge of $74.4 million for pension settlements, a charge of $7.7 million for restructuring activities, a $6.5 million net loss on the sale of businesses and related property, and a total charge of $13.2 million for various other items. Also included in the gain -- also included is a gain of $59.8 million for insurance recoveries received for property damage incurred from the natural disaster and a benefit of $10.9 million for excess tax benefits from share-based compensation.

Corporate expenses were $28 million in the fourth quarter and $82 million for the full year. Overall, SG&A on an adjusted basis was $144 million in the fourth quarter or 16.3% of revenue, down from 16.7% in the prior year quarter. For 2019, overall SG&A on an adjusted basis was $581 million or 15.4% of revenue, down from 15.5% in the prior year. For 2019, the company had cash from operations of $396 million compared to $496 million in the prior year. Capital expenditures were $106 million for the full year compared to $95 million in the prior year, and proceeds for damage to property and disposal of property were $81 million compared to $11 million in the prior year.

Free cash flow was $371 million for the year compared to approximately $411 million in the prior year. In 2019, the company paid approximately $111 million in dividends and repurchased $400 million of company stock. Total debt was $1.17 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 $37 million at the end of the year.

Now before I turn it over to Q&A, I'll review our outlook for our 2020. Our underlying market assumptions for the year are unchanged. For the industry overall, we expect North American residential HVAC shipments to be up mid-single digits. We expect North America commercial unitary shipments to be flat, and we expect North American refrigeration shipments to also be flat. The company guidance for 2020 remains the same as we presented at the December Investment Community Meeting, and we continue to expect adjusted revenue growth from 4% to 8% with neutral foreign exchange. And we still expect GAAP and adjusted EPS from continuing operations in a range of $11.30 to $11.90.

I would like to highlight that we expect the flow of EBIT over the quarters for 2020 to be a bit different this year than historical seasonal averages due to some effects stemming from the tornado that I will detail in a moment. Specifically, first quarter historically averages about 14% of annual EBIT. This year, we expect about 11% of the annual EBIT to flow through the first quarter, with the difference coming in the second half of the year, which will be -- which will then be higher than historical seasonal averages. There are a couple of primary reasons for this. The first relates to factory productivity. As mentioned previously, we have incremental depreciation from the new equipment in Iowa facility, and we also have lower factory absorption in the first quarter. As you recall, we made the decision to more level load the Iowa factory in the third and fourth quarters of 2019 to prebuild ahead for the 2020 summer season. We mentioned the decision not to do a typical season ramp down in that factory to avoid the disruption in the labor force and production in that facility post the tornado.

The second reason relates to lower-margin business we expect to have and winning back business after the tornado impact. This lower-margin business is planned for in our annual guidance and is expected to primarily impact the first half of 2020.

Now let's run through the other key points in our guidance assumptions and the puts and takes for 2020, all of which are unchanged. We expect a benefit of $30 million in net price for the year. Commodities are expected to be a $20 million benefit, and freight, a $10 million benefit. We expect a $25 million benefit from sourcing and engineering-led cost reductions and $10 million of benefit from residential factory productivity. Residential mix is expected to be a $5 million benefit.

For the headwinds in 2020, we expect $5 million of headwind from tariffs. We are planning $15 million for distribution investments. As part of that, we are resuming Lennox store openings and have 20 planned for 2020.

Within SG&A, we will continue to make investments in research and development and IT for continued innovation and leadership in products, controls, e-commerce, factory automations and productivity.

A few other guidance points. Net interest expense -- net interest and other expenses is expected to be approximately $50 million. Corporate expenses are targeted at $90 million. We expect a final tax rate in the range of 21% to 22% on an adjusted basis for the full year. Capital expenditures are still planned to be approximately $153 million including $53 million funded by insurance proceeds received in 2019. And finally, we continue to expect the weighted average diluted share count for the full year to be between 38 million to 39 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) Our first question is going to come from the line of Deepa Raghavan from Wells Fargo.

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

Todd, can you talk about the momentum in your Residential business, especially how we should think about weather actually normalizing -- weather normalizing being a plus or minus to your existing guide? I guess, it wasn't pretty clear to us at the Investor Day how we should think about based on how you're thinking about weather impacting guide in fiscal '20.

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

I'll answer what I think the question is. I think, weather last year was cooler in especially in the summer selling season. And then as we've gone into November and December, it was warmer in the furnace season. And so in a more normalized year, I would expect weather to be a tailwind in 2020. When I think about our guide, we call for the market to be up mid-single digits in resi. If we get a warm summer, then the market will do better than that.

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

Got it. Yes, that was my question, if there's any way to normalize, how we should think about fiscal '20. My follow up would be on Q2. I mean, you called out -- obviously, Q1, now you reset it a little bit for us. But you're expecting everything to be second half-loaded at this point in time, whatever delta has been captured. Anything with Q2 we should think about? I mean, do things just start to get normal from Q2 on? Or is there some impact from this Q1 falling into Q2 as well?

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

The exact words that Joe used when he was talking about the lower-margin business we expect to have, he referred to it, the lower-margin businesses planned and our annual guidance is expected to primarily impact the first half of 2020. So we -- as you know, we don't give quarterly guidance, but we, in essence, just did for first quarter. But there'll be a lingering impact in second quarter. So the way I think about it is we spent quite a bit of time at the December Analyst Day, which obviously you were at, talking about the rebates and the different things we had to do to win back some of the lost share. And we start to lap that midyear. Although it will be most pronounced in first quarter, there will be a lingering effect in second quarter also.

Operator

Our next question will come from the line of Julian Mitchell from Barclays.

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

Maybe just a question on the Commercial business, very good performance in terms of sales as well as incremental margin. So just wondered if there was anything on the revenue line you'd call out that surprised you.

And on the margin front, the margin performance in Commercial was a bit volatile quarter-to-quarter over the past sort of 6, 7 quarters. Do you think that we're now on a sustainable footing for steady margin expansion in Commercial?

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

First, on the revenue point, as you well know, joint -- Commercial can be lumpy. We obviously -- if you just look at one quarter, we obviously significantly outperformed the market in fourth quarter. That was driven, as you heard in Joe's comments, a nice quarter in national accounts, nice quarter in new construction. That all doesn't repeat itself as we go into 2020 for the whole year, but we still think we're going to -- we call for the market to be flat. Maybe the market does a little bit better. I think momentum in Commercial is stronger than what it was even a month ago when we had the December Analyst Day, and our business is gaining share.

On the margin impact, our plan is that we're going to have more steady margin movement in 2020. The item that really sort of bounced -- 2 items have bounced around in 2019 was, one, our factory performance, and we've talked in some detail around that. The major driver being labor availability, and we've addressed that in multiple ways as we've talked about in December. And then just the mix of the business, and that can bounce around. We do better -- have higher profit with national accounts. And so in a strong national account month like we did in fourth quarter then we see even stronger margins. But I would think the sign curve amplitude starts to dampen, and it's an upward trend rather than an up and down trend.

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

And then my follow up would be on Residential. Just wondered, you talked in December about the lower margins or lower operating leverage coming through on some of that market share recapture. So even with that, you still had very good gross margins firm-wide in Q4. So maybe just any update on how that incremental margin in resi is trending versus what you'd thought?

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

No changes from what we talked about at the Analyst Day. So there was nothing in fourth quarter that materially changed. Again, we (inaudible) guided in mid-December, so we have a pretty good view of what was happening. And so everything I said in December is standing today.

Operator

Our next question then is going to come from the line of Jeff Hammond.

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

Just on kind of share recapture progress, we're hearing in the channel people kind of discounting to hold on some of that borrowed share. Just what are you seeing and kind of what -- where do you think share captures kind of played out in the fourth quarter versus expectation?

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

I mean, it played out where we -- broadly where we expected it to, Jeff. I mean, we called it in December that we were going to get back 80% or so of the lost share, and we roughly did that in first quarter, and we're feeling pretty good about where we're at. I mean, it's -- as you know, it's always a competitive marketplace, and it's -- but broadly, a disciplined structure. We announced price increases for 2020 that we're going to get $30 million of price, and that's net of any of this matching that we have to do to hang on or win back some of our lost share. So I know some of the sell-side notes about years, but others have sort of talked a little bit about this. I don't think it's much different than it's been in past years.

Now we've called out that there's going to be some impact in our -- our incrementals are 20%. So the normal 30% in 2020, that's part of this, but that's all accounted for in our guide.

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

Okay. And then it sounds like some of the commercial issues in the plan are resolved, and your margins are going to be more stable. Can you just speak to any kind of labor inflation inefficiencies in Refrigeration, Residential and kind of how those play out through the year in terms of normalizing?

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

We feel -- I think the guide that we gave -- I'll just check my fact sheet here. We guided in December that we'd have $10 million of factory productivity in 2020. We had negative factory productivity. I think that's called inefficiency in 2019. And so we're feeling better about things across the enterprise. And so some of the initiatives I talked about, maybe specifically around Commercial, of moving more the full-time labor versus the temps, doing more level loading, we've done that across the enterprise and as well as, quite frankly, have made some management changes and sort of stream some talent into our factories to improve things. And so we're feeling much better going into 2020. Obviously, we need to do it. But we feel better at this point in the year than we've, quite frankly, felt the last couple of years.

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

Okay. I don't know if I missed it. Did you give independent versus company-owned distribution growth in 4Q?

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

We did not. I'm not afraid to give it. So I'm just turning to make sure we got it. If I can find it, if someone can find it in the fact sheet, we'll call it. I think roughly, they were the same in fourth quarter. We didn't have the outgrowth that we've had in prior quarters. Quite frankly, we just spiked it out in the script, but we'll dig that up and make sure we say it.

Operator

Our next question now is going to come from line of Nigel Coe from Wolfe Research.

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

Todd, so you mentioned the level loading back in December. Just -- is this the way it's going to be going forward? Or is it because we've got a new setup, as [market sounds,] maybe a tight labor market. Obviously, you don't necessarily want inventory to build up too much, but is this -- do you plan to level load more going forward?

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

Most likely, the answer is yes. But I mean, we have the flexibility to sort of adjust as need be. But I -- again, there's a benefit, quite frankly, to inventory and cash management when we adjust up and down, especially when the sensitivity that we had around the labor force. Now we've always done, quite frankly, some amount of level loading. We never go to 0 and then ramp back up. So in some ways, it's on the margins. And so we'll retain some flexibility. But I think we'll most likely -- unless labor loosens up, we'll most likely do it for a while.

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

Okay. Great. That's great. And then, Joe, I appreciate a little color on the bridge and the 1Q seasonality. Does the 1Q seasonality also embeds a slightly weaker market growth in 1Q? And I'm just curious how January might have trended relative to 4Q?

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

No, I mean, the guide -- or the earnings had nothing to do with revenue growth. It was just things that Joe talked about. It was gross margins both around factory productivity and around the lower-margin business.

January was a little soft. I mean, the weather was warm. And if you look at degree-heating days, it was down 20% from a year ago. So January is a little soft. But look, March is half the quarter. And March is as much about dealer sentiment and confidence. And at AHRI, dealers are confident. We spent a lot of time with our dealers. They're confident. We just came out of a sales meeting, people are ready to go. So it's too early to be nervous about anything or because of the weather. So we'll see how it goes. But first quarter guide didn't have anything to do with revenue.

Just to go back to the question that Jeff asked, we had the people in charge of the Iowa caucus print this out sort of real time. So our independent business was up high single digits in fourth quarter, and our Lennox business was also up about the same. So they both had roughly the same growth rate, which was the overall growth rate.

Operator

Our next question then will come from the line of Nicole DeBlase from Deutsche Bank.

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

I was wondering if you could talk a little bit about what you saw with respect to backlog within Commercial and Refrigeration.

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

In Commercial, our backlog is relatively flat year-over-year. We sold a lot in fourth quarter, and so it drained it a bit, so it's flat, slightly down. But again, when we're looking at the order quoting activity, we still feel pretty good about 2020 in first quarter.

On Refrigeration, it's up slightly year-over-year. And again, it's seasonally a light time to really be looking at backlog. It becomes a bit more important as we get into first quarter.

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

Okay. Got it. And then my follow up is just around Refrigeration margins. You guys saw that year-on-year expansion come through, looks pretty good in the fourth quarter. Any major drivers to call out or sustainability of that level of improvement through 2020?

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

Again, it's similar conversation I had around Commercial. Our big issues -- well, slightly different. I mean, our big issues in Refrigeration in 2019 around margins were, one, factory productivity or lack thereof. And just like Commercial, I think that's now behind us both at our U.S. factory and our European factories.

And then the other issue in our Refrigeration business was mix, that we had a stronger year in our Europe business than our North America business, our North America business has higher margins. And the other issue year-over-year in 2020 was from 20 -- excuse me, 2019 was from 2018 to 2019, we had less of a refrigerant allocation change that impacted us.

Operator

Our next question then comes from the line of Robert Barry from Buckingham Research.

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

Do you actually have an estimate for how much the share recapture contributed to the revenue in 4Q for resi?

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

The way I'd calculate -- I don't have the math -- the sheet in front of me, Robert, is just take the impact from fourth quarter last year, that revenue that we guided to. In order of magnitude, it's 80%. And so when I talk about the 80% share of gain back, I look back a year and multiply it times 0.8 and that's order of magnitude, the number that we've been talking about.

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

Got it. And so with the difference between if we back that out and what you actually did versus a mid-single-digit number all be weather? Or do you think kind of the underlying fundamentals in the market were also just weaker?

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

I think it was exclusively weather. That's the short answer, if I understood the question right. But I think it's hard to sort of back us out that way. But I think if you look -- I'd think about it this way, if you look at industry data, the market was flattish in fourth quarter. And so that's how I would think about what the market did.

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

Got it. And then I just did want to follow up on this comment about the, I guess, the mix impacts of the share recapture, make sure I'm understanding that. It was my impression that the share that you lost because of the tornado is generally very rich mix, like 50, 60s-plus incrementals, that there'd be a lot of room for discounting and still have above-average incrementals on that business as it comes back. Is that inaccurate or...

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

I think there's -- some of the -- I think it's a mix of the mix. So I think clearly, there were some very high profitable and we saw the drop-through on that. But there's also sort of this mid-tier dealer, if you will, that we've had to get back. We've had decremental margins because of it.

Operator

Our next question then will come from the line of Steve Tusa from JPMorgan.

Patrick Michael Baumann - *JP Morgan Chase & Co, Research Division - Analyst*

This is actually Pat Baumann on for Steve Tusa. Just with regard to the lower-margin business you're winning back that's first half weighted, can you update us on your assumptions for just the overall market share recaptured at resi in 2020 and the expected cost to win that share back? And then any reason why that's expected to be a first half versus a second-half thing?

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

Well, I'll answer the first -- or second part of the question first. It's because we'd already started gaining share back during the second half of the year. So it's really a lapping effect, right? So we started gaining share back in third quarter when the factories were fully running mid-half of the year. And then fourth quarter, I just called out that we, in essence, gained back the 80%. And so it completely lapped in fourth quarter, partially lapped in the third quarter. So the real impact is in first and second quarter. And the guide is no different than what we talked about at the December Analyst Day, that it's a 20% incremental drop-through. And we went through at the December Analyst Day the impact of that lower-margin business, and none of those guide points have changed.

Patrick Michael Baumann - *JP Morgan Chase & Co, Research Division - Analyst*

And I guess, with first quarter margins softer in resi, I assume resi, so there's no change in how you think about resi margins for the entire year? And what is your guide on that for the year versus the 20% in 2019? I don't think you gave a guide on the actual margin, did you for resi, for 2020?

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

No. We don't give segment guidance for margins. And so the 20% was the incremental drop-through for the corporation, but we haven't given a resi margin guide.

Patrick Michael Baumann - *JP Morgan Chase & Co, Research Division - Analyst*

Okay. But no change in -- it's just the profile of the year versus what we had in our models versus anything that you were expecting that's different?

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

Yes. I mean, I -- the way I'd characterize what we talked about new here was, we talked about both those effects, both the factory productivity and lower-margin businesses in some great detail in December. What we didn't do was calendarize it. And we were using this as an opportunity to revisit the exact same things we talked about. Full year impact hasn't changed. Our assumptions haven't changed. Nothing's changed. We just want to be more transparent around the cadence of it during the calendar year, quite frankly, so there wasn't a disconnect between how investors were anticipating things and how we were anticipating things in 2020.

Operator

Our next question then will come from the line of John Walsh from Crédit Suisse.

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

So really good performance on the Commercial side of the business. It sounds like from walking around AHR, we're going to see a lot more competition in that space around kind of refreshed product, et cetera. One, I don't know if you'd agree with that characterization. And then maybe, what are you doing from a new product or pricing perspective as we think about Commercial?

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

I mean, we think we have a very, very good product line. Our Ultra Energence is the best in the market for high efficiency, and our Landmark and Raiders is as competitive as it gets in entry level. There's always a long -- or better stated, there's a time lag from people announcing that they have a new product to the market accepting and going. I think one of the competitors you're talking about also sort of bragged about the new residential product line they were having 1 year or 2 years ago. And I think in fourth quarter, they were down mid-single digits, York and Residential. So there's a gap between -- we have a great new widget to the market accepts the widget, your salesforce can sell the widget. Your salesforce can (inaudible) the widget. So we'll put our product against anyone in the marketplace. We'll certainly put our unitary salesforce. So yes, I'm not worried that they had a big booth at AHRI and are talking about new products.

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

Got you. And then maybe you can just remind us, obviously, with VRF, you have the partnership there. As we think about also heat pump versus kind of gas furnace, can you just remind us your mix there as we think about electrification?

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

Yes, I don't know if we've publicly talked about our mix of heat pump, but we have a very strong heat pump lineup. We view it as an integral part of what we do and we make significant investments there. And when we come out with new products, we -- the heat pump is part of it. So again, we're as good as anybody with our heat pump product line, continue to make investments there.

Operator

And at this time, I have no further questions in queue.

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

Thanks, everyone. To wrap up, we are well positioned for a year of strong growth and profitability in 2020. And look forward to driving performance to another record year. I want to thank everyone for joining us today.

Operator

Thank you. Ladies and gentlemen, that does conclude our conference for today. Thanks for your participation, for using AT&T Executive Teleconference. You may now disconnect.
