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LII - Q3 2019 Lennox International Inc Earnings Call

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OVERVIEW:

Co. reported 3Q19 GAAP and adjusted revenue of $1.03b, GAAP operating income of $157m and GAAP EPS from continuing operations of $2.94. Expects 2019 adjusted revenue to grow 2-4% and GAAP EPS from continuing operations to be $10.65-10.95.

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PRESENTATION

Operator

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

I would now like to turn the conference over to Steve Harrison, Vice President of Investor Relations. Please go ahead.

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

Good morning. Thank you for joining us for this review of Lennox International's financial performance for the third 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.

Before I turn the call over to Todd, I would like to announce the date of our annual investment community meeting. The event will be held the morning of Wednesday, December 18 in New York City. Please mark your calendars. Invitations and more details will follow. The meeting will also be webcast.

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

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

Thanks, Steve. Good morning, and thank you for joining us. Let me start with an overview on the third quarter, our view on the rest of the year and provide some thoughts on 2020. For the company overall in the third quarter, GAAP and adjusted revenue was $1.03 billion. GAAP revenue was up slightly, including 7% of headwind from the tornado and divestitures: 2% from the tornado and 5% from divestitures. Excluding the impact from divestitures, adjusted revenue was up 6%, including a 2% of negative impact from the tornado and set a new third quarter high.

Foreign exchange was neutral to both GAAP and adjusted revenue. GAAP operating income was $157 million, up 8%. GAAP EPS from continuing operations rose 11% to a third quarter record $2.94. On an adjusted basis, total segment profit was up 15% to a third quarter record $175 million, and segment margin expanded 140 basis points to a third quarter record of 17%. Adjusted EPS from continuing operations is up 26% to a third quarter record $3.34.

In our residential business, revenue hit a new third quarter high of $638 million. Revenue was up 7% from the third quarter a year ago in which a tornado damaged a major manufacturing facility and disrupted our high end business. Revenue from the replacement business was up high single digits, and revenue from new construction is up mid-single digits. Residential segment margin expanded 80 basis points to a third quarter record 19.8%, and segment profit rose 12% to a third quarter record of $127 million.

Residential business in the third quarter continued to face adverse weather conditions, with cooler weather than last year in key swing regions and for the U.S. overall. This was a significant headwind to residential performance following the cooler and wetter weather of the second quarter. Residential revenue was negatively impacted $23 million or 4% from business not recovered following the tornado. Segment profit was negatively impacted $12 million, offset by $16 million of insurance recovery for lost profits. The net $4 million benefit to segment profit was $3 million below our guidance.

For the full year of 2019, we continue to expect $99 million of negative tornado impact to residential revenue and negative $54 million impact to segment profit and insurance recovery for lost profits of $94 million. The resulting $40 million of net benefit to residential segment profit in 2019 is unchanged. For the fourth quarter, we continue to expect an impact of approximately $14 million to revenue. We expect an $8 million negative impact on segment profit, offset by approximately $20 million of insurance recovery for lost profits for a net benefit to segment profit of $12 million in the quarter.

Taking a step back and looking at the big picture for both core and noncore related to the tornado, we continue to expect total insurance proceeds of approximately $372 million. We have received $262 million of that as of the end of third quarter, and we are working towards receiving the remainder by the end of 2019. The 2019 noncore gain expected for the difference in book value and replacement value of assets remains approximately $91 million or a benefit of approximately $1.73 per share to GAAP EPS. A tornado financial chart is posted on the front page of the company website summarizing the guidance I just discussed.

Turning to Commercial in the third quarter. Revenue was up 7% to $253 million. Commercial profit was up 5% to $47 million, and segment margin was down 30 basis points to 18.6%. Commercial revenue in the third quarter was led by double-digit growth in national account equipment business. We won 13 new national account customers in the quarter across medical, fitness, entertainment, education, hospitality and retail end markets. Regional and local equipment revenue was up mid-single digits.

Breaking out the business another way, Commercial new construction revenue was up high teens at constant currency, and replacement revenue was up low single digits. Both planned and emergency replacement revenue were up low single digits.

Our VRF business was up double digits in the third quarter. On the service side, Lennox National Account Service revenue was up mid-single digits.

In Refrigeration for the third quarter, adjusted revenue was flat at constant currency. North America revenue was up mid-single digits, and Europe was down mid-single digits. Adjusted segment profit was down 10% to $20 million, and margin was down 130 basis points to 13.9%.

Looking at the end of 2019, we are now in the heating season, and the fourth quarter is off to a nice start. We continue to expect top line growth and margin expansion year-over-year across each of our businesses to exit the year with strong momentum heading into 2020.

For 2020, a few thoughts. Setting aside the adverse weather impact we saw in the summer months of 2019, underlying market conditions look solid, led by residential and then commercial. We have regained about 85% to 90% of the business impacted by the tornado and now -- have now pivoted back to company initiatives to win new market share in 2020 in the coming years. Many of the cost headwinds we saw in 2019 flip to tailwinds in 2020. We expect commodities to reverse from a $20 million headwind this year to a benefit next year. Likewise, we expect freight to move from $50 million headwind this year to a tailwind next year. As it stands today, we expect tariffs to still be a headwind in 2020 but less than a $10 million impact that we saw in 2019. We continue to take mitigating actions as well to offset the tariff impact with price.

Just as we captured price in 2019 for a 2% yield full year, we plan to capture additional price in 2020. We will continue to make investments in distribution expansion as well as information technology and research and development but generally plan to benefit from leveraging SG&A next year. And we will continue to drive our sourcing and engineering-led cost-reduction initiatives for similar order of magnitude savings as in prior years. Finally, we plan stock repurchases to maintain our debt-to-EBITDA ratio of 1.5 to 2x on a normalized basis. We will put numbers to all these elements for 2020 in our investment community meeting this December, but this provides some color on our current views of 2020.

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 third quarter, revenue from Residential Heating & Cooling was up 7% to a third quarter record $638 million. Volume was up 6%. Price was up 1%, and mix was flat. Foreign exchange was neutral. Residential profit was up 12% to a third quarter record $127 million. Segment margin expanded 80 basis points to a third quarter record 19.8%. Segment profit was favorably impacted by a $4 million -- by a net $4 million of benefit from insurance proceeds for lost profits relative to negative tornado impact in the quarter, which was $3 million less than our guidance. Segment profit benefited from higher volume, favorable price, lower material costs, favorable warranty and tariff rebates for prior periods. Partial offsets included cooler weather, the tornado impact, lower factory efficiency and higher other product costs, unfavorable mix and higher distribution, freight and SG&A expenses.

Turning to our Commercial Heating & Cooling business. Commercial revenue was up 7% to $253 million. Volume was up 4%. Price was up 1%, and mix was up 2% on the strength of national account growth. Foreign exchange was neutral to revenue. Commercial segment profit rose 5% to $47 million. Segment margin was down 30 basis points to 18.6%. Segment profit was favorably impacted by higher volume, favorable price and mix and sourcing and engineering-led cost reductions. Offsets included higher commodity and other product costs, tariffs, lower factory efficiency and higher distribution, freight and SG&A expenses.

In the Refrigeration segment, adjusted revenue was $142 million, down 2%. Foreign exchange had a negative 2% impact on revenue. Volume was up 1%. Price was up 1%, and mix was down 2%. Adjusted segment profit was $20 million, down 10%. And margin was 13.9%, down 130 basis points. Adjusted segment profit was impacted by lower factory efficiency, unfavorable mix, higher commodity and other product costs, tariffs and higher SG&A expenses. Partial offsets include higher volume, favorable price, sourcing and engineering-led cost reductions and lower freight costs.

Regarding special items in the third quarter, the company had net after-tax charges totaling $15.3 million. This included $5.9 million for the partial advance on the second quarter of 2019 of insurance recoveries related to lost profits, $4.8 million for restructuring activities, $2.7 million for other tax items and a net charge of $1.9 million for various other items. Corporate expenses were $18 million in the third quarter compared to the $28 million in the prior year quarter.

Overall SG&A on an adjusted basis was $143 million, flat with the prior year quarter. Adjusted SG&A was 13.9% of adjusted revenue, down from 14.7% in the third quarter a year ago. Net cash from operations in the third quarter was approximately $235 million compared to $266 million in the prior year quarter. Capital expenditures, proceeds from the disposal of PP&E and proceeds of property damage totaled $24 million compared to $13 million in the prior year quarter. Free cash flow was $211 million compared to $253 million in the prior year quarter.

The company repurchased $150 million of stock and paid $30 million in dividends in the third quarter. Total debt was $1.45 billion at the end of September, and we ended the quarter with a debt-to-EBITDA ratio of 2.2. Cash and cash equivalents were $46 million ending the quarter.

Now turning to our guidance for the company overall for 2019. We are updating guidance for adjusted revenue growth from a range of 2% to 5% to a new range of 2% to 4%. We are updating GAAP EPS from continuing operations from a range of $11.91 to $12.51 to a new range of $10.65 to $10.95. This includes a noncash pension settlement charge of approximately $28.9 million after tax or approximately $0.73 a share that we expect to recognize in the fourth quarter of 2019.

Similar to what we did in the second quarter, this pension settlement charge relates to an agreement we entered into with Pacific Life Insurance Company in October to annuitize $78 million of our defined benefit pension obligation. As part of this transaction, we also transferred $75 million in pension assets to Pacific Life. This event required a remeasurement of the pension plan and resulted in a noncash $28.9 million after-tax settlement charge we expect in the fourth quarter to write off the related accumulated actuarial losses. We continue to expect a pretax gain of $91 million in 2019 related to factory reconstruction costs and the associated gain from replacement value above book value. For adjusted EPS from continuing operations, we are updating guidance from a range of $11.30 to $11.90 to a new range of $11.15 to $11.45.

Now let me run through the other key points in our guidance assumptions and the puts and takes for 2019. First, the guidance elements we are updating. For price, we still expect a 2% yield for the full year. Though with lower volumes through the summer season, this now equates to $75 million versus the prior guidance of $80 million. Corporate expense is now expected to be approximately $85 million, down from our prior guidance of $90 million, primarily due to lower variable compensation. Free cash flow is now expected to be approximately $320 million for the year compared to guidance of $390 million. The change is due to approximately $15 million of lower earnings and $55 million of inventory. Given the tight labor market for manufacturing employees, instead of reducing direct labor as is typical for a cooler summer, we decided to be more level loaded -- we decided to more level-load production from the Iowa factory and prebuild some product for 2020, which will burn off over the course of the year.

For the 2019 guidance elements that remain the same, we still expect a $25 million benefit from sourcing and engineering-led cost reductions. We continue to expect $20 million -- a $20 million headwind on a full year basis from commodities. We still expect $15 million of headwind from freight and $10 million from tariffs. We continue to expect headwinds of $15 million for distribution investment and $15 million from SG&A. 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, most likely on the low end of that range.

The weighted average diluted share count for the full year is still expected to be between 39 million to 40 million shares, which incorporates the $400 million of stock we repurchased this year. And finally, we still -- still plan approximately $155 million of capital expenditures with $55 million of that funded from insurance proceeds.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question is from the line of Julian Mitchell with Barclays.

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

Maybe just the first question on the Residential business. Just give us some updates, Todd, on how happy you are with the commercial side of things in terms of sales and market share traction. And also, within resi, any updated thoughts on incremental margins over the next 12 or 18 months? You've got, perhaps, more efficient refreshed operations now in Marshalltown and some tailwinds or normalized cost environment. So just wondered how all that roll together for overall resi incrementals.

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

On the small c commercial side, I think we're satisfied where we're at is the way I'd put it. I think we're happy with the end markets. I mean the consumers still feel -- still strong, adjusting for the tornado impact, while revenue in resi was up 7% and we had negative 4% of tornado impacts up 11% if you adjust for that. So I think the end markets still feel strong, consumers still feel strong. And then what we guided at last call of recovering 85% to 90% of the tornado impact, that's still where we're at. That's where we'll end the year at in fourth quarter. We're a little less than that in third quarter if you go through all the math, more like 75%, and we'll end the year at 85% to 90% of it recovered.

In terms of the drop-through, I think everything you said is true. I think the numbers will be clouded by the fact that the $40 million of net insurance recovery was a onetime item in '19. But if you strip that off, the things you talked about are true. And then I'd lay on top of that, given some of the softness and -- because of weather in second and third quarter, we've taken some action on the SG&A side and cost containment as we go into 2020. And so I think that will help the margin drop through also.

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

And then my second and last question, just around the Commercial segment, capital C. You lowered the end market outlook a touch for North America back on the last earnings call, good revenue numbers today in commercial, I think particularly in the new construction or OE side. So maybe just give any updates about different verticals. Were you surprised by what's happening in Commercial? Any color on backlogs.

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

Going in the fourth quarter, our backlog is up slightly in the commercial segment. I mean we had a really good third quarter, but it was chunkiness of some large national accounts as you saw in the script that it was driven more by new construction and replacement growth. And again, that's just timing year-over-year differences. So pleasantly surprised in third quarter. Again, the verticals that are hanging in there most for us, believe it or not, continue to be retail as they both build and replace small office buildings, so -- entertainment, theaters and light health care. So those verticals continue to stand up, and we were pleasantly surprised in the quarter.

Operator

Next, we go to Jeff Hammond with KeyBanc Capital.

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

Just going back on kind of the moving pieces with insurance recovery and the lost EBIT. So I guess, of the $54 million of lost EBIT in '19, what -- just given some of the share recapture that you're not getting, how much of that do you expect to get back ultimately and -- with some of the mix dynamics?

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

I would -- pausing to make sure I thought about that the right way. I would -- out of the $54 million for lost profits, I'm going to sort of fire from the hip and say, I will look over a 2-year period. So I'd look at what we lost in '18 and what we lost in '19, and we're going to get 70 -- we're going to get 85% to 90% of that back, both on revenue and on profit. So I wouldn't look narrowly at the $54 million. I'd have to look at sort of the 2 years combined and say we're going to get 75 -- or 85% to 90% of that back.

Does that sound right, Steve?

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

Yes.

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

Okay. There's no mix dynamics from that being higher mix share that you're not getting fully back or?

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

No. I think over the longer term, the mix will be fine. I mean we'll guide it all in 2020. I think there are some absorption and productivity issues that were buried in that $54 million that may not come back. But it will be absence of badness is goodness is one way to think about it.

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

Okay. And then just a couple on Refrigeration. One, maybe just give us a view of the demand outlook into 2020. And I think you mentioned some manufacturing inefficiencies. Just talk about what's going on there.

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

Yes. I mean in Refrigeration on an end market, we were flat. Revenue was flat in third quarter. What we're seeing in North America, as the market continues to be hanging in there, low single digits, we were up mid-single digits for the quarter. Europe, we're seeing some slowdown specifically in Germany where we have a process cooling business where auto is a large vertical, and as everyone understands, that's slowing down. And even in our Commercial HVAC business, which is predominantly France and Spain, we've seen some slowdown. So continues to bubble along in North America, slowing down in Europe.

And then I think there was a question about factory productivity. The issue that we're seeing in Refrigeration, and then also, quite frankly, in Commercial, is a very tight labor market where our factories are located at -- in Refrigeration in North America, it's Georgia; in Commercial, it's Arkansas. And the product -- the lack of improved efficiency year-over-year in the factory, in large part, is driven by the labor scarcity. It's hard to find and hold on to folks, and that's impacting what we can do in the factories around productivity.

Operator

Next, we go to the line of Ryan Merkel with William Blair.

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

A couple of questions. So first, I just want to understand the resi profit performance a little bit better since it missed my model. So is the story simply lower absorption and unfavorable mix, and that was offset by positive price cost? Is there anything else to think about?

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

No. I mean I have a Q&A here and you answered it, but I'll rattle through it, so everybody hears it directly from me. I mean the margins being down 300 basis points adjusted for the tornado, really 2 major drivers. You hit them. One is mix, down year-over-year. And a big driver of that is our entry-leveled Allied business that has lower margins, was up over 20% in Q3, much less impacted by the tornado than what our Lennox business was and also some mix down quite frankly with some customers. And the second was factory productivity due to lack of absorption. Joe talked about on the cash side that we allowed the Marshalltown, Iowa factory to continue to throttle level-load, but our other North America factories, we had to take down production because of Q2 and Q3, and we had pretty significant negative absorption that impacted margins. And those are the 2 major drivers.

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

Got it. All right. Well, you sort of answered my next question. So we should be looking at the unfavorable mix as sort of a one-off this quarter. We wouldn't extrapolate that in 2020.

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

I wouldn't extrapolate it into 2020. I think what we'll do is we're going to snap a new baseline, and we'll move forward. And I think mix will improve. In fact, our guide will be for mix to improve next year.

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

Perfect. And then just lastly, maybe just a little color by geography will be helpful. Most interested in the Midwest and Southeast, if you can give us anything.

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

Yes. The key swing regions where we saw the most impact from weather was the Northeast and the Upper Midwest. And if you look at degree cooling days in July and August where it really mattered, it was down about 10%, and that's sort of the swing areas. Chicago up -- through Pennsylvania, through Ohio, up into the Northeast, and those were down and had an impact on our revenue. Sort of on the flip side, you look at a state like Texas, cooling degree days were up 9% in Q3, and our revenue was up 10%. So again, just like in second quarter where it's cooler, revenue was down. Unfortunately, we're more skewed towards the north than others. And where we had warm weather, we -- revenue was up significantly.

Operator

Next is the line of Steve Tusa with JPMorgan.

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

So I just want to kind of be clear on this resi margin dynamic. Do you know -- you're saying that there are things that will flip or at least turn next year. I mean it sounds, though, like it would have been worse if you didn't run your factories and kind of level load over time. So shouldn't that be somewhat of a material headwind next year? So I mean, are we talking about more of a, okay, this will improve off of a lower base but not necessarily flip next year? So just trying to kind of understand what are the kind of onetime items, and on a kind of a net basis, how should we think about this? Maybe just some color around, hey, this -- on a net basis, it should have been the margins would have been 50 basis points higher or something like that to give us some idea, given all the moving parts here for next year.

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

Well, let me directly answer the absorption point. We did 1 factory that accounts for about 25% of our hours, and we level loaded it, more level loaded than we normally do. I'd also tell you that it sort of came down. It just didn't come down as much as the volume would have -- better stated, production was down year-over-year but wasn't down as much as the volume would have demanded that we do it. And then the other 75%, which is our other 3 factories in North America, we took those down. And so sort of on a year-over-year basis, it's going to be more sort of avoidance of bad news, and it's going to be having a tough comp year-over-year, if that makes sense.

And then I think if I understood your question, and I probably won't give you as much granularity as you might want, but if order magnitude, if our margins were down 300 basis points in resi year-over-year adjusting for tornado, order magnitude, about 40%, 45% of that was mix; about 40%, 45% of that was factory productivity, and then there were sort of nits and gnats of other things that I won't bother to call out.

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

Got it. Okay. That's helpful. I guess when we kind of -- why are we -- haven't we kind of anniversaried the tornado comp? I mean why are we still calling out kind of like lost profits and lost sales from this at this stage of the game?

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

Well, I mean, because we guided for 2019, we thought it would be sort of chicken(expletive) halfway through the year to quit talking about it. So we won't talk about it going into 2020. But we gave full year guidance. We thought it was appropriate to continue to guide through the year.

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

Got it.

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

Number one. Number two is sort of the impact of the tornado didn't follow the calendar, that 12 months afterwards, everything was completely gone. We guided at the beginning of the year, or when the tornado happened, that this was going to be order magnitude and 18-month recovery, and that's sort of the guides that were given.

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

Okay. Any update on the consolidation dynamics over the next 12 months? Any update there on how you're viewing that? Or no real change?

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

No real change.

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

HVAC consolidation?

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

Yes. I mean we -- as you know, I think the industry could benefit from consolidation. We'd love to participate, and it's going to require others to sort of make a similar calculation. But we'd love to participate.

Operator

Next, we go to Robert McCarthy with Stephens.

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

Well, I guess, moving on from chicken(expletive), let's talk about the fourth quarter dynamics or actually, it might be doubling down. Could you talk maybe -- you talked about strength in the fourth quarter and then also some of the dynamics around the season in terms of, obviously, anecdotally, I think cooling degree day -- or excuse me, heating degree days should probably be up given some of these episodic events we've been seeing so far in the month and then also, obviously, the compare in association with the disruption last year. Can you talk about kind of the factors and how that's shaping up at least qualitatively for the fourth quarter in your Residential business?

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

Yes. I mean high level, it's the elements that you talked about. I said we're off to a nice start, which is a calibrated word that we're halfway into the first month, and things look good. But when you think about the months in the quarter, it's, in essence, 1/3, 1/3 and 1/3 this year between October, November and December for us, and so there's still a lot of work to do. I think the important thing to get through in October is this sort of bridge period. And what I mean by that is it's not really cool enough for dealers to rush out and buy furnaces, so in some ways, they're buying on faith and sentiment. And the fact that we're off to a nice start in the case that the dealers are still confident and feel good about things as they go into the furnace selling season. And then as we get deeper into the furnace selling season, November and certainly, December, then it's more about the weather driving demand. But yes, we feel pretty good about things, but there's still a long way to go for the quarter.

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

As a follow-up, I mean, you said some tantalizing things about, obviously, your rise at -- in growth at Allied, and obviously, some of that is due to comps, tornado disruption. But you did cite, anecdotally, some trade down there. Obviously, the cycle still looks good because excluding kind of the tornado impact, you're kind of comping to -- close to double digits. But are you seeing anything on the horizon that's getting you incrementally nervous about consumer replacement as a whole?

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

No, and I wouldn't. The Allied point was -- to mathematically explain the mix down, the -- it's not to make a point that overall, the consumer is mixing down. It just explains our math. I mean our growth in Allied is, across the board, a great story. We're converting distributors from our competitors, sort of all the noise of some of our competitors about investments that they're making, is the business going to be sold, how is it going to be handled, allows us to convert those distributors from others, competitors over to our business. And that's all good news for us. It's just we don't sell Dave Lennox Signature series, we don't sell 26 SEER in Allied. We don't sell sort of all the high-end products. But net-net, it's incremental to our margin, our EBIT margins and very good business for us, and we're just doing very well there.

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

So actually, it's more of a share story, given the disruption we're seeing with some of your competitors with these...

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

Yes, I mean -- yes, that's exactly. And so we have the tornado overhang on Lennox, but our Allied business doesn't have that, and so all the initiatives that we've talked about are paying off there, and we're getting share.

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

All right. Then the last question, I don't want to delve too much into political views because it's probably not particularly helpful on the call for a variety of reasons. But given the fact that we could be seeing, perhaps, some more progressive administration and policies over the next -- with the next election cycle, is there anything that's been on the drawing board for energy efficiency or increased standards of global warming being accelerated? Anything around code, standards or practices that could be very stimulative to your business across the board or anything you'd cite?

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

No. I think the point I would make, and again, in the spirit of being apolitical, is as a businessperson and certainly in our industry, having clarity and advanced warning on regulations is critical. And so quite frankly, you tell us the rulebook and give us enough advanced warming, we'll play by it and make good money off it. The danger is when things change quickly and swing one way or another, that causes problems. And so I would expect whatever new policies could put in place, whoever wins the election, I would hope we'd have advanced warning and some clarity of what the changes are going to be.

Operator

Next, we go to the line of Robert Barry with Buckingham Research.

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

Just wanted to follow up on a few earlier things. First, you touched on the weather helping some places, hurting others. Was there a kind of net estimate for what it impacted you by in the resi segment in the quarter?

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

We didn't -- it's hard to know, Robert. We didn't even do that, and I don't think we did that in second quarter. Net-net, it was degree cooling days were down about 5% or so for the quarter and especially in the swing areas, that's where it hurt us.

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

Got it. And I know you -- I think you touched on this briefly earlier, but the price in resi kind of stepping down from what was 4 last quarter to just 1 this quarter. What was driving that?

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

I think that's just the lapping of the price increase. We had a midyear price increase last year where we sort of jammed it hard, and we lapped that. And so now we're just, if you will, comping against the beginning of the year price increase, which is a more traditional yield of 1, 1.5.

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

Got it. So when we think about price for 2020, you seem confident you'll get some, but it sounds like that should be a pretty modest expectation. Is that fair?

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

Well, I think -- I go back to years where we had significant commodity deflation and the markets were strong, we still got 0.5 point of price, and so I -- my expectations would be that's absolutely the floor. But I think we'll do better than that.

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

Got it. And then I just wanted to clarify how to read the comment about the $23 million impact from the tornado on the resi revenue. Is that how much you are still down since before the tornado?

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

Correct. I'm turning to people and making sure that's the answer. Yes. Correct.

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

So I think like last year, you had a headwind of $50 million. You clawed back an implicit $27 million. So you're still down $23 million.

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

Correct.

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

Got it. And so that $27 million versus the $50 million implies about just over a 50% recovery.

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

I think if you add the 2 years together -- I'm looking at the data to make sure I got it right. I'm sorry, I don't have that piece.

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

This is the first year of the recovery.

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

Yes. When I did the math on third quarter and I added the 2 together, I got about 65%. So I'll double-check the math, and we'll make sure we gave it to you right.

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

Well, just to clarify, when you say you expect to get 85% to 90% back, over how much time is that?

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

We're expecting as we go in the fourth quarter when you do the math over a 2-year period, look what we lost fourth quarter last year, what we lost fourth quarter this year and then how much of it we clawed back, it will be about 85%, 90%.

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

Got it. And this $23 million -- sorry for all the questions on this, the $23 million that is kind of the second year of lost impact here, is that going to be covered by insurance? Or at what point?

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

Yes.

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

Okay. So if next year, you're still down 10%, 15%, like where do you kind of snap the line and it's just the insurance won't recover, won't pay? Is that still up for debate?

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

Yes. We're expecting to have full insurance recovery by the end of the year, and we're in negotiations with them about what's transpired so far and then what we're projecting will happen in the future. And that's sort of all in the guide that we've given now. So we'll work that through with our insurance providers who I assume are listening.

In terms of our guidance going into 2020, and Steve and I sort of talked a little bit about that, when we go into 2020, we're not going to talk about tornado anymore. We'll snap a line at the end of '19 on public guidance. And so we'll give revenue, and we'll give EBIT. And we'll talk about misses and overachievements, and tornado won't come up after the end of the year.

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

Got it. And sorry, just one more. Do you know what year-to-date your kind of ex-tornado margin is in resi? I'm calculating like just above 18%, but...

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

I'm turning to the guys. We can get you that answer, Robert. I don't have that math right in front of me.

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

Yes. Because I was just curious if your expectation would be that next year, whatever that number is, would that be up, flat or down.

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

Our sense is it should be up year-over-year.

Operator

Next, we go to Gautam Khanna from Cowen and Company.

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

A couple of questions. First, I was wondering, on PartsPlus rollouts, what's the expectation for the number? How many have you done this year? And what do you expect in next year?

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

I'm turning someone to make sure I got the right number for this year. So on a year-to-date basis, we've done a handful this year sort of relatively flat that we've opened a couple of stores, closed a couple of stores. As we go into 2020, we're still finalizing what we want to do for new store build. I think the majority of new stores next year, most likely will be second half of the year. We're also aggressively just looking at now that we're up to 200 -- how many stores do we have, Steve?

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

236.

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

Now that we're up to around 240 stores, we're also sort of looking at what we should prune and what we should get out of, and we've identified some stores that we're closing between now and the end of the year because they're just not covering, they're not a handful of stores. And so there's going to be some sort of net eliminations and then some additional stores added.

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

Okay. In terms of the national account business in commercial, what sort of -- is the pipeline of opportunity there still as robust as it appeared to have been going into the third quarter? Just curious, like what are the forward indicators there?

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

Yes. I mean as I called out earlier, backlog is up slightly in our Commercial business. When we ended the quarter, it was up, from memory, high single digits. Customers are still strong, are still spending money. I think is -- I don't think, I know this time of year, we do some business, mostly planned replacement at this point, very little new construction or less new -- excuse me, new construction. And they're looking towards the Christmas -- many of our retail customers towards the Christmas selling season decide what they're going to do. So I think net-net, it's still solid. I think it's less solid maybe than it was a year ago. I don't know about quarter-over-quarter because of the macroeconomic uncertainty. And so there's some risk there. But customers still feel pretty solid.

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

Okay. And just to round out your comment on pricing, getting some net price next year in resi, have you seen or do you anticipate any change in competitive behavior with Ingersoll splitting, with Carrier splitting, what have you? Just anything that you've seen or that you are starting to be concerned about incrementally.

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

No. Haven't seen any changes. Don't expect any changes on that dimension. I mean the people who -- whether you're part of a larger conglomerate or not, they understand that they need to price the offset commodity increases and labor shortages and all the things, freight and tariffs and all the things we have to price for. And so I -- we're confident we're going to get price, and I don't think the industry dynamic is going to change.

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

Okay. Joe, one last one, Q4 tax rates, just making sure we're conforming. What are you guys implying there?

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

Yes. For the full year, I think we'll be slightly above the 22% rate, but for the full year, we'll be closer 22%. So that's what I would expect in the fourth quarter.

Operator

Next, we go to the line of Deepa Raghavan with Wells Fargo Securities.

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

A couple of questions for me. So still a pretty wide range coming into Q4, especially since it's a nice start. Just curious, what's embedded in the high end? Or is it low end, especially for residential growth? I mean your resi mix margins should get better. You're going into the seasonally margin -- higher margins on the sales season. I guess where I'm trying to go with this is, is there any scenario where you might have lost some furnace demand because of the limited prebuy that happened in spring and also maybe at this lower overall dealer recapture, any impact? How do I think about the lower end versus higher end given your range?

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

Short answer to the back end of the question, though, we don't think we've lost. Other than the tornado impact that we publicly called out over and over again, we're not losing furnace share. In fact, when we look at the numbers, the public numbers in July and August, we think we're doing well, and it's sort of tracking the way we'd expect it to. So I don't think there's any concern there. I think the range on the high end, it's -- we --

residential markets will -- or we saw revenues a little stronger than what we think it might be or could be or better stated, the midpoint of our guidance adjusted. And so I think the real swing is Residential revenue. I don't -- it's not really mix. It's Residential revenue.

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

Got it. That's helpful. My follow-up is, Todd, how do we think about your market share gains going forward just given your experience with this dealer recapture coming in slightly below expectations? Is the 50 bps of share gains still what you're planning albeit from the lowered base? Just curious, what -- if that's the case, what drives that confidence now and especially as you're lapping all these stronger market share gains that cumulatively -- you have accumulated cumulatively over the years?

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

Yes. Our guide will be 0.5 point of market share. And I get confidence because of strategies that we focus on continue to work. I think building out distribution, we've taken a pause for that. And I suggested, we'll take a bit more of a pause as we go into beginning of 2020, but that's still a strategy that works. The significant investments we're making on supporting our dealer network through e-commerce and prognostics and diagnostics with our iComfort controllers, our ability to support the dealer on our LennoxPROs portal, all those things are still working. All the investments we make are significant having the best product lines. So the strategies still work, and we're making significant investments to growth, and even in this tornado year, we've continued to make investments, and we'll see those benefits in 2020.

And so there's a sort of -- and also, just quite frankly, we've done our best, even though the numbers have sort of moved around a bit, to be a bit of a duck, right? So what we publicly show is every -- the sailing is clear, and we're gliding. But underneath, the team has been paddling very hard and paddling very hard and doing lots of work to offset the tornado and take care of customers and work through complaints and manage inventory levels to get the right product to the right people and handle a lot of negative phone calls. All that now goes away. Because we have the product, we can support everybody, and all of a sudden, you snap a line, and you're back on the offense rather than on the defense. And that's now behind us. And so we're doing all the work now, quite frankly, with many of our customers to convert new dealers to win in 2020, and we're focused on doing that.

Operator

Next, we go to Nicole DeBlase with Deutsche Bank.

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

So I guess, just 2 questions around margins into 4Q. On the Commercial segment, I think the expectation was for a return to year-on-year expansion in 3Q. You kind of talked about the reasons why we didn't see that. But can we see Commercial return to year-on-year margin expansion in the fourth quarter? And then similar question with Refrigeration since the comp gets so easy.

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

Yes, we expect both Commercial and Refrigeration margins to be up year-over-year in fourth quarter.

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

Okay. Got it. That's helpful. And then around price cost, I think you guys had like a $17 million positive impact in the second quarter, and you expected that to be a high watermark. Can you just give us a sense of what the price cost impact was for 3Q and whether it steps down or remains similar in the fourth quarter?

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

I don't have that number handy, so I'm turning to Steve to see if he has it.

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

Let me grab it real quick.

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

I think the short answer is the price element of price cost will be roughly the same in third quarter -- third and fourth quarter. And then the impact from commodities continues to trail off in fourth quarter. So my guess is we might even be a little bit more positive price cost in fourth quarter than what we were in third quarter.

Operator

Next, we'll go to the line of Jeff Sprague with Vertical Research Partners.

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

Just 2 quick ones for me. First, I appreciate kind of moving on from the tornado, but if you end up having residual insurance recoveries kind of just cleaning up the loose ends, will you disclose and let those -- let us know what those are in 2020?

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

Absolutely. Yes. I mean we're going to be completely transparent on the insurance. We won't pad our number with insurance. We'll let you know.

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

Terrific. I appreciate that. And then just on the free cash flow, $70 million cut on a $10 million net income cut at the midpoint, is that $60 million all the inventory we're talking about? Or is there something else going on there?

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

Yes. I mean when we lowered the cash guide from $390 million to $320 million. As Joe said in this call, I think he said this in this call is, $15 million of that is from lower earnings. So just we're making less money because the earnings went down. And then $55 million is from the inventory. And then, as Joe talked about, that's tied to the tight labor market. It's having more level-loaded production at Marshalltown, our Iowa factory, and then -- because typically, what we would have done would have been -- or the play -- the tax book, if you're [manning] just purely for working capital, would have been we would have throttled down in August, and then we would have had to throttle back up in January -- December, January to start getting ready for the cooling season, it's a union workforce and it's a tight labor market, and so the thought -- and it's fragile because we just got everything up and running.

The thought of ramping down, having everyone bid out on new jobs, reshuffling everybody and then 3 months later, ramping back up, finding workers, reshuffling all the union jobs again just seems so disruptive to the business. And so -- and we're not making lettuce. And so everything we're building, we're just building at 3 or 4 months early. So one way to think about this is everything being equaled, cash, because of inventory, will go down by $55 million in '19, but everything being equal, whatever you had in your model will go up by $55 million in 2020 as we burn off that inventory.

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

Just thinking about kind of the rebuild footprint, if you will, I mean, your inventory terms were drifting down a little bit before we got the tornado. Obviously, they're lower now on all this disruption. But where do you think you can get your turns to once we kind of stabilize everything?

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

We're going to continue to focus on it. I mean I haven't publicly given an inventory target or a turn target. I think it's -- I tend to think about it more as it's a competitive weapon for us to build out distribution, to build out part stores. We want to keep our turns relatively flat or slightly improved, and we certainly don't want them deteriorating like they have been over the last year because of the tornado. But when the cost of debt is so cheap, if we can gain -- if it's a driver of gaining 0.5 point of market share and we can win new customers with inventory, as a distributed product business, we're going to focus on that. So short answer is we haven't publicly given a target, but -- and we think about it, but I think it more in the whole context of total shareholder return.

Operator

Next, we go to Joe Ritchie with Goldman Sachs.

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

So my first question is just on the commodity tailwind that you alluded to earlier in your prepared comments, Todd. So just any color that you can provide us on how much of the -- how much of your commodity tailwind next year is going to be copper and whether you're locking in a certain percentage of that this year.

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

When -- the commodities that we buy in order of importance are steel, copper and aluminum. And steel, we have some fixed pricing, but most of it is variable, tied to market pricing during the prior quarter that we can then get a discount on. Copper and then aluminum, we hedge or technically use forward contracts, and 12 months out, we're about 50% hedged. And so we're -- I don't know the exact number but above 50% hedged I think at this point for 2020 and -- that we're locking in some of the benefits already.

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

Got it. Okay. That's helpful. And then just maybe touching on freight a little bit. Any qualitative comments you can talk about on, obviously, $15 million headwind this year but what you're seeing in the freight market and how that could swing potentially next year?

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

No. A couple of things. One is we made some system investments in our freight transportation to have better visibility on freight, and I think that's going to help us. I think more fundamental is a softening in the freight market overall, and I think we'll be beneficiaries of that as others are. So the thinking is we're in the process of negotiating rates for next year, and so we'll know more as we negotiate those rates. But we look at spot pricing, what's happening in the marketplace, where it was a year ago, it reflects the slowdown in some segments of the economy, auto, for example, which is a major driver of freight rates in North America. And we think we'll be a beneficiary of that.

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

And can you just quickly remind us how much of your freight costs is spot versus contracted?

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

I don't think I've ever publicly said that. If I had to guess, I'd say it's 75% contract, 25% spot. But I'm -- that's a bit of a wild-a** guess. I feel like President Trump. I've sworn twice on a conference call.

Operator

Next, we go to Josh Pokrzywinski with Morgan Stanley.

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

Todd, I was wondering if you could help out a little bit with the sequential dynamic on mix and resi. So I understand weather kind of played a role in both quarters. You obviously had a little bit more time to get your feet underneath you. But anything specifically that we should read into kind of the 2Q to 3Q margin progression? Anything about the market that was heavier on the mix side or what is showing up in 1 quarter versus another and maybe help kind of triangulate that dynamic?

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

No. I mean I think we had some mix headwind last quarter 2. And so I don't think it was -- we had positive mix last -- I don't think we had -- I think we had negative mix last quarter also, similar dynamics. It just didn't rise to the level that we spent a whole lot of time talking about it. So no, I don't -- I think the other piece would be the part that I called out that Allied growth was dramatic this quarter, and that's just the timing of new distributors that they signed on and when they got the business, and so I think it's more about Allied than anything that was happening in Lennox.

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

Got it. And would -- price costs have been better sequentially. I know you probably don't want to get into the half or long term, just I would imagine directionally, though, that was probably better.

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

I think price cost is better in second quarter than third quarter because we hadn't lapped the midyear price increase yet. So I think costs were better in third quarter than second quarter. But from memory, we had 4% of price in resi last quarter, and we have a little bit over 1% this quarter on a year-over-year basis.

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

Got it. And then just one last one from me. I mean we hear a lot about a good amount of inventory being out there in the channel, more competitively than necessarily something specific to Lennox. But has that at all kind of impaired the ability to regain share that maybe there's just too much inventory to go after folks this quarter? And should that normalize in the next year and make the work easier?

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

I will broaden -- thematically, I'll agree with you, but I'll broaden the answer a little bit and just say it's always tougher to gain share in a soft market than a more robust market. And so certainly, even more so in second quarter than in third quarter, that hindered some of the gaining back some of the customer business because it is tougher to do that in a down market because the other guy is as focused as you are, hanging on to things. And again, as Robert and I went back and forth, I mean, we're not to the 85% yet, but our guide is that in fourth quarter, we're back to -- we'd have 85% to 90% of the lost revenue gained back, and that will roll into 2020.

Operator

Next, we go to the line of John Walsh with Crédit Suisse.

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

So a lot of ground covered, just maybe finer points on a few questions. As we think about the free cash flow bridge into next year, I just want to make sure we're understanding it or I'm understanding it correctly. But we're going to have -- we had from last quarter, some push out of CapEx that went from '19 into '20, and then we're going to have this kind of inventory dynamic from this quarter. Anything else to be mindful of? Or are those the 2 big moving pieces of the bridge?

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

I think those are the 2 moving pieces of the bridge. I'm looking at Joe to make sure.

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

Yes, those are the big pieces you got.

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

Okay. And then, I guess, also around the earlier question about Refrigeration margins, you do have the easy comp. Any more finer point you can put on that? Should we think about normal sequential decrementals? Or do you want to kind of throw a range out there just to help with the modeling because it can move around?

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

For Refrigeration?

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

Correct. Yes, for Q4.

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

Yes. No is the short answer. Sorry, John. I -- again, I think, as you said, we had a tough -- we have a much easier comp or we have an easy comp over last year, and we think the margins are going to be up in fourth quarter even on relatively flat revenue.

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

Got you. And then maybe just one last one here. From a high level, as you think about the regulatory environment, a couple of questions early on that. I mean should we just think about it as kind of a steady drumbeat of kind of change pushing towards higher efficiency than really anything on the horizon that might be a step function change? Is that the correct way to think about it?

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

I mean that's how we think about it. I mean I think anything is possible. But certainly, the way the industry has worked with a few minor exceptions over the last 30, 40 years has been a constant increase in efficiency, a constant improvement in the type of refrigerant that we use. And we typically have 5 -- I think, by law, it's 4 years that we have to have advanced warning and sometimes, oftentimes, we have more than that. And again, as long as we know, we can work through the technology with our supplier partners to do what we need to do.

Operator

Next, we go to Nigel Coe with Wolfe Research.

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

So adjusting -- I mean, I hate to use the word tornado again because I think we're already at record levels here. But adjusting for the lost market share in 3Q last year, 3Q this year, so roughly 3% like-for-like growth in Residential, number one, is that kind of like in line with what you are thinking? How does that compare to the markets? And I'm not sure you actually talked about what you thought the actual market did, and if I -- if you did, then I'm sorry for missing that. But how does that 3% compare to the market?

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

I'm not sure what the market is going to do. I would -- I think that -- I have some math down here somewhere, but when I think about the year over -- this sort of a 2-year growth, it's about 4%, 5% revenue growth over a 2-year period. And that -- I think that's obviously less than the market, but that reflects the share loss that we got because of the tornado.

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

Okay. So you think -- so you're saying 3% would be better than the market this quarter? I mean I think most people would see this going to be factor down this quarter.

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

I think we're going to see. I -- Watsco announced earlier. We're certainly in line with them for the [quarter]. And then we will see what the others do.

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

Let me just go back to the Allied performance. 20% up for Allied since. It looks like the core Lennox was probably flattish. That differential between the 2 brands, is that what we've seen in the past? Or -- I mean, again, just thinking about this potential mix shift with the consumer, but is that differential unusual in time?

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

Yes. I mean -- but again, I think what it -- I mean, it reflects 2 things. It reflects the tornado impact primarily in the Lennox brand and sort of all the disruptions associated with that. And then it shows the lumpiness of selling through independent distribution. And so when Allied gained share, it's because they have converted a large distributor, and significant share accrues with that. And so being up 20% in a quarter just reflects the timing of converting distributors.

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

Okay. And then the final one for me. The commercial market, there's obviously a lot of bull/bear views on the -- on that market, more bears than bulls. What is your view as we go into 2020 on Commercial construction and Commercial HVAC? Flat backlog, you got an easy comp this quarter compared to last quarter, but how do you think about that market in 2020?

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

We'll true everything up in December. I think it's flat sort of the best scenario we can think of. But we'll give better guidance when we get closer to the -- at the December Analyst Day.

Operator

And our final question is a follow-up from Steve Tusa with JPMorgan.

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

Sorry for the follow-up. Just listening to kind of all the puts and takes and just kind of like looking at the model a bit. With the insurance dynamics and then all the other kind of nits and gnats that you highlighted, can you guys -- do you think you'll be able to kind of grow earnings in 2020? I mean is that kind of a base case assumption that you will grow earnings in 2020?

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

I mean let me just refresh the math for others. For 2020, you have to adjust the $40 million net benefit for insurance recovery, that was above lost profits for '19. So that means if operationally, we're $40 million better then we have flat profits year-over-year. Short answer is our target is to look to grow earnings, but we'll guide all that on the 2020 call.

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

Okay. And then one last one, just on resi. Is an unreasonable way to look at it to look at kind of a 2017 base and then just kind of assume whatever we're going to assume on growth for 2020 and then take those 2 and apply like a 30% to 35% incremental margin on that? Or is the business somehow meaningfully different and there will be different headwinds and tailwinds on kind of that kind of just taking the tornado impacts out entirely? Is that a bad way to look at it?

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

I mean the way I would build the model would -- I would do it that way, I will take out all the tornado stuff. I would look at '17 as a base case, and then I would look at the 2020 revenue. I think I might have it closer to 30% than 35%, but I would start there.

Operator

And we'll be turning the conference back to you, Mr. Harrison.

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

Okay. That's -- my biggest compliment of this call is to be called Steve Harrison. So thank you. To wrap up. As we move into the heating season, the fourth quarter is off to a solid start, and we look forward to a strong finish to the year. The residential market continues to look robust. Weather aside, commodity costs are trending down for more price cost benefit moving forward, and investments we have made in products and distribution set us up well for 2020. I want to thank everyone for joining us.

Operator

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