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LII - Q1 2020 Lennox International Inc Earnings Call

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OVERVIEW:

Co. reported 1Q20 revenue of $724m, GAAP operating income of $36m and GAAP EPS from continuing operations of $0.32. Expects 2020 revenue to be down 11-17% from last year and adjusted EPS from continuing operations to be $7.50-8.50.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Lennox International First Quarter 2020 Earnings Call. (Operator Instructions) As a reminder, this conference 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 first quarter of 2020. I'm here today with Chairman and CEO, Todd Bluedorn; and CFO, Joe Reitmeier. Todd will review key points for the quarter and the outlook. Joe will take you through the company's financial performance and expectations. (Operator Instructions)

In the earnings release we issued this morning, we have included the necessary reconciliation for 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 and available for replay.

We'd like to remind everyone that in the course of this call, to give you a better understanding of our operations, we will be making certain forward-looking statements. These statements are subject to numerous risks and uncertainties that could cause actual results to differ materially from such statements. For information concerning these risks and uncertainties, see Lennox International's publicly available filings with the SEC. The company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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

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

Thanks, Steve. Good morning, everyone, and thanks for joining us. Let me start with a quick overview on the first quarter, then discuss our current outlook for 2020 and the actions we are taking in this unprecedented time.

For the first quarter, company revenue was $724 million, down 8% on a GAAP basis and down 4% on an adjusted basis that excludes the impact from divestitures last year. GAAP operating income was $36 million, down from $95 million in the prior year quarter that included approximately $47 million of insurance benefit related to the 2018 tornado. GAAP EPS from continuing operations was $0.32 compared to $1.73 in the prior year quarter that included $0.87 of insurance benefit.

On an adjusted basis, total segment profit was $38 million compared to $99 million in the prior year quarter that included $40 million of insurance benefit. Total adjusted segment margin for the first quarter was 5.2% compared to 13.1% in the prior year quarter as reported and 7.8%, excluding the insurance benefit. Adjusted EPS from continuing operations was $0.56 compared to $1.68 in the prior year quarter that includes $0.75 of insurance benefit.

Looking at the business segment performance for the first quarter, there are a couple of overarching comments to make. First, weather continued to have a significant adverse impact. Heating degree days were down from last year and every month, and down 15% overall for the quarter. Second, we saw an increasing impact on our business in March from the COVID-19 pandemic, first in Europe and then in North America. On the demand side, we saw contractors stocking up less residential equipment ahead of the spring and summer seasons due to the rising economic uncertainty. And national account customers in both our Commercial and Refrigeration businesses have pushed orders out.

Operationally, HVAC has been designated an essential business in North America, Europe and in Mexico. We have managed the supply chain well across regions that we source from, including Asia. And combined with our buffer stock, we have not seen an impact on our manufacturing capability in this regard. In late March, we did make the decision to close some of our factories for a couple of weeks and broadly protected the Lennox team from COVID-19 cases at those locations. These factories are all back up and running. And of course, protection for the team members are in place.

In our Residential segment in the first quarter, revenue was down 5%. Revenue from replacement business was down high single digits, impacted by the warm weather. New construction revenue was up high single digits as the warm weather generally enabled homebuilders to get an early start in the year. Residential segment profit was $33 million, down from $87 million in the prior year quarter on a reported basis that included the $40 million of insurance benefit that I mentioned earlier. Segment margin was 7.4% in the quarter compared to 18.6% as reported or 10% excluding the insurance benefit in the prior year quarter.

In Commercial, revenue was up 3% in the first quarter and segment profit rose 24%. Segment margin expanded 180 basis points to 10.5%. Commercial equipment revenue was up low single digits in the quarter. New construction revenue was up high teens and replacement revenue was down high single digits. Breaking out the business another way, revenue from regional and local business was up low single digits, and national account equipment revenue was also up low single digits in the quarter. On the service side, Lennox National Account Service revenue was up low double digits.

In the Refrigeration segment for the first quarter, adjusted to exclude the impact from divestitures in the prior year, revenue was down 11% at constant currency. Segment margin declined 730 basis points to 0.7%, and segment profit was down 93%. The segment has approximately 55% of its revenue from North America and 45% from Europe, which has seen soft markets for some time and that was impacted earlier from the pandemic than North America, including a shutdown at both of our French factories. North America revenue was down mid-single digits, and Europe revenue was down high teens.

Looking ahead for the company overall. Market conditions are highly uncertain and there are significant challenges we are addressing, but Lennox has a focused and seasoned team with experience managing through economic downturns and difficult times. For me personally, I mean, at Carrier's HVAC business in Southeast Asia in the wake of the Asian financial crisis in the late '90s, those of you who don't remember, I encourage you to go Google it; I managed Carrier's North America HVAC businesses through the impact from 9/11; and then a CEO at Lennox through the residential new construction collapse in the global financial crisis of a little over a decade ago.

Based on how HVAC markets performed in those prior downturns, our current view is that the North America residential and commercial unitary HVAC and refrigeration markets will be negatively impacted about 20% this year by the pandemic. We have reset our financial expectations for the year based on that level of market impact and now expect revenue to be down 11% to 17% from last year versus our previous guidance for growth of 4% to 8%.

We expect adjusted EPS from continuing operations in the range of $7.50 to $8.50 for the year. We have already taken cost reduction actions to realize approximately $115 million in SG&A savings for the balance of the year. The decremental drop-through on the guidance reduction on our revenue is 25%, which reflects our aggressive cost actions.

We expect cash generation to remain strong for this year as working capital requirements shrink. And capital expenditure plans have been reduced from $153 million to $120 million this year. We tend to think of maintenance CapEx levels of being around 10% to 15% of that. We are targeting $340 million of free cash flow for 2020.

Lennox is rated investment grade by both S&P and Moody's, and we expect to remain well within our debt covenants. Our bank revolver and asset securitization line do not have to go through renewal again until the latter half of 2021, and our senior notes do not mature until November 2023.

The company's quarterly dividend plans are unchanged, most recently $0.70 per share or more than $115 million in total for this year. We repurchased $100 million of stock in the first quarter of our $400 million planned going into this year, but we have placed repurchases plans for the second quarter on hold and we will review plans for the third and fourth quarter as the year progresses.

As I turn it over to Joe to discuss financial results, I will just say that while we execute on what is required in these current economic conditions, we remain mindful of the future and are confident we will once again strengthen our position in the market as we emerge in the recovery.

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, starting with Residential Heating & Cooling.

In the first quarter, revenue from Residential Heating & Cooling was $442 million, down 5%. Volume was down 6% and price and mix combined was up 1%. Foreign exchange was neutral to revenue. Residential profit was $33 million, down 62% as reported or down 30% adjusted for the insurance benefit in the prior year quarter. Segment margin was 7.4%, down 1,120 basis points as reported or down 260 basis points adjusted for the insurance benefit in the prior year quarter.

Segment profit was negatively impacted by the year-over-year difference in the insurance benefit, unfavorable weather, COVID-19 pandemic that led to lower volume and factory shutdown costs, higher other product costs and unfavorable mix. Partial offsets included favorable price, lower material costs, lower tariffs, favorable warranty costs, low freight costs, lower SG&A expenses and favorable foreign exchange.

Turning to our Commercial Heating & Cooling business. Commercial revenue was up 3% to $178 million. Volume was down 2%, price and mix combined was up 5% and foreign exchange was neutral to revenue. Commercial segment profit rose 24% to $19 million. Segment margin expanded 180 basis points to 10.5%. Segment profit was favorably impacted by favorable mix, lower material costs and lower SG&A expenses. Partial offsets included the COVID-19 pandemic that led to lower volume and unfavorable warranty costs.

In Refrigeration, on an adjusted basis, first quarter revenue was down $103 million, down 12% -- or excuse me, first quarter revenue was $103 million, which was down 12%. Volume was down 12%, price and mix combined was up 1% and foreign exchange had a negative 1% impact on revenue. Refrigeration segment profit was $1 million in the first quarter, down 93%. And segment margin was 0.7%, down 730 basis points. Segment profit was impacted by the COVID-19 pandemic that led to lower volume and factory shutdown costs, higher other product costs and unfavorable mix. Partial offsets included favorable price and lower SG&A expenses.

Regarding special items in the quarter. The company had net after-tax charges totaling $9.2 million. This included $8.3 million for -- in total for other tax items net and excess tax benefits from share-based compensation; $1.3 million for loss from natural disaster, net of insurance recoveries; and a net benefit of $0.4 million for various other items. Corporate expenses were $14 million in the first quarter. And overall, SG&A on an adjusted basis was $131 million or 18.1% of adjusted revenue, down from 18.7% in the prior year quarter.

In the first quarter, the company used $99 million of cash from operations compared to a usage of $141 million in the prior year quarter. Capital expenditures were $25 million compared to $37 million in the prior year quarter that also included $7 million of proceeds from divestitures and insurance. Free cash flow was a use of approximately $123 million in the quarter compared to a use of $171 million in the prior year quarter. Due to the seasonal nature of our business, the company tends to have a cash -- have a use of cash early in the year and generates cash later in the year.

The company paid $30 million in dividends and repurchased $100 million of stock in the quarter. Total debt was $1.44 billion at the end of the first quarter, and we ended the quarter with a debt-to-EBITDA ratio of 2.3. Cash, cash equivalents and short-term investments were $43 million at the end of March.

Now before I turn it over to Q&A, I will review our current market estimates for 2020. For the industry overall, we now expect North American Residential HVAC shipments to be down mid-teens compared to prior expectations to be up mid-single digits, a 20-point negative impact from the COVID-19 pandemic. We expect both commercial unitary shipments and refrigeration shipments in North America to be down 25% compared to our prior expectation for flat markets.

Under these market assumptions, we expect our revenue to be down 11% to 17% from the prior year compared to our prior expectations of 4% to 8% growth. We expect GAAP EPS from continuing operations to be in a range of $7.07 to $8.07 for the year, including a pretax charge of approximately $10 million expected in the second quarter for restructuring actions. We expect adjusted EPS from continuing operations to be in the range of $7.50 to $8.50 for the year. Previous EPS guidance for both of these was a range of $11.30 to $11.90.

Looking at the various puts and takes in our financial assumptions for 2020. We now expect a benefit of $25 million in net price for the year compared to our previous guidance of $30 million. We now expect $20 million -- a $20 million benefit from sourcing and engineering-led cost reductions compared to prior guidance of $25 million. Residential factory productivity is expected to flip from a $10 million benefit to a $10 million headwind given the significantly lower volume. Residential mix is now expected to be flat compared to prior guidance of a $5 million benefit. Tariffs are now expected to be neutral compared to prior guidance for a $10 million -- or excuse me, a $5 million headwind. And commodities are still expected to be a $20 million benefit. And freight is still expected to be a $10 million benefit.

A few other points to mention on our current financial outlook. Corporate expenses are targeted at $75 million compared to 20 -- excuse me, compared to $90 million previously. Net interest expense and other expense is now expected to be approximately $40 million compared to previous guidance of approximately $50 million. We still expect an effective tax rate in the range of 21% to 22% on an adjusted basis for the full year.

We continue to expect weighted average diluted share count for the full year to be between 38 million to 39 million shares, and as Todd mentioned, our repurchase of $100 million of stock in the first quarter of our $400 million plan going into this year. But we have placed the repurchase plans for the second quarter on hold and we will review plans in the third and fourth quarters as the year progresses. The company's quarterly dividend plans are unchanged, most recently, $0.77 per share or more than $115 million for the total year.

We are targeting capital expenditures of $120 million this year, down from $153 million previously. Free cash flow is expected to be $340 million this year compared to previous guidance of $410 million. And as Todd talked about, we have taken SG&A cost reduction actions to realize $115 million of savings over the remaining 3 quarters of this year. We are well prepared to manage through these market conditions and make adjustments as needed along the way.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Ryan Merkel with William Blair.

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

So first off, Todd, can you break down the Resi mid-teens decline to -- into replacement and new construction?

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

We haven't broken out that guide. We usually don't give an annual guide. But I think sort of the phenomena that you saw in the first quarter will play out for a little bit longer, which is the starts that have started will continue. And so I wouldn't be surprised to see, in the near term, new construction up as that on replacement continues to go down. But I think -- certainly think during the second half of the year, the new construction will start to pull back significantly.

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

Okay. And then maybe talk about the sales cadence through March and into April. Are you seeing Resi down 10%-plus at this point?

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

Yes, we are. I mean what we've seen is through the end of March, it sort of hung in there. And then during the first 2 weeks of April, it's been down mid- to high teens. And that's, quite frankly, what I would expect. I mean, what we're seeing is we really have 2 broad buckets of add-on and replacement this time of the year. Demand business, which is dealer sees a job, buys the equipment, installs it. The demand business actually is hanging in there relatively well, I mean, it's down low single digits. But where we're seeing a real slowdown is dealers stocking up for the summer selling season. They're just not doing that given all the uncertainty.

Now I -- and I will get a little bit more into this later, is we're a central business and so we're going to continue to produce. People need our products, and that's going to continue to flow. So we'll see what happens.

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

Okay. All right. And just lastly on the $115 million of cost saves. How much of that is temporary versus permanent? And then what's the quarterly cadence for our models?

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

I would look at it -- I would think about the $115 million cost savings this way. About 20% of the savings comes from salaried headcount reductions; about 40% comes from discretionary spending, like cuts, like travel, marketing, incentive trips, et cetera; and about 40% comes from pay actions, 0 executive incentives and a salary reduction for our salaried employees, 50% for me, 12% for other executives and 6% for other salaried employees.

And when you think about those snapping back, I would -- if I was modeling 2021, I would certainly assume that the salary reductions snap back in 2021. Because if you do a longer than 8 or 9 months, it's really not temporary. And then the other 2 categories, we just wait and see what what's going on with the market conditions.

Operator

Our next question comes from Julian Mitchell with Barclays.

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

Just my first question around decremental margins. Those were pretty steep in Q1. I think you're expecting a narrowing of those as you work through the year, even though the sales trends deteriorate presumably in Q2 and Q3. So maybe just help us understand the logic behind that.

And also, what impact did the under-absorption that you'd cited back at the Q4 call that we should expect in Q1? How bad did that end up being given you had an additional volume shortfall?

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

Well, I think there's sort of a lot to unpack there. I mean, the decremental margins in the first quarter were primarily driven by the bad mix that we had in Residential, and we talked about that publicly at Steve Tusa's conference about midway through March. And what we said there was that the warm weather had impacted our furnace sales and our parts and supplies sales, and those are our 2 most profitable business lines. And that had a real impact to the business.

When I think about the balance of the year, the reason we're able to get 25% decrementals is we've taken $115 million cost out of the business. Our normal contribution margin is, order of magnitude, 38%, 40%. And if we took no cost actions, then the decrementals come in around 40%. But we took out $115 million of costs, and so we're now going to see decrementals in the order of magnitude of 25%.

And then the other point I would make -- I haven't been asked the question, but I'll ramble while I'm talking. I mean, 20% is an uncertain number. We -- that's after an obvious statement for the day. And as I mentioned on the call, I've been through a couple of these. And when I was at Carrier in North America running commercial business after 9/11 and then here at the financial crisis, and so the 20% sort of feels right given what happened during those downturns. But it's sort of a ballpark number, and we were able to get 25% decrementals on a 20% drop in the market.

But if the market goes down more than 20%, the cost levers are harder to find. And so if you're building your own model, our decrementals, after we're down more than 20% revenue, are going to be more like 30%, 35%. But for that first drop of 20%, $115 million of cost takeouts allowed us to -- will allow us to deliver a 25% decremental.

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

That's very helpful. And maybe just my follow-up question. You talked a fair amount about Residential trends. Maybe just clarifying in the Commercial side of the business. Are you seeing -- what are you seeing in terms of, I guess, the aftermarket parts of Commercial? And any major bifurcation you'd call out in your guide for commercial unitary between OE and aftermarket just for 2020 as a whole?

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

The broad -- the guide that we gave is down 25% for North America unitary. We haven't bifurcated it. Although I would, without putting numbers on it, tell you that my experience, what will happen, quite frankly, what is happening is that the new -- it's like residential, new construction continues until all the projects set have started wind down, and that hasn't happened yet, but it will. The planned replacement continues to flow for a little bit until all the decision-makers decide what they need to do to pull back to get their companies lined up correctly. So planned replacements, some of it, it's slowing down over the last 2 weeks. And then the third piece of the business is [at-want demand or emerging] replacement, and that continues to flow even in the tough times because people need to buy HVAC.

And so my experience when I ran Carrier during 9/11 is the marble rolls off the table on Commercial quickly. And -- or better stated, when it happens, it happens quickly. And the marble hasn't rolled off yet. I mean, we're down where that -- backlog order rates are down maybe 10%, not 25% yet. But our guess is it will be.

Operator

Our next question comes from the line of Jeff Hammond with KeyBanc Capital Markets.

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

So can we just talk about, just obviously a lot of moving pieces here, just what you're seeing from a share shift dynamic and being able to get that back. And just what plans have changed, if any, for kind of PartsPlus build-out?

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

The PartsPlus build-out is we've put the 20 stores that we're going to add in 2020 on pause for right now. So right now, the plan is not to add. We're not in the process of adding any new stores. We'll get partway through the year, just like in the share buyback, and reevaluate that.

What we've been very focused on is we made these SG&A cuts. Again, my experience from prior downturns is it's easy to cut costs. It's easy to gain share, it's hard to do both at the same time. And so we've been very focused about what are the investments we want to protect. And so we've protected all our new product development programs. We've protected all our key digitization programs. And while we aren't adding new stores, we're not decimating our distribution network, we're keeping it intact. And so it's protection of the key growth initiatives that we have. We're still keeping those intact. And we've asked for a shared sacrifice of employees as we've taken a salary reduction rather than cut some of those key programs.

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

Okay. And then just on the -- it sounds like the biggest impact on Q1 was kind of seasonal build. What kind of feedback are you getting from contractors in terms of like the selling season and people change -- them being able to kind of get out, just that -- I'm just wondering if you go into the season with less inventory and then maybe things are a little more normal, do you get some spring loading here catch-up?

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

Sure answer is yes to that final piece, which is we got lots of inventory, and we're not -- we're going to manage inventory appropriately to hit our free cash flow target. But we're prepared for the spring-back. And so we hope we're wrong on the 20%, I hope it's a lot less than that. And if it is, man, we're going to be [chuck], and we'll be selling product and our dealers will be ready to go. They just don't want to carry the inventory right now, so we're carrying it for them.

When we talk to the dealer-contractors, depending on what part of the country you're in, and you could figure that out on your own, where there's less concern about all this, they're still relatively optimistic. But again, my experience on prior crisis was if you rely on your dealer contractor to tell you the market is going to turn, then you've waited too long, that they're sort of quick and the dead in all this. And you either sort of figure out that the market's turning, you get your costs in line and you have inventory in case you're wrong. And then you bounce back with it. If you don't do that, what happens is you chase the market down with cost cuts and you end up cutting costs right when the market is getting ready to turn. And it's better to cut them now, get it behind you, move on. That's what we've done. The optimistic answer to your question is, if we're wrong on the market and the market starts to come back, we'll rock and roll and so will our dealers.

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

Okay. And then if I could just squeeze one last in. The Refrigeration margins got hit pretty hard, and I think you mentioned a couple of things. But just maybe speak to that business, what really happened?

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

I mean, there were a couple of things in the quarter that...

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

2Q from a margin perspective.

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

Yes. There were a couple of things in the quarter that really drove the margins down. And obviously, they were disappointing margins. One is we had our 2 French factories shut down because of COVID virus, and that was about $2 million of EBIT negative impact. We had year-over-year difference in refrigerant sales. Remember last year, we sort of had this windfall of a couple of million in first quarter, that didn't repeat. And then the volume being down 10%. The volume went down 10% and we hadn't taken all the cost actions yet, and so we had some painful decrementals.

As we go through the balance of the year, the -- hopefully, the factory shutdowns are behind us, but who knows? The refrigerant noise is behind us. And we've taken the cost actions to adjust our cost for the lower volume.

Operator

Our next question comes from the line of Steve Tusa with JPMorgan.

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

Thanks for all the details, as usual. A lot of companies are obviously not have been giving guidance. And so the color is always very helpful. And you guys are always on top of this stuff. So I appreciate that.

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

I'll just sort of give an advertisement then for my colleagues. We've always been transparent. But every training and leadership instinct I've ever been taught or learned is, in a crises, you want to even be more transparent. So I think sort of pulling guidance and hiding isn't the way to go now.

Again, we're putting large caveats around our guidance. I mean 20%, God knows whether we're right or not. But we're trying to give you a view of our decrementals at 20%, our decrementals if it's worse than 20%, and the costs that we've taken out and sort of how those costs will behave when the market recovers. And so that's what we're trying to communicate.

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

Right. I mean, I was giving more credit to Joe and Steve anyway. So -- but you're doing -- you get a little bit of credit as well because you have to have this kind....

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

I'm glad to see this crisis hasn't softened you in any way.

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

Yes, you've got to give the rubber stamp.

So anyway, how much of your business is housing now? I feel like a couple of years ago, you guys were a little bit overweight on the housing front. How much of your business is builders in housing?

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

15% to 20%, 1-5 to 2-0 percent resi.

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

Okay, got it. And then just -- yes, resi of course.

And then just on the guidance. So if I kind of do the bridge of the midpoint, negative kind of 14% of revenue and then 25% decrementals, it's kind of more around the $7 of EPS range, not $8. Is that -- am I missing something there? Or maybe there's a few kind of below the line items that we haven't kind of squared away on that front? I can also take that off-line if it's -- if I'm off.

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

Interest rates are down and so we have better interest costs. That may be a piece of it. I don't know if that explains the whole dollar, but that's it. But take it off-line, I mean, as you can -- we've worked and modeled detail ourselves, so we can work with you.

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

We can walk through it, Steve.

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

Okay. And then how are you balancing this? I mean, it seems like you have embedded some share gains in your numbers, or are you no longer embedding that? And how are you kind of balancing these cost cuts with that drive to kind of recapture some of the tornado share?

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

We still have some share gain in there. But again, as we talked about at the end of December when we were together, a lot of that share gain is already baked into the cake. In other words, those were dealers we were converting in third and fourth quarter and as we turned our new business development process loose. And so now we just need those dealers to buy. So I think we already have some new share baked into the cake.

And then again, as I mentioned earlier, we continue to sort of protect our key investments to go gain share. And our sales guys, while they're not physically calling on many of our customers, they're calling on our customers and we're still out there pushing and driving to get share of wallet of our customers. So again, there's not heroic share gain in that number, but there's some share gain in that number.

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

Okay. And then just one last quick one. Usually, Commercial kind of has a weak 1Q and then steps up to almost double that in the second quarter and then bounces around a little bit, perhaps kind of fades through the rest of the year. Given you kind of -- you didn't really see a drop-off there yet, but your -- you're going to kind of experience one here in the next couple of quarters, are we -- should we just kind of assume like a flat to up type of number from the first quarter for the rest of the year? Like, I'm just trying to kind of better understand the seasonal dynamics here or the lack thereof.

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

So let me get this right. Most of my peers are pulling guidance, and you want me to give a segment revenue forecast by quarter.

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

No. I guess, just do you anticipate that seasonal step up? I guess is the simple question. It would seem like you do in your guide, but I'm just -- that's the simple question.

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

I think the answer is our commercial team is on a roll. And they were on a roll before the virus hit, and so the virus is going to impact them in a meaningful way. The market is going to go down 25%, but they're gaining share and they're winning in the marketplace. And I think all that's going to be consistent even with the market that's down 25%.

Operator

Our next question comes from the line of Nicole DeBlase with Deutsche Bank.

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

So maybe carrying on from Steve's question a little bit. With respect to the 20% revenue impact that you've embedded for the full year, is all of that coming in the second quarter? And I guess was there any in 1Q? And are you embedding like a pretty quick snapback in the second quarter? Just trying to get a sense of like where that impact is lying.

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

No. I mean, I'm not going to necessarily give quarterly guidance, but what we baked in was for the balance -- for full year, our guide is down 20%. And so for balance of year, it's down even more than that. I think if you use the weighted average of what happened in the first quarter, it's down 21%, 22%, 23% for the balance of the year. And that's the guide that we're giving.

Now I think it may be worse in second quarter than it is in third and fourth quarter, but I'm not sure. But the way we've loaded into our internal models is equally split across the quarters, so it's down the same each quarter. Because again, it's -- I don't want to give too much precision assumption around the 20%. I mean, it's not like we did this bottoms-up roll by quarter, by business unit, by AOR, by new construction and came up with this detailed number. It's 20%, and we ran it across the business, we did it by quarter, and we set our cost that way. And we're going to stop to see how this plays out. There's too many variables to really know for certain how it's going to play out.

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

Okay. Totally fair. Got it. And then just for my follow-up, then maybe drawing on what you've seen in your career in past downturns. Is there a risk that in the Resi business, we see a big shift away from replacement and towards repair, Band-Aid of systems over the next several quarters as this plays out?

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

Yes. I think when you -- if we end up in a world which looks like we're going to do with 25%, 30% unemployment, people are going to try and Band-Aid their units. So yes, I think we'll see a spike up in parts and repair parts and a decline in units. And I think that assumption's sort of baked in, broadly speaking, to our number. But yes, that's what happened.

Now how is this for trying to find a silver lining? That -- just like we saw through the financial crisis, that demand doesn't go away, it just gets pushed out. And I'm looking forward to, I don't know if it's a year from now, 1.5 years from now, we'll have a new model out about all the pent-up demand that was created in the throes of all this, and all that demand will come back to us. And just like in '10, '11 and '12, we'll have Resi markets that are up double digits because all this pent-up demand will be unleashed. So we're not Carnival Cruises, we're not Caesars Palace. It's not when this demand goes away, it never comes back or you lose it forever. This demand gets pushed out, and so we're pushing it out, but it will come back.

Operator

Our next question comes from the line of Tim Wojs with Baird.

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

I guess among some of your third-party distributors and just some of your larger-stocking dealers, how do you feel about just kind of their financial profile and kind of access to credit, I guess, more broadly?

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

It's a great question. We keep a close eye on that. They're in good shape, broadly speaking. I'm not aware of any of our large dealer or distributor customers having any issue. They're savvy business people. We aggressively reached out to the dealer network and had webinars and training around the small business loans that were available, or grants. And hopefully, there's more of that money coming. And we've worked with our partners to make sure they have access to that if that's something that they want to do.

But again, it's a little bit of the survival of the fittest. Most of our customers survived the financial crisis and housing downturn and the bubble of residential market. And so they're savvy. They know how to -- they know what they need to do.

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

Okay. Okay. And then just on mix. Have you seen -- I guess, on the demand-oriented business, have you seen any changes in mix over the last probably 4 to 6 weeks? And then are you embedding some deterioration as you kind of go through this summer?

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

We've -- again, it's early because we're only a couple of weeks into this. But what our expectation would be, would be you'd have some mix down in resi, and that's built into the numbers.

Operator

Our next question comes from Nigel Coe with Wolfe Research.

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

And I do want to say well done on the guidance because I don't think there's going to be too many people giving us perspective. So it's really well appreciated.

So on the components of the guide, you took down the price by $5 million. Is that purely just on the lower volumes, you get obviously less price benefits? Or is there some element of pricing pressure across various businesses? And I guess the question is, are you seeing any deterioration in pricing?

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

No. You got it. It's broadly speaking, the reduction of volume.

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

Okay. Great. And then on -- you mentioned shutting down factories at the end of March in both U.S. and Europe. We've seen this across the board. To what degree did that impact your productivity, actually having those factories shut for a week or so in the quarter? And then on a go-forward basis, testing employees and maintaining distances within the factory, to what extent does that limit or maybe raise costs in terms of ramp of production and raising the kind of go-forward costs?

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

We've managed it well so far. We've -- cleaning the factories, lots of hand gel, even things like putting plastic barriers between some of the assembly stations. We're in the process of ramping up PPE, gloves, taking people's temperatures, those sort of things. And so we're -- like most of industrial America, we're working our way through this. We had a shutdown in our 2 French factories. We had a shutdown in our Marshalltown factory because we had some cases and also quite a few quarantines, but both those factories are up and running.

As I speak today -- I didn't check first thing this morning, but as I speak today, all our factories are running. Different levels of absenteeism in our factories as people stay away from work. And again, this isn't a political statement, it's just an observation, that our factories in places like Iowa, Arkansas, Georgia, and they're not in New York City, they're not in California. And so some of our workers have a different perspective on the virus than I do maybe. And so they're coming to work. But even beyond that, we're taking care of them, make sure it works.

I mean -- and then second order equation, obviously in our factories, has to do with the supply chain. And our team has done a great job of managing that, first in Asia, and that's now way in the rear-view mirror. Increasingly, it's about Mexico and U.S., of making sure that our supply base runs, and it has.

And then the final piece is you get a little bit more wiggle room on this when the markets are declining. So the markets are declining, even if we have some issues around production, we're able to absorb it in a natural way. Because even if we had 100% production capability, we would have to bring down our factories in any case to help manage the inventory levels. And so even if we have some places where we have to take it down, we take it down in an orderly way.

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

That's great color. And then a quick one on the Mexican supply chain. I hear there's 1 or 2 factories were shut down by the Mexican government. Is that now back up and running?

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

Our factory was never shut down. So we actually went through -- I'm going to be careful I don't advertise it to the -- too much to the government where they want to prove me wrong. But we had the federal Mexican government come in and inspect us on an afternoon and we've got a stamp of approval, both as an essential industry and also about all the processes that we were using to protect our people. And so we were down in Mexico, we took it down just for production reasons, but we haven't taken it down because the government thought we should.

Operator

Our next question comes from the line of John Walsh with Credit Suisse.

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

So I guess, I think it was in response to an earlier question when you were talking about how the decrementals throttle at different volume declines. You've obviously [running] that scenario analysis. So what are you watching for to see if volumes could actually be down worse than you're kind of expecting? Is it the employment numbers, is it consumer confidence, something else maybe? What are the indicators you're watching for that?

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

Yes. I mean this is, as you know, an imprecise science. And I think we're watching macro trends. But I mean, we're sort of off the board with macro trends. And so we're trying to spend time with our customers. We're looking at order rates. We're just seeing what happens. I -- the one number that I have taken most comfort in to date has been the demand business in our Residential. And as I said earlier, that was down a little bit month-to-date but still reasonably solid now all things considered. And that gives me comfort that, when people's air conditioning breaks, they need to get it fixed, they need to get it addressed, they're at home, and it's still flowing.

And the other thing that I -- that we keep track of is -- and we're happy that we're an essential business. And so our dealers are working across the country and they're up and running and they're going out and taking care of their homeowner customers. And so as long as all that's in place, then that's a good sign that we look at.

But the way I think about this is we measured twice and then we cut once. So we measured 20% down, we cut. And now we, quite frankly, just got to let it play out a little bit. I'm not sure we're going to know a whole lot more next week than we know today or even 3 weeks or a month. I think we're going to have to get through the summer selling season or into the summer selling season to see how things are behaving, and then we'll readjust our thinking then.

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

And then maybe just a follow-on, a high-level picture here. Obviously, one of the nice secular tailwinds in HVAC is around energy efficiency regulations, refrigerant changes. It might be too early, but are you hearing conversations that some of the bodies that govern this might be wanting to throttle back or push back dates of when we get some of these changes? Or is that not something you would expect to see, depending on the duration of this downturn?

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

The honest answer is I don't know. We haven't heard anything yet. I mean, there's 2 ways to look at it. One would be some may think that's a stimulus to the economy, not to force industries to add costs. Another view may be the scientists may actually be right on some of these things, and protecting the environment may make sense. So I think it could cut both ways.

Operator

Our next question comes from Deepa Raghavan with Wells Fargo Securities.

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

Can you -- Todd, can you talk through how your revenue mix is right now on the Residential front versus geographies that have been hard hit with the lockdown? I mean New York, California, Pennsylvania and some parts of Midwest, obviously. But are you underrepresented or overrepresented in some of these places? Can you talk through that broadly, please?

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

No. I don't -- I'm not worried about being underrepresented anywhere or overrepresented somewhere else. I think, again, it's a small sample size. But sort over the last 3 or 4 weeks, there's parts of the country, the Southeast, that continues to do well. So our revenue in Resi over the last 3 weeks in the Southeast is actually up. Our revenue in Canada is down and down pretty significantly. And I think that reflects the Canadians took the lockdown pretty serious and things aren't flowing as well there. But I don't think we're under -- we're not -- we have lower share, certainly, and higher share depending on where you look at the country, but there's no step-function difference. So we're ready to play no matter -- where the markets are strong.

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

Okay. So you've not necessarily been additionally hit in places where the lockdown has been stronger? [It's the best that,] how you...

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

No, I misunderstood the question. Yes. I mean, the -- in the parts of the country where people are abiding most closely. So in the Northeast, we're down much more than we are in the Southeast. And so in Florida, we're actually up year-over-year in April. In the Northeast, we're down and down pretty significantly year-over-year. So yes, I think you can think about it that way.

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

Okay. Got it. My follow-up is on some color versus last cycle, you obviously divested some businesses since the last recession, Hearth, et cetera. Can you talk through some data on how the repair and replacement dynamic played out, not including those businesses?

And how maybe you're thinking through how unemployment rate or any of these other metrics that you probably analyze at your end that actually will determine when people actually get back into replacement mode? I mean, obviously going to recession, people choose to repair. You have mid-teens unemployment rate, but that probably starts to peter out. But is there like a threshold metric, like an unemployment rate or something that you're going to follow at your end?

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

No. I mean there's not a math formula. When I think about what happened during the financial crisis, it was a multitude of things. And some of them are true now, some of them aren't, and then there's a whole new set of things now.

So one thing we saw during the financial crisis, it was a housing-led problem. And so that was in our sweet spot. And existing home values went down in many parts of the country, 30%, 40%, 50%. And that had a chilling effect on people wanting to spend $5,000 to put an air conditioner in. And then you laid on top of that, the housing crisis turned into a financial crisis, which led to unemployment and lack of consumer confidence.

Now where we sit today so far in this is it's going to be higher unemployment. Consumer confidence, we'll see how that plays out, but I guess -- my guess is it's going to follow unemployment. But we haven't had the crash in the housing market so far.

And so -- and then the other question is what's the recovery look back like and how quickly do people come back? And so I just think there's variables out there. I think there's clearly going to be some repair versus replace in the near term. How long it lasts, I'm not certain.

Operator

Our next question comes from the line of Walter Liptak with Seaport Global.

Walter Scott Liptak - *Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst*

I want to say thanks, too, for the guidance. I wonder if you could talk a little bit more, kind of a follow-on to the last question, about the 3-recession analysis, which I think looks like the right way to look at this. But each one of those recessions was a little bit different. And I wonder why, considering what you just said in the last question, why you took the conservative route with the guidance versus expecting more of a snapback in the second half.

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

My experience, especially from 9/11, running the Carrier Commercial business, is it was death to chase the market down. I think you got to get out ahead of it and get your cost sized right. And the costs that we took, a lot of them were pay cuts and incentive cuts and things that can -- that we can sort of unleash again if we had to if the market takes back. But the worst thing to do, I think -- or one of the worst things to do is one call, we say the market is going to be down 5%, then it's down 10%, and it's down 15% then it's down 20%, because that means we're running our business that way. And then if you're chasing the cost down, it's just so disruptive to the organization. It's better to get it out of the way, measure twice, cut once. And if you're wrong, have enough inventory to prove everybody that you can manage the upside also. And I think that's what we've done. I just find that a better way to run the business.

Walter Scott Liptak - *Seaport Global Securities LLC, Research Division - MD & Senior Industrials Analyst*

Okay. Okay. Fair enough. The bad debts this quarter didn't look that bad yet. And I wonder if you can talk about how bad debts should trend given your outlook and how they did in the last recessions.

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

Yes. They held up well last time. We didn't have much of a debt problem. And again, we're not -- we're exposed to tens of thousands of small customers. And we have a pretty good group who's constantly monitoring that. And even on the national account side, we sell to pretty high-caliber brands and customers. And so that wasn't a concern last time, I don't expect it will be a major concern this time, although we're focused on it and watching it.

Operator

Our next question comes from the line of Robert McCarthy with Stephens.

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

Two questions, and I know we're getting kind of top of the hour, so I'll keep it quick.

One, on the Commercial side, it looks like you took a very appropriate assumption for that 25% decline. I guess -- and again, thank you for all the detail on the guidance. So this is a bit of an unfair question. But it probably takes into account the initial disruption, but we just hosted a call with a former CFO of a large retail-based restaurant company for quick service dining in a lot of malls. And from that standpoint, given what we're seeing with casual dining and then the expected cut in units and then also the independents, we could be in kind of a nuclear winter for commercial real estate for quite some time. How do we think about that in the context beyond the guide of how you're going to manage your business? Because could it be maybe not as bad as the 25%, but could we be looking at 2 to 3 years of just kind of a really tough slog here on the commercial real estate side? And let us know how you think about it.

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

Well, I'd say a couple of things. I mean our Commercial business, we're 2/3, close to 70%, replacement. And so we're buffered from commercial new construction in many ways, and that's because we're a replacement market and replacement units are going to have to flow. And then I think there's pockets of demand. I mean, Amazon is a customer, Costco is a customer, Walmart is a customer. Those are all big customers of ours. And so yes, new construction, you pick your worst case. And it could be bad, but we're replacement, and we have some large customers, and some are doing well and some aren't doing well.

And again, as I said earlier, look, I don't have a crystal ball. And I can convince myself it's going to snap back, I can convince myself that I should pull my head underwater. But we picked a middle path and have sized the business accordingly. And if we're wrong either direction, we'll adjust.

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

And then just anything else you can add in terms of what you've talked about in terms of just cash collection? And should we be nervous about cash conversion this year just given kind of the -- so [city-generous] nature of this downturn? Or do you think that's going to be something that's fairly manageable?

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

I think it would be fairly manageable. I mean, we'll see how it plays out. But I mean, we've -- we're going to shrink our working capital. We'll -- we have a line of sight with our customers. And we're collecting receivables, they're not aging fast yet. And we'll shrink the inventory. And so we'll generate cash there. And then we pull back on our working capital. And if you look what happened during the financial crisis. And again, it was different, and I know you lived through it, Rob, I'm not sure everyone on the call did, intimately. But I mean, you didn't have the fear of dying, but you certainly had the fear that the world was on fire. And even during the financial crisis, we generated more cash during the financial crisis than we did before because we're able to take working capital up quicker than our earnings go down, and that's what we'll see this year.

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

And the last thing is it sounds like from a financing perspective, the fixed income and financing markets remain very robust. Wouldn't you confirm that from your seat?

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

Yes. I don't know if I -- I'm not sure I'm in a position to say very robust. I'd say we have no concerns, no issues. We're in great shape.

Operator

Our next question comes from Damian Karas with UBS.

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

Appreciate all the color on your preparedness to navigate through this downturn as well as on how you're getting to the 20% forecast. Just have a quick follow-up question on Resi mix. You talked about, in the past during the global financial crisis, how you kind of really saw a bifurcation, if you will, in the resi market with a much higher proportion of the population flocking to minimum efficiency. Have you started seeing that dynamic play out yet? It sounds like in your guidance, you're expecting to some extent that to happen.

And could you just kind of remind us of how the sort of price and margin variance is as you move from the minimum efficiency up through your premium products?

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

It scales rough -- on the price size, it's -- price side, it scales roughly in line with SEER. So a 26 SEER order of magnitude is twice as expensive as the 13 SEER. And then the margin percentages, they don't scale quite that way, but a margin percentage at the high end -- we have a greater margin percentage on the high end than we do on the entry level, although much closer than it was 7, 8 years ago as we've taken cost out of the entry-level product.

Yes. As I said earlier, we expect certainly some mix down, and it's early. But 2 or 3 weeks into April, we're seeing some of that. And again, as you mentioned -- or you right, correctly remembered what we saw during the financial crisis was a barbell distribution. People who had money continued to have money, and people who were in troubled weren't or didn't and so bought entry level. But all these things are different. We certainly expect some mix down. We built that into our guide.

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

Okay. That makes sense. And with the current lockdown situation, just wondering if you've seen any change in trends with your online platform. Is there a potential here to maybe see an acceleration in the ramp there? Or just kind of too soon to tell with the softening demand environment?

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

Our online platform is for our dealers, contractors. And our sales guys are talking to them all the time. So they want to give us an order over the phone, we'll take it there. So I don't think there's a huge ramp-up online. It's not like a signal to the grocery store, I'm using ships instead to buy it and it's all going online. Our relationship with the dealers hasn't changed that much. We're not going into their office every day, but we're talking to them every day. And a lot of the orders, quite frankly, that they will come online, the dealers just tell us and we place the orders ourselves.

Operator

Our next question comes from the line of Gautam Khanna with Cowen.

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

Appreciate the granularity as well. I'll be brief. A lot of questions asked and answered. But first, Todd, I was hoping you could give us some historical perspective on how pricing behaves in these downturns and why the industry will be more rational this time.

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

Yes. Even in the financial crisis, we got price. We got -- I'm doing it from memory, but I think the worst year in pricing, we got $15 million, $20 million of price on a smaller business than we have today. And we're able to pass it on because there's still sort of pressures that you have on the business. They're not commodities anymore, but it's the additional cost that we have to help protect us from COVID. It's the absenteeism that we have to manage through. So it's sort of the inflationary pressures from -- or the cost increases that we're having in that direction, we pass the price on. And we've already, in many ways, passed the price on. It's in the price books. We've had the conversations with our customers. And so we're going to pass it on. And my expectations is our competitors will do the same thing.

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

And as a follow up, we've asked about consolidation forever. Do you think the current environment makes it more or less likely to happen?

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

I mean, I think I'll just give you a textbook answer. I think it would be -- if someone gets into a liquidity issue, it certainly helps. And it would have to go on -- the equity values at the current levels would have to stay there. Hopefully, they don't, but would have to stay there for some period of time before people reset expectations. But it's hard to imagine that very many deals get done in the near term anywhere in any industry because people just don't believe that they're worth 30% less than what they were a month ago or 2 months ago.

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

Right. And I'm sorry, a last one if I could sneak one in. Just to play macroeconomist. When -- what year would you expect to get back to 2019 levels? I mean, do you -- just based on historical context, is this a 3-year workout, a 5-year workout? How's bad is it in your -- from where you're sitting?

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

The honest answer, I just don't know. And the reason I don't know is -- I think you have to answer the -- my opinion, you have to answer the medical question first, and I just don't know. And so look, if we have therapeutics in 2 months, I'd say it's, Katy, bar the door. If it's 3 years and we're still searching for a vaccine, then the barn's burned down. So you have somewhere between those 2, and I just don't know.

Operator

And our last question comes from the line of Joe Ritchie with Goldman Sachs.

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

Appreciate all the detail. So I'll keep it quick. I'm not sure I heard your answer to Julian's question earlier on the cost outs. Are they linear?

And then secondly, if this does turn out to be worse than a down 20% market, Todd, what other kind of levers do you have at your disposal to try to offset some maybe more dire weakness?

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

I'm not sure I answered that -- or I answered that question earlier, so I'll answer it for you. I mean, broadly speaking, the cost takeouts are linear. Although all things being said, as you can imagine, some of these things kick in a little later in the year. But we've already announced internally the restructuring. They're already effective. The salary reductions take effect May 1. And so all that's happening.

And then in terms of what other costs we have, I mean, it's still the same 3 buckets. I mean, it's can you do -- you have to attack heads, you have to attack discretionary spending and you'd have to attack pay. But as I said earlier, we were able to get to a 25% decremental with a contribution margin of close to 40%. And so the next tranche down, I would expect the decremental to be closer to 30%, 35%. And so that means while there's some cost there, you run out of -- diminishing opportunities.

Okay, everyone. Appreciate the time, appreciate the interest. To wrap up, these are unprecedented times, but Lennox has a focused and seasoned team with experience managing through difficult challenges. We will execute on what needs to be done near term while mindful of the future and are confident we will again strengthen our market position as we emerge in recovery.

Thanks, everyone, for joining us today. Have a good day.

Operator

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