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AYI - Q2 2020 Acuity Brands Inc Earnings Call

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OVERVIEW:

Co. reported 2Q20 net sales of $824m, diluted EPS of $1.44 and adjusted diluted EPS of $1.84.

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PRESENTATION

Operator

Good morning, and welcome to Acuity Brands Fiscal 2020 Second Quarter Financial Conference Call. (Operator Instructions) Today's conference is being recorded. If you have any objections, you may disconnect at this time.

Now I would like to introduce Mr. Pete Shannin, Vice President, Investor Relations and Corporate Development. Sir, you begin.

Pete Shannin - *Acuity Brands, Inc. - VP of IR & Corporate Development*

Good morning. With me today to discuss our fiscal 2020 second quarter results are Neil Ashe, our President and Chief Executive Officer; Karen Holcom, our Senior Vice President and Chief Financial Officer; and Ricky Reece, our Executive Vice President and President of Acuity Brands Lighting. We are webcasting today's conference call at acuitybrands.com.

During this call, we will also discuss certain non-GAAP financial measures. Reconciliations to comparable GAAP financial measures can be found in our second quarter press release and 10-Q SEC filing. I would like to remind everyone that during this call, we may make projections or forward-looking statements regarding future events or future financial performance of the company. Such statements involve risks and uncertainties such that actual results may differ materially. Further, forward-looking statements speak only as of the date that they are made, and we undertake no obligation to update publicly any of these statements in light of new information or future events.

Please refer to our most recent 10-K and 10-Q SEC filings and today's press release, which identify important factors that could cause actual results to differ materially from those contained in our projections or forward-looking statements.

Now let me turn this call over to Neil Ashe.

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Thanks, Pete. Good morning, everyone. I'm pleased to be with you today to talk about Acuity. Obviously, we all wish the global context were different right now. We are embarking on the next generation of Acuity. As we start on that journey, we are dealing with the shocks caused by the COVID-19 pandemic. As we manage through the current situation and begin to change our company for the future, we do so with a strong financial footing, with a market-leading position in our core business and with a strong team to navigate the company through this. Given that we're new together, I want to outline what we will cover today.

First, I will give you some perspective on our second quarter performance, and Karen will go into more detail about the financials. Then I will cover how we prepare for it and how we are handling the shocks related to COVID-19. I will provide you with some of my initial observations of the company, talk to you about digital transformation and give an outline of who I think Acuity is and can become. For consistency, we will continue to discuss the business and present metrics that you've traditionally seen for at least the remainder of this fiscal year. Following our opening comments, Ricky Reece will join us for the Q&A period.

Our second quarter performance was a mixed bag of continuing trends with several signs of improvement. After a very weak December, the business picked up in January and February, and we began to see real traction, specifically in our independent sales network channel, which represents over 2/3 of our sales and was up over 4% for the quarter, inclusive of TLG. Some of the business and product highlights included success with our Contractor Select products. Sales grew at 30% this quarter. We successfully launched Modulus technology. Modulus is a proprietary and innovative low-voltage distributed power and control system for LED luminaires, enabling design flexibility, greater connectivity options and lower installation costs. And the integration of TLG is progressing as expected and is accretive to our performance. Those were balanced by some of the same dynamics that you have heard from Acuity in the past.

We continue to face year-over-year revenue declines in retail as a result of our changed home center strategy and in corporate accounts as a result of the timing of relight projects at several large retailers. We expect these dynamics to continue. We also saw revenue declines in direct sales of industrial and infrastructure accounts, primarily due to large projects in the prior year that did not repeat. Despite that revenue performance, we were able to expand gross margins year-over-year and to generate strong cash flow, both of which demonstrate the adaptability and durability of our core lighting business.

With that, I'll turn it over to Karen for more details on the financials. Karen?

Karen J. Holcom - *Acuity Brands, Inc. - Senior VP & CFO*

Thank you, Neil, and good morning, everyone. I know many of you have already seen our results, but I would like to make a few comments on the key highlights for the second quarter of 2020. Net sales for the second quarter were $824 million, a decrease of 3.5% compared with the year ago period.

Overall, net sales volume declined approximately 7%, while the price/mix of products sold was favorable this quarter by approximately 1%. We estimate price/mix was impacted by a favorable shift in channel mix, partially offset by an unfavorable mix of products sold. The positive change in sales channel mix was mostly influenced by the decline in net sales of lower-margin products sold primarily through the retail channel, partially offset by product substitutions to lower-priced alternatives primarily for more basic, featured -- lesser-featured LED luminaires sold in certain channels as well as declines in shipments for larger commercial projects, a historical strength of the company. Acquisitions added about 3% to our growth.

In addition, we believe the demand in the second quarter for private nonresidential construction, in general, and more specifically lighting, was down in the low single-digit year-over-year percentage range. We believe these declines were due, in part, because of the continued concerns over global trade and economic issues. We do not believe that the COVID-19 pandemic had a significant impact on our second quarter results.

From a channel perspective, there were a few key areas of significance. First, net sales through our independent sales network, which makes up approximately 72% of our total net sales, increased 4% over the prior year. Our performance compared with the year ago period was impacted by the contribution from acquisitions, market share gains in certain lighting and controls categories and growth in our Contractor Select portfolio. Additionally, our building management solutions platform at Distech performed well again this quarter. The impact of these items was partially offset by continued weak demand primarily for larger commercial products -- projects.

Second, net sales through our direct sales network were down 16% over the prior year's second quarter due primarily to the completion of certain larger infrastructure projects in the year ago period.

Third, lower shipments in the retail channel resulted in a decline of 23% in this channel as compared to the prior year's second quarter. The decline in this channel was primarily due to the impact of previously announced actions taken by the company to exit and phase out of certain products whose profitability was most negatively impacted by the additional tariffs. As we mentioned in previous earnings calls, we expected these efforts to result in lower net sales and more favorable gross profit margins.

Lastly, net sales in our corporate accounts channel were down almost $20 million this quarter compared with the year ago period primarily due to the completion of certain projects in the year ago period that did not repeat this quarter and to a lesser degree, slower releases for certain renovation projects. As we have noted in previous earnings calls, we expect net sales through this channel to be inconsistent based on the nature of the construction cycle of the customers served, primarily big-box retailers.

In the second quarter of fiscal 2020 and 2019, we had some adjustments to the GAAP results, which we find useful to add back in order for the results to be comparable. In our earnings release and Form 10-Q, we provide a detailed reconciliation of these non-GAAP measures. Adjusted results exclude the impact of manufacturing inefficiencies, acquisition-related items, amortization expense for acquired intangible assets, share-based payment expense and special charges for streamlining activities. We believe adjusting for these items and providing non-GAAP measures provide greater comparability and enhanced visibility into our results of operations. We think you will find this transparency very helpful in your analysis of our performance.

Gross profit was $344 million, up approximately $10 million from the year ago period. Our gross profit margin for the second quarter was 41.7%, an increase of 260 basis points compared with the year ago period. The increases in gross profit and margins were primarily due to the benefit of acquisitions, favorable channel mix and lower cost for certain inputs, partially offset by the impact of lower net sales as well as the higher cost due to the enacted tariff. Reported operating profit was $81 million compared with $96 million in the year ago period, while adjusted operating profit for the second quarter of 2020 was $102 million compared with adjusted operating profit of $112 million in the year ago period. Reported operating profit margin was 9.9%, a decrease of 130 basis points compared to the prior year. Adjusted operating profit margin was 12.3%, a decrease of 90 basis points compared with the margin reported in the prior year.

Our SD&A expenses increased approximately $23 million compared to the year ago period. The increase in SD&A expense was primarily due to the addition of costs from acquired businesses, including higher employee costs and amortization of intangibles, increased commissions, higher professional fees and higher variable incentive compensation. Our adjusted SD&A expenses were up approximately $20 million or almost 9% compared with the year ago period.

The effective tax rate for the second quarter of fiscal 2020 was 23.4% compared with 23.1% in the prior year quarter. We currently estimate that our blended effective income tax rate before discrete items will approximate 23% for fiscal 2020. Our diluted EPS for the second quarter of $1.44 was $0.23 lower than the prior year. Our adjusted diluted EPS this quarter was $1.84 compared with $1.99 reported in the year ago period. The decrease was primarily due to lower pretax income.

We continue to have a positive cash flow from operations and ended the quarter with a strong balance sheet. We generated $250 million of net cash flow from operating activities during the first half of fiscal 2020, which was up $26 million or 14% compared to the prior year. At February 29, 2020, we had cash and cash equivalents balance of $381 million, a decrease of $80 million since August 31, 2019. Our total debt outstanding was $406 million at February 29, 2020, and we currently have additional borrowing availability of approximately $396 million under our bank credit facility. The bank credit facility and term loan mature in June 2023.

We clearly are pleased with our financial strength as we enter this uncertain time due to the COVID-19 pandemic.

Thank you, and I will turn it back to Neil.

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Thanks, Karen. Obviously, the effects of the coronavirus pandemic have turned the world on its head. I'll spend a few minutes updating you on what has happened and what we've been doing about it. I'll begin to say -- by saying how pleased I am with the company's resilience, beginning with the supply shock when China went on lockdown.

As China began to shut down, we were able to use our preferred position in the industry to gather additional supply. Other than some specific finished goods inventory products, we so far have been able to largely buffer our customers from the effects of the supply shock. As companies are forced to reevaluate their supply chains, we can report that our diversified supply chain has performed well. As the potential worldwide ramifications started to become clear, we began to work to prepare our people, facilities and operations for what would come next. Our priorities were and are the health and wellbeing of our people while addressing both the risks and opportunities that the situation presents.

Beginning in late January, we started making changes in our manufacturing and distribution facilities to ensure the health of our associates and the continued operation of our facilities. We reengineered the people flow in our buildings to create more social distance and to limit the number of people that any one person could come in contact with. We also changed the sanitation procedures to proactively eradicate as many contaminants as possible. At the same time, we have been working with various jurisdictions to respond to their directives to help slow the spread of the disease. In almost all instances, we have been deemed an essential business and remain open. However, we have scaled back some less essential parts of our business to spread out our operations and to reduce the number of associates that we have in our buildings. So far, the vast majority of our manufacturing and distribution facilities are operating at the capacity necessary to meet demand.

We were also able to transition our other functions to completely work from home. As a newcomer to the company, I was amazed at the seamless transition. We made the decision to work from home on a Monday, and on Tuesday, it was business as usual. Our product and go-to-market teams and our enabling functions transitioned overnight from all together to completely virtual. We also transitioned our communication with our channel so that we could effectively conduct business. We have been able to continue our important product work and to maintain our communication and alignment with our important independent sales network through this transition.

From a financial perspective, we entered the shock with a solid balance sheet, as Karen discussed. We've taken steps to ensure that we are prepared for as many scenarios as we can imagine. Our priorities have been to ensure our liquidity and to use this as an opportunity to make our company stronger after the event than we're going into it. We are scaling our variable costs to respond to the changes in demand, and we are reevaluating our fixed-cost investments as well. None of us can predict exactly how this will play out over the coming months. With that in mind, we are taking responsible actions in light of the current downturn in demand but that do not inhibit our ability to rebound when things return to normal.

With that, I'll talk about what we all expected to be talking about on this call. I took over as CEO on January 31. I'd first like to thank Brian for his outstanding leadership of the company. He led the transformation of the company from a diversified conglomerate to a market-leading lighting business that has led many of the technology transitions in the industry. I've spent the last 8 weeks getting to know the company and our people and working through this crisis. I have visited all of our largest facilities, some, multiple times. I've met and worked with many of our talented associates, and here are my initial thoughts.

Our lighting business is an industry leader. Our lackluster performance over the last few years obscures the underlying strength of our go-to-market, product development and supply chain operations. Our lighting business can compete effectively at the top, middle and bottom of the market. The recent revenue trends, however, will not fix themselves. There has been industry deflation. We have additional work to do on our business and product portfolio to position us for future growth. We cannot and will not take for granted our market leadership position as we evaluate future trends and competitors. Our independent sales network is and will continue to be a strategic differentiator for Acuity. Acuity has led many of the technology transformations in the industry, and we need to continue to do so in the future.

Our existing technology businesses, including Atrius, have potential, but we have real work to do to realize it. We have a very talented team of can-do, will-do people who work well together. They are and will be the foundation of our future success. Our business model is adaptable and durable. We have the ability to generate cash and to continue to deliver efficient returns on our committed capital.

Now let me spend a minute on digital transformation. Although digital transformation has become one of the trite, overused and ill-defined terms of late, the reality is that every company that was not originally digital needs to adapt itself to what is a fundamentally different world. In a sentence, what used to be a push-based world is now a pull-based world. And through this lens, Acuity is a push-based company in a push-based industry in a pull-based world. Acuity is no different from other successful companies. The better we were at what got us here, the harder it is to adapt to this new world order. We can and will adapt Acuity to these new realities.

I have had the opportunity to lead digital transformations at some of the largest and most important companies in the world. In my experience, this process has 4 key components, all of which apply to Acuity: transformative customer experiences, everyone has new and expanded expectations; business model transformations, we need to understand the whole value chain and adapt our business models accordingly; using technology to improve business operations, data can simplify and accelerate the business; and run like a digital company, we can capitalize on the tools and methods of digital companies to be faster and more effective.

As I've gone through these transitions at Walmart, CBS and CNET, there are 2 things that have been true. First, in all instances, the core business has gotten stronger as a result of the changes. The second is that by building from and adding to the core business, we have created larger, more vibrant companies. You may have noticed that we changed our boilerplate in this release. This will begin the process of defining Acuity for who we plan to be. We have the opportunity to be a market-leading industrial technology company. We already have leading or developing leadership positions in Lighting Controls and building management, in addition to a market-leading lighting business. We have the potential to be a leader in location-aware applications. Through the necessary changes of our digital transformation, we can improve our existing businesses and bear market competitiveness. We can continue to develop new businesses that are focused on defining the future of the industry. Those changes will strengthen our current business model. We will continue to be a strong cash generator. We have the opportunity to use that cash to grow our company through reinvestment and acquisitions.

In conclusion, we have a strong company in a period of great change. We are aggressively managing to the uncertainties caused by the COVID-19 crisis. We have the financial strength and resolve to get through this and also to emerge a stronger company. Over the long term, we have the opportunity to more broadly adapt the company to expanding opportunities in our core businesses and to develop new ones. We have the market position, the people and the cash flow to become a larger, more dynamic company that delivers for our customers, our associates and our shareholders.

With that, I'll pause and open it up for questions. As I mentioned, Ricky Reece will be joining us for the Q&A period. As we transition to questions, I'd like to both acknowledge and thank Ricky for his contributions to Acuity and his outstanding work in his new role as President of Acuity Brands Lighting.

Operator, we are ready for questions.

QUESTIONS AND ANSWERS

Operator

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

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

So first off, Neil, you mentioned opportunities that COVID presents. So I'm curious where in your business do you see revenue opportunity? And where do you see the biggest challenges?

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Thanks, Ryan. As I said, we're trying to deal with both the challenges and the opportunities. So the challenges are obvious as we scale the business appropriately. We feel like we entered this period with developing momentum around our product portfolio and the core lighting business, and we have the opportunity to continue that process as we emerge from this. So the combination of the strength of our supply chain as we've been able to manage and have consistent supply through this process as well as some of the new product portfolio that we've been rolling out give us momentum for the -- whenever we emerge from this, and we think those are real opportunities.

We also think there's opportunities to do some of the hard work under the covers that we need to do to evolve the company. While we can't solve those and make those changes in months, we can get a little bit of a head start while we're -- while we have folks that have more time on their hands than they would have otherwise.

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

Got it. Okay. And then maybe just on the bigger challenges that you see, I think the retail segment is a big market for you. Are you seeing push-outs and cancellations there? Is that an area that we should expect to be pretty weak?

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

So on the retail side, obviously, I've got a new set of eyes on the situation here, and we're going to evaluate the retail side for the long term and for the short term.

And so let me address the long-term question first. So we're evaluating the customers that we reach with our products through the channel generally and trying to get a better understanding of who exactly we're serving through that channel and how effective they feel like they're being served through that channel. And so we'll go through that process.

Specifically, on the short term, we've seen fairly consistent results so far, but we expect the demand shock to flow through them as well. We just don't know exactly when that's going to happen.

Operator

Our next question comes from Christopher Glynn with Oppenheimer.

Christopher D. Glynn - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Neil, good to hear you on your first call. And you discussed improving the existing business and the adaptability. I'm just curious, in your view, maybe this question is a little early, but to what extent might this entail a fundamental margin reset over time? And if so, what are your views on enacting such an adaptation quickly or slowly?

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Thanks, Christopher. It's good to be with you. I -- that's an obvious question that we're in the process of evaluating. We -- and I do think it's too early to call. I would take a step back though and say that one of the things that attracted me to this company was the strength of our business model and its adaptability. So as we think about kind of where we want to be 2, 3 years from now, we obviously want our lighting business to be beating the market, and we want it to be the most efficient company in the market. And the exact implications then on how we potentially restructure the income statement a little bit over time are still to be determined.

We've been -- I've been pleased with what I've seen so far about our ability to develop products to engineer them to the appropriate margins to compete at the low, middle and high parts of the market. As an outsider, one of the first things I wanted to understand was how effective we were at competing at each one those sections in the market. And I think our Contractor Select performance is demonstrating that we can compete effectively in pretty much any product scenario.

So then as we think about kind of what our long-term revenue make-up is going to be based on customers we target and products we offer, that will be the ultimate determinant of how we manage that income statement going forward. And our priorities will be to get to a position where can we be a market leader with more predictable revenue growth and appropriate return on our capital.

Christopher D. Glynn - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

That's really helpful. And then just kind of a bookkeeping question for a follow-up. The adjusted SD&A was up about $20 million year-over-year. I'm guessing maybe $5 million or $7 million from the acquisition. So in this demand environment where your revenues are contracting, can you just contextualize the growth in the SD&A?

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Yes, I'll treetop it, and then if you want more specific answers, Karen can jump in here when I'm done. But the big picture, the -- you're right. Most of that was the impact of the acquisitions, so both TLG and LocusLabs which rolled into this period, and then some incentive compensation and other things that were natural as a result of the second quarter performance.

As we're thinking about kind of the changes that we're making as a result of the crisis, I want to emphasize kind of what I said earlier, which is that we're going to -- we're managing, obviously, the variable costs aggressively. And it's worth saying out loud that the variable costs don't manage themselves. So that's hard work, and we're on it. We're also taking a look at the distribution of our fixed costs, so that we're positioned for where we want to be going forward. That work is ongoing. So we'll continue to take a look at that through the period.

Operator

Our next question comes from Brian Lee with Goldman Sachs.

Brian K. Lee - *Goldman Sachs Group Inc., Research Division - VP & Senior Clean Energy Analyst*

I guess kind of staying on the topic of the day, the recessionary environment we're entering here. I know it's still very fluid, Neil, but as you think about framing the potential downside here for the market, if we take 2008 to 2009 as context, there was a roughly 20% decline in revenue for Acuity during that downturn. Why or why not would this downturn be less severe? And I guess that's in the context of just a lot of your end markets right now, commercial, office, hospitality, retail seems like those are seeing the most shutdown and restrictive policies from stay-at-home mandates. So just wondering if you could frame for us a bit how this compares to the last downturn of '08-'09 when revenues were down 20%.

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Yes. I'll start, and then I'll kick it over to you, Ricky, since you were actually -- you actually lived through the '08-'09 downturn and can provide kind of direct comparisons. I'd say the way we're starting to -- we've been modeling this brand as we've been trying to think about it in terms of months and depths and of decline. So this has been sort of a -- it's almost like a series of rolling brownouts is the way I would describe the demand as we're seeing it across the market. Obviously, we've continued to write orders and to sell. And a lot of what we've been supplying is for important things from field hospitals to government facilities to other infrastructure projects necessary to get through this. And so we've seen a range -- we've modeled a range of outcomes by month that are -- could be really steep and -- but we don't know for how long. And the comparison to the 20%

as I -- as, Ricky, as I kick it over to you, really depends on how long the shock lasts and how we can come back out of that. And we don't have a crystal ball.

Ricky, you want to pick it up from here because we're thinking about both on the top line and how that might evolve.

Richard K. Reece - *Acuity Brands, Inc. - Executive VP & President of Acuity Brands Lighting*

Yes. A couple of comments that I would add that I think are different this time both for the type of the recession as well as where we are positioned. First, on the type of recession, the depth may be as deep, no one knows, as what we saw in 2008-2009, but most people believe it won't be as protracted. That big recession lasted for 2 years or so, 18 months, 2 years, before you saw a recovery. Most people -- no one knows, but most people believe this one will -- maybe not a V shape, but that we will see a rebound once this situation passes. And hopefully, we have opportunities to treat this and vaccines and so forth, should we see a rebound.

The other difference this time, I believe, is there is liquidity in the market. The last 2008-2009, there was a pretty significant financial crisis, a lot of liquidity lost out of the market and so forth, both from what the federal government has done as well as just the state of the financial markets. I think there will be more liquidity this time, and the infrastructure spending bills that are being put forward and passed seem to be more implementable and maybe more shovel-ready than what we experienced in 2008-2009. Time will tell, but I do think those are different.

Looking at us as a company, in 2008-2009, 80% of what we sold was into new construction. And clearly, new construction has the biggest potential for the impact in many of the sectors. This time, only about half of our revenues would be into new construction. We're much more into renovation, much more into other aspects than just new construction, and those areas have the potential to rebound quicker than new construction might do.

And then, as Neil said, and just to comment somewhat on the questions earlier from Ryan, while retail stores and all may be down, we are seeing good activity in distribution centers and logistics centers and so forth as people now are buying more and more online, being delivered. So we're seeing good opportunities in aspects of the business beyond the front-facing retail stores. So still hard to know where it's going to play out, not to suggest by any means, we're not going to see a negative demand shock. We certainly think we will, and we're planning aggressively for that. But I do see some stark differences and potentially positive from this one versus 2008-2009, Brian. Great question.

Brian K. Lee - *Goldman Sachs Group Inc., Research Division - VP & Senior Clean Energy Analyst*

All right. No, I appreciate that. That's super helpful context. Second one for me, and I'll pass it on. Just on Tier 3, Tier 4 sales, I might have missed it, but did you break out what the percent of sales in the quarter was or what the growth in that category of products was year-on-year?

And then, I guess, just as a segue into the question. Neil, I know a big part of why you joined the firm is around the sort of the digital transformation opportunity, and given your background, you obviously have a lot of experience with that. As you think about beyond COVID-19 and sort of as we move into more of a normalized environment, whatever that may be coming out of this, do you see kind of, at a high level, a need to sort of pivot the strategy around [transformation] given what might be the fallout in the retail environment? I know a lot of the initial rollouts have been with that community of customers. But are you thinking about it any differently? I know we're only about 3 or 4 weeks into this pandemic, but it seems like the retail end markets would see the most amount of transformation potentially coming out of this and wondering how that might impact the strategy around your digitalized approach in Tier 3 and Tier 4 specifically.

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Yes. Brian, I'll chew on some of that, and then, Karen or Ricky, jump in here at the end with any specifics that you feel like I left out. So Brian, just to start where you finished, I think it's undeniable that this will be one of those events that, after which, nothing will be exactly like it was before. So we are -- as we imagine kind of the strategy for the company going forward, we are mindful that we expect there to be pretty major changes coming out of this. To spend a second again on digital transformation, I think one of the things that people often do is think that digital transformation is somehow using technology in the organization, which is why I went through the 4 things, but it's really what we do and how we do it.

So you picked up on the strategic part. As we think about kind of what services we can provide with our technology to other end points, both retail and otherwise, it really falls into 2 buckets, which is we can either be in the business of moving market share or we can be in the business -- our data can be in the business of moving market share or delivering efficiencies for our partners. So as you think about kind of the technology that we've obviously rolled out at retail first, there are real opportunities to do both in those categories. And those needs will probably be more prescient after this than they were before this. The efficiencies necessary also will translate into other examples.

Ricky mentioned the impact in industrial facilities and the opportunities that, that presented. I was in our Des Plaines distribution and manufacturing facility, and we run Atrius in that facility to manage all of the materials in that. So we have an app that we use there that manages or evaluates the productivity of forklifts. It's -- on the face of it, it's a small thing, but it's a window into the different ways that this technology can be used. So I think it's a truism of technology that the impact is overestimated in the short term and underestimated in the long term. And I think our location-aware applications that we're describing here will continue to -- will take longer than we expected to realize, but the potential opportunity may even be larger than we originally expected.

And then second, on just kind of the general technology evolution, I would say that like at all parts of the business, both the lighting part of the business and then the controls and other kind of -- and ultimately location-aware applications will continue to walk themselves off a technology curve. So the -- I often describe technology companies is there -- it's really not about 1s and 0s or about technology products but about really the length of their product life cycles. And so as we shorten those product life cycles, we can be continually moving customers and products up the curve of technology. So that'll happen. We expect -- we all expect that to continue to happen in our core businesses, both the lighting businesses and the controls businesses that we've historically lumped into tiers.

So big picture, I think that it's going to take a while, and it might be slightly different. But the -- upon the kind of location-aware applications. But big picture, they're about data that either moves market share or create sufficiencies for customers and companies, and they have applicability in multiple different verticals over time. I feel pretty confident about that. And then our controls business can and will continue to be a grower and has real market opportunity.

Ricky or Karen, do you want to add to any of those specific answers?

Richard K. Reece - *Acuity Brands, Inc. - Executive VP & President of Acuity Brands Lighting*

Just a couple of comments from me. And then, Karen, you may want to provide some of the specifics on the percentage of sales and growth of Tier 3, Tier 4. But I will say Tier 3, Tier 4 continues to be a focus. The solutions we're building that are much more than just the Atrius, we do have the network, energy-focused type solutions that we sell. The unified system is getting traction and so forth. So actually pretty excited on the development in all side of Tier 3 and Tier 4. Obviously, the current situation may slow down sales of those products, but we are going forward, launching some new solutions into that Tier 3, Tier 4 world, leveraging some of the technology we got with the recent acquisitions but also further integrating the businesses and the technologies that we have. Examples is single-room control. We'll be launching here later this year, a very exciting product that I think will be well accepted as a way to very efficiently commission a single-room control that would be code compliant and provide the energy savings. So a lot of activity continues in Tier 3, Tier 4, and we see it as a good growth engine for us.

Karen J. Holcom - *Acuity Brands, Inc. - Senior VP & CFO*

Yes. And specifically, our Tier 3, Tier 4 sales are consistent with what we've reported before. They're about the 15% to 20% range of our revenues.

Operator

Our next question comes from Deepa Raghavan with Wells Fargo.

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

Neil, welcome and look forward to your leadership. A couple of questions from me. Can you talk about the order book performance towards March end and how that compares versus February or even your negative 7% volume growth this quarter? What I'm more looking for is any sensitivities around how to think about upcoming quarter, just given the job sites being closed could mean that even renovation projects are being impacted.

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Yes. Ricky, I'll let you pick that one up.

Richard K. Reece - *Acuity Brands, Inc. - Executive VP & President of Acuity Brands Lighting*

Absolutely. Yes, it's interesting. We are seeing probably all the different things you might expect. We are seeing some markets where the construction sites are shut down. So obviously, we're not shipping product into those. We have other parts where we're seeing projects being accelerated. So we are shipping ahead of when we might have otherwise as they're trying to get product in ahead of any disruption that may occur in the supply chain. We're seeing business as usual in some parts of the country. All to say that the impact in March has not been significant. Yes, we've seen a bit of a slowdown, but it hasn't been significant. And I think the strong performance -- and I want to give my thank you to our supply chain team and our suppliers and vendors that we've been able to continue to provide that supply and continue on. We don't certainly expect as more construction sites get slowed down and as this goes further that we will see a drop in demand, and as Neil mentioned earlier, are planning accordingly. Exactly when that hits and how deep it hits, no one knows. But we are aggressively managing our variable cost to be prepared for that as well as looking at the fixed cost. But as of now, yes, we've seen a bit of a slowdown, but it's still going reasonably well.

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

Got it. Neil, a question for you, probably a little early, but I'll ask it anyway. Can you provide us your thoughts on the need for near-term capital preservation versus your maybe initial thoughts on long-term basis for capital deployment, ideas on buybacks, M&As versus dividends?

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Yes. Sure. The -- as I started to detail in our comments earlier, Deepa, we are -- we feel really good about the strength of our balance sheet entering this. And as we've stress-tested the model for the company through this period, we are obviously building up from cash forward. And as Karen mentioned, we have access to significant additional liquidity. So we feel like we're as well positioned kind of going into this as we possibly can be.

As we think about kind of what we're going to do with cash in the intermediate and then longer term, first, on the kind of the intermediate term, obviously, we're going to -- we need to mind our knitting and take care of ourselves first. So we need to make sure that we stay liquid, we stay as well positioned as we can. Then as we look forward, we're obviously going to be paying attention to how this impacts other companies in our business and the ones adjacent to us to understand kind of where they are. We'll be mindful of our own company's value and performance. But our bias for the long term is that we believe we have a highly efficient cash-generating business, which returns high returns on invested capital, and we'd like to use that capital -- we'd like to bias the use of that capital for growth both through reinvestment in our business as well as to add adjacent businesses to great size of the company.

Operator

Our next question comes from Jeff Osborne with Cowen.

Jeffrey David Osborne - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Just 2 quick ones on my end. I was wondering, Neil, if you could update us on the situation in Mexico and your manufacturing facilities there. Any reduction in throughput with social distancing or how the facility in general is doing with some of the approaches that Mexico has taken with COVID-19?

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Yes, sure, Jeff. I've have been down to Monterrey twice now. We started working on people flow and sanitation starting January 31, and they have implemented a number of different changes there so far. Currently, all of our facilities are operating there. We are meeting demand. The backlog and the activations there have been consistent with historical performance. Even as we've restructured the facilities, moved people apart, implemented everything from temperature checks to increasing the size of the manufacturing cells there so that we can spread people apart while they're working to changing the people flow so that cells don't come in contact with the cells unnecessarily. So for example, they all go eat at the same table at lunch every day with the same people, so there's no overlap. So far, we continue to operate there.

As you alluded to in your question, the situation in Mexico is evolving and evolving pretty rapidly. So some of the other states in Mexico have implemented more stringent kind of stay-in-home or sheltering restrictions. That has not yet happened in Monterrey. We're working with the authorities there to -- obviously, we're an essential business because you can't build any of the things necessary to get through this without lights. So we're continuing to work through that. And we're -- we have a very constructive positive relationship with the authorities there to -- and our associates to help make sure that we're doing everything that we can, and we'll move forward. But as you alluded, the context there is fluid. It continues to change. But as of now, we're operating at -- we're meeting demand there in Mexico.

Jeffrey David Osborne - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

That's great to hear. And then my second question was around your approach to the monthly modeling and sensitivity. Not looking for what the specific figures are, but certainly, regional diversification is imperative to understand as it relates to an outsider understanding what your exposure is to the current situation, let's say, in April and the first half of May. And so can you just give us a sense of context either for the last fiscal year or more recently, what's your mix is as it relates to, say, the state of California and the Northeast in aggregate? Is it similar to the GDP generation of America, 2/3 or so? I'm just trying to get a sense of your regional diversification. Certainly, states like Georgia have just implemented measures relative to California being the first. So I'm trying to understand, as we think about, in particular, this upcoming quarter, what's your scope of reach is on a diversified geographic perspective.

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Yes, I'll start and then I'll pass it to Ricky for any additional color. Our modeling has been to being dramatic and to be relatively universal. So as we've looked at it from a build-the-company-up perspective, we are looking -- we don't want -- we have not allowed precision to be the enemy of insight as we've done our modeling. So we've assumed kind of the worst cases and worked our way back from there. As Ricky stated, and I'm about to hand off to him, but as Ricky alluded to before, our demand so far has not obviously been the worst case. And we've seen it kind of roll through different areas of the country. I'm talking about demand, not the demand shock.

So Ricky, do you want to address kind of how that's happened and how you think about our regional diversity?

Richard K. Reece - *Acuity Brands, Inc. - Executive VP & President of Acuity Brands Lighting*

Absolutely. We are, Jeff, pretty consistent, as you suggest, with the GDP around the country. I would say we may be a little, and I stress a little, I'm talking percentage points, a little less in maybe the very large urban areas and a little more, therefore, in the rural, heartland type areas. Some of that goes back to the legacy of one of our brands, our largest brand, Lithonia Lighting, which was the best value in lighting and does extremely well throughout the country. And our focus has been probably disproportionate there versus some of the more architectural higher end that would be bigger in the urban areas, think of New York City, Chicago and L.A. and so forth. Having said that, we've done a lot to build out our architectural capabilities and so forth. So we're pretty close to that. And yes, we are seeing, as you would expect, in the geographies where they are having the most impact from this pandemic and are having construction sites shut down or shelter in place and so forth, those are the areas we're seeing a bit more of an impact than we are in other parts of the country.

Operator

Our next question comes from John Walsh with Crédit Suisse.

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

Welcome to Neil.

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Thanks, John.

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

I guess maybe coming at the kind of the throughput and some of the variable cost question from a different angle, can you talk about how you're managing your inventory levels or how you kind of plan to manage them in the coming months? Should we think that there'll be kind of a drawdown on inventory as the demand outlook is a little bit uncertain? Or any color you could provide there as we think about how it relates to free cash flow in the coming months as well?

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Yes. Sure. That's a great question and one we've spent a fair amount of time on. So again, I'll start, and then, Ricky, jump in if you feel like you want to add something. But because there are 2 things going on here, there's -- the impact of this rolls through, first, the supply shock as Asia and China specifically started to shut down. And then there's the -- which -- some of which the impacts of -- are continuing. And then there's the -- how long does this last and how do we smooth our production and such through this. So I'd hit kind of maybe 3 big buckets there. The first is on Asian finished goods inventory. We have been pretty consistent about maintaining that supply so that we can make sure we're in the market with those products over the last month, and we'll continue to do that over the next.

The second is that we've been aggressive about making sure that we have access to necessary components for our other products. So the -- and where we might have been easing back on inventory in preparation for this, we've made sure that we have supplies there, not in an irresponsible way, but in a way that -- to make sure that we're available to the market and we come through this -- both through this and after this as the supplier that the market could count on.

And then finally, the production and management of our production efforts. We still manage, as you know, a pull-based system. So we are building to demand there, so we're modulating where the inventory levels as they come through that. But basically, we are building to demand.

Ricky, anything you want to add to that?

Richard K. Reece - *Acuity Brands, Inc. - Executive VP & President of Acuity Brands Lighting*

Yes. I would just stress that we are pretty far in our lean journey, particularly in the supply chain. Virtually all of our inventory, both components as -- and finished goods is on kanban. So as Neil rightly explained, very much a pull-based. So as we see demand slow down, it will automatically slow down the purchasing of components and finished goods to match that demand. Yes, we do a little bit of oversight on that as we know of big projects or spikes that may come into that. But it works really well. We're well tied into our supply base. So I'm confident that we will be able to continue to aggressively manage this inventory during this time frame. But we do, as Neil said, want to take advantage of our size and scale to be that supplier that people can count on, if the rebound comes back very quickly or as we're seeing there's critical demands, whether it's for mobile health care facilities or infrastructure projects and so forth that we can be a supplier they can count on to support them.

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

And then a perfect follow-up to that is, some of the smaller suppliers when we do our checks is they might have a project, but they can't give the customer a shipping date. Is that an opportunity because your supply chains haven't been as impacted? Can you actually go and win that business that you might not have already won? Or is this more of an opportunity on the other side where when you're talking to the customers, they know that you're going to be reliable. So I understand on the other side of COVID, right, but just wondering if there's actually an ability to win business that you didn't previously win because you have the product today.

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Ricky?

Richard K. Reece - *Acuity Brands, Inc. - Executive VP & President of Acuity Brands Lighting*

Yes, yes, absolutely, there is. And in fact, we have done some of that. And that's true even without a crisis like this. There's always times when a supplier, for whatever reason, isn't able to supply and the customer obviously looks for an alternative. But because of our fortunate situation, at least today, and I am knocking on wood, that our supply chain and our production facilities and our distribution facilities are operating at a level to reach demand -- meet demand, we have been able to take some opportunistic business that unfortunately, others -- unfortunately for others, not for us, but for them, that they were not able to service. So we have had some of that. And then we'll continue to, as I said, be that reliable supplier that they can turn to. And I agree with you, on the back end, could be even the greater opportunity. If we can serve them through this, then that will give them the confidence to rely on us on the back end as well.

Operator

Our final question comes from Tim Wojs with Baird.

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

Welcome, Neil.

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Thanks, Tim.

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

Just -- maybe just going back to just priorities and maybe potential investments both near and intermediate terms. I guess from where you sit today, do you think you can fund any sort of incremental investment through the P&L, through kind of the existing expense structure? Or do you think you might have to build some additional capacity for potential investments?

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Are you talking about in the medium term or in the medium term and longer?

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

Yes, I'd say probably more in the medium term, just given the overarching macro situation.

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Yes. So one of the things you'll hear from me a lot is that time is the only constrained resource. There's always more of everything else than there is of time. And the time of your most valuable people is the most constrained resource. And so as we think about kind of reinvestment that ultimately manifests itself in results on the P&L, we think about how can we use the time of our most valuable engineers and other associates as productively as possible. So that's what we're really focused on during this period of uncertainty and as we go forward.

As we think about kind of the medium and longer term, I believe that our more mature businesses we can hold -- we can evaluate their growth and their reinvestment on their ability to grow and return on invested capital. We will need to obviously protect our developing businesses a bit, and that may require us to invest in them and to take some impact to the P&L to do that. And if we do that, I think we have an obligation to be relatively transparent with you about what our thoughts are on that without affecting, obviously, our competitiveness by doing so. But I think that we have the opportunity to build very attractive businesses. And over time, we want to be in a position where we are delivering organic revenue growth and we're delivering -- continuing to deliver a return on invested capital in a -- in hopefully a much larger-sized enterprise with more lines of business than we currently do.

So that's the aspiration. That's where we want to get to. And we want to -- we are willing to use our financial strength to do that both on the income statement and on the balance sheet. And we'll -- over time, we'll obviously bring you along with us in our thinking on that so that you can know and hold us to account to our performance about it. But I came here because we all believe that we have a solid foundation. We have a company and a business that is more durable than I think is currently appreciated, and we'll demonstrate that through this downturn that we are efficient cash generators, that we have market access, and we have talent and real opportunity to grow and acquire additional lines of business, which complement our current lines of business.

So we're obviously -- despite the near-term, and short-term hopefully, but near-term impacts of the current situation, we're going to get through that and then we're going to really get -- hopefully be in a good position to grow the enterprise over time.

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

Okay. Okay. No. That's helpful. And then just a housekeeping question. On the SD&A line, is there a way to break out for us how much is kind of a pure variable cost in terms of, like, shipping and some of the incentives you pay to the agents, and then how much of that is really fixed in terms of just your overhead in your SD&A?

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

Sure. I'll let Karen handle that one.

Karen J. Holcom - *Acuity Brands, Inc. - Senior VP & CFO*

Sure, Tim. We don't -- you won't see that in our public filings. We don't break that out separately. But one thing you can look at is when you're looking at the disaggregated revenue disclosure, and you see that mix shift towards more of the independent sales network, you will see an increase in the SD&A because of the higher commissions when that mix shift happens to those channels. So you will see a bit of a shift there.

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

Okay. I'm trying to think of if volumes would go down, how much of the SD&A would just kind of go away from not having to pay a commission or not having to pay freight?

Richard K. Reece - *Acuity Brands, Inc. - Executive VP & President of Acuity Brands Lighting*

Now Karen, I think in the past, we've indicated that's in the 12% range -- 12% to 13% range in the aggregate that's pretty directly variable in the SD&A cost.

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

Okay. Okay, great.

Karen J. Holcom - *Acuity Brands, Inc. - Senior VP & CFO*

And just consider that mix shift as well.

Operator

Thank you for participating in today's Q&A. I would like to turn the call back over to Mr. Neil Ashe for closing remarks.

Neil M. Ashe - *Acuity Brands, Inc. - President, CEO & Director*

As I started, it's a pleasure to be with you all. I wish -- I know we all wish the global context were different, but we're excited to be with you, and we want to thank you for your interest in our company and for being a part of this journey with us as we start on the next generation of Acuity. So thank you for your interest and your time, and we'll be in touch again soon.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.
