THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

## AYI - Q1 2020 Acuity Brands Inc Earnings Call

EVENT DATE/TIME: JANUARY 09, 2020 / 3:00PM GMT

**OVERVIEW:**

Co. reported 1Q20 net sales of $835m, reported operating profit of $83.6m and reported diluted EPS of $1.44.

## CORPORATE PARTICIPANTS

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

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

**Vernon J. Nagel** *Acuity Brands, Inc. - Chairman & CEO*

## CONFERENCE CALL PARTICIPANTS

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

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

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

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

**Joseph Amil Osha** *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

**Kai Shun Chan** *Robert W. Baird & Co. Incorporated, Research Division - Junior Analyst*

## PRESENTATION

**Operator**

Good morning, and welcome to Acuity Brands Fiscal 2020 First 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 may begin.

---

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

Good morning. With me today to discuss our fiscal 2020 first quarter results are Vern Nagel, our Chairman and Chief Executive Officer; and Karen Holcom, our Senior Vice President and Chief Financial Officer. 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 first quarter press release.

I would like to remind everyone that during the call, we may make projections or forward-looking statements regarding future events or future financial performance of the company. Such statements involve risk and uncertainties such that actual results may differ materially. Further, forward-looking statements speak only as to the date that they are made, and we undertake no obligation to update publicly any of these statements in light of new information and 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 on forward-looking statements.

Now let me turn this call over to Vern Nagel.

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

Thank you, Pete. Good morning, everyone. We have a great deal to discuss this morning, including our CEO succession plan, which I will address later in the call. But first, Karen and I would like to make a few comments regarding the quarter, and then after we will answer your questions.

As you will recall from our last earnings call, we expected our net sales to be down this quarter compared with the year ago period, primarily due to the significant pull forward of orders last year as customers placed orders in advance of 2 announced price increases, and to a lesser degree, the impact of our efforts to improve the margin profile of our product portfolio. While the precise impact of this pull forward in the year ago period was impossible to determine, we felt it was probable our net sales would decline this quarter by mid- to upper single digits from last year. This decline played out pretty much as we expected. However, we believe the decline in our net sales this quarter was also exacerbated by additional weakness in the overall demand primarily due to continued concerns over global trade and the economic issues.

Nonetheless, our results for the first quarter were solid despite these issues as witnessed by our enhanced gross profit margin profile and strong cash flow from operations. In addition, we took several actions in the quarter to better align the resources of our company to current demand and to further invest in our key strategies to drive profitable growth in the future. Some of these actions resulted in a special charge this quarter, which we will further discuss later in the call.

I know many of you have already seen our results, and Karen will provide more detail later in the call, but I would like to make a few comments on the key highlights for the first quarter of 2020.

Net sales for the first quarter were $835 million, a decrease of 10.5% compared with the year ago period. Reported operating profit was $83.6 million compared with $116.4 million in the year ago period.

Reported diluted earnings per share was $1.44 compared with $1.98 in the year ago period. There were adjustments in both quarters for certain special items as well as certain other add backs necessary for our results to be comparable between periods as Karen will explain later in the call.

In adding back these items, one can see adjusted operating profit for the first quarter of 2020 was $119 million compared with adjusted operating profit of $134.1 million in the year ago period. Adjusted operating profit margin was 14.3%, a slight decrease of 10 basis points compared with the margin reported in the prior year, even with net sales down 10.5% from the year ago period.

Adjusted diluted earnings per share was $2.13 compared with $2.32 earned in the year ago period, a decline of 8%. Net cash provided by operating activities was a solid $130 million this quarter, while our cash position at the end of the quarter was $267 million even after investing over $300 million for strategic acquisitions and investments made during the quarter, leaving us with plenty of liquidity to execute our growth strategies.

Looking at some specific details for the quarter. Net sales decreased 10.5% from the year ago period. Overall, net sales volume declined approximately 16%. While the price/mix of products sold was favorable this quarter by approximately 3%, we estimate price/mix was impacted by a favorable shift in channel mix and to a lesser extent, realization from price increases implemented in fiscal 2019 partially offset by 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 basic, 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 2.5% to our growth, while the impact of changes in foreign currency was immaterial this quarter. As I noted earlier, the decline in net sales this quarter compared with the year ago period was due in large part to the significant pull forward of orders last year as customers acted to avoid the impact of 2 announced price increases, one in September to help offset inflationary cost pressures and another in October due to enacted tariff increases on Chinese-made components and finished products.

In addition, we believe demand in the first quarter for private nonresidential construction in general, and more specifically, lighting was weaker than most experts originally forecasted with the lighting market being down year-over-year in the low to mid-single-digit percentage range. We believe these declines were due in large part because of the continued concerns of the global trade and economic issues.

These next few points are important in further explaining the movement in our top line. From a channel perspective, while we experienced declines in most channels, there were 3 key areas of significance. First, net sales through our independent and direct sales networks, which makes up approximately 84% of our total net sales, were off approximately 6% this quarter compared with the year ago period.

Our performance in these 2 networks compared with the year ago period was impacted by the pull forward of orders just noted, continued weak demand, primarily for larger commercial projects where we have particular strength and the completion of certain larger project -- infrastructure projects in the year ago period. The impact of these items was partially offset by implemented price increases, the contribution from acquisitions, market share gains in certain lighting categories, including for certain Lighting Controls and our Contractor Select portfolio as well as growth of our building management solutions platform at Distech, which again performed exceptionally well this quarter. While shipments were down in these key networks, we believe that our performance was reflective of overall market conditions and not specific to Acuity.

Second, lower shipments in the retail channel accounted for about 1/3 of the total decline in net sales this quarter compared with the year ago period. The decline in this channel was primarily due to the impact of load-ins in the year ago period for a major customer

(technical difficulty)

repeat this year and from the impact of previously announced actions taken by the company to eliminate or significantly reduce shipments of those 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, primarily in the retail sales channel and more favorable gross profit margins.

Lastly, net sales in our corporate accounts channel were down almost $18 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 very lumpy based on the nature of the construction cycle of customers serve primarily big-box retailers. Nonetheless, we continue to add to the total square footage covered by our connected lighting and our Atrius-based IoT solutions. I will speak more about our advancements in this channel later in the call.

Our adjusted operating profit for the quarter was $119 million, down approximately $15 million compared with the year ago period while adjusted operating profit margin for the quarter was 14.3%, down 10 basis points from the year ago period. Furthermore, there are some additional points for you to consider as you evaluate our financial performance this quarter.

First, our gross -- our adjusted gross profit margin for the first quarter was 42.8%, an increase of 330 basis points compared with the year ago period, a huge improvement and the highest that we have had in the last 12 quarters despite the decline in net sales volume. Adjusted gross profit was $357 million, down approximately $12 million from the year ago period. The decline in adjusted gross profit was primarily due to the impact of lower net sales as well as higher cost due to the enacted tariffs. These factors were partially offset by favorable price/mix, lower cost for certain inputs and the contribution from the acquisition of TLG.

The really important point here is that our efforts to prune our product portfolio and reduce our channel exposure to those products that do not meet our profit profile and to capture price all had a net positive impact on our adjusted -- our adjusted profit margins this quarter while not unduly impacting our profitability. And to be very clear, this is while growing our value-oriented Contractor Select brand. Further, our adjusted SDA expenses were up approximately $3 million or a little more than 1% compared with the year ago period.

Adjusted SDA expense as a percentage of net sales was 28.5% in the first quarter, an increase of 330 basis points from the year ago period primarily due to the decline in net sales. The increase in adjusted SDA expense measured in dollars was relatively modest on a year-over-year basis, but very significant when measured as a percentage of net sales suggesting our cost structure is too high, given current market demand.

As a consequence, the company initiated a number of actions to streamline its operations to be more consistent with current market demand to reduce our cost structure and to better allocate resources toward programs with higher profitable growth potential. Karen will provide more details on our special charge later in the call.

Our adjusted diluted earnings per share this quarter was $2.13 compared with $2.32 reported in the year ago period. The decrease was primarily due to lower adjusted pretax income, partially offset by a lower effective tax rate this quarter as well as lower average shares outstanding.

Before I turn the call over to Karen, I would like to comment on a few important accomplishments this past quarter. On the strategic and technology front, we continue to make positive strides, setting the stage for what we believe will be solid growth in revenue and profitability over the longer term. This quarter and in December, we continued our torrid pace of introducing innovative and cost-effective solutions that we believe will drive profitable growth for Acuity over the longer term.

We also continued our pruning efforts to reduce the sale of lower-margin products sold primarily in the retail channel, while we invest to bring innovative and cost-effective solutions to our preferred customers in this important channel.

From a commercial perspective, we continue to experience success in our connected lighting Atrius-enabled solutions. Our products and services enjoy strong market acceptance in retail applications, now deployed in over 5,000 retail stores in North America. We have several large retailers with our Atrius SaaS applications now deployed or in detailed evaluation. Currently, those early technology adopters are now activating Atrius services as part of their customer engagement, customer insight and associate productivity enhancement programs. Increasingly, we see data analytics and data science opportunities generated by our connected lighting Atrius platforms as critical areas of investment, allowing retailers and now others to garner valuable insights about their businesses and facilities from our services.

Additionally, we expanded our connected lighting Atrius-based solutions into other verticals as awareness by these customers of our meaningful points of differentiation and the broad capabilities of our IoT solutions increased significantly, particularly as they realize the opportunity to transform their spaces from expense items to strategic assets. These additional verticals include major airports, light industrial facilities, including warehousing and health care.

Net sales of our Contractor Select portfolio grew again this quarter particularly in the C&I market and now makes up slightly more than 10% of our net sales. Contractor Select is our fighter brand in response to those Chinese-based lighting companies, many of which we believe are clearly being subsidized in some form that are influencing pricing for certain basic, lesser-featured fixtures sold in certain channels. Again, we are very pleased with the growth and profitability of this product portfolio, and we will not yield this portion of the market for many strategic reasons.

We continue to make positive strides in expanding our industry-leading Lighting Control platform and light as well as our building management systems business, Distech, which grew nicely again this quarter. We believe Acuity has the most comprehensive and feature-rich wired and wireless commercial Lighting Control systems available, and importantly, are connected to our growing BMS solutions, providing customers with even greater functionality.

Further, we initiated many actions this quarter to further streamline our operations to reduce cost and improve our productivity. We believe these initiatives will enhance our future operating and financial performance as well as allow us to accelerate investments in areas with higher growth opportunities.

And lastly, we continue our efforts to complement our solutions portfolio with strategic acquisitions and investments, including the acquisitions of The Luminaires Group in mid-September and LocusLabs in November. The Luminaires Group or TLG is a leading provider of specification-grade luminaires for commercial, institutional hospitality, and municipal markets, all of which complements and enhances our architectural lighting platform. LocusLabs is a leading indoor mapping and location platform whose software supports navigation applications used on mobile devices, web browsers or digital displays in airports, event centers, multi-floor buildings and campuses.

The combination of LocusLabs technology with our Atrius IoT platform will provide venues with an enhanced indoor positioning system that can be rapidly deployed and easily maintained, enabling visitor and employee wayfinding, asset tracking and business analytics.

We are pleased to welcome the associates of The Luminaires Group and LocusLabs to the Acuity family. In addition, we made small but important investments in 2 innovative early-stage companies to enhance our lighting control platforms for circadian lighting and smart sensing solutions.

Our solid performance despite continued economic challenges is a result in dedication and resolve of our 12,000 associates who are maniacally focused on serving, solving and supporting the needs of our key stakeholders.

I will talk more about our expectations for fiscal year 2020 later in the call. I would like to now turn the call over to Karen. Karen?

---

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

Thank you, Vern, and good morning, everyone. As Vern mentioned earlier, we had some adjustments to the GAAP results in the first quarter of fiscal 2020 and 2019, 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 non-GAAP measures for the first quarter of fiscal 2020 and 2019. Adjusted results exclude the impact of 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 these 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.

During the first quarter of fiscal 2020, we recognized a pretax special charge of $6.9 million in order to streamline the operations to be more in line with current market demand and to allocate resources to activities with higher profitable growth opportunities. These charges consisted primarily of severance cost and lease impairments related to planned facility closures.

Additionally, we recognized relocation cost and lease asset impairment associated with the previously announced transfer of activities from planned facility closures. We expect to continue to incur additional cost in future periods related to current streamlining actions primarily attributed to moving costs associated with the closing of certain facilities. We expect that these actions to streamline our business activities will allow us to reduce spending in certain areas, while permitting continued investment in future growth initiatives, such as new products, expanded market presence and technology and innovation. We expect to achieve pretax savings in fiscal 2020 in excess of the special charge, with most of the benefit occurring in the second half of the fiscal year.

Fiscal 2020 first quarter results were impacted by the adoption of Accounting Standards Codification 842 leases, which requires most leases to be included on the balance sheet.

We adopted ASC 842 using the modified retrospective method and applied the standard to all leases existing as of September 1, 2019. Information for prior years presented has not been restated and continues to reflect the standards in effect for those periods. As of September 1, 2019, we recognized total operating lease liabilities of $64.7 million in our consolidated balance sheet. We additionally adjusted our consolidated balance sheet to derecognize $5.1 million of previously recorded net deferred rent balances and reported right-of-use assets of $59.6 million related to our operating leases.

Please refer to Note 4 to our financial statements included in our Form 10-Q filed earlier today for additional details of the impact of the adoption of the new lease accounting standard on the balance sheet.

The effective tax rate for the first quarter of fiscal 2020 was 22.9% compared with 25.2% in the prior year quarter. We currently estimate that our blended effective income tax rate before discrete items will approximate 23% for fiscal 2020. We generated $130 million of net cash flow provided by operating activities during the first quarter of fiscal 2020, which was relatively flat compared with $132 million for the year ago period. During the first quarter of fiscal 2020, benefits of the decrease in operating working capital were offset by the lower net income.

At November 30, 2019, we had a cash and cash equivalent balance of $267 million, a decrease of $194 million since August 31, 2019. The decrease was due primarily to fund acquisitions and investments in plant and equipment and to pay dividends, which is partially offset by the cash flow from operations.

During the first quarter of fiscal 2020, we spent $302 million related to the acquisitions of both The Luminaires Group and LocusLabs. Our total debt outstanding was $356 million at November 30, 2019. Our debt to capitalization at November 30, 2019, was 15.2%, and our net debt to capital was 4.3%. At November 30, 2019, we had $350 million of publicly traded senior unsecured notes outstanding at a 6% interest rate.

On December 16, 2019, the notes matured, and we refinanced with borrowings under our term loan facility. We borrowed the full $400 million available under the term loan facility as the delayed draw mechanism expired at the end of December. These borrowings are currently based on the short-term borrowing rates that are currently approximately half the rate of the public notes. The estimated interest savings associated with the refinancing of the public debt is $7 million to $8 million for the remainder of fiscal 2020, assuming no meaningful change in short-term interest rates.

Currently, we have additional borrowing capacity of approximately $396 million under our bank credit facility. The bank credit facility and term loan mature in June of 2023. Please see Note 19 in our Form 10-Q filed today for more information.

We clearly enjoy significant financial strength and flexibility to support our growth opportunities, which may include acquisitions, and we will continue to seek the best use of our strong cash generation to enhance shareholder value.

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

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

Thank you, Karen. While current market conditions in the overall lighting industry continue to be challenging, we are optimistic regarding our long-term future and that of our markets. We believe our many actions to improve our market reach, enhance our customer solutions and capabilities and drive company-wide productivity will help optimize our financial performance in the future, while affording us the opportunity to continue to invest in areas we believe have high profitable growth potential over the longer term. That notwithstanding, we believe current market demand for lighting will continue to be sluggish and inconsistent so long as concerns over key economic issues, including global trade policies and the potential for future tariffs remain unresolved. We are hopeful that the recent announcements regarding key global trade issues will remove these uncertainties that have negatively impacted the private nonresidential construction markets over the last several quarters.

On a positive note, we are seeing some early indicators, such as the Dodge Momentum Index turning positive for the first time in a while, which could suggest an improvement in the -- in market conditions for lighting in the latter half of calendar 2020.

In addition, we believe there are a few other factors that will continue to influence the lighting market, including continued product substitution to lower-priced alternatives for certain products sold through certain channels, labor shortages in certain markets and continued cost increases, particularly for imported electrical components and finished goods as well as higher freight and wages, though announced streamlining actions as well as a decline in certain input costs should help mitigate some of these factors. As we mentioned in our last earnings call, we are maniacally focused on executing our plans to grow market share, improve our margin profile and to reduce our cost structure to be more consistent with overall market conditions.

As I mentioned on our last earnings call, those action items include continued introduction of new innovative solutions, including the expansion of our Atrius-enabled lighting solutions into the retail and other key verticals as well as the expansion of our Contractor Select portfolio to more aggressively gain share in certain market segments. And lastly, actions to improve our productivity and cost structure.

These growth and margin improvement initiatives are part of our longer-term growth strategy to fulsomely leverage our market leadership position with technology-enabled solutions that are differentiated and valued by customers so we can gain further market share and to appropriately structure our business to the current opportunities to enhance our profitability and cash flow.

Further, the execution of our integrated tiered solutions strategy, including the expansion of our Tier 3 and 4 holistic lighting, building management and our Atrius platform and software solutions and our opportunities to participate in the interconnected world is an integral part of our overall longer-term profitable growth strategy to meaningfully expand our addressable market by adding broad-based holistic solutions that will allow our customers to transform their connected intelligent buildings and campuses from cost centers to strategic assets.

Lastly, our goal is to outperform the growth rates of our key markets and channels we serve. While our strategies include further penetration of the renovation markets particularly for meeting to smaller projects, which continue to experience growth, we are still leveraged to longer cycled, larger commercial projects, which have been most impacted by the global economic issues noted earlier. Additionally, while we expected to participate in the retail sales channels by serving the needs of our customers in a mutually beneficial manner, our efforts to improve our profitability in this important channel could continue to result in lower shipments.

Last evening, we announced that Neil Ashe will become the next President and CEO of Acuity Brands effective January 31. We are extremely excited and pleased to have attracted a leader with Neil's background and long track record of entrepreneurial success to lead our great company as we continue the transformation of Acuity into a global industrial technology company.

Neil is a proven leader whose knowledge and skill in expanding and transforming businesses in rapidly changing markets will enhance and accelerate Acuity's ability to leverage its portfolio of technology and solutions to create great value for our key stakeholders in a globally competitive environment.

By way of background, the Acuity board began the process for senior leadership succession with the promotion of Karen to the role of CFO on September 1. Ricky became President to assist me in running the day-to-day operations of the company, while continuing to develop our very talented leaders. The Board originally anticipated that the search for my successor would be deliberate, open process, not be time-bound beginning sometime in 2020, most likely taking a full year to complete, followed by a normal transition period. As it happened, I was introduced to Neil almost a year ago. We began working with Neil to assist us in exploring new avenues to accelerate the adoption of our technologies, including our Atrius-based IoT solutions. During that process, I introduced Neil to the Acuity Board, first, to consider him as a Board candidate and then more recently, as a CEO candidate.

As I said, our succession plan for me was not time-bound, but when the right person with the right experience and leadership skill is before you, I said to our Board, you should move quickly, and we did. Our succession plan has been designed to ensure that Acuity will provide consistent and lasting stability to our customers and associates in an ever-changing landscape. We have attracted a seasoned leader in Neil with a proven track record of great success in rapidly changing and dynamic environment to lead our great company for years to come. We are confident Neil will build on our robust platform to create even greater value for our customers, associates and shareholders.

On a personal note, I'm extremely proud to have led this great company and its associates for the last 15 years. We accomplished a great deal, transforming the company into a technology leader in our industry while enhancing our market leadership position. I am particularly proud of the 12,000 associates at Acuity, including our senior leadership team. They dealt with economic adversity, including the Great Recession, they had to embrace change to not only survive but to thrive during one of the greatest technology changes any industry has ever witnessed. And along the way, they changed the financial profile of this company into a high margin, high return on capital and robust cash flow generator well beyond many of our industry competitors.

During our time together, we have more than doubled our net sales, tripled our operating margins and created an eightfold increase in shareholder value. Today, we have a great team of associates that embrace change and use it as a competitive advantage as well as a culture of continuous improvement to bring exceptional value to all of our key stakeholders.

We have a tremendous company with great associates, market-leading solutions and a very strong financial profile that will provide Neil and team with a strong platform to drive profitable growth in the future. I am pleased that Neil and the Board have asked me to continue as Executive Chairman, and Ricky as President of our Lighting company and EVP of Acuity to ensure a smooth and effective transition.

Thank you. And with that, we will entertain any questions that you have.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question comes from the line of John Walsh with Crédit Suisse.

---

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

So I guess looking back in the model, you didn't use to have that much variability around your gross profit margin line within a year, looking kind of quarter-to-quarter. Obviously, very good start beginning of the year. We do expect some volume kind of to come back towards the back end of the year. Should we be able to kind of hold this level around the gross profit margin and go back to that kind of historical pattern where 1 quarter to another quarter, there wasn't a lot of variability?

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

So our focus is to obviously continue to drive improvement in our gross profit margin. The benefit has been really from a sales channel perspective, that mix has shifted a little bit. We continue to have very aggressive programs to enhance our cost structure, both from a material perspective as well as a conversion perspective. So this level of gross profitability -- gross margin profile should be relatively consistent as we go forward. Obviously, additional volume rolling through there will also have an incremental benefit on our margin profile. So as we look to the second half, if you will, of our fiscal 2020, our expectation is that the markets should show some improvement.

I'm personally excited about some of the rhetoric that we're now hearing about how we might resolve some of these tariff issues. We have our own North American trade discussions that are going on. Hopefully, they'll pass that. The Dodge Momentum Index has started to improve, that's the first time in a while. So many of those things, in my view, are positive indicators of potential. And the notion of having volume becoming a little bit more consistent, particularly for larger projects would have a favorable impact on Acuity's gross profit margin profile.

---

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

And then as we've been talking about these streamlining actions, you took some actions here in the quarter. How should we think about what the dollar value opportunity is at Acuity as you kind of take these streamlining actions going forward?

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

Sure. Karen, maybe you would like to address that?

---

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

Sure. As I addressed in my comments, we do expect to recover the cost of that streamlining actions and start to see benefit, particularly in the second half of the year. So you will see some improvement with some of that being reinvested back into the business. So do look for improvement, mostly focused in the second half as we recover those costs, but do continue to make investments in the business.

---

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

Well, I guess maybe just to clarify the question there. It sounds like there's more to do. I mean should we think of this as kind of a program that we should see quarter after quarter that you'll be able to find some streamlining and get associated payback with that going forward?

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

So we are -- this is Vern. We are always looking to continuously improve our cost structure, drive productivity and do things, but this particular charge was specifically identified around some key actions. And when you take the charge, you also have to allow for follow-on expense under GAAP accounting. So we identified these actions. We are taking those actions and our expectation is that, okay, let's complete those. In addition to that, we are always looking for ways to improve our cost structure through engineering efforts to reduce material cost, engineering efforts to change our -- how we produce these products, work within our facilities, both our factories as well as our back-office operations to improve our productivity. It's part of our ABS process to look for continuous improvement, but those typical continuous improvement items do not result in what we'll call a special charge.

---

**Operator**

Our next question comes from Josh Chan with Baird.

---

**Kai Shun Chan** - *Robert W. Baird & Co. Incorporated, Research Division - Junior Analyst*

It was good following the company under your tenure, Vern, and best wishes in your future endeavors.

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

Thank you so much. It's really been exciting 15...

---

**Kai Shun Chan** - *Robert W. Baird & Co. Incorporated, Research Division - Junior Analyst*

Yes, that's right. Yes, maybe we can start off on that. Vern, you were kind of obviously on the Board and thanks for the color on the succession planning. Could you talk a little bit more about kind of specifically what the Board saw in terms of Neil's skill set? And then also, could you also address the timing, at least from an external perspective, the transition looks kind of quick. Why not have Neil join the organization and then become CEO maybe at a designated time later? Can you just kind of go through some of those topics?

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

Sure. Sure, fabulous. I have been talking with the Board about just normal succession. We often have -- not often, regularly, it's part of our job as a Board to have succession planning discussions. So as we were thinking about both Ricky's plans and opportunities, the development of Karen and other leaders in our business, the timing was right to begin the process. There was no -- as I mentioned in my prepared remarks, there was -- it was not time-bound. We said, let's begin the process. And we were going to start looking really some time in 2020. But as fate would have it, we were introduced to Neil by one of our directors.

And he said, Vern, you really need to meet this guy. He's fantastic. He understands business models. He understands the opportunities to transform industries, and with Atrius and the way you all have been transforming your company, bringing in new innovation, looking at new markets, our Atrius IoT capability. So Ricky and I met with Neil almost a year ago, and some of our teammates were involved with Neil in exploring ways to take advantage of what Acuity's platform is about. And so we became quite knowledgeable of Neil. And if you look at Neil's background, he is a serious player, and he has really taken businesses and transformed them.

If you look at where Walmart is today. It was fantastic. The CEO of Walmart came out and said that their stores are their key points of differentiation. If you look at what Neil did is he enabled those capabilities through the development of e-commerce capability. So in every instance, as we've gotten to know Neil, what he has been able to do is transform businesses and make their core businesses even stronger and more robust.

And so I first introduced Neil to some of the other Board members as a potential Board candidate. And again, as Ricky and I got to know Neil more and more, we said this is the real deal. And Neil is a highly, highly sought after executive by many, many large companies.

So what got Neil excited about Acuity is really its platform and its opportunity for great future growth in the marketplaces that we serve and how we may future serve those customers, so it was mutual. And when you have someone with that kind of talent, Neil is 52 years old. I'm not a selfish person. I own a lot of shares. And I said, this is the right thing to do while my own personal time frame could have been something different. When you have this opportunity, you take advantage of it, we did. Neil is the right leader for the future of our business, and I just couldn't be more excited. And I'm pleased that the Board and Neil have asked me to continue as Executive Chair to really help facilitate a smooth transition. Very excited for Ricky to be the President of our Lighting business. He knows it well. The people know him well, and I'm looking for really personally, a solid future growth from this great team.

---

**Kai Shun Chan** - *Robert W. Baird & Co. Incorporated, Research Division - Junior Analyst*

That's great. And if I could ask one question on the quarter. I think you mentioned that the market was down in your estimate low to mid-single digits. And it looks like that your independent channel might be down a little bit more than that if you take out the acquisitions. So is there simply quarterly fluctuations or anything to think about there in terms of share?

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

Sure. So Josh, and for everyone on the call, our expectation, and it was really difficult to know precisely. If you go all the way back to last year's first quarter, we knew a pull forward was happening. It was difficult for us to really get our arms completely wrapped around that. So we guesstimated that it was probably mid- to upper single digits as the influence. My own personal bias based on some analytics is that it was probably in the high single digits that pull forward. So when we looked at our business and you look at the total amount, we also felt that what was happening, and we do have some good analytics around this is that the market this quarter, both the private nonresidential construction market was extremely soft, lighting even further, particularly for larger projects. And then we have noise around some of our stuff. That's why we tried to identify what was happening, if you will, for certain products in our product pruning focus to lessen the sale of products that really don't meet our financial profile. So you had a little bit of noise there.

And then in our corporate accounts world, which is really servicing some of these larger retailers, we've always known that it's going to be a lumpy cycle. It depends on releases, it depends on their own activities. So I feel when we look at our core business, and I made that comment in my prepared remarks that what we saw in those things that were an apple to an apple, the marketplace or Acuity was not overly penalized or not overly advantaged by the market changes right now. So I don't -- the noise around the pull forward and then it being exacerbated by the softness in the market, I think created just a little bit more of a headwind than what we had originally anticipated. Again, just to be clear to everybody, we still think the markets are sluggish and will be until we get some clarity around these things. But I do take some comfort that the Dodge Momentum Index is finally starting to turn positive, which it hasn't for a while.

---

**Operator**

Our next question comes from Jeff Sprague with Vertical Research.

---

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

Just 2 from me. First, just thinking about the distortions that have been caused by the pull forward and the comps associated with that. Obviously, there's a big cyclical and economic overlay on top of this, but are the normal seasonal factors in play here for your business as we look forward to Q2? Or is there something else we should be thinking about as we kind of jump off this Q1 starting point?

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

Sure. Seasonal patterns, well, are alive and well. Our Q2 is traditionally the lowest sales number of any of our quarters, we still expect that to happen. And you all know why. It's just because of December, January, February and then construction markets, weather usually impacts those types of things. So we expect that to happen. We hope to get past all of this noise around pull forward here pretty soon. For sure, it will be in the second half that we won't have this noise. There could be still a little bit of noise around that for Q2. And then additionally, as I mentioned in my prepared remarks, we still are looking at our portfolio and still pruning a little bit, some of these product life cycles and how we position those need to be managed in an appropriate way. So there's probably still a little bit of headwind around that.

Now having said that, we continue to focus on ways to drive and enhance share gain in the marketplace. We mentioned what we're doing around certain types of renovation in smaller and medium-sized capability. So yes, seasonal noise, a little bit of pruning and then expectation around how can we execute to drive some share gain.

---

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

And could you elaborate a little bit more on projects. I think we all kind of get it, the macro uncertainty just is not helpful, but are you seeing projects kind of taking outright cancellations? Is it a function of things that were in your front log that actually are not moving forward and any particular kind of additional vertical market color on the type of projects?

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

Sure. So on those larger projects, they're traditionally specification-driven. Our great agent partners are very, very focused on that portion of the marketplace, very skilled at that. And as I travel around the country and talk with both contractor customers as well as electrical distributor customers with our agent partners, their backlogs are robust. But these projects just are slow and have been slow to release. We hear different reasons why. In certain markets, we hear that there are labor shortages for contractors and so -- or for electricians. And so contractors are picking and choosing jobs, they're not necessarily growing larger projects. People are still wondering what's going to happen with costs. So if I wait, we'll have a lower cost potential. So we just keep hearing different anecdotal reasons why people are slowing down. They all seem to make some sense. But here's what we do know. Our agents have strong backlogs that just aren't releasing.

---

**Operator**

Our next question comes from Joseph Osha with JMP Securities.

---

**Joseph Amil Osha** - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Thank you, and again, Vern, let me add my voice to the congratulations on your long tenure.

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

Thank you.

---

**Joseph Amil Osha** - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Two questions for you. First, I'm wondering if we might get some comments on future plans as regards to use of cash. Obviously, this year, things skewed a little bit, but I'm curious about the balance going forward between acquisitions, buybacks and whatever else you might do with this very generous free cash flow you're generating?

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

So obviously, we pointed out that Neil will start January 31. He is working hypothesis around different views of strategy, both for Acuity as well as our core lighting and lighting solutions business, our BMS businesses. So we have a very, very healthy financial profile. And what I'd like to do is defer to Neil when he visits with you on the next earnings call to articulate more of that. One of the things that I believe has attracted Neil to Acuity is not only the culture of our people around driving value for our key stakeholders, but the platform that we have as well as the financial strength to really go after and attack markets by serving customers in a different way. And how he uses the balance sheet to drive his strategy, I really think that he should be the one to articulate that.

I will say on behalf of the Board, Neil's initial thoughts, we are very excited about his vision and what it means for our current 12,000 associates, which I expect that number to grow. So I would just defer to him. We've had a -- he's very focused on capital allocation, very focused on return on invested capital, very focused on growth -- profitable growth. So if you'll allow us to defer to him on that to the next call.

**Joseph Amil Osha** - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

And then, I'm going to change my second question then, because that's very interesting, obviously without tipping your hand because you don't know yet. Is it fair to say that as part of this transition, there is kind of a broader review of allocation of capital across different priorities taking place?

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

Yes. So again, I would say that the Board is quite excited about Neil's vision for the future. And his vision, I think is rooted quite well in his past. I think if you look at the things that he has done in his past, he has transformed different businesses and taking advantage of the opportunities in those markets. What he sees in Acuity in his glimpse into Acuity was pretty significant, when he was working with some of our Atrius folks as well as some of our lighting folks as a real platform. So I think he sees the current, if you will, platform that we have as well as our financial strength to get after markets and customers that are consistent with what we do today, but thinking about how he can transform and change their businesses to become better and more effective using the capabilities that we have and potentially additional capabilities that we will add.

Acuity has been a very aggressive acquirer over the last, I'll call it, 15 years, we've spent over $2 billion, done over 20 acquisitions. So you shouldn't be -- no one should be surprised about a continuation of how do we build our platform and core capabilities. And I think that Neil will continue to do that, but that is a continuation of what we've been doing. So I just am very excited about the platform that he has, the financial strength of the company that he has, coupled with his gifted mind and his really entrepreneurial spirit to do great things for our shareholders.

**Operator**

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

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

Vern, my congratulations to you as well.

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

Thank you.

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

Two quick questions for me. Can you talk generally, not just for the quarter, but how the Contractor Select initiative has been performing within the retail channel, without the -- I mean without the Lowe's load-in? And also, I don't know if I missed it, what was the Tier 3 and 4 sales performance in the quarter?

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

So let me answer the second one first. Our sales in Tier 3 and Tier 4 combined were significantly better than the decline that we had in others because it was the others that were influenced by the pull forward. So we didn't really provide that data, but Tier 3 and Tier 4 actually -- I don't know that you should take one quarter and compare it, but our total share in that area or that percentage of our business is still favorable. It's probably north of -- well, it's definitely north of 15%. It's probably closer to 17% or 18%. So we did fine there. That is also driven by larger projects to a degree. It's also driven by some of the things that we do in the corporate accounts channel. So give us another quarter where we get past all this noise to then bring that back to you, but I just want to say it was favorable. The pull forward impacted Tier 1 and Tier 2 more significantly.

With respect to Contractor Select and what's happening, if you will, in the retail channel. Contractor Select is a portfolio of products that were designed to compete with, if you will, some of the lesser featured, more price-sensitive portion of the market, so limited SKU range, but it's an important element of not only how we serve the retail channel, but it's also an important element in how we serve, if you will, the C&I channel. So we are pleased with the growth rates in that business, even though some of what we're doing in the retail channel with potentially other products is managing that portfolio, if you will, down a little bit.

So having said that, I think Contractor Select gives us the opportunity to further leverage and further penetrate both channels, both retail as well as the C&I sold primarily through the electrical distributor. Again, I think we're going to continue to see growth there. What I think you should all take away as a positive is that our gross profit profile continues to improve, even though that portion of the market or our business continues to grow as well.

---

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

Got it. My follow-up is on your portfolio pruning actions. Should we think about that as a low single-digit revenue headwind, not just for the upcoming fiscal Q2, but for rest of the year as well?

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

Yes. My view -- and Karen, please chime in here. My view is that some of those pruning efforts should really start to abate as we get kind of through second and maybe a little bit into third quarter. We've done a good job there. And so I would expect that kind of headwind to start to abate.

---

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

Yes. I think it will be consistent in the second quarter against our (inaudible).

---

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

Okay. Does it mean all the known headwinds from Lowe's load-in, pruning, et cetera, should all be done with by the time we get into second half. Is that a fair assessment?

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

It may leak into Q3 a little, but I think that we feel like it should start to tail off. We shouldn't be making big comments around this.

---

**Operator**

Our next question comes from the line of Christopher Glynn with Oppenheimer.

---

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

Vern, congratulations.

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

Thank you.

---

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

So I just want to go back to the gross margin, maybe try to understand that a little bit better given the magnitude. Also, in particular, it was up sequentially on $100 million lower sales. I mean some of the factors you talked about were more year-over-year driven. So wondering about that sequential resilience given the kind of reflexive thought of how much can change from 1 month to the next, maybe a bunch of higher cost work in progress rolled off. What's going on there?

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

Well, we have had puts and takes that have been pluses and minuses around these things. The tariffs are still a significant headwind to us. We think that our pricing strategies have countered some of that, countered most all of the tariff. The channel mix issue and including the pruning, if you will, of those lower-margin type products that are mostly impacted by tariffs has had a favorable impact on the mix. So what it's doing, Chris, is it's giving you a reflection into the profitability and the value-add that we bring into those other channels. So you're seeing that uptick. We'd love to have more volume.

And so our strategies, our tactical plans are to become focused in certain portions of the market that maybe we haven't traditionally focused on, that represent opportunities for growth for Acuity. So the volume issue is kind of the wildcard, I think, for me, in Q2 I think from material inputs. We're working aggressively to continue to drive cost out of our products through our engineering efforts. We continue to really do well in our factories in terms of driving productivity. Our service is up quite nicely. So we see opportunities to try and grow our business in this challenging market by taking share.

---

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

Makes sense. And then similarly, kind of a sequential look at revenue. The seasonality has been more pronounced to the adverse side sequentially the last couple of quarters. Do you think the big mover there has been as tariff resolution gets closer that people holding on to projects and backlog gets more pronounced because they can see a light at the end of the tunnel? Or alternatively, are you -- is there more impact from transitioning from larger enterprise retail Atrius rollouts taking place?

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

I think that the tariff -- this is just my opinion, so be careful here, I think that the tariffs and these trade discussions create a -- just a degree of uncertainty into the marketplaces. And so I think that people's enthusiasm and their money stay on the sidelines for these larger capital projects. The economy and employment is just fantastic. So you would think that with rising rents and rising in both industrial and commercial, more people working, all of those have traditionally been really positive signals for people coming off the sidelines and investing in real estate. These rising rents -- look where you live. I mean the cost of rents in that market are going up significantly. Typically, that would mean that people would add capacity into those things, they haven't done that yet.

So our view is that, that money comes back. The governing factor around that maybe also some of these labor issues on the trade side. And it's not just electricians, all of the trades, it's a challenge. So even if that money comes back, we're going to have to figure out how to do certain things differently. And Acuity is doing that. We are aggressively looking to change how we service, how we sell, how we do certain things to that customer base, so we can make them more productive. And in turn, they buy more of our solutions.

---

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

And what about transitions from previous key supports to the revenue run rate from Atrius rollouts?

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

On the Atrius rollouts, we are very excited by now our expansion into these other verticals. I would have to tell the world that I think that some of the technology has taken us just a little bit longer to hone and really make it reliable. And I think that we are meaningfully ahead of anyone else in the space. And these customers who are now using these solution sets are starting to say, wow, this can -- this actually can enhance my business model. And so our applied technology team and our sales forces are starting to get into some of these other verticals with these solutions to experiment on how we can add not just quality of light energy savings, but a third element to the value proposition. And that's still going to take time. I think Neil will help accelerate that, by the way, he's a very gifted entrepreneurial. So it will not only make our customers better solutions, but it will give our many sales forces more solutions to sell, changing hit rate, changing value proposition and not having to subject always to just price as the only point of differentiation.

---

**Operator**

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

---

**Vernon J. Nagel** - *Acuity Brands, Inc. - Chairman & CEO*

Everyone, thank you so much, Dan and I were trying to compute, we think this is like the 72nd or 73rd time that you've heard my boring voice. It has been truly a pleasure. Neil and the team will have just a -- it's a great future. I'm so excited about our foundation. So again, thank you for your time this morning. Our future is bright. Thank you.

---

**Operator**

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may now disconnect. Everyone, have a great day.

---