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AYI.N - Q2 2021 Acuity Brands Inc Earnings Call

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**OVERVIEW:**

Co. reported 2Q21 net sales of $777m and diluted EPS of $1.74.



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## PRESENTATION

**Operator**

Ladies and gentlemen, thank you for standing by, and welcome to the Acuity Brands Second Quarter 2021 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference may be recorded.

I'd now like to hand the conference over to your host today, Charlotte McLaughlin, Vice President of Investor Relations. Please go ahead.

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**Charlotte McLaughlin**

Thank you, Liz. Good morning, and welcome to the Acuity Brands 2021 Second Quarter Earnings Call. As a reminder, some of our comments today may be forward-looking statements based on management's beliefs and assumptions and information currently available to management at this time. These beliefs are subject to known and unknown risks and uncertainties, many of which may be beyond our control, including those detailed in our periodic SEC filings. Please note that the company's actual results may differ materially from those anticipated, and we undertake no obligation to update these statements. Reconciliations of certain non-GAAP financial metrics with their corresponding GAAP measures are available in our 2021 second quarter earnings release, which is available on our Investor Relations website at www.investors.acuitybrands.com.

With me this morning is Neil Ashe, our Chairman, President and Chief Executive Officer, who will provide an update on our strategy and detailed highlights from the last quarter; and Karen Holcom, our Senior Vice President and Chief Financial Officer, who will walk us through this quarter's earnings performance.

There will be an opportunity for Q&A at the end of the call. (Operator Instructions) We are webcasting today's conference call live. Thank you for your interest in Acuity Brands. I will now turn the call over to Neil Ashe.

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

Thank you, Charlotte, and good morning, everyone. Thank you for joining us to discuss Acuity Brands. I'm pleased with our company's performance in the second quarter of fiscal 2021. We have delivered solid results while continuing to make progress on our strategy. We've improved the way in which we serve our customers, expanded margins and allocated capital effectively.

As you know, the pandemic has created real challenges over the past several quarters and we have yet to return to a steady state. The slowdown last year had a global impact on supply chains and logistics, and we continue to feel the impact of this in the economy and in our operations, yet we have continued to have consistent and strong performance during this time.

As we look forward, we are facing some new and existing challenges. As demand begins to rebound, global logistics, for example, continues to encounter issues. New challenges include the global chip shortages and the rising cost of some components. To be clear, these are good problems to have. We are managing these challenges aggressively, and our entire team will work tirelessly to deliver the best possible outcomes for our customers and continued high-quality results.

So moving on to the second quarter highlights. Our team delivered great results this quarter. Sales were down 5.8%. However, we saw gross profit margin of 43.4% expand 170 basis points and reported operating profit margin expand 180 basis points against the prior year. The expansion was largely a result of product and productivity improvements throughout the business, and we are very happy with the results. Karen will speak in more detail about this later in the call.

As we highlighted in our earnings release, we continue to allocate capital effectively and as of February 28, 2021, had repurchased nearly 10% of our shares outstanding since last May. Finally, in a message to our associates earlier this month, we announced that we were carbon-neutral in our operations. I will talk more around this later in the call, but I'm delighted that we were able to announce this milestone as quickly as we did.

I now want to update you on our ongoing transformation. I have been at Acuity Brands for a little over 12 months, and what I continue to see every day is a team that is striving for success, that is not shy about changing and that believes in Acuity and where we are going. It is no secret that I came to Acuity because I saw the opportunity for our company to be more than a lighting business. Our core lighting and Lighting Controls business was and is way more durable than the market gives it credit for, as evidenced by our performance over the past several quarters. And we will continue to transform our business and the broader industry. We have the best go-to-market network in the industry and the broadest product lines that serve a wide variety of end markets.

We continue to improve the effectiveness of our products and the efficiency of our supply chain through the implementation of new technologies. We have a valuable and growing business in Distech; and in Atrius, we have the potential to build a very valuable technology business. Finally, we have the ability to grow through acquisitions, both in our current businesses as well as in new ones.

In our lighting and Lighting Controls business, we announced an exciting evolution in the leadership of that business. Trevor Palmer has taken over as president. Most recently, Trevor was leading our Controls business. He joined the company through the Distech acquisition nearly 5 years ago, and he exemplifies the talent that already exists within our organization. Trevor brings 27 years of industry experience to the role. I'm excited for what Trevor and his team will do with this business going forward.

During the quarter, we continued to invest in product development. We have introduced new lighting and controls products and improved and evolved parts of our product and solutions portfolio. In our Contractor Select portfolio, we saw significant demand for the Compact Pro High Bay, a versatile high bay that has been in demand as a result of the increase in warehouse renovations, driven by the shift to online retail and the expansion of logistics networks across North America. The CPHB is a breakthrough product that was designed to deliver improved performance in a smaller size to ensure ease in installation. The product uses fewer inputs, is more efficient to transport and is both globally sourced and manufactured in our facilities to ensure supply chain flexibility.

Within our GUV category, we introduced EvolAIR with UV technology -- with UV Angel technology, excuse me. This product uses onboard 254-nanometer technology and circulation above the fixture to locally disinfect air in occupied and unoccupied spaces. We have installed this





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product in multiple Acuity locations and have specifications being developed with this product in education, office and health care applications. It is worth pointing out that our Controls capabilities are a key differentiator for successful GUV lighting solutions.

Our Hall of Fame products continued to win bids in infrastructure projects. We were awarded the order for the relighting of the Big Dig project in Massachusetts that will begin in the second half of our fiscal year. Part of the scope of this mandate was to replace existing low-cost fixtures that had been installed several years ago and were not performing as expected. Hall of Fame is known for its quality and durability, and I am pleased we are the partner of choice to make the necessary improvements.

Throughout the pandemic, we have continued to invest in product vitality. We have maintained the pace and quality of product rollouts this year, which positions us well for the market recovery. I continue to be impressed by the agility of our team.

Transitioning to go-to-market. We are committed to our independent sales network. This quarter, we announced a realignment in the northeast that will benefit our customers in the region and nationwide. We are creating a new agency through the consolidation of what were formerly the Acuity-owned agency in New York, the New Jersey territory and the independent agency in Philadelphia. This transaction demonstrates our commitment to the independent sales network, which we believe to be the strongest in the industry. By creating this new agency, we are better positioned to participate in designs and specifications that start in New York and travel around the country. We are also better positioned to serve contractors who work in New York, New Jersey and Philadelphia.

We continue to make progress with Distech and Atrius. Distech is uniquely positioned in the building management space, built on open protocols and distributed through a network of independent systems integrators. It has continued to grow throughout the COVID-19 pandemic. We're also making progress around the product road map for Atrius. We are recruiting best-in-class talent to drive the capabilities in that business.

In early January, Sandeep Modhvadia joined the business as Vice President of Product Development. Sandeep comes to us from Google Cloud, where he was responsible for the product development team building vertical solutions for the manufacturing, industrial, automotive, power and transportation industries. We will continue to add talent to Atrius and make progress building unique and valuable technology solutions.

Now I would like to take a few minutes to highlight our progress on the ESG front. ESG is directly aligned with our values and our business strategy. We care about the environment, our people and our communities. Our company has been built on products, technologies and services that deliver sustainability and energy efficiency. Over the last year, we have focused on our own operations. Our recent accomplishment of achieving carbon neutrality across scope 1 and 2 emissions in our operations is the result of this work and demonstrates our commitment to continually improving our communities.

We achieved carbon neutrality as a result of reducing environmental impacts in our facilities and through investing in carbon off-site projects. Some of the energy-efficient improvements made in our facilities can be highlighted by our Crawfordsville, Indiana facility, where we optimized air compressors, installed more efficient belts and added switches to reduce energy consumption. And by our Conyers, Georgia and Des Plaines, Illinois facilities, where we installed our new I-BEAM IBG and Hall of Fame Phuzion high bay lights and used our Atrius Building OS technology to conserve energy and improve the quality of light in the space. And in our facility in Newark, Ohio, in which we rebuilt the glass furnace to improve overall efficiency and which has now completely converted to renewable electricity, a win for the environment and the cost savings.

Our priority is a reduction of energy usage in our facilities and for our customers. Until we were able to realize the full impact of our energy efficiency improvements, we are supplementing with an offset program that is focused on helping the communities where we operate. We are investing in a series of carbon offset projects in Mexico, Indiana and California, all communities where we have a presence. These projects support energy efficiency and renewable energy options at colleges and universities, landfills and agricultural sites. These programs allow us to remove carbon from the atmosphere and balance our carbon footprint from operations.

While the focus of our recent accomplishment has been environmental, we are giving equal prominence to the S and the G parts of ESG. Simply stated, we want to be the place where the best people come to do their best work. To do this, we are continuing to focus on improving the lives of our associates by strengthening our culture and removing the barriers to success. Acuity is proud to be an inclusive company where we all



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succeed together. Finally, we have addressed several issues of governance over the last year by, among other things, diversifying and restructuring our Board of Directors and overhauling our total rewards program, including improving our long-term incentive plans.

Moving on to capital allocation. As I previously mentioned, we have now repurchased nearly 10% of our outstanding shares since May 2020. Effectively allocating capital is an important part of how we will create value for our company. To reiterate, our capital allocation priorities are clear: first, to grow our current businesses; second, to grow our company through acquisitions; third, to maintain our dividend; and fourth, to create value through share repurchases. We were able to capitalize on the dislocation in our share price and have been very effective repurchasing shares over the last year. As we look forward, and barring another significant market dislocation, we do not anticipate maintaining this rate of share repurchases. We will return to our priority of using capital to grow the business.

As we look ahead, we see improvements in the end markets we serve, and we are cautiously optimistic about the outlook for the remainder of fiscal year '21. We intend to use the breadth of our product portfolio and the strength of our go-to-market teams to deliver a solid top line performance. While there will be global challenges ramping back up, we are aggressively addressing them. We will continue to invest in our business with the intention of becoming a larger, more dynamic company.

With that, I'll turn the call over to Karen and be back for Q&A and for some closing remarks. Karen?

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

Thank you, Neil. I want to start by echoing Neil's initial comments regarding this quarter's performance. Our associates pulled together to deliver a solid performance and the fourth consecutive quarter of gross profit margin over 42%. I am proud of the changes and progress we continue to make.

Moving to our second quarter results. Net sales were $777 million, a decrease of 5.8% compared to the prior year, which we believe was a very good performance in this market. Notably, within our sales performance, our independent sales network and direct sales network were approximately flat with the prior year as we continued to see strength in medium to large projects, offsetting some of the pressure in the commercial office space, which continues to be impacted by the COVID-19 pandemic.

Retail channel sales declined approximately 24% as compared to the prior year as a result of strong year-over-year pre-pandemic comparison. This was exacerbated by one of our large customers carrying out an inventory rebalancing, which we believe to be a one-off impact. We expect to see sequential growth in this channel in our fiscal third quarter of 2021.

Finally, sales in corporate accounts declined just over 50% as compared to the prior year. We continue to see large retailers defer renovation spend as a result of safety concerns resulted from the COVID-19 pandemic. In the last few weeks, there has been indications that these concerns are slowly lifting, and we expect to see continued sequential recovery through the balance of the year.

Moving on to the rest of the income statement. Gross profit margin was 43.4% for the second quarter of fiscal 2021, an increase of 170 basis points over the prior year. This was an outstanding achievement. This outperformance was the result of product and productivity improvements that yielded returns, and we believe that this will position us well for any unforeseen challenges. Given this gross profit margin improvement, we believe attaining a gross profit margin above 42% is reasonable on an annualized basis.

Reported operating profit margin was 11.7% of net sales for the second quarter of fiscal 2021, an increase of 180 basis points over the prior year. Adjusted operating profit margin was 14% of net sales for the second quarter of fiscal 2021, an increase of 170 basis points over the prior year. The majority of this improvement was driven by the higher gross profit margin and continued cost containment efforts, particularly around travel expenses and sales and marketing costs resulting from less in-person activity due to the pandemic.

As we continue to demonstrate our ability to drive margins, we will begin to reassess our reinvestment strategy, prioritizing systems and software development as we focus on executing our digital transformation. As the economy continues to open up, we expect to see travel and other





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marketing expenses increase throughout the balance of the year. We are working with our associates to ensure that only essential travel and marketing expenses are being incurred and do not expect to return to pre-pandemic expense levels in fiscal 2021.

As previously discussed, this quarter, we were able to share with our associates that we achieved 100% carbon neutrality within our operations by prioritizing efficiency improvements in operations and some offsetting measures. This is not just an initiative for the management team. Both Neil and I believe this is the core to the ongoing success of the company. As part of the offsetting measures, we expect to see a modest SDA investment, but this will not be material.

The effective tax rate for the second quarter of fiscal 2021 was 23.5% compared with 23.4% in the prior year quarter. We currently estimate that our blended effective income tax rate will be around 24% for the full year fiscal 2021. Finally, we saw a significant improvement in diluted earnings per share for the second quarter of fiscal 2021. Diluted EPS of $1.74 increased $0.30 or 20.8% over the prior year, and adjusted diluted earnings per share of $2.12 increased $0.28 or 15.2% over the prior year.

Moving on to cash flow. Net cash from operating activities for the first half of fiscal 2021 was relatively flat at approximately $213 million compared to the prior year. We invested $21 million or 1.4% of net sales in capital expenditures during the first half of fiscal 2021 and currently expect to invest approximately 1.5% of net sales and capital expenditures in the full year of fiscal 2021. On February 28, 2021, we had cash and cash equivalent balance of $499 million. I am pleased with the continued solid cash generation.

Over the last 12 months, we have been extremely judicious around our capital allocation decisions. We continue to prioritize long-term growth and believe that reinvestment into the future of the company is core to our success. We are further committed to maintaining our dividend and being opportunistic around allocating capital to buyback. As a result, we have repurchased 3.2 million shares of common stock during the first half of fiscal 2021 for a total of $338.3 million at an average price of $104 per share, with 4.4 million shares still remaining under our current Board authorization.

Before I turn to the Q&A, I would like to introduce a new section of our earnings call. Going forward, I will spend a few minutes reviewing some of the most important conversations around our company and industry and offer insights into how we are thinking about them. There are 3 discussions that have been top of mind: How are we seeing the price increases play out? What is the potential impact of commodity price increases throughout the balance of the year? And what is our plan to deal with the electrical component shortage?

Price increases did not affect our fiscal second quarter earnings. We had previously announced that price increases would go into effect March 15, 2021, across the portfolio, which is the beginning of our third quarter, with any potential effect not being felt until April. To date, we do not anticipate any drop-off in demand as a result of the price increases.

Similarly, our first -- our fiscal second quarter was not impacted by escalating input pricing. On our first quarter 2021 earnings call and throughout the second quarter, we have been deliberate about changing the conversation around the impact of price and cost. As we highlighted last quarter, our prior discussion ignored that we, as a company, control several levers within our cost of goods sold structure. Our associates understand that it is our obligation to be in control of the relationship between our price and cost, separate from whether raw material prices go up or go down.

The continuous improvement in our gross profit margin demonstrates that the move away from the price/mix conversation is appropriate and that the discussion around operating the company towards a gross profit margin target is the correct lens in which to view our margin performance. The ongoing improvements had been a result of product and productivity improvements. Essentially, we are reengineering our products to meet the needs of our customers while also meeting our margin obligations. Whether commodity prices increase or decline, we believe we can hold gross profit margin above 42% by controlling what we can control and through the ongoing improvements throughout our business.

Finally, the electrical component shortage is starting to make its way through the supply chain, which will create challenges for the entire industry. We have seen indications that some of our products may experience procurement issues, and we are working diligently to service our customers.





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To wrap up, we have seen encouraging signs of improvement in our end markets, although some challenges still remain, and I continue to be proud of our dedicated team. We are committed to instilling discipline across the organization to ensure the long-term stability and predictability of the company and we are, to date, satisfied with the progress we are making.

Thank you for joining us today. I would now like to turn the call over to the operator for questions.

## QUESTIONS AND ANSWERS

**Operator**

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

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

First, I appreciate the extra detail you're now providing in the prepared script. Found that very helpful and wanted to kind of use that as a springboard for the first question here. So I guess one of your competitors was out with additional price increases. You talked about how the raws really haven't flowed through yet, but you have both this product and productivity benefit you called out. Can you provide a little bit more color around if you need to get more pricing, if you need to kind of pull the product value engineering lever more or maybe the productivity lever more? I mean where will that offset come from as you see those raws flowing through?

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

Yes, John, thanks for the question. And obviously, Karen was pretty deliberate about pointing out, the team is focused on the relationship between price and cost. So we are extremely pleased with the benefits that we've seen from the improvements in our products and productivity. And obviously, that will continue as we go forward. So you saw the benefit of that in the second quarter and that will continue on into the third quarter.

An example of that is the Compact Pro High Bay work that I mentioned, which uses less material, delivers a higher-quality customer experience and output. So that's what we mean when we say there are multiple levers. So that product is not going to require more steel in the third or fourth quarter, for example. So we'll continue to see that.

As it relates to price, we are -- our focus right now is on the successful implementation of the price increase we already announced. So as we look forward, we think that relationship and pricing cost, as Karen indicated, on an annualized basis, gets us comfortable over the 42% gross margin, which it's worth noting is significantly higher on a consistent basis than the company has been in the past.

So we like where we are going into this process. But as we both mentioned, this is -- the ramp-up is going to have its challenges. There are going to -- we are -- the entire industry is going to be working through the supply chain challenges and costs. And we feel really good about our team, but it's going to be -- this is hard work and the team is up for it.

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

Great. And then as a follow-up to that, was just wondering if you could talk a little bit about the competitive nature in the quarter. We can all see the supply chain bottlenecks and higher freight that maybe some of the Asian imports or importers will feel coming into the U.S. But have you been able to use delivery times or other things to actually take market share? And is that actually a correct premise that maybe some of the importers haven't been able to fulfill demand?



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

Well, I mean, of course, we're going to use, John, every advantage we have in the marketplace to deliver the highest customer experience and that is our priority. So as it relates to service levels, yes, we have consistently, throughout the pandemic when there were other challenges, been able to smooth those challenges to the benefit of our customers. And we believe that, that has accrued to increase market share for us. And we'll continue to do that going forward.

And it's worth just spending 1 second on the balance in our supply chain. So we have -- as you know, we have about 20% imported from Asian finished goods, about 60% manufactured in our facilities in Mexico and the remaining 20% manufactured in our facilities in the U.S. and a little bit in Canada. So that gives us more dexterity often than many of our competitors, and we're definitely using that to our advantage.

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**Operator**

Our next question comes from Ryan Merkel with William Blair.

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

Congrats on the quarter.

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

Thank you, Ryan.

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

So I guess, first off, can you dig a little bit more into your comments about end markets improving? I've heard in some of my checks that agents and distributors have seen backlogs and quoting built the past couple of months. So are you seeing the same thing? And what do you think are the main drivers?

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

Sure. Ryan, we continue to be impressed with how our agents have performed really early on in the pandemic and also as we continue to see improvements in our end markets. In the first quarter, we mentioned that we saw inconsistencies across geographies, and we continue to see that same performance today, just can be very inconsistent across the different geographies that we serve.

We've seen some improvements due to activity for warehouses and logistics as a really strong area for us as well as K-12 performance, and that's helping us kind of manage where we see some softness in the market. So we still see some optimism, and we're just cautiously optimistic about the ramp-up that we're seeing currently.

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

Okay, perfect. And then, Neil, can you articulate why you see a growth story in intelligent buildings? Just talk about what's changed versus a few years ago. And then what are the main use cases?

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

Yes, Ryan. So let's kind of frame this first. First, with Distech, and I mentioned this in my comments, we have an attractive asset that's uniquely positioned in the market. It's -- from a technology perspective, it's built on open protocols. And from a distribution perspective, it's distributed with independent systems integrators. That gives Distech the opportunity to really have -- present building owners with the opportunity to adapt to a number of different scenarios going forward.

With Atrius, we've pivoted the focus then to really be about the applications largely in the cloud, which deliver real business value to around buildings, around people and around independent use cases, which are different than really we can see anybody in the marketplace doing right now. For a long time, IoT has been a solution in search of a problem, in my opinion. And what we're really focused on are what are these applications that can deliver demonstrable value for our customers? So we're in the course of building that out.

And so over time, what you will see with this group is you'll see a high-quality product business in Distech and a high-quality technology application solutions business with Atrius, which should deliver continuous recurring revenue and growth. But as I said, Atrius is still an option at this point. We're obviously recruiting very impressive talent to take this where we are pivoting it to go. But it's still early. So that will -- so -- but when you summarize that, Distech will continue to grow, and you'll see that more later in the year as we provide more transparency. And Atrius, we believe, can grow to be a meaningful recurring revenue business.

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**Operator**

Our next question comes from Chris Snyder with UBS.

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**Christopher M. Snyder** - *UBS Investment Bank, Research Division - Analyst*

First on gross margin. Can you just provide a bit more color on the sequential improvement in the quarter? I know the company called out productivity improvement, but it feels like a sharp kind of sequential improvement. And then what level of pricing improvement, if any, is embedded into the 42%-plus target going forward?

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

All right. If we look over the past several quarters, for the past 8 quarters, we delivered gross profit margins above 40% and 6 of those 8 quarters have been above 42%. So you're right, this was a sequentially strong quarter at 43.4%. But as we mentioned, we continue to work on product and productivity improvements, and some of those did yield results a bit faster than we expected, which really positions us well for what we see ahead. Given our current gross profit margin improvement, we think that we can achieve the gross profit of above 42% for the balance of the fiscal year.

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**Christopher M. Snyder** - *UBS Investment Bank, Research Division - Analyst*

But I guess on that, is there any -- that 42%-plus for the balance of the year, does that embed -- or what level of pricing improvement does that embed?

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

Sure. We announced the price increase and it will be effective. It was effective in March and we'll feel the benefits of that probably later in the third quarter. We are focused on full capture of the price increase and just taking advantage of the price increase to offset some of the costs that we see ahead of us. Neil, anything you want to add?

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

Chris, it's just worth noting that we consistently have the highest gross margin in the industry, so this positions us well competitively as we look forward. So as we've been saying for really every quarter since I've gotten here, we are working on these products and productivity improvements to make this company more predictable and reliable.

Number one -- and this goes back to the earlier question about the supply chain, number one, to our customers and in the marketplace. We want the entire marketplace to know that they can rely on Acuity Brands to solve their needs. And in so doing, we've been able to increase the quality and the margin profile of our products and how we make them and deliver them, which is delivering these productivity improvements.

So as we said, there's -- the ramp back up is going to be bumpy for the entire industry, frankly, for the entire economy. So we don't want to get out in front of ourselves, which is why we've done so much hard work to position ourselves for where we're going to be for the remainder of the year.

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**Christopher M. Snyder** - *UBS Investment Bank, Research Division - Analyst*

Appreciate that. And then I guess for the second question, for the -- thinking about nonres new construction business, could you provide some color on when you think revenues there could bottom? Assuming they haven't already, just because when we look at the start data, the comps are turning easier and it's definitely getting better. But given the lighting lag, it'd just be helpful when we're trying to model that out to when you guys think that could bottom.

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

Yes. Karen addressed this in her comments. But as we said in the last call, it's helpful to see the disaggregated revenue in our lighting explanation, and the C&I independent sales network has been incredibly consistent at a level through the pandemic. Obviously, that's starting to increase. And Chris, that's a combination of a number of different verticals and products, and as Karen mentioned, some inconsistency around regions across the country. So we think that return will be a little bit bumpy as a result of that, but there's no question that there's demand.

As we look to external kind of indicators which are kind of spot on, we've talked about this in the past, it really is around total construction. And as you look forward and think about kind of where we're going to be over the next several years, I just want to emphasize a really simple yet pretty obvious point, which is that you can't build anything or renovate anything without lights. So whether it's a highway, a building, a warehouse, a school, a hospital, an office, et cetera, a home, nothing -- you can't build anything or change anything without lights. So we feel like we have a place to play in the economy over the foreseeable future.

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**Operator**

Our next question comes from Jeff Sprague with Vertical Research.

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

I guess if we could just talk about supply chain a little bit more, Neil. So the semiconductor thing is pretty well understood, is maybe obvious and enough of a challenge for everyone. But is there -- are there any particular other areas where you see constraints that you're trying to get ahead of? And is there -- no one knows what the future brings in terms of end demand, but do you actually see kind of supply governing your revenue trajectory here is, call it, the next 2 to 4 quarters?

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

Yes, Jeff, that's a really good question. So the global chip shortage goes all the way back to the fabs, so this is a problem which spans everyone. That impacts largely our controls business so we're working our way through that. Obviously, we're the largest supplier in the lighting business so we can use that to our advantage, but we're small when you compare us to, say, the auto industry, for example. So there's -- so we're -- we will do the best we can, and I'm confident our team is working incredibly hard to -- and they will do better than most.

As you think about kind of other challenges, there are kind of discrete -- there are some discrete items which are maybe unique to some of our products, but there isn't -- there won't be a systemic kind of impact to everything that we do. So yes, it will -- it may create some bumpiness in our shipments over the course of the next several quarters. But we are -- as I said earlier, we're doing the best we can and we've demonstrated -- we're working really hard at, we've demonstrated through the pandemic that we'll be better than most. And our team is primarily focused on how can we be as consistent and predictable as possible to our customers and end users so that over time, we continue to drive preference to Acuity.

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

Great. And could you just elaborate a little bit more on this sales agency change in the northeast? A little more color on what you attempt to accomplish with this change. And is this something that would be happening across the country, if you can get the stars to align, it might impact just kind of the front end of your business would be interesting?

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

Yes, Jeff, it's a really good question. So it's worth a little bit of background here. The New York market was a bit of an odd duck in our go-to-market strategy in that it was an owned agency. The only other place we have that is in Toronto and everywhere else, we rely on independent sales agents. The -- so we saw 2 things that happened as a result of that. First, we were constrained in the New York City market on our ability to serve projects where designers and specifiers may want, I don't know why they would, but may want a product that wasn't made by Acuity. So the logic of these independent sales agents is that they can curate a collection of products that allows us to have a higher success ratio when it comes to bid day, and we can win more projects and, as a result, grow market share. So we were pretty hamstrung in the New York market.

At the same time, we saw that we needed to provide some consistency to contractors that did business across New York, New Jersey and Philadelphia. So the -- that effectively, from their perspective, is a single market, and it was ineffective for them to be doing business with multiple of our different agencies. So we see the consolidation of these agencies as a way for us to better serve the New York design and specification community, which we hope will carry specifications across the country, number one; and then number two, better serve and more consistently serve these contractors that are working in New York, New Jersey and Philadelphia.

So we feel really good about this. It doesn't necessarily portend similar changes across the country because we don't own any agencies in other markets. But we've been underperforming in the largest market in North America as a result of this owned agency. So it was pretty important for us to get this sorted out.

And then finally, I do want to emphasize that this is demonstrating our commitment to this independent sales network, which we believe to be the strongest in the industry. We'll continue to work with the independent sales network to improve their performance. And we will continue to drive for better outcomes for both them and for us in other markets across the country.

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**Operator**

Our next question comes from Christopher Glynn with Oppenheimer.

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

Congrats on the results. Was curious about capital. The repurchase sounds like -- the high level repurchase is kind of done. You're quite asset-light and you have no net debt, a lot of cash. So it kind of shines a light on the pipeline question. What are you seeing? What are your intents for deals over the next, say, 1.5 years or so?

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

Yes. Thanks for the question. And your observations are spot on and are a large part of the reason why I'm here in the first place. So if we kind of do a check-in, we talked about the durability of our lighting and Lighting Controls business and the opportunity to transform that business. I feel really good about where we are going there.

We talked about the opportunity and the option to build a technology business with Atrius. And as I indicated earlier, it's still early stages but we're assembling a rock star team there that we believe can make a real difference, which gives us the opportunity then to focus on how can we -- the company is in a position to process, and how can we focus on how to continue to grow the company through acquisitions.

That will flow into 2 big camps. The first would be bolt-on acquisitions to our existing businesses. So we have a healthy pipeline now of opportunities that are relatively small, but we -- which we feel like we can do in the foreseeable future around our existing businesses. And then we'll start to turn our attention, and it's very early and we don't have a lot to share on this, on what other areas we would invest in post that.

But our objective, as I said earlier, was to be a technology company that solves problems and spaces in light, and we see the opportunity to expand to additional areas over time. And so I would expect kind of bolt-ons for the -- in the immediate future and then we'll start to focus on larger things after that.

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

Great. And I was curious, a lot of border topics in the news lately, and maybe the word chaos comes to mind a little bit. I'm not sure how the maquiladora regions intersect with some of the border issues. But could you update us on the security, the visibility and risk factor of just sustaining all your output out of Mexico?

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

Yes. That's a great question. So let me start at the border. And obviously, there's -- we move a lot of product from Mexico to the U.S. We actually -- we haven't seen challenges as a result of some of the stuff that you're referencing in the news. We did see them in the -- when the storms went through that region and Texas shut off natural gas to Mexico, which cost us a couple of days of production in Mexico, which I personally didn't see that one coming.

But the -- as we think about the maquiladoras, they're obviously incredibly important to the economic infrastructure of really all of Mexico. And so our leadership team in Monterrey is highly visible and highly relevant to the industry group of the maquiladoras. We meet regularly with the key members of the government there to ensure that there is continuity. And we have been, for example, really helpful on the -- throughout the pandemic on health and safety issues. We've developed them in our facility, shared them with the other maquiladoras, share them back with the health and labor secretaries as we progress there.

So I would say that we work very hard at making that area of the world as stable as possible for -- so that we can continue. And we feel pretty good about where that stands right now.

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**Operator**

Our next question comes from Tim Wojs with Baird.

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

Nice job. I guess my first question just on productivity. Could you just, I guess, give us a little bit more color or detail about maybe what's really changed on the productivity side? Because it sounds like things have, and it's always been a lever that's been available to Acuity for a long time, so just -- are you doing just more on the productivity front than before? Is there more structure or maybe some internal incentives around it internally? Just trying to understand. It does seem like there's more emphasis on that. I'm just trying to understand if there's anything that's really changed behind the scenes.

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

Yes, Tim. So a lot has changed. So we've been able to optimize our productivity around specific facilities. So we've consolidated 1 facility. We've changed the flow through several of our facilities. On the manufacturing side, we -- transparently, as a result of COVID, we were forced to rethink many, many things. And so we re-architected the cell structure to keep people distanced and we were able to process the frankly, the same amount of output, as you've seen, with a smaller base. And the -- kind of never missed the opportunity presented in a crisis to improve our operations.

And then on the distribution side, through -- we've increased the throughput of our distribution facilities so we can process more through. On our Asian finished goods, we've changed how we distribute those. So in addition to -- we've spread the distribution out throughout the country so that we're delivering materials from Asia to the East Coast as well as to the West Coast. So it's a series of -- it's a cumulative series of things.

And as I say a lot about transformation around here, Tim, is oftentimes, we think that there are really things but -- the really large things but the cumulative impact of small things can be really meaningful and differentiated. And I would say that this both product and productivity improvement point to the accumulation of a number of small things, which have been really impactful.

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

Okay. Okay, great. That's really helpful. And then maybe on a go-forward basis, I mean, you did talk about the 42%-plus gross margin target. How are you thinking about SD&A and just leverage? Because that's been a source of opportunity over time. Kind of pre pandemic, you were in this kind of 26-or-so percent of revenue as a percent of sales for SD&A, and that's obviously migrated higher with the pandemic. I mean, is 26% still a target or attainable as you see the end markets recover and you don't have to put as much SD&A back into the business?

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

Yes, Tim, that's a great question. We have been managing costs very closely during the pandemic. As you know, some of these costs came down naturally as we traveled less, we held less in-person events. And as the market comes back, we see that starting to increase a bit. But we really are going to manage this carefully and not invest ahead of the market recovery.

So we'll continue to work with our associates to make sure when they are traveling and when we're doing these marketing events, that they are the right ones and are delivering a return for us. But I could see us sequentially start to increase just a little bit throughout the balance of the year but probably not to the full level of dollar spend that we were pre pandemic.

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

Okay. So from a dollar perspective, you see -- sorry, Neil, go ahead.



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

Yes. No, Tim, I just want to add in to Karen's point there. And we want to prioritize our reinvestment going forward because, and I want to make sure we put a marker out there, that we are going to reinvest going forward. And we're going to prioritize a lot of that reinvestment around things which we consider investments as opposed to expenses, predominantly around the software development and other changes that we want to make as part of the transformation. So we will be adding back some expenses going forward, but we believe those are investments as opposed to spent dollars.

**Operator**

(Operator Instructions) Our next question comes from Brian Lee with Goldman Sachs.

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

Most of my questions have been answered, but maybe just could you give us a sense on the -- Neil, I know you came in with a big view on the digitalization opportunity here for the company, Tier 3, 4 Atrius-type solutions, you sort of alluded to building that out here as well.

Can you also kind of put that into the context of the corporate channel here? How does the mix shift you guys have been struggling kind of in that channel here through the pandemic, but even before the pandemic, it seemed like that channel was struggling to grow? Is it fair to assume that a lot of the digitalization opportunities through that channel -- I'm just trying to understand where it shows up in your new sort of segment breakouts.

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

Yes, Brian. Well, we've addressed this in the past, and so let me just spend a second on generally what enterprise accounts are. Obviously, the largest accounts we have there are retail accounts. They are -- and we've had a lot of success with some of the most important retailers in North America. The results have been -- we've said consistently that those results will be inconsistent based on the need for those customers to manage access to their buildings. And you've seen that throughout the pandemic.

So a lot of the drop-off you've seen, and if you look at it on a sequential basis, it's literally a drop-off. It's not a declining curve, is the result of the reality that throughout the pandemic, their priority was only having their associates and their customers in their facilities. But as you know, these entities can't go on forever without renovation. So retailers are generally on a 7- to 10-year-ish kind of renovation schedule. So this will come back. And we're -- and we will participate in it when it does. We're, I think, the best positioned in the industry for that segment.

The second part of that question that we've said or I've said consistently since I got here is that what's interesting about the luminaire and lighting is that it's a capital-efficient way to introduce technology to spaces. By that, it's the incremental cost of the technology is relatively low, and the real cost is around the installation of that technology and the changes necessary in that process. So when you're renovating, it's a very efficient time to introduce new technology into spaces, which we have done and we will continue to do going forward.

And then -- so you will see the manifestation of that, to your question, as we think about the lines of business through sales of Atrius-enabled luminaires, Lighting Control products through -- and products through the ABL channel. As we start to develop applications which drive business value, you will see those applications show up in Atrius and see those in our spaces, in the conversation about our spaces group.

So the synopsis of that is that lighting and luminaires and the renovation opportunities around them provide a capital-efficient way to introduce new technology to spaces will benefit from that by having the highest quality technology. And then second, we will use that technology to power as a part of the powering of applications, which deliver real business value to our customers through Atrius.



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

Okay, great. That's helpful. And then maybe just a quick one. I know the ink's not even dry on this, but have you guys had a chance to sort of sift through President Biden's infrastructure agenda? I think he's out this afternoon outlining it in a speech, but the White House has put out some high-level markers around different parts of the package here. Any impact or tailwinds that you'd be anticipating from what you've seen thus far?

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

Yes. Unfortunately, we haven't had the time to dig through it. Obviously, if that were to happen, it would be a benefit for the economy. And as I mentioned earlier, it's impossible to build anything without lights. So whether it's a highway or school or a VA hospital as the tree-tops view I saw earlier this morning, all of those things will need lights. And so we'll continue to use this as an opportunity to drive our product and productivity improvements so that we're best positioned for whatever that ends up being.

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**Operator**

Our next question comes from Jeff Osborne with Cowen.

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

Just one question on my end. I was curious if you could update us on what the status is of the UV lights. Any momentum there with the acquisitions you've done in new product introductions?

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

Yes. Thanks, Jeff. We are now officially in the market with those, as I mentioned earlier, around the 254-nanometer and lights -- luminaires, which are interesting, and I didn't explain them perfectly but they include the 254-nanometer technology. They circulate air above the fixture to -- so that they work in a situation where people are present or not present, which is unique for the 254-nanometer technology.

That's now in the marketplace. We've obviously, as I mentioned, we're eating our own cooking so we've installed that throughout our supply chain facilities, and it's having a positive impact. So we expect kind of revenues in the third and fourth quarter from that going forward. And then we'll layer in the rest of the products that you've heard us mention before.

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**Operator**

That concludes today's question-and-answer session. I'd like to turn the call back to Neil Ashe for closing remarks.

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

Thank you, Liz. We're pleased with our results in the second quarter. Our team is hard at work at dealing with the challenges that we've been discussing of ramping up, and our focus will remain on serving the needs of our customers and on delivering quality results. So I'd like to thank you all for joining us today. As we've said, we will be providing deeper insight into our lines of business later this year, and we intend to host an Investor Day. So please sign up at the investor website and be in touch with Charlotte, and we'll -- for updates and we'll announce that date soon.

So with that, thank you for your time and thank you for your interest in Acuity Brands, and we hope you have a great rest of your day. Thanks.

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**Operator**

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

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