REFINITIV STREETEVENTS

EDITED TRANSCRIPT

AYI.N - Q1 2023 Acuity Brands Inc Earnings Call

EVENT DATE/TIME: JANUARY 09, 2023 / 1:00PM GMT

CORPORATE PARTICIPANTS

Charlotte McLaughlin *Acuity Brands, Inc. - VP of IR*

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

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

CONFERENCE CALL PARTICIPANTS

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

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

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

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

Joseph John O'Dea *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

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

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

PRESENTATION

Operator

Good morning, and welcome to the Acuity Brands Fiscal 2023 First Quarter Earnings Call. (Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to Charlotte McLaughlin, Vice President of Investor Relations. Charlotte, please go ahead.

Charlotte McLaughlin - *Acuity Brands, Inc. - VP of IR*

Thank you, Crystal. Good morning, and welcome to the Acuity Brands Fiscal 2023 First Quarter Earnings Call. As a reminder, some of our comments today may be forward-looking statements based on our management's beliefs and assumptions and information currently available to our management at this time. These beliefs are subject to known and unknown risks and uncertainties, many of which may be beyond our control, include those detailed in our periodic SEC filings. Please note that our 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 and their corresponding GAAP measures are available in our 2023 first 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 first quarter highlights; then Karen Holcom, our Senior Vice President and Chief Financial Officer, who will walk us through our financial performance.

(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.

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

Thank you, Charlotte. Happy New Year to all of you joining us on the call this morning.

We delivered solid results in the first quarter of fiscal 2023 as we continue to demonstrate our ability to drive sales growth through product vitality and service in both our lighting and spaces businesses. We expanded adjusted operating profit, substantially grew adjusted diluted earnings per share and generated strong cash flow from operations. We again created permanent shareholder value through share repurchases.

Both our lighting and spaces businesses started the year with strong sales performance. First, in the Acuity Brands Lighting and Lighting Controls business. Our strategy of increasing product vitality and service levels continues to be a key differentiator for our customers. Our Contractor Select portfolio continues to be an excellent example of where these efforts are creating value.

As a reminder, Contractor Select is a collection of the most important everyday lighting and lighting control products made up of a limited number of products with high product vitality and high service levels. This portfolio includes products from the Lithonia Lighting, Juno, Sensor Switch and IOTA brands and competes effectively in the electrical distributor and retail channels.

An example of continued product vitality in the Contractor Select portfolio, this quarter was the reintroduction of the upgraded DSX family of outdoor lighting. These products are used for commercial outdoor lighting as well as area lighting for schools, retail and other everyday workspaces. The refresh focused on improving the design and increasing the control functions, including the ability to embed our nLight wireless controls. It is a significant step forward in enhancing our outdoor offering.

Our focus on a concentrated offering with high product vitality and high service levels allows us to deliver high end user satisfaction at attractive levels of profitability. Our product vitality strategy addresses several of our priorities, including our sustainability efforts. This quarter, in our A-Light brand, we launched a trio of sustainable products, lean, stitch and wings that are marketed to office, commercial and other similar customers. These products have a number of innovations, including collapsible designs and the use of new materials. For example, the materials in the wings products are 100% recyclable.

Additionally, the collapsible design means the products contain less packaging waste and take up less shipping space, which reduces the amount of fuel consumed during transportation as well as our shipping costs. The feedback on these products has been positive across the design and specification community and has been recognized.

Our A-Light brand is leading by focusing on innovative design and sustainability, and I'm pleased to announce that this quarter, our A-Light team won 2 GRAND PRIX DU DESIGN Awards that celebrate the work of designers and architects who improve the quality of life in the built environment.

We are also making progress on our strategy of improving service levels. We are beginning to satisfy more of our late backlog and decrease lead times as component availability becomes more stable. One of the core reasons our service continues to be differentiated is our manufacturing facilities in Mexico. Not only are they strategically located, but they are also productive and very innovative. Our team of associates there is highly engaged and aligned to our values. I visited in December, and I was impressed by the changes that they are making in staffing and employee engagement that will help us adapt to evolving market conditions.

Finally, this quarter, we took the decision to exit our Sunoptics daylighting business and our Winona custom architectural lighting solutions. These businesses were no longer strategically relevant, and we do not expect them to meet our financial expectations in the future. We will continuously evaluate which businesses we operate and where we choose to compete. Karen will talk more about this in her comments.

Now moving to our Intelligent Spaces Group. The spaces team delivered good sales and operating profit growth this quarter. Both Distech and Atrius were successful in winning several new key customers and expanding services to existing customers. Our Distech product portfolio of controls and sensors is winning in the marketplace, largely in North America and France, and it has broader applicability. Therefore, we are focusing on increasing the addressable market for Distech. The first step is expanding the geographic markets that we serve. This effort is off to a promising start in the U.K. We are assembling the right group of independent systems integrators and are already delivering customer wins, including a large multimillion dollar multiyear contract.

In October, I was in Europe and had the opportunity to visit a large mixed-use construction site in Lyon, which was using a full suite of our Distech products to control the entire space. This installation is a great example of the power of a full Distech implementation with HVAC, lighting and shake control throughout all areas and for all tenants of the space. We look forward to continuing our market penetration in France, while we grow the U.K.

Moving to capital allocation. During the quarter, we repurchased just under 0.5 million shares, which brings the total amount repurchased since May of 2020 to just over 20% of our shares outstanding at an average price of approximately $140. Our capital allocation priorities remain the same. Our priorities are to invest for growth in our current businesses, invest in acquisitions, maintain our dividend and allocate capital for share repurchases when we perceive there is an opportunity to create permanent value for shareholders.

Now looking to the rest of fiscal 2023. There are 2 themes that we are focused on. First, there's obviously uncertainty around the economy, inflation and interest rates, which we know will affect our business over time. Second, we believe that as component availability improves, lead times will improve and backlog levels will return to normal. We are beginning to see this in our business. We are well positioned in a variety of our end markets and our continuing investment in product vitality and service positions us well for these dynamic environments. Our organization continues to adapt to the changing requirements of our customers. And as a result, we have positioned ourselves not to predict the future perfectly, but rather to adapt to whatever comes our way.

Finally, before I hand over to Karen, I want to congratulate our team on the accomplishments detailed in our 2022 EarthLIGHT report. Our products and services save our customers' energy and reduce their carbon emissions, and we are proud to announce our commitment to achieving net zero by 2040. As part of this, we have been working with the science-based targets initiative to establish new interim targets to further reduce our Scopes 1, 2 and 3 carbon emissions. This is both good for the environment and good for our business.

Now I'll turn the call over to Karen, who will update you on our first quarter performance and provide a strategic update.

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

Thank you, Neil. Our first quarter of 2023 was a solid start to the year. We delivered good sales growth and strong adjusted diluted EPS growth. We improved adjusted operating profit, grew cash flow from operations and continued to allocate capital effectively.

As Neil mentioned, during the first quarter of fiscal 2023, we took the opportunity to strategically review our portfolio and sold our Sunoptics business. This business provided dome skylights and smoke vents to several different types of commercial buildings. We also announced plans to discontinue our Winona custom architectural lighting solutions by the end of the fiscal year. As a result, we took nonrecurring charges of $22 million or $0.52 per diluted share related to impairments, severance, accelerated amortization and a loss on the sale of the Sunoptics business.

In the first quarter, we generated net sales of approximately $1 billion, which was 8% higher than the prior year, largely due to price. Both the ABL and ISG businesses contributed to the growth during the quarter. Operating profit in the first quarter of $109 million and adjusted operating profit was $140 million. The higher adjusted operating profit was a result of the good gross profit performance as we continue to manage price and costs. However, the fall-through of the higher sales to adjusted operating profit was lower because of the impact of strategic decisions made for fiscal 2023 around commissions.

Finally, we continued to grow adjusted earnings per share. Our diluted earnings per share of $2.29 was a decrease of $0.17 or 7% year-over-year as a result of the $0.52 of nonrecurring charges I detailed before, while our adjusted diluted earnings per share of $3.29 increased $0.44 or 15% over the prior year. The growth in adjusted diluted earnings per share was due to higher operating profit, benefits from foreign currency and lower shares outstanding due to the share repurchases.

I now want to expand on our segment performance. Net sales of ABL grew to $947 million, an increase of 7% compared with the prior year. This increase was driven by higher year-over-year sales in our independent sales network, the direct channels, corporate accounts and the retail channel. ABL's operating profit was $118 million, a decrease of $10 million versus the prior year, with ABL adjusted operating profit relatively flat year-over-year. The lower fall-through rate was primarily the result of higher commissions, as I mentioned previously.

Now moving to ISG. The spaces segment had a strong quarter and improved both net sales and operating profit. Sales in the first quarter of 2023 were $57 million, an increase of $10 million or 22% versus the prior year. During the quarter, Distech had strong performance across a variety of projects and was able to work down a significant amount of backlog from the fourth quarter of fiscal 2022 as component availability improved. ISG's operating performance also improved due to the higher sales and benefits from the mix of products as we cleared some of that backlog. Operating profit in the first quarter of 2023 increased to $8 million this quarter.

Now moving to cash flow. We generated $187 million of cash flow from operating activities for the first 3 months of fiscal 2023, an increase of $103 million over the prior year's first quarter. As a reminder, last year, we invested in inventory in order to support our growth as well as insulate our production facilities from inconsistent supply availability, with the intention of working down that inventory over several quarters, which we have done. We are now down 13 inventory days from the peak in February of 2022. We also invested $18 million in capital expenditures during the first quarter of fiscal 2023 and $78 million to repurchase approximately 0.5 million shares during the first quarter.

Before I turn the call to the operator for questions, I want to reiterate the following. We are pleased with our performance in the first quarter of 2023. We delivered solid sales growth and strong adjusted diluted EPS, our outlook for 2023 remains unchanged, and we continue to position ourselves to quickly adapt to changing market conditions and to continue to allocate capital effectively.

Thank you for joining us today. I will now pass you over to the operator to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question will come from Tim Wojs from Baird.

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

Nice job and Happy New Year. Maybe just on the backlog, Neil, it does sound like you made some progress kind of working that down. Any thoughts on kind of when you think the backlog returned to more of a normalized level? And I guess on the supply chain, could you compare and contrast where the supply chain is performing today maybe relative to 6 or 9 months ago?

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

Yes, sure. So there's a fair amount to unpack there, Tim. Thanks for the question. So big picture, our expectation is that as component availability becomes more consistent, and it is more consistent, although not yet back to normal, so it's -- I don't think that the industry or we are completely out of the woods yet on that. But we are starting to see some more consistent availability, then that will enable us to reduce lead times. So that's obviously a positive.

Along the way, we'll be working through that backlog. So as we've said over the last several quarters, and I would say the -- your question implies probably pretty accurate, off the top of my head, probably second or third fiscal quarter of last year was when we peaked on our absolute level of backlog. And so we've been working down through that over the course of the last couple of quarters and will continue over the next quarter or 2 to be working through that. That should get us to a more normal relationship between order intake and lead times and net sales, which we think is net -- obviously going to be a net positive. We don't know exactly how long that will take. So that's just an estimate, but that's -- I think, round numbers, that's about right.

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

Okay. Okay. Good. And then maybe, Karen, just on the commission comment, could you elaborate, I guess, what exactly that was in the quarter? And I guess if that's isolated to the fiscal quarter? Or is it just going to generally be a higher level of commissions for the year?

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

Yes. Thanks, Tim. There are several things going on in commissions this year. And what we're really focused on is investing in future business. So for example, we've made some investments and changes to our direct sales force commissions to position them for the upcoming future infrastructure business. And we've also invested to secure a certain project business. So I think what you'll see is that this is going to continue through the balance of the year at this level.

Operator

Our next question will come from Chris Snyder from UBS.

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

I wanted to start with one on capital allocation for Neil. In the past, when you've provided your framework, M&A always kind of came in above buybacks. But over the last year or 2 now, really all the capital has gone towards buybacks. And I think most of the [rate] with the multiples we've seen compressed in the marketplace, that was the right use of capital. But as we look forward here, can you talk about is that starting to shift more in favor of M&A? Could you maybe talk about any sort of M&A pipeline? And then specifically, the types of assets the company is looking for? Because in the past, the -- you talked about maybe tech assets to build out the ISG group, but also maybe looking at semi-adjacent industrial verticals to kind of deploy some of the software tech assets across them.

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

Yes. Thanks, Chris. So we've been consistent since I've been here about our priorities for capital allocation. We'll invest in our current businesses, we'll invest in M&A, we'll maintain our dividend, and we'll use capital for share repurchases when we feel like there's an opportunity. So over the course of the last several years, obviously, our value has been less than the general market's value, and it's created an opportunity for us, as I said in my comments, to repurchase over 20% of the company at about a little less than $140 per share. So we feel really good about that capital allocation.

The world, as you indicated, is starting to change and come back to us a little bit. So as valuations on other assets start to come back to more reasonable levels, then we do feel confident in our ability to deploy capital going forward. So the first thing that we did, obviously, was the OSRAM OPTOTRONIC's acquisition for our lighting and lighting controls business, which allows us to control the technology in our luminaires to develop an OEM, a broader OEM channel and to take greater control of our electronics supply chain, which obviously has borne significant strategic fruit.

So as we look forward, we have a pretty solid pipeline of interesting opportunities most notably in areas where we can expand the addressable market of our Intelligent Spaces Group. And we're seeing acquisitions of all different sizes there. So we'll continue to evaluate, obviously, our ability to generate cash, which is significant. So we were very pleased with the operating cash flow this quarter. As Karen indicated, we're paying down the investment we made in working capital last year. And that positions us with plenty of capital to meet all of our capital allocation priorities.

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

And I just want to kind of follow up on operating leverage. Can you just talk about the confidence in the ability to generate operating leverage as the environment starts to normalize. And the reason I ask is, this quarter, gross margin was flat year-on-year, and the company realized healthy high single-digit growth, but operating margin was down year-on-year. I mean I know investing in growth is a big priority. So just kind of through this, any thoughts or confidence in the ability to generate operating leverage through the rest of the year or even into the following year.

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

Yes. We're confident in our ability to generate operating leverage. So as Karen indicated, and I'll elaborate a little bit. I think if you -- when you see us over the course of time, so from 2020, '21, '22, '23 and beyond, and you would see a -- and if you look at that period in retrospect, you probably see, obviously, last year, we had a significant growth in net sales that was not -- we did not grow margins quite as fast, and you'll see us grow margins now as we start to bring those things together. So those haven't been perfectly synchronous, but we're generally pleased with the decisions we've made and our ability to take share.

So now as our focus is on generating that margin and leverage going forward, as Karen indicated, we've made some investments in commissions, kind of anecdotally, we invested in Holophane so that they could be positioned to -- for the infrastructure dollars that we expect to be coming. We've changed out a couple of our agencies. So we've talked about New York, and I think others have talked about Atlanta as example. So there are a series of these things which add up to a net investment in commissions, but not a permanent change in the percentage of sales that we invest in commissions.

Operator

One moment for our next question, please. And our next question will come from Joe O'Dea from Wells Fargo.

Joseph John O'Dea - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

I want to start -- could you just help a little bit with the bridge from fourth quarter margins to first quarter margins, if we take it both from a gross margin and an SG&A approach, what it was that sort of led you to be able to achieve kind of flattish gross margin sequentially? And then similarly, on the SG&A, is that all a function of commissions or anything else going on there?

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

Yes, I'll start, and then Karen, keep me honest here. So sequentially, I think the -- Joe, as you know, we have lower sales in the first quarter versus fourth quarter. So the ability to deliver consistent gross margin was a solid performance on the gross profit side. That was largely driven by 2 things. One is our ability to maintain price. And the second was our ability to maintain the levels of productivity in our own production facilities. And then on the operating expense side, as Karen has indicated, really the whole story has been commissions. So that relatively mild increase in investment in commissions is what has delivered the operating profit where it is. And as I said to Chris' question, we're confident that over time, we can leverage those expenses.

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

Yes. And, Joe, the only other thing I would add is, when you -- when I mentioned the ISG in my opening comments, they did have a really strong margin performance this quarter as they -- their electronic component availability improved, and they were able to clear some of the backlog that really did result in some favorable margin for them.

Joseph John O'Dea - *Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst*

Got it. That's all helpful. And then on the demand environment, I know we're just sort of days into the calendar flip, but I'm just curious as you're seeing sort of supply chain ease and maybe a little bit more comfort out there and at the same time, some of the macro uncertainty that you touched on, just as we think about sort of cadence over the last few months, anything you're seeing in terms of sort of shifts in demand, whether you're seeing a little bit more caution and wait and see. Obviously, we see kind of the ABI over the past couple of months, but sort of what you're tracking on the most real time on the demand front.

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

Yes. So Joe, I'll start and Karen add to anything that you want to on this. So obviously, we're focused on the economy. So inflation, the Fed, interest rates, et cetera. And we obviously don't have a crystal ball better than the market. So we're paying attention to that. As I indicated, there's 2 other things that we are paying a lot of attention to. The first is that as component availability, as you indicated, supply chain, there will be -- we will start to be able to return to more normal lead times. And so that transition will impact -- probably impact demand for a short period of time as we work through where people have probably bought ahead a little bit so that they could ensure that they have availability.

An example of that would be distributors that would have stage and store inventory in their inventory. So that would be where a contractor or a distributor or a project would have bought earlier than normal on their lighting and lighting controls, and they would have done that for any number of reasons, but the 2 most obvious would be to ensure that they have the product when they needed it, number 1; and 2, they might have bought ahead of some price increases as their -- so that they could capitalize on those lower prices. So we expect that to -- the combination of those things to impact demand over -- kind of over the next several periods. We don't know exactly how much and when, but we expect those to affect us. But net-net, we were confident in our ability to continue to take share in the industry and -- through our product vitality and our service levels, which are tools that we did not have in our toolkit the last time we faced an economic environment like this.

Operator

One moment for our next question, please. And our next question will come from Christopher Glynn from Oppenheimer.

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

Happy Monday, everybody. So on the improving lead times and getting some backlog out, Karen did a little bit of drill down into ISG with the margins there. Curious, as pertains to ABL, are you seeing a pathway to have more predictable level loading of the factories that might be a little gross margin opportunity as the year goes on?

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

Yes. Thanks, Chris. Is happy Monday an oxymoron? I wanted to check, and thank you all for showing up at 8 o'clock on a Monday for this call. Big picture, yes, we are moving -- we are trying to move towards more level loading of our facilities on the ABL side. So to take 2 steps back on the electronic component supply. So obviously, and I mentioned earlier, we bought OSRAM now, referred to as OPTOTRONIC for 3 reasons: one, to control the technology in our luminaires; the second, to expand our exposure to the OEM market; and the third is to take greater control of our supply chain.

So over the course of the last year, when the kind of the market was -- when we had just bought it and the market was bouncing around, we prioritized OEMs so that we could demonstrate to the market that they were -- we were serious about being in that business. We believe that, as we go forward, we have now have the opportunity to take greater control of that electronic supply chain. So that is obviously the pacemaker items have been on the electronic component and driver side. So as we start to take more control over that, we think we will have more control and the ability to have greater level loading over time.

The level loading won't be perfect, obviously, because that will be balanced by lower absolute levels of backlog as we lower lead time to get more -- in a more normal operating rhythm. But yes, we believe that net-net, we are in a position to better level load our facilities going forward and via taking greater control over electronic supply chain.

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

Great. And on the follow-up, it pertains to Sunoptics and some of the Winona discontinues. What's the associated revenue and cost savings with those? And should we be considering those in our annual model? Or does it just kind of dovetail with the guidance framework that you laid out last quarter and reiterated by reference today?

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

Yes. Let me just take a -- put this in context first, and then Karen, you can answer the specifics on the financials. We do want to get in front of changes that we see in the marketplace. And so we're going to constantly evaluate the businesses that we compete in. And Sunoptics was an acquisition from about 2013 or so, I think that just frankly wasn't performing anymore. And our Winona custom business was just that a custom business that we didn't expect to perform in the upcoming environment. But these are also demonstrations of our willingness and ability to make decisions that we think are going to impact the business going forward. Each of these were -- so we will absorb the impact of these in our guidance, both to top line and the profitability going forward, and that was contemplated, obviously, in our -- in Karen's comments about this year.

Operator

One moment for our next question, please. And our next question will come from Ryan Merkel from William Blair.

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

I just had a couple of follow-ups. My first question is on gross margin. Is the shape of gross margins, it's still the same where the second half is going to be better than the first half? Or has that changed because componentry is a little bit easier to get?

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

Yes, Ryan, when we talked last quarter, we did talk about some of the pressures that we would see and some of the higher cost inventory started to flow through in the first half of the year. So that really hasn't changed. Our perspective is that inventory will continue to flow through in the first half of the year. And so that should indicate some opportunity for improvement in the back half as well as to what Neil mentioned earlier with the opportunity for more level loading of our facilities and to have more control over the electronics in our supply chain.

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

Got it. Okay. And then a follow-up on SG&A. I think you said you're going to leverage SG&A this year. When do you expect to do that? Does that happen in 2Q? And can you just unpack what changes from 1Q? I'm not sure I heard that.

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

Yes. So thanks for the opportunity to clarify that because that's not what I said. Chris' question, I think, was, are we confident that we can leverage SG&A? And yes, we are confident that we can leverage SG&A. The change in the first quarter sequentially from the fourth quarter in the SG&A number was primarily around the investment and commissions that Karen outlined. And that was positioning us for future growth not a permanent change in the rate of commission. So we see those commissions. We expect those commission investments to continue through the next couple of quarters in relation to sales. So don't expect us to leverage that line. Obviously, we will constantly be evaluating our operating expenses and especially if the market changes. But all of that's contemplated in the guidance that Karen provided.

Operator

And our next question will come from Jeffrey Sprague from Vertical Research Partners.

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

I guess maybe next Monday will be happy Monday, if we are all off for MLK day. So I feel like we're beating a dead horse with this commission question, but I'm a little bit confused here. It sounds like you're paying higher commissions today for potentially better sales in some future period. Is something else going on here, which is kind of the ability to retain salespeople or kind of just labor costs, labor availability? And why would you be kind of front loading commission costs for this potential future infrastructure revenues and the like?

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

Yes. So let me be a little bit more granular, Jeff, which I think will give you some more insight and color. So on the infrastructure side, we are evolving how we take Holophane to market with our direct sales and some agency relationships. So in some cases, we're paying double -- we're paying double commissions on existing business. We will work through that over time so that, that will return to a more normal level. And second, as we indicated earlier, as we make sometimes some changes in markets like New York, which we've talked about, or Atlanta or others around the country, we incur some period costs as we make those transitions that show up in the commissions line.

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

Understood. And then just on Distech, the international opportunities that appear to be unfolding, can you just give me a sense of kind of the total footprint? Is it now just U.K. and France and Europe? Are you looking at other markets? Maybe just give us a sense of kind of the plan there, maybe it's kind of a 2- or 3-year plan, it sounds like, but to rule that out more broadly.

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

Yes. Thanks for the question. So Distech is a very attractive business. So they have the best technology in the market. They compete effectively on the building management control sensor market. And it's largely been focused on North America and France. So we have good penetration in France. We have developing penetration in the U.S. And, yes, the technology is applicable in multiple markets. And so it is a multiyear strategy. So first is the U.K. The second will be to start to grow. We have a very small business, but we have -- we'll have a developing business in non-China Asia, which we think provides a large opportunity. So net-net, we think we can continue to push this geographic expansion. And the theme around Distech will be -- we do have a better mousetrap so now we want to increase the addressable market.

Operator

One moment for our next question, please. And our next question will come from Brian Lee from Goldman Sachs.

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

Happy New Year. Maybe just zooming out a little bit at a couple of bigger picture questions. I know you don't like to talk about price too granularly, but you've mentioned over the course of the past several quarters, including earlier today, that price increases have been a tailwind, and you've had multiple price increases, obviously, in the past year. Any sense just kind of, again, big picture, what the outlook is for pricing given input costs, freight? They seem to be coming back in now. Any feedback from customers and/or peers around whether you'd expect some level of price to give back here through 2023?

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

Yes. So, Brian, big picture on price. Over the course of the last couple of years, we've done several things, which will ultimately impact price. The first is to dramatically increase our product vitality. So we're delivering better value through our products to our end users through productivity in those products and the relationship between what they're getting and what they're paying for it. The second is that we've been strategic about our pricing. We price based on market conditions so that we can compete effectively in everyday products, and we can win the projects that we like to win.

That combination of product vitality, having the right product at the right price, at the right value for customers, and our ability to manage price strategically has been what has allowed us to deliver the results in the past market that we've encountered. We think those tools are really valuable in the market that we expect to encounter going forward. So having the kind of the best products at the right price in the right place, the ability to make margin when we do that and the ability to price strategically based on a difference between, say, everyday products and choosing, which projects we want to win is really valuable going forward.

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

Okay. Fair enough. All makes sense. And then I guess maybe related to that a little bit, just China reopening, again, the comment around freight costs starting to normalize. Any updated thoughts on just sort of the competitive landscape, especially from overseas suppliers?

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

Yes. No, it's always a good question, and we have tremendous respect for competition. We consider competition as a gift. Having said that, just to reiterate, about 20% of our product is sourced from Asia, about 60% is manufactured in North America, as I indicated, Mexico, the U.S. and Canada. So -- 60% in Canada and 20% in the U.S. So what that allows us to do is compete effectively with whoever the new competitors are. So just like everyone else, we've dealt with challenges getting our products out of Asia and here. So net-net, while we expect there to -- on the margin be a little bit more competition, obviously, we've been competing effectively in the same market they have.

Operator

And I'm showing no further questions in the queue at this time. I'd like to turn the call back to Neil Ashe for any closing remarks.

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

First of all, thank you all for joining us as we indicated early on a Monday morning. We are pleased with our performance in the first quarter. We had solid results. We're well positioned in our end user markets, both on the lighting and lighting control side and increasingly on the Intelligent Spaces side, where we're working to expand our addressable market. We expect the kind of the continuation of the current trends in the economy, and we're pleased with our ability to be adaptable to whatever the market sends our way. So with that, we'll send you on your way. And we hope you have a great rest of your day, and we look forward to talking to you again soon.

Operator

This concludes today's conference call. Thank you for your participation. You may now disconnect. Everyone, have a wonderful day.

REFINITIV