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AYI.N - Q1 2022 Acuity Brands Inc Earnings Call

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OVERVIEW:

Co. reported 1Q22 net sales of $926m, diluted EPS of $2.46 and adjusted diluted EPS of $2.85.

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

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

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

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

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

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

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

Miguel E. De Jesus *Goldman Sachs Group, Inc., Research Division - Associate*

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 First Quarter Earnings Call of Fiscal 2022. (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, Liz. Good morning, and welcome to the Acuity Brands Fiscal 2022 First Quarter Earnings Call.

As a reminder, some of our comments today may be forward-looking statements based 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.

Reconciliation of certain non-GAAP financial metrics with their corresponding GAAP measures are available in our 2022 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 CEO, who will provide an update on our strategy and detail highlights from the last quarter; and Karen Holcom, our Senior Vice President and Chief Financial Officer, who will walk us through our earnings performance. There will be an opportunity for Q&A at the end of the call. (Operator Instructions). We are webcasting today's conference 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, and happy new year to everyone joining us this morning to discuss Acuity Brands. I'm proud of our performance in the first quarter of fiscal 2022. Our team delivered sales growth of 17%, expanded our operating profit margin by 160 basis points and increased diluted EPS by 57% despite global supply chain challenges and unpredictable market conditions. Our performance demonstrates that by prioritizing customers, we are driving sales growth and turning that into operating income while continuing to invest in the long-term growth and transformation of the company.

I want to start today's call by taking a deep dive on the current market conditions. As you are aware, this is a dynamic market with a fair share of paradoxes. Demand across our end markets remain strong. At the same time, the availability and cost of key inputs remain challenging. In short, it's the best of times and the most challenging of times.

First, on demand. Business is strong both in ABL and in spaces. Within ABL, demand is strong across all of our channels to market, except retail, which we expect to improve this calendar year. In this dynamic pricing environment, we have been prudent and successful passing on price increases, while at the same time, providing as much consistency as we can to our customers so that they can plan and execute their projects effectively. At the same time, input costs and availability remain unpredictable, and we expect this to continue. Obviously, everyone is dealing with this. Our strategy for managing through this has been consistent: Prioritize satisfying customer demand and ensuring the health and well-being of our associates.

So now let me spend a minute on what we mean by satisfying our customer demand. First, we have chosen to honor pricing on all of our placed orders. As I've said before, it is important to me that we are known in the industry for doing what we say. There is a gap in time between when we receive orders and when we fulfill them in normal times, and that is even greater now. Therefore, we believe that this position will serve us well in the long term with specific customers and with the industry.

From there, we are also doing everything that we can to fulfill these orders as quickly as we can. While we don't disclose backlog, what I will say is that it is meaningfully higher than during normal periods. This is the result of higher demand, coupled with changing component availability and the general supply chain and transportation challenges. Again, these are not unique to Acuity. To combat these, we have prioritized 3 key activities.

First, we have focused and invested in our strategic relationships with manufacturers and suppliers to procure as much of the available component supply as possible. We benefit from being the largest and most consistent in the industry.

Second, we have empowered our teams to source components in the spot market, and we have prioritized speed and access over cost. This allows us to maintain higher levels of production at the expense of some higher cost.

Third, our product, engineering and manufacturing teams have been continuously redesigning and reengineering existing products based on what components are available. To give you an idea of the magnitude of that effort, our Distech engineers spent over half their time in the last quarter dedicated to this type of redesign. Our ABL team made the same commitment in addition to changes and improvements in our manufacturing processes to ensure consistent production.

These efforts also extend beyond our company into our broader ecosystem. We have been working with suppliers to help them find necessary components and make engineering changes in the products that they supply to us.

The overall effort has been herculean, and our teams continue to remain flexible and to adapt to an ever-changing environment. The changes that we have implemented over the last 2 years have enhanced our ability to see across our business, work across our stakeholders and improve our service levels.

So where are we on our transformation? One of the points that I stress to our team is that transformation is a process, not a destination. In challenging times, sometimes, the first reaction is to revert to what you know. In our case, we are using these times to redouble our transformation efforts.

Let me start with the ABL business. Trevor and his team are focused on maintaining high product vitality, continuing to elevate industry service levels and continuing to use technology to differentiate us. During the first quarter, we launched several interesting products to drive our portfolio expansion, products like the STACK PACK and STACK Switch products. These are the next generation of center-element LED lay-in lights for commercial indoor spaces.

The STACK has a lower profile and more efficient packaging that saves on transportation costs. It also has an adjustable lumen output that can be reconfigured at any time through the STACK Switch. This means that there is no time wasted on a job site if there need to be changes to the configuration.

In controls, we introduced the CLAIRITY link. This is part of our nLight lighting controls platform that offers remote connectivity capability. The remote capabilities reduce the need for in-person visits, offering quick troubleshooting resolutions and a reduction in maintenance cost. This product fundamentally changes the way we service projects and is an important step forward for our customers.

Now moving to the Intelligent Spaces Group. The mission of ISG is to use technology to solve problems in spaces in order to make them smarter, safer and greener. We do this in 2 ways. We collect data through hardware, for example the Distech controller; and then analyze and take action on the data through software applications powered by Atrius.

Our ISG group had an eventful quarter. As I mentioned, even though the engineering team at Distech spend over half their time focused on redesigning Distech products for the available components, we continued to roll out several important products and product enhancements.

The Distech ECLYPSE APEX was introduced in the first quarter and is the most advanced version of our controller for HVAC and building automation. The APEX introduced artificial intelligence to the edge and increases compute capacity in buildings, which helps customers manage energy usage more effectively.

We also further expanded the availability of our Atrius Building Insights service by enabling it for additional languages and local privacy requirements. Atrius Building Insights is now available in the U.K., Ireland France, Germany, Spain and Norway.

As I turn the call over to Karen, I want to take a step back. We are currently and expect to continue to be operating in unpredictable times. Input prices and availability can sometimes feel like a game of whack-a-mole, and we are dealing with Omicron, which materialized only a few months ago. As we face these challenges and new challenges we will maintain our focus on satisfying customer demand in ensuring the health and well-being of our associates. I remain optimistic about 2022 and our ability to effectively manage in this environment. We have a great team who are executing today while also remaining focused on the long-term growth and transformation of the company.

I'll now turn the call over to Karen, who will take a deeper dive into our performance. And then I'll be back for the Q&A and for some closing remarks.

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

Thank you, Neil. I want to start by thanking our team for their work over the last quarter in this environment. I continue to be impressed by our team's dedication to our transformational priorities while we continue to navigate the day-to-day performance of the business.

We delivered a strong first quarter performance. Net sales were $926 million, an increase of 17% compared to the prior year. This performance was driven by our improved service levels, a continued recovery in the end markets of both of our business segments and the benefits of recent price increases.

Gross profit was $386 million, an increase of $53 million or 16% over the prior year. This improvement was driven by revenue growth and by offsetting the significant increase in material and freight costs through price increases and product and productivity improvements. Gross profit as a percentage of sales was 41.7%, a decrease of 30 basis points from 42% in the prior year, a significant achievement given the cost environment.

Reported operating profit margin was 12.4% of net sales for the first quarter of fiscal 2022, an increase of 160 basis points over the prior year. Adjusted operating profit margin was 14.4% of net sales, an increase of 120 basis points over the prior year. The majority of this was the result of improved operating leverage as we continued to balance cost management and growth investments.

The effective tax rate for the first quarter of fiscal 2022 was 19.6%. In the same period of 2021, the rate was 24.7%. The decrease in the effective income tax rate was primarily due to favorable discrete items recognized in the first quarter of fiscal 2022 related to excess tax benefits on share-based payments. We expect our tax rate for the full year of 2022 to normalize to around 23% absent these discrete items.

Finally, we saw a significant improvement in diluted earnings per share for the quarter of fiscal -- for the first quarter of fiscal 2022. Diluted EPS of $2.46 increased $0.89 or 57% over the prior year. And adjusted diluted earnings per share of $2.85 increased $0.82 or 40% over the prior year. Our share repurchase program favorably impacted adjusted diluted EPS by $0.07 and the tax impact was approximately $0.16.

Moving on to our segments. During the quarter, our Lighting and Lighting Control segment saw sales increase 17% to $884 million versus the prior year. This was driven by improvements within our independent sales network, which grew 14%; and the direct sales network, which grew about 12%. These increases were a direct result of our strong go-to-market efforts and an improved demand environment as well as the favorable impact of price increases.

Our corporate accounts channel saw an increase in sales of approximately 62% compared to the prior year as large accounts began previously deferred maintenance and renovations. The performance in this channel is dependent upon our customers' renovation cycles and can be uneven quarter to quarter. Sales in the retail channel declined approximately 16% in the current quarter.

ABL operating profit for the first quarter of fiscal 2022 increased 30% to $128 million versus the prior year, with operating margin improving 160 basis points to 12.4%. Adjusted operating profit of $138 million improved 28% versus the prior year, with adjusted operating margin improving 140 basis points to 15.6%.

Now moving on to the results for our Intelligent Spaces Group. For the first quarter of 2022, sales in spaces increased approximately 14% to $46 million versus the prior year, reflecting continued demand primarily across our building and HVAC controls. spaces' operating profit in the first quarter of 2022 increased approximately $2 million to $2 million versus the prior year. Adjusted operating profit of $6 million increased approximately $2 million versus the prior year as a result of the strong sales growth.

Now turning to cash flow. We continue to generate solid cash flows. The net cash from operating activities for the first 3 months of fiscal 2022 was $84 million. This was a decrease of $40 million or 32% compared to the prior year and reflects an increased investment in inventory to drive growth. Additionally, cash flow was impacted by the timing of income tax payments and the prior year deferral of withholding taxes as a result of the CARES Act. We invested $9 million or 1% of net sales in capital expenditures during the first 3 months of fiscal 2022.

During the quarter, we continued to execute on our capital allocation strategy and repurchased approximately 300,000 shares of common stock for around $53 million at an average price of $176 per share. We have approximately 3.5 million shares remaining under our current board authorization.

Our capital allocation priorities remain the same. We will continue to prioritize investments for growth in our current businesses, to invest in acquisitions, to maintain our dividend and to allocate capital to share repurchases when there is an opportunity to create permanent value for our shareholders.

I would now like to spend a few minutes addressing current topics of note. First, on the pricing environment. As Neil said, we are managing price aggressively while at the same time balancing the relationships with our customers. We announced another price increase this week effective for orders placed in February. We will continue to be deliberate in our strategic approach to pricing.

Next, I would like to update you on the OSRAM integration. We have made significant progress in our integration of OSRAM. We bought the OSRAM North American DS business to ensure control over the technology, to expand our OEM channel and for the benefit it brings through the integration into our supply chain. The addition of OSRAM contributed over 300 basis points to our sales growth in this quarter. There was also a relatively small dilutive impact to gross profit margin, but OSRAM was an overall positive contribution to operating profit. The acquisition is delivering on our expectations and we are very excited that the OSRAM team is now part of Acuity.

Finally, you may have noticed that this quarter, we have added an additional metric to our earnings release. We have included EBITDA and adjusted EBITDA in our tables of reconciliation to enable easier comparisons and to improve the consistency around reported adjustments.

As we continue to navigate 2022, we will continue to prioritize our customers to drive sales growth and operating income. We will also continue to allocate capital in a way that drives long-term growth and that creates permanent value for our shareholders.

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

QUESTIONS AND ANSWERS

Operator

Our first question comes from John Walsh with Credit Suisse.

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

Maybe first, if we could talk a little bit about the operating profit margin performance. I appreciate the comments in the script. Looks like you were really able to leverage the fixed portion of your SD&A bucket, kind of the non-freight and commissions. Wondering if you could just give a little bit more color there. Is it kind of just the stronger sales flowing through on that? Or are you also driving some productivity on that fixed part of your SD&A cost structure.

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

Karen, you want me take that? I'll jump in first. So John, yes, thanks for the question. Taking a step back, the plan, as we've said all along, has been to drive sales growth and then to turn that sales growth into operating margin. The first step of that was the product vitality efforts that we did. And now we're -- the second step of that is leveraging the fixed cost.

So there's -- I'd say the answer to your question is both. There's obviously improvement because of the larger absolute dollars of sales and a smaller growth in the fixed operating expenses. And within that number, there are and there will continue to be parts of the transformation that provide additional leverage.

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

Great. And then I guess, just a question on you feel strong about the sales growth going forward. Obviously very early in the year, so kind of not surprised to see no change to the guide. But can you maybe talk a little bit about what you're seeing in terms of maybe renovation and retrofit demand from energy efficiency and decarb perspective?

And then maybe any color on Holophane and if you're seeing any benefit from the passed infrastructure bill yet. And then I'll pass it along.

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

Yes. I'll start. Karen, fill in if I leave anything out. So first on the financial framework that we provided at the end of the last fiscal year, beginning of this fiscal year. It is our intention to not update that on a regular basis, but to rather provide that framework. And so obviously, you're familiar with that framework.

As we look forward to the rest of the year from a sales perspective, obviously, we had a really strong performance this quarter. That was driven by a combination of factors. First, obviously, as I mentioned, the strong end market demand. So demand is strong and continues to be strong, which is leading to, as I indicated, building up a larger amount of lead time in our orders. So we're processing those orders as effectively as we can. That compares to last year, which is normally -- the first quarter, as you know, is a normally lower seasonal quarter, our fiscal first quarter, as well as the generally lower level of demand due to the pandemic at the time. So it's a combination of those factors.

As we look forward for the rest of the year, we see sales continue -- we're continuing to process that demand. So as we said, that is our priority, is to satisfy that customer demand. That will mute some of the normal, but not all of the normal, impacts of seasonality so as we look forward. So the second quarter obviously has Christmas and a couple of other things, so it won't be like the first quarter. And then we expect to return to normal levels at some point kind of later this year or early next year.

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

Yes. The only other thing I would call out, John, is when you look at that corporate accounts channel, it had a really strong quarter at 62% growth year-over-year. And so that can be inconsistent quarter-to-quarter as well.

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

And then finally, on your question about Holophane and the industrial. Holophane had a good quarter. Candidly, not a great quarter yet. We see lots of opportunity in the future as those projects start to happen. But it's going to take a minute for them to get specced, to get designed and to get funded and to get started.

Operator

Our next question comes from Ryan Merkel at William Blair.

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

So Neil, I wanted to start with supply chain, I guess a 2-part question. Do you think you're taking market share just based on how well you're managing things?

And then secondly, do you feel like the worst is over? Or is it too early to say that?

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

So on your first question, I've said this since I got here, it's frustrating that there isn't more clear information about market so that we could say in absolute terms it's where we are. As you see our performance and then you'll see our competitors' report, I think all indications are that we are taking share.

And it's is on the basis of, I really think 2 key factors, which we've identified, which is product vitality, the investments we've made over time and making sure we have the right products; and then the supply chain, which is really about having the right products in the right place at the right price and at the right time.

We, I believe, have performed better than most on that front, which kind of gets to your second question, which is, is the worst of this over? The short answer is we don't know. The -- it's -- we continue to be all surprised, as I indicated in my comments earlier. So no one saw Omicron coming. So we don't know if that will impact our labor and therefore our production capacity, for example, over the course of the next several months. But we're working through that.

And what I want to highlight is that I believe the dexterity of our supply chain is what has allowed us to perform so well. And by dexterity, I mean we source from multiple places. We have -- on the one hand. But also our team. Our team has been incredibly adaptable. They're reinventing how they source products. They're reinventing how they schedule production. They're reinventing the flow-through through our factory and distribution systems. So we continue to dynamically change these things to make us better.

So we're positioning ourselves, Ryan, for uncertainty in the supply chain so that we can continue to perform whether it gets worse or it gets better. And my expectation is that it's going to be this way for a little while longer.

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

Got it. Makes sense. And then on price capture, when do you think we'll see the full impact of the price increases that you've put through? And then will the realization be enough to cover your higher costs?

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

Karen?

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

Yes. Let me start with that, Ryan. As we mentioned in our comments, there is a lag between when we have the price increase and when we see that in the results. And then also the timing of the costs, the costs come in a lot faster than the price does. So as you know, we've now, as of this week, had 5 price increases. And so you'll start to see benefits of that accumulate throughout the course of the year, while we also expect the cost to increase commensurately throughout the course of the year.

So that being said, I think we'll still see some benefit from price and be able to offset cost, but still a bit uncertain and just monitoring what the costs are going to do, and then if we have to take actions in the future to offset some of those. And again, we're not just focused on price. We're also focused on product and productivity improvements to continue to improve our margins.

Anything else to add, Neil?

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

Yes. No, Ryan, I'd just say, strategically, we've been able to get price whenever we've asked for it. And we've made -- as I said in my comments earlier, a -- what I think is an important strategic decision, which is that we're going to honor the prices on orders placed. And that provides a consistency to the end markets who are trying to execute projects.

And as Karen mentioned, there's a time lag between when we lock in the pricing on those orders and what the component input costs end up being. But as you can see from the results, it's driving top line and we're turning it into operating profit margin.

Operator

Our next question comes from Jeff Sprague at Vertical Research.

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

Two for me. One maybe is just kind of housekeeping. On the comment on the guide that you don't plan to regularly update it, do you plan to, though, I guess, reevaluate if you're outside of kind of some band of materiality? Or should we expect that, regardless of what you're printing through the year here, that this framework remains exactly the same?

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

Well, so thanks for the question, Jeff. And let me be -- let me give you my view of this philosophically, which is that the reason we use the term framework is because that's what we mean for it to be, which is the framework for how we're thinking about the year. I think it's more important that we provide you how we are thinking about it so that we then collectively can evaluate how we're doing going forward. So that's why we use the term framework as opposed to guidance, and that's why we want to keep it in place.

I also will tie you back to what we said at the time, which is that we expected this year to be a higher growth year than our normal expectation for framework. So if you go back to our Investor Day when we gave you kind of the general perspective of our 2 segments.

And that's philosophically how we want to think about it. We want to have an intelligent and qualitative conversation with you about the outlook and then try and deliver the best results that we can.

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

Great. That's helpful, given the whole framework/guidance approach with you. Helpful, but new for all of us given prior practices. So thanks for that insight.

Can we come back to kind of the retrofit/reno work? What kind of backlog of activity do you see there? And I understand it might not be in your product backlog per se given the nature of your business and how you book orders. But in terms of kind of feet on the street, people out working projects, do you see that sort of work broadly coming back at this point in time? And any color on how the peak of the season as it relates to that type of activity would be interesting.

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

Yes, Jeff, this is Karen. We are seeing improvements in several areas related to retrofit and renovation. As we've said before, industrial continues to be a strong market for us. We're seeing improvements -- slight improvements in -- excuse me, office space. Education is strong and depending on the time of the year. So all those markets with renovations continue to be strong. As we said, a lot of the large retailers are coming back and reinvigorating their renovation program, so that's good to see.

It's still lagging a bit in markets like hospitality. That seems to be a bit slower to come back than others. So we're seeing that in the orders that we get today. And anecdotally, our agents and our other channels are seeing similar activity in their markets.

Operator

Our next question comes from Christopher Glynn at Oppenheimer.

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

Had a question about [IGS]. Neil, you mentioned several product expansions into a range of international arenas. I'm curious to hear you talk about the prospects outside North America. Are they different from ABL? Because I think ABL's has been sort of happenstance, not necessarily strategic. You may have some qualifiers, but -- to that. But materially, is there a difference in the international outlook for IGS?

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

Yes. Thanks, Chris. Great. I appreciate the question and the opportunity to talk about this some more. So before I get into the spaces group, let me spend a second on ABL, which is that North American lighting is different for a number of reasons, between European or Asian lighting, different standards, different electricity, a number -- and different industry structure. So it makes a lot of sense for us to -- in our lighting business to continue to focus on North America and try and continue to take share as we've done.

Now switching to the spaces group. When you think about both Distech and the controller and the technology there, it has broader applicability outside of just North America. So the technology there is already present in Europe. We're very strong in France, for example, with Distech. So we see a broader international opportunity for the Distech portion of spaces outside the U.S. as well.

And let me spend a second. I talked about Atrius Building Insights earlier. As we're consolidating Atrius and making it the software applications which analyze and then over time provide the ability to take action on data.

What that means in this case, Atrius Building Insights allows any facility to understand exactly what their energy costs were, what drove those energy costs and provides them the ability to see that in a consistent way. And so what we've done is now localize that for the European markets that I introduced, which gives us a pathway to continue that European expansion of both Distech and Atrius combined with Distech for the solutions that we envision in the future.

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

Great. And I was curious about the ABL top line framework for high single digits. Just if we kind of tease out normal seasonality in the next couple of quarters, and I think you indicated second quarter might be on the heavier end of normal seasonality given the first quarter strength. But kind of backs into a flattish fourth quarter to exit the year, I think we'll attribute that to your guidance explanation rather than a ratification of that implication. Is that correct?

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

That's correct.

Operator

Our next question comes from Brian Lee at Goldman Sachs.

Miguel E. De Jesus - *Goldman Sachs Group, Inc., Research Division - Associate*

This is Miguel on the line for Brian. I just wanted to start real quick. On the price increases, you mentioned the fifth price increase announced this week. And then on the 4 announcements, we were just curious, are all of those -- I guess, is the impact of all of those fully realized in this quarter's results? Or is there still to be left realized on those 4 prior price increases? Or will those flow through future quarters, along with the fifth one that you just announced?

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

Yes. Thank you, Miguel. As we mentioned, our backlog is meaningfully higher than what we would typically see. So I think in normal times, you might see the price increases come a bit faster. But where we are today, there's still more of the price increases that would come through just in terms of the timing of when they were announced, when they were impacted and then how that backlog will flow through.

As we also pointed out, we're not repricing our backlog and adjusting it. So it only reflects the prices that were implemented at the time the order was placed. So you will see a lag in some of the pricing coming through.

Miguel E. De Jesus - *Goldman Sachs Group, Inc., Research Division - Associate*

Okay. Great. And then I had just a quick follow-up, too. It doesn't sound like it, but how are customers, I guess, responding to price increases? You mentioned that you built in a lag for when you announced the prices. And then I think in a prior call, you mentioned that there's a possibility there have been some demand pull-forward as customers maybe anticipate further price increases. But do you see any possibility of maybe a decline in customer orders if prices go up to a certain level, given if material costs and things maybe go up higher than expected?

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

I'll take that one. So first of all, no one likes higher prices. We don't like them, our customers don't like them. But everyone recognizes that this is a time where all costs are changing, and therefore, prices are -- there's a general expectation that prices are going to go up. So our end markets are, as I mentioned earlier, are taking all of the price increases that we are putting forward.

Part of the -- but let me spend a second on the strategy of price, which is -- and a couple of important components to that. The first is that we're trying to be prudent and strategic about our pricing because we believe that, at the end of the day, it will come back to we need to have the right product, which is product vitality; in the right place, which is effective service levels; at the right price. And so we're -- part of the investment we're making in honoring our -- the prices of our orders is the investment in that relationship with our customers and the end markets so that they can see that, they can expect and plan their projects accordingly.

So are input price is going to change and will that potentially have an impact on prices over time? Of course, they will. And they could go in either direction. But our strategy is to have the right product in the right place at the right price. And we are demonstrating that, that strategy is driving growth, which we think is in excess of the market, and we're leveraging our cost to expand margins at the same time.

Miguel E. De Jesus - *Goldman Sachs Group, Inc., Research Division - Associate*

I appreciate that. And I just had 1 more, if I could squeeze in a real quick. It's on OSRAM. You mentioned just now a 300 basis point sales -- a 300 basis point contribution to this quarter's kind of results. I think in the past, you mentioned that, over the course of fiscal '22, it would be at 200 basis points contribution to the top line. So are you still tracking to that 200 basis point sort of framework? Or maybe are you seeing signs that that's starting to accelerate?

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

Yes, let me take that one. For OSRAM, as we said, this quarter is the 300 basis points. And the acquisition is going really well, it's on track, and we're really pleased to have that as part of our product portfolio and our capability.

What I would say is that, just remember, we did buy it towards the end of the year. So we have 2 months of it in our results, so you will see, I would kind of say 300 basis points is a reasonable amount to assume for the first few quarters. But then towards the back end, it will tail off a bit since we did own it in the fourth quarter.

Operator

Our next question comes from Chris Snyder at UBS.

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

I want to follow up on the ABL high single-digit growth commentary. And I understand that this is more of a framework than maybe hard guidance. But with M&A adding 300 to 400 bps of growth and the company up low teens organically in the first quarter, the guidance embeds kind of low single-digit organic growth the rest of the year if my math is correct. And which seems highly unlikely, given elevated backlogs and improving nonres activity. Are there headwinds here that we should be watching out for?

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

Yes. Chris, as Neil said, it's a framework, and that was the framework that we gave kind of as we started the year. This year, we have seen abnormally high growth that is not reflective of what we've seen in the past. And you see that in the 16% or 17% sales growth this year. So I think your math, you understand the math part of the equation, and we just want to give you the framework and kind of the paint by numbers to look at for the year. The first half of the year, I would say, was a low comparison to prior year. So you are seeing a bit of that. And then -- and so I would say it's a framework, and we don't intend to update that.

Neil, anything you wanted to add?

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

No, nothing to add.

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

And then for the follow-up, as we think about the gross margin cadence and achieving the full year guidance of 42% plus, is it fair to assume that Q2 steps down before a back half recovery? And is the latest price increase needed to get back above 42% in the back half? Or should we view this maybe more as a cushion?

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

So Chris, let me reiterate what I've said multiple times so far on this call. First, our framework is a framework that we provided at the beginning of the year, and we don't intend to update on a regular basis. Second, we're doing everything we can to deliver the highest possible results that are consistent with our investment and long-term growth and transformation of the company. Third, we've grown sales growth, and we've turned that into operating profit margin. So we've demonstrated that we are both taking share, we are getting price and we're effectively managing the supply chain to deliver on that operating profit and sales growth.

Operator

Our next question comes from Joe O'Dea at Wells Fargo.

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

First question is just on the operating environment. And if you could talk about what you've seen unfold since you last reported and the degree to which you've seen stabilization. And anything that you can call out that's changing either better or worse.

And maybe relate that to the most recently announced price increase, whether what you saw 3 months ago kind of gave you indications that you're going to be taking price up again, or whether you've seen things that required more pricing action?

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

Yes. Thanks for the question, Joe, and I appreciate you picking up coverage. As we're -- the tree top view is that we continue to see really strong demand, as we said, and we've been really dynamic in the management of supply chain based on availability and access to the necessary inputs to manufacture each of the products. And so it was our expectation and when we laid out the framework and we talked to you last, that this was going to be a dynamic environment. We've been kind of continuing to talk about that. That prices are changing on a regular basis, and therefore, probably our prices are going to change as well. So we're not surprised by, obviously, the fact that prices have increased.

And maybe we can provide some anecdotes to give an indication of kind of what we're talking about. So when you think about kind of the inputs, obviously, we're talking about chips, we're talking about steel, we're talking about aluminum, we're talking about resin. And we're talking about things like transportation.

And one of the kind of interesting examples is that our normal transportation time from -- for the components and the finished goods that we source in Asia, is normally around, say, 20 days of time on the water. That's approaching almost 60 days at this point. So that has an impact on -- that timing has an impact on cost, obviously. That timing has an impact on inventory. That timing has an impact on a number of things. And that's just one anecdote and one example of how we're combating this.

So the answer to your question is yes, we expect prices to -- we expect costs to change over the course of the year, and we expect prices to continue to change over the course of the year.

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

I appreciate the color. And then a second question just related to cash and deployment and how we should be thinking about free cash flow conversion on adjusted net income this year, given some of the inventory build, whether you think that inventory cushion is comfortable at this point. But then when we think about the current cash levels and the ongoing kind of cash generation, what your appetite is for buybacks at this point versus a preference to be patient on deals.

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

Yes. This is Karen. First, I wanted to reiterate our capital allocation priorities. As we've said before, our first priority is to invest in the growth of our current businesses. The second is to invest in M&A. The third is to maintain our dividend. And then fourth, we will do share repurchases when we believe there's an opportunity to create permanent value for our shareholders. So if you look at kind of those 4 priorities and start with the first and your comment on inventory, let me just make a few points on inventory.

Really, inventory is up for about 3 reasons, 3 key reasons. One, to support the increased demand that we're seeing in the environment that we've talked a lot about today. Second is to secure supply when there is availability. So when we see the opportunity to buy components and secure supply for future orders, given the shortages, we are certainly doing that. And then third goes to what Neil just referenced with some of the longer lead times on products that are on the water that's already our inventory. So we are investing in inventory for the growth of the business.

So those are our priorities. We'll continue to focus on those. And then to answer your direct question about share repurchases, as we see value to create -- that opportunity to create value for shareholders, we will do so.

Operator

Our next question comes from Jeff Osborne at Cowen & Company.

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

Two questions on my end. One, Karen, I was wondering if you could just remind us on what the typical lag is from order to revenue recognition. And you mentioned that, that is stretching out. But can you just put it in perspective what that is in normalized times and what it is today?

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

Yes. Typically, we would have seen, it depends on the projects, but you would have not seen elevated backlog like we're seeing today. So it could be a few weeks, it could be a few months. But just based on kind of the availability of the components, the supply chain challenges that we've discussed with the lead times, it is stretching beyond that. So it can be upwards of 6 months or so. But these are all placed orders. They're not speculative orders. It's really just the timing of when we can ship the orders.

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

Got it. That's helpful. And then maybe for Neil. 18, 24 months in now, can you just give us a sense of the UVC product line? You haven't mentioned it in recent earnings calls, but has that been successful? Or any update on the product momentum and availability would be helpful.

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

Yes, thanks for that. As we said, we built a -- we have built a robust product line now for GUV on the expectation that people will buy it consistently. We've seen some traction with larger individual accounts that recognize the value of kind of the investment. But I would not say, as I said, to kind of several quarters ago, we don't view this as a game-changer for us. But it's a -- but rather as an adaptation to a market environment.

We'll see. I think the -- with every additional variant, it becomes more clear that we're going to have to collectively make longer-term investments in keeping spaces safer. And we've got the best portfolio of GUV products to do that. So to the extent the market comes our way, I think we're well positioned. But the market isn't as large as I think some had hoped it would be.

Operator

Our next question comes from Tim Wojs at Baird.

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

Maybe just the first one, I just want to kind of run back to seasonality. Q2 is kind of typically your weakest quarter from just a gross margin perspective just kind of structurally. And I think normally, it's down 50 to 100 basis points from Q1 levels. And so I know you don't want to necessarily give quarterly guidance, but just given how tough the comp is last year, would you expect kind of a similar kind of seasonal trend to play out this year, kind of Q1 to Q2? I just want to make sure we have that calibrated correctly.

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

Tim, are you talking about on a year-on-year basis or a sequential basis?

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

Sequential.

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

So let me address the -- obviously, we had a blowout margin -- gross margin quarter and last year. And we've talked extensively about kind of what's changed between then and now and why. So as we look at the -- sequentially from fiscal first quarter to second, first quarter and address the seasonality.

So obviously, in the second quarter, we have Christmas, we have New Years. We have a lot of impacts which makes top line lower in the second quarter than the first quarter, which naturally will depress gross margin on a sequential basis because of the leveraging of the fixed cost in our supply chain. So that's the kind of the general outline. And as we've said, we're -- as I've said and Karen reiterated, now we're really trying to work through -- we're prioritizing this customer demand. And I gave a framework for how we're doing that, which will ultimately lead to what kind of gross margin is.

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

Okay. Okay. So it sounds like more seasonal than last year would maybe be the framework to say. Okay.

And then I guess, maybe just like big picture, when you think about the environment in terms of quoting projects and how those customers think about lighting in general. I mean, there has been a lot of deflation in the market over the last 4 years, and that's clearly flipped to inflation now. I mean, do you think this phenomenon around how people are kind of thinking about lighting and kind of speccing that in and pricing is kind of a cyclical benefit right now? Or do you think there's the potential that there's kind of a mindset change in terms of how people are thinking about lighting on a go-forward basis?

I don't know if that makes sense, but hopefully, I'm just trying to understand, like, if there's kind of a conceptual difference in terms of how the end customer is thinking about lighting today than maybe 4 or 5 years ago.

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

Yes. I mean, I think the -- I think we're going to be anecdotal as opposed to kind of philosophical, I think, at this point, Tim, because I think the market has changed so fast that people are responding to where it is right now.

I will say on the kind of the opportunity for this to be a longer-term phenomenon as it relates to us, specifically, the product vitality, the quality of product, the breadth of product and the impact of that product in the marketplace is a game-changer. I emphasized the Compact Pro High Bay in the past, which is a game-changer from a value and impact perspective. The STACK that I referenced today is changing how the end market can interact with our product, which changes the general value chain for the market because it costs less to install, it has more flexibility.

So those things are permanent increases which are permanent value changes. And so we're accessing other areas of value that we can deliver, and we're participating in that. So if, for example, you use a lot less labor to install, then there's a lot less pressure on the value of the luminaire or the control solution. So that's -- kind of strategically, that's why we pushed the product quality.

We've also pushed it on the products, as I said, around the right product in the right place at the right price so that we can be consistent and deliver on those high service levels. I also think that will continue.

So I think the -- will the general inflationary environment continue broadly? I think that's up for debate. And as I've said in the past, CEOs are generally terrible economists. So I wouldn't believe what I had to say about that anyway. But I do think that the changes that we're making specific to us are positioning us well for both this period and the periods that follow.

Operator

Thank you. And I'm showing no further questions in 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*

Thank you. Before we break, I wanted to thank all of you for joining us and again reiterate a Happy New Year. I want to bear attention to the publication of our 2021 EarthLIGHT report We've made substantial progress on our ESG strategy in 2021. And I'm really pleased to say these efforts are being recognized. In December, the Carbon Disclosure Project vastly improved our rating over prior periods. It's a testament to the team for prioritizing and driving our ESG initiatives.

We're really pleased with where we are. We're really pleased with where we're going, and we appreciate you investing both your time and your capital in Acuity Brands. So thanks for your interest, and we look forward to talking to you again in about 3 months.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.
