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<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Great. Good afternoon. I'm Tim Wojs. I cover Building Products here at Baird. And we're delighted to have Acuity Brands join us again at our Global Industrial Conference this year. Acuity Brands is the largest luminaire manufacturer for the commercial market in North America, and they also have a growing presence in building controls.

From the company, we have Chairman, President, and CEO, Neil Ashe with me on stage. We have CFO, Karen Holcom, who's down here in the front row. And then we have Charlotte McLaughlin, who's VP of IR.

So we've got a few prepared remarks or slides from Neil, and then we'll get into Q&A. So I'll turn it over to you.

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

Great. Tim, thank you. Thank you all for joining us after lunch, we'll do our best to decaffeinate the environment, so we don't get stuck there. So, quick overview of our company, the – I would say that for those of you who've known us for a long time, we are the same company, but we're very different. So I'll focus on, first of all, how we do things, and then I'll dive into our businesses.

So we believe that our way of working, which we call better, smarter, faster, and our values combine to create an environment and a culture that's unique to us, which allows us to be talent dense, to move with pace, and to be incredibly productive.

Our entire organization understands how we create value, which is grow net sales, turn profits into cash, and don't grow the balance sheet as fast. I was in distribution centers last week on a tour, and you can find hourly workers that will be able to repeat that to you.

And then finally, we've demonstrated that we're very effective capital allocators. So we focus on growing our current businesses. We focus on growing through acquisition, which I'll discuss here in a second. We increase our dividend. And over the course of the last four years, we've repurchased about a quarter of the company at an average price of a little under $150 a share.

So first, our largest business is Acuity Brands Lighting and Lighting Controls, which is the largest lighting, lighting control company in North America. We have a very specific strategy that has allowed us to transform that business over the last several years, focus first on product vitality; second on increasing service levels; third, on using technology in our products and in how we operate the business to differentiate ourselves; and then fourth, is driving productivity.

And we very much think of this as a flywheel. So this business, since 2020 and/or if you went back 15 years has basically grown compound annual growth rate in the mid-3s to 4% per year. We've taken operating margins since 2020 from round numbers 15% to 18%, which makes us the highest, the most profitable company in the industry by a large margin.

On our fourth quarter call, we talked about the future of this business and we're comfortable that we have a growth algorithm, which is we will grow with the market, we will continue to take share and then we will enter new verticals, which will ensure that we outgrow the industry. And second, that we're confident that we can continue to increase operating profit margins in this business 50 basis points to 100 basis points per year.

Second, our smaller business is our Intelligent Spaces Group where our strategy is to make spaces smarter, safer and greener by connecting the edge to the cloud. You can see we've had tremendous growth of course, in this business over the course of the last four years. It's grown about 80% and profits have grown about 400%. And we do that by what we control in a building and where we choose to compete.

We announced the signing of an acquisition of a company called QSC in late October that should close in our fiscal second quarter. QSC is the disruptor in the audiovisual control. So we are the disruptor in building management systems. They are the disruptor in audio video controls. We have a different theory of the case than most of our competitors. Our view is that data is the foundational creator of value in this generation and we seek to bring together the entire data estate of a built space.

So with our current ISG business, we control the management of the building, so HVAC lighting, lighting controls, et cetera, and the data that comes from that. QSC controls what happens in a space and we control the data that comes from that. And then the other category would be who's in a space. And so we believe that over time the normalization of that data and the data interoperability that we can create allows us to change outcomes in those spaces in new and exciting ways.

Some specifics on the acquisition, we paid $1.215 billion with net of about $100 million present value of tax savings. So a net $1.1 billion, that's 14 times trailing 12 months adjusted – approximate EBITDA for the business ending in our fiscal year, which would be the end of August of 2024. We're financing that with cash on balance sheet and a short-term term loan of about $600 million. And we expect to close that sometime in our fiscal second quarter, so kind of the January-ish time frame.

So bringing that all together, we have two very interesting businesses. The largest lighting, lighting control business in North America with growth differential to the market and margin and continued margin expansion opportunity. We have a much faster growing and very interesting Intelligent Spaces Group, which is built on connecting the edge to the cloud in multiple different areas. We have a differentiated way of working in culture. We know how we create value and we're pretty good at capital allocation.

So with that, Tim, I'll turn it over to you.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Great. Thank you for that overview. It's great. Trying to think if I want to start with lighting or if I want to start with controls, all right, let's start with controls. So I'll – we'll start there. So I mean, obviously Distech came into the fold was that 2018 maybe, something like that? That was kind of lighting in HVAC. Now you're bringing in audio and visual with QSC.

I guess, where within the building do you feel like you still need to add controls presence? I mean, is this something where you really want to have the controllers behind every kind of function in the building, or are there areas you want to play in or not play in?

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

Yes. It's a great question. So as Tim mentioned, Distech was the core business we started with here, which is the disruptor in basically HVAC and energy management across the building. So it controls everything you don't see basically. So then QSC is the disruptor to companies like Crestron or Biamp or Extron. So those sorts of competitors, they control what you do see.

Both of which are controlled by basically two column computers that sit in the back room. So that's the opportunity there. We've used our Atrius brand and we've reused the Atrius brand and we're created what we call the Atrius DataLab, which is the layer of data that takes heterogeneous data from the build space and normalizes it so you can build applications. So that's where it all comes together.

So Tim, we can – through DataLab, we can have things, which we control and things which we don't control. So it can become the clearinghouse of data for that built space. So then our choice of what we do control is where can we affect the outcome of the – for the end user in the built space, which is part of why we chose the QSC as a place for us to expand.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Can you just, I mean, because it's not enlightening. So can you just talk about how these businesses go-to-market? And then I think this wasn't a competitive bake off, if I understand correct. So how did you kind of come to know this company? How did you guys kind of come to the point of instead of partnering or whatever, let's acquire you?

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

Yeah. So first, just it's not in lighting. So it's important to know that the Acuity of today is a vibrant lighting, lighting controls business and a separate and equally, if not more vibrant spaces business that is growing and expanding. They do have overlap. So Distech is an OEM supplier of product to the lighting business for some of their controllers. But that's basically where it ends.

Part of the reason for that is their go-to-market channels are very different. So lighting is through independent sales network and our direct and retail. The both Distech and now QSC go through specialized systems integrators and we use independent systems integrators throughout North America. And now, we're expanding around the world.

Our existing ISG business is strong in France and growing in the rest of Europe, most notably the UK and a little bit of Asia. QSC is much more global. So that's an opportunity for us to come together.

As you pointed out, we first met each other when our Distech and Atrius product and engineering teams and the QSC product and engineering teams came together through our digital partner programs. So this was very much an organic. We recognize our desire to control the same things or the same endpoints and they came together. So ironically, that work was done long before we even started to talk about an acquisition with them.

So second, this has been a private company for 50 years owned by founders who didn't have heirs and run by a management team that were part owners. So the founders and the management team were looking for the best place for their company to thrive for the ensuing generation. And they – and so we were the only ones that they talked to. And it highlights how we make acquisitions also, which we can go into if you like. But basically there's a very strong cultural alignment with their team and our team and what we think we can do together going forward.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

So then how does the ISG business model evolve over time? Because it still sounds like it's kind of more of a selling a unit. But from your – from what you're saying, I mean, it does sound like over time there's going to be a, some sort of an outcome layer or a software layer or some sort of recurring revenue nature or something like that that can get layered on top of that.

So I guess, am I…

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

Good idea, Tim.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

I guess, am I thinking about that correctly?

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

That's a really, really good idea, Tim. So this model will evolve over time to hardware, software and services. So we are – we don't break the revenue out that way yet, but in our ISG business, a meaningful portion of the revenue is software. And so as these solutions evolve over time, they will become more software driven. That's what differentiates QSC and its marketplace. That's what differentiates among the things that differentiate Distech and Atrius in our marketplace place. And coming together can accelerate that, that process.

So – and the other thing that I think is unique to how we approach the world is we very much focus in both of our businesses on end user outcomes. We want to change the outcome for end users. So we very much focus on driving end user satisfaction and those outcomes and that ultimately will need to be delivered by software.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

And then how much of the businesses today, if you combine them, would be like a new construction or new space versus, I don't know, a building like this, where can you retrofit this stuff into existing buildings or is it more of a new construction type?

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

So on the ISG side, you can retrofit it into anything. And so obviously, there's generational change going on in spaces as, and these are not just offices or university campuses. So it's important to note that the QSC and its – Distech is kind of its mirror this way. The end markets are vast.

So office is one, education is another, hospitality is another, healthcare is another, stadiums are another. So airports are another. So it's controlling one-to-one communication, one to many to communication, and many to many communication and one to many communication. So it processes – we process all of that. So the opportunities to continue to grow here are pretty dramatic.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

And I mean the ISG business, I mean, I guess, it's going to change a little bit maybe with the acquisition, but I mean your current ISG business is doing what 20% margins, north of 20% margins?

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

That's right.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

So I mean, is this going to be – is there a pretty long runway for margin as you kind of move into more of a software or service model?

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

There is and we – but we prioritize growth over margin.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Okay.

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

So as you – if you go back and study us and watch the performance of our existing ISG business, that's we've grown, I think since I've been at the company, we've grown the top line, we basically doubled top line and quadrupled the profit. So there's plenty of opportunity there going forward.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Okay, okay. Any questions from the audience? Maybe just kind of going on your point before about M&A, I think historically Acuity has just been known as, hey, we've got this lighting agent network. We go pick a product and we put it in our network and that's always been kind of the M&A strategy. Obviously, you're outside of that now. So what have you kind of changed internally around like the M&A process, the integration process, for these kind of non-lighting type deals?

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

Yeah. So first of all, those aren't the lighting deals we're doing anymore. So there's been a generational change in the company and in its performance and the strategy. So for those of you who have known us for a long time and maybe are looking at us again for the first time or again, let's start from where we are now. So our acquisition strategy there is to add bolt-on acquisitions that matter.

So specifically in the lighting side, it's been components and vertical integration, which has been yielded huge benefits for us. On the spaces side, obviously this adds a big adjacency, but we're also adding new control planes. So we added refrigeration controls and there are more of those to happen. So that's big picture kind of where we're focused. Our priority is on the spaces side and continuing to scale this business.

You know the math. Acquisitions generally don't work. So I've done over 250 and they generally have. And so our view on this is really, really, I think, very straightforward, but highly important in how it's executed, which is understand the strategy that you're trying to execute, make sure you're buying the right things. The second is to understand where value is created. The third is to make sure that all of the plans and execution are aligned to where that value is created. And then the fourth is make sure that everyone that is required to execute that strategy is bought into that strategy, whether they're a part of the company that's acquiring or the company that's becoming part of that team. Because we've got to build one team.

And so with this, we had an integration call on Thursday, for example, with this company. And I think it's fair to say they were positively shocked by how straightforward we are for them to become a part of and how straightforward the opportunity for them to integrate, for them to become a part, for them to adopt some of the ways we do things so that they can accelerate the growth of their business.

And so that clarity, which is kind of emblematic of how we're running the whole company, we've got strategic clarity. Everyone understands what their role is in that, and then we build agency among all the people that need to execute on that. That is an unbelievably positive flywheel for us.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Okay. On the vertical integration side, within lighting, how differentiated is that relative to your competition and what advantages does it give you?

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

So we just reorganized the lighting business into our Luminaires Group and our Electronics Group. And so the vertical integration part is really electronics, and it starts with drivers, which are the part of the luminaire that powers the light engine, the inverter. That's where the technology largely exists. That's the acquisition we made from OSRAM, and we owned some assets before that.

The second is around sensors and controls. So lighting controls. So that together, that electronics ecosystem is a very powerful kind of part. We're not the only one that has each one of those pieces. We're the only one that puts it together the way that we put it together. And so that gives us starting with the technology and the product itself. And we believe product is the atomic unit of the business, but it extends all the way to how we go to market. So our independent sales network, for example, is exclusive to us on our controls. So that creates a unique combination of luminaire and controls for us as compared to others in the marketplace.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Okay, okay. You recently also in your lighting business, kind of segmented, so you have Contractor Select, and you kind of had the rest of the lighting business. Now you're kind of going Contractor Select, designer select, made to order. What are the biggest kind of internal challenges to kind of making those product segmentation decisions?

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

So if you allow me to go back for a second and make sure everyone understands what Contractor Select is. So Contractor Select is basically products which are designed to be resold. And so it's analogous for us to Kirkland at Costco. Our Contractor Select is for the electrical distribution industry, inclusive of the retailers Lowe's and Home Depot.

So what we've done there is developed significantly high product vitality on a concentrated number of SKUs less than 300, which are designed to be stocked and resold. That allows us to be the most efficient company manufacturer for them to do business with, which drives value for them. And it also allows them to carry less inventory because they don't have to carry inventory from a bunch of smaller manufacturers. So as a result of that, there is a very positive, again, flywheel effect of the integration between us and the distributors. That has changed the market over the course of the last three or four years. So, and it makes us a significantly stronger competitor.

Now we're starting to do the same productivity. And so you can see our margin enhancement is by, number one, delivering more value to other people in the channel. And as a result, we get more margin for ourselves. So we're making them more money and therefore we can make more money. So that seems to make a whole lot of sense to me. So that same productivity now, we're expanding into the next stage, which we call Design Select. So this is really target a lighting specifiers, contract build contractor – design build contractors, excuse me, other kind of architectural firms, et cetera, so that we can drive the same productivity for them that we've driven for distributors at the Contractor Select level.

Over time, there will be lots of benefits for us as well. Of course, there will be more volume for those specific parts or those specific products, which will allow us to realize higher margins from those also. And then finally we're pushing all the rest of the volume into made to order, where over time, we're confident we'll get paid for the differentiation.

So is it hard? It's really – it's harder to execute than it is to explain – to be blunt. But the entire organization is aligned to this now. So it allows us, it impacts our – obviously our product segmentation and portfolio segmentation. And it, over time, will overhaul how we approach the product lifecycle management process. And so when we go back to kind of what's happened in the last four years, what's really driven all this value in the lighting business, the strategy is very clear. Drive product vitality, increase service levels, use technology to differentiate, drive productivity, rinse and repeat.

So that's a virtuous cycle. It all starts with the product vitality. So by getting the product vitality right, which it was not before, and we define product vitality as changing a product, not necessarily new product introduction, but changing a product. And that's – we round numbers, we're going to overhaul the entire portfolio every four or five years, something like that. So if you get in front, our view is if you get in front from a product vitality perspective and you run faster than everyone else does, no one will ever catch you. So – and then by using service to change the business model of our customers so that they're more productive, then why would you go anywhere else?

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Right, right. So I mean really with the product segment, I mean, you're in this new kind of wave segment of the portfolio. You're in like the first inning, second inning.

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

Yeah, most second or third inning. So we're very – I mean, Contractor Select is in the seventh or eighth inning, but design select and made to orders in call it the second inning.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Okay. Yeah, it feels like it's almost kind of like 80-20 where you're kind of putting in a lot of the SKUs that people order normally, basically putting them together normally, standardizing a lot of the componentry, that type of stuff and then everything else fits over here and then you charge appropriately for all those things.

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

Keep marching on down the road.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Yeah. Yeah. Okay, good. I guess from a share perspective, at least from the outside looking in, it feels like you're kind of the steady ship in a lighting market that's kind of all over the place. So you have some consolidation with your competing OEMs. Feels like there's more and more consolidation on the agent level. I guess, is that providing a real opportunity for share relative to products or is it really both?

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

Well, it certainly is helping us. So – and I think it's fair to say our performance is driving a lot of the actions that are happening through kind of the rest of the industry. So if you compare our, as you pointed out, Signify and Cooper combined, which were number two and number three, so they're number two to us now. And then Current and Hubbell combined, which were four and five, became three. Share wise, we're low to mid-20s and they cascade meaningfully below that collectively.

And from a margin perspective there – signifies public. So you can compare. We're a lot higher margins. So yes, it is helping us. I believe that we're the instigator now of a lot of that change. And so then on the same thing is happening through the channel. So again, I think I said this earlier, but our core belief is if you add value, you get paid and we're happy to pay when there's value added. And so we're driving out inefficiencies. So where people are getting paid for not adding value will drive those inefficiencies out of the marketplace. And so that's creating a lot of the change I think as well.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Okay. Just on new verticals, I think you're in more like petroleum stations. And that's not been a place you've concentrated on horticultural. And then I don't know if this just more the market itself, but just data centers. I don't know if you want to talk about each one of those, kind of where you stand and kind of why you wanted to get into a few of those newer markets.

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

Yeah, sure. So, again, the growth algorithm for the lighting business is we're the largest in the industry, will grow with the market, we will take share and then we will enter new verticals where we either haven't competed or haven't competed as effectively as we feel like we should.

So petroleum is a great example. If we do that, we're by definition we're growing faster than the industry. Petroleum is a great example of that, where a decision was made a long time ago not to be in that business. We hadn't revisited that decision as a company and then now we did.

And so we're kind of doing this to make a point, Tim, that we can develop this organically. So we put a team together, they created canopy lighting solutions in about six months that are industry leading now. So against the competitors in the market, there's two larger ones and a handful of smaller ones. We then hired the number one independent sales agent in that market and you can imagine that others will join and we'll grind that out. That's guaranteed to be share gain for us over time. So we're using that playbook then and we're focused on kind of a couple of others.

The second would be healthcare. Healthcare is one where we have not had the penetration that we feel like we should. And so we approached that similarly, which is we created a new brand called Nightingale. We created a new product portfolio to – for the patient room to pull us through to hospitals and ambulatory care facilities. That brings all of the rest of our portfolio into those places because we have most of the rest of the portfolio. And then data centers is a good example. I laugh about data centers and automated fulfillment centers. Good news is they need lights.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Every place needs lights.

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

Well, you would think of a data. If there's anywhere that doesn't, it's a data center and an automated fulfillment center. But turns out they need lights. So obviously we have a package to grow there as well.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Okay, okay. It's topical. The election, what could happen in terms of tariffs and those types of things? Can you just kind of rebase us kind of where you see risks, you see opportunities, where it might come from, because there's obviously a big supply chain out of China and Mexico and the U.S. and those types of things.

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

Yeah, I long for the days when we don't have to focus on geopolitics and running the business. But I guess that's probably not going to happen in my career. So big picture for us, we embarked on a China plus one strategy several years ago. So we have a lot of dexterity in our supply chain. About round numbers, 18% of our finished goods come from Asia, which is – of which China is an increasingly small subset.

The remainder, about 60% is manufactured in Mexico and the remaining 20%-ish is manufactured in the U.S. and Canada. We have taught ourselves how to move production over the course of the last couple of years as we've kind of practiced this and if we need it, we have capacity in the U.S. that we could move to.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Okay. Okay. So it sounds like you have the ability to be nimble, if you…

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

We've been – we've demonstrated a fair amount of dexterity through the supply chain stuff and that's kind of we're going to lean on that if we have to.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Okay. And then just with the capital structure you have – you had a pretty big cash balance. Now you've got some debt. I guess, in the near-term, how are you kind of thinking about capital deployment.

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

Again, our priorities are grow our current businesses grow through acquisitions, increase our dividend and repurchase shares, sometimes a lot little and sometimes a lot. We have the demonstrated now financial capacity to do all of the above. So we've got our kind of our hands on all of the levers if we do that. If we choose to repay the term loan we have here, we're operating at less than one times leverage now. We can take it back to zero and then we're prepared for whatever comes next or if something comes along sooner. We're comfortable running at kind of one or two or three turns in the process. But we don't see the need to do that right now because we have the capacity.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Okay, okay. And then just I guess from a margin perspective, I mean, you've seen some nice EBIT margin expansion over the last couple of years. How focused are you on continuing to expand margins? I mean, it sounds like you're willing on – you're probably more willing to invest and grow EBIT dollars as opposed to just trying to get margin expansion. So do you want both? Do you prioritize one or the other?

<<Neil M. Ashe, Chairman, President and Chief Executive Officer>>

Over time, it'll be both. And we – I like to say that regular companies do or and great companies do and so we will do and over time there. The – so first of all, on the ISG side, we will prioritize for growth there. We've demonstrated that we can do and there. On the lighting side, we've demonstrated a lot of margin growth and we believe now we're in the opportunity as the world comes back a little bit to grow some more too. So we'll do more. One call out on the geography may change some. So when we focused on we will continue to drive gross margin expansion, but we focused on operating margin 50 to 100 basis points margin acceleration, because there's going to be some geography. We're going to have to invest in some OpEx to drive the gross margin over time.

<<Timothy Wojs, Analyst, Robert W. Baird & Co., Inc.>>

Okay, great. We're out of time. So please join me in thanking Acuity Brands for being with us today.