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AYI.N - Q3 2020 Acuity Brands Inc Earnings Call

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OVERVIEW:

Co. reported 3Q20 net sales of \$776m, gross profit of \$328m and diluted EPS of \$1.52.

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good morning, and welcome to Acuity Brands Fiscal 2020 Third Quarter Financial Conference Call. (Operator Instructions) Today's conference is being recorded. If you have any objections, you may disconnect at this time.

Now I would like to introduce Mr. Pete Shannin, Vice President, Investor Relations and Corporate Development. Sir, you may begin.

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

Good morning. With me today to discuss our fiscal 2020 third-quarter results are Neil Ashe, our President and Chief Executive Officer; Karen Holcom, our Senior Vice President and Chief Financial Officer; and Ricky Reece, our Executive Vice President and President of Acuity Brands Lighting. We are webcasting today's conference call at acuitybrands.com.

During this call, we will also discuss certain non-GAAP financial measures. Reconciliations to the comparable GAAP financial measures can be found in our third-quarter press release and 10-Q SEC filing.

I would like to remind everyone that during this call, we may make projections or forward-looking statements regarding future events or future financial performance of the company. Such statements involve risks and uncertainties such that actual results may differ materially. Further, forward-looking statements speak only as of the date they are made, and we undertake no obligation to update publicly any of these statements considering new information or future events. Please refer to our most recent 10-K and 10-Q SEC filings and today's press release, which identify important factors that could cause actual results to differ materially from those contained in our projections or forward-looking statements.

Now let me turn this call over to Neil Ashe.

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

Thanks, Pete. Good morning, everyone, and thank you for spending time with us today to talk about Acuity. Our company performed well during an incredibly challenging market environment. The combined strength of our go-to-market channels, product portfolio and supply chain allowed us to effectively serve the needs of customers across many categories. None of us are nor do we ever want to become accustomed to these levels of revenue decline. Despite lower revenues, we were able to expand gross margins and to generate cash through a combination of actions that we took both during and before the pandemic.

Some of the highlights of this quarter included our supply chain performing very well. We took care of the health and well-being of our associates, which allowed them to continue to effectively serve our customers. Our facilities remained open and productive, and they consistently met customer demand despite fully complying with regulatory work restrictions imposed to reduce the spread of COVID-19 and working through some component supply issues. Our product portfolio is increasingly aligned to customer demand, and we had several key product highlights this quarter, including new product launches, a strategic alliance on germicidal UV and continued growth in our Contractor Select portfolio, all of which I will talk about in more detail later.

We're adding talent, and we have begun to deploy teams focused on executing our digital transformation. This transformation is beginning, and I'll provide additional thoughts later in the call. Most importantly, our performance this quarter has demonstrated the adaptability and durability of our business. While our revenue declined 18%, largely due to the COVID-19 pandemic, we grew our gross profit margins 170 basis points, responsibly managed our fixed expenses and generated \$150 million of free cash flow during the quarter.

With that, I'll turn it over to Karen for more detail on the financials. Karen?

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

Thank you, Neil, and good morning, everyone. I know many of you have already seen our results, but I would like to make a few comments on the key highlights for the third quarter of fiscal 2020. Net sales for the third quarter were \$776 million, a decrease of 18% compared with the year ago period. Overall, the decrease in net sales was due primarily to a 20% decrease in volume, largely as a result of the negative impact on demand due to the COVID-19 pandemic, partially offset by the benefit from acquisitions of about 2%.

From a channel perspective, there are a few key areas of significance. First, net sales through our independent sales network, which makes up approximately 75% of our total net sales, was down approximately 10% over the prior year. Our performance compared with the year-ago period was impacted by the decreased demand due to COVID and, to a lesser extent, unfavorable pricing, partially offset by the benefit of acquisitions. Second, net sales through our direct sales network were down 31% over the prior-year third quarter due primarily to weakness in large projects that had been postponed due to COVID as well as some large projects in the year-ago period that did not repeat this year. Third, lower shipments within the retail channel resulted in a decline of 18% in this channel as compared to the prior-year third quarter. The decline in this channel was primarily due to the impact of previously announced actions taken by the company to exit and phase out of certain products that have poor financial returns largely due to the impact of additional tariffs. As we mentioned in previous earnings calls, we expect these efforts to continue to negatively impact net sales in this channel for several more quarters.

Partially offsetting the net sales decline in the retail channel was growth in several core products in this channel due to enhancements in our product portfolio and increased demand that we believe was due to more do-it-yourself projects as more people were at home and had the benefit of stimulus checks.

Lastly, net sales in our corporate accounts channel were down 59% this quarter compared with the year-ago period, due primarily to the impact of COVID on retail customers. These customers delayed many retrofit opportunities as they were limiting the activity in their stores. Additionally, as we have noted in previous earnings calls, this is an important part of our business, but we expect net sales to be inconsistent based on the nature of the construction cycle of the customers served, primarily big-box retailers.

In the third quarter of fiscal 2020 and 2019, we had some adjustments to the GAAP results, which we find useful to add back in order for the results to be comparable. In our earnings release and Form 10-Q, we provide a detailed reconciliation of non-GAAP measures. Adjusted results exclude the impact of acquisition-related items, amortization expense for acquired intangible assets, share-based payment expense and special charges for streamlining activities. We believe adjusting for these items and providing these non-GAAP measures provide greater comparability and enhanced visibility into our results of operations. We think you will find this transparency very helpful in your analysis of our performance.

Gross profit was down \$328 million, down -- excuse me, gross profit was \$328 million, down approximately \$56 million from the year-ago period. The decrease in gross profit was due primarily to the decline in volume due to the impact of the COVID-19 pandemic and unfavorable pricing, partially offset by the benefit of acquisitions, lower costs for certain inputs, a favorable channel mix and actions taken to reduce labor costs in response to the decreased demand. Gross profit margin for the third quarter was 42.2%, an increase of 170 basis points compared with the year-ago period as lower costs for certain inputs, contributions from acquisitions and favorable sales channel mix were partially offset by the decline in volume and lower pricing. We thoughtfully managed our variable costs this quarter in response to the lower demand, resulting in favorable gross profit margins.

Our SG&A expenses decreased approximately \$22 million compared to the year-ago period. The decrease in SG&A expense was primarily due to [lower] cost in response to the lower sales, including freight, commissions, travel expenses and marketing costs and the benefits of streamlining activities, partially offset by the addition of costs from acquired businesses.

Reported operating profit was \$83 million compared with \$120 million in the year-ago period, while adjusted operating profit for the third quarter of fiscal 2020 was \$105 million compared with adjusted operating profit of \$136 million in the year-ago period. Reported operating profit margin was 10.7%, a decrease of 200 basis points compared to the prior year. Adjusted operating profit margin was 13.5%, a decrease of 80 basis points compared with the margin reported in the prior year.

The effective tax rate for the third quarter of fiscal 2020 was 23.1% compared with 20.9% in the prior-year quarter. The increase in the effective tax rate was due primarily to the recognition in fiscal 2019 of certain research and development cost tax credits, including claims for prior periods that did not recur in the current fiscal year. We currently estimate that our blended effective income tax rate before discrete items will approximate 23% for fiscal 2020.

Our diluted EPS for the third quarter of \$1.52 was \$0.70 lower than the prior year. Our adjusted diluted EPS this quarter was \$1.94 compared with \$2.53 reported in the year-ago period. The decrease was primarily due to the lower pretax income.

We continue to have positive cash flows from operations despite the decline in sales, and ended the quarter with a strong balance sheet. We generated \$378 million of net cash flows from operating activities for the 9 months ended May 31, 2020, which was up \$66 million or 21% compared to the prior year.

At May 31, 2020, we had a cash and cash equivalent balance of \$521 million, an increase of \$60 million since August 31, 2019. Our total debt outstanding was \$404 million at May 31, 2020, and we currently have additional borrowing availability of approximately \$396 million under our revolving credit facility. The revolving credit facility and the term loan mature in June 2023.

We clearly are pleased with our financial strength and performance during this first chapter of the COVID-19 pandemic. Thank you, and I will turn it back to Neil.

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

Thanks, Karen. We are all dealing with the coronavirus pandemic and its widespread impacts on our people and on the economy. We have aggressively managed our business to protect the health and well-being of our associates, to operate effectively an uncertain and rapidly changing market conditions, and to compete to win both during the downturn and whatever follows. Our #1 priority has been to ensure our associates are protected from the spread of the virus while in our care. We have quickly implemented changes to our facilities, including meaningful changes to

people flow, changes to manufacturing cells, additional cleaning requirements for common spaces, mandatory face coverings, hand-sanitizer stations and social distance workspaces.

We have implemented educational programs, contact tracing and engagement with our communities to improve the environment both inside and outside of our facilities. Early on, we reviewed all government orders where we operate and confirmed that we were designated an essential business. This was a critical step in allowing us to service our customers in a variety of ways during the pandemic. For example, our teams deployed lighting solutions to temporary alternate care sites. In less than 48 hours, our custom architectural lighting solutions and applied technology solutions teams developed a portable healthcare light stand designed for lighting patient pods per specifications of the U.S. Army Corps of Engineers. They were deployed to facilities in Michigan, the Javits Center in New York and McCormick Place in Chicago to support the life-saving treatments for the most critically ill.

We installed smart lighting and controls for a top-rated university's quantitative biosciences institute at the forefront of fighting COVID-19, through the host and protein identification that the virus uses in the host to replicate itself. We supplied lighting and building management solutions to data and logistics centers that are supporting the remote work capacity. Our indoor positioning and heat-mapping technology was used to keep shoppers safe through social distancing measures in grocery stores and pharmacies. And we worked with our suppliers on health and sanitation best practices to help them both reopen and stay open to minimize disruption to our key component supply.

As Karen described, net sales of \$776 million were 18% below the prior year. The effects of the pandemic became more evident in April and May, particularly in the retail and commercial office verticals. At the same time, we saw more business in the industrial and education sectors, and were able to take advantage of these opportunities as we were open and operating effectively.

Our product development activity remained strong in this challenging environment. And we continued to invest in innovative product solutions to better position us during this time of market uncertainty. We launched a new slot fixture from Mark Lighting that aligned the right product and great quality, and we were able to ship to our customers when others could not. We were recognized by Buildings Magazine as a product award winner in the building and energy management category for the Allure UNIWAVE series of wireless interfaces and remote controls from Distech.

We continue to enhance and grow our portfolio of Contractor Select products. Sales of these products were up 7% over the prior year as we were able to take advantage of discretionary opportunities due to the strength of our supply chain and our robust portfolio. On June 1, we announced that we entered into a strategic alliance agreement with Ushio America Inc. Ushio has agreed to supply Acuity Brands with its Care222 UV disinfection module, which uses filtered excimer lamps to generate 220-nanometer far UVC light, capable of inactivating viruses and bacteria on indoor surfaces. The agreement is exclusive to Acuity Brands for general illumination uses throughout North America.

While we were focused on managing responsibly during the third-quarter effects of the pandemic, we were also focused on coming out of this stronger than we went into it. We have begun the process of our digital transformation. We have added a new Chief Technology Officer, and we have deployed teams to begin to reimagine our business processes. I'm pleased with the talent that we were able to attract and that we already have within Acuity. As we said last quarter, we expect this to be a journey that will ultimately make us better, smarter and faster competitor. Our focus is on improving customer satisfaction and the time it takes us to perform key activities through improved processes and better technology. Our core business will get stronger as a result of this transformation. And this will better position us for success in our existing business and in future opportunities.

In summary, I'm proud of my colleagues and our performance during the third quarter. As I said before, we are demonstrating the ability of our business and our continued ability to generate cash. However, there is still great uncertainty around demand and the timing of any economic recovery. In addition, we expect pricing pressure and continued costs related to tariffs in the fourth quarter. As we look forward, we plan to balance the management of our costs with the investment in our transformation. And we have a robust new product portfolio that is positioned to benefit from a recovery in demand.

We believe we have the financial strength and the resolve to manage the effects of the pandemic and to emerge stronger. Over the long term, we have the opportunity to more broadly adapt the company to expanding opportunities in our core business and to develop new ones. We have the

market position, the people and the cash flows to become a larger, more dynamic company that delivers for our customers, our associates and our shareholders.

With that, I'll turn it over for questions, and we welcome Ricky Reece, our President, to join Karen and me for the question-and-answer period.
Operator?

QUESTIONS AND ANSWERS

Operator

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

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

So just thinking about the gross margin performance year-to-date here, 42% plus. Is there any reason why that should kind of deviate either in kind of the last fiscal quarter or as we think about the business on a go-forward basis?

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

Yes. I'll start, Karen, and then if you want to weigh in as well. Obviously, we've done a lot of work to achieve that improvement in gross margin. So as we indicated in the comments, we're the beneficiary of work we've done to reduce input costs and to aggressively manage our variable costs through the change in demand. As we look forward, we obviously want to continue to achieve high gross margins. But there will be variability in those fixed costs and in other costs such as tariffs that we indicated. So while we're pleased with the improvement and we like where we are, we expect there to continue to be a little bit of volatility in that number going forward.

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

Yes. I think that's consistent with what we've said. John, the other thing I would call out is we are seeing some pricing pressure a bit more so than we have in the past, and we were able to raise prices in response to the tariffs last year. This year, you're seeing pricing come down a bit, but we still have the tariffs.

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

Great. And then I guess, maybe just thinking about the strong cash generation and where you're sitting from a net kind of liquidity position, can you just help us prioritize the timing of when we might see some deployment, either -- it sounds like there's some bolt-on M&A opportunity and/or share repurchase, just because the balance sheet just seems to be in a very strong position?

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

Yes, John, if we go back to kind of what we said last quarter, our #1 priority was to demonstrate the durability of our business model, and we feel very good about our performance this quarter, even in a tremendously down revenue environment to demonstrate the durability of that cash flow, which you highlight, has turned into continued strength in our balance sheet. That was our first priority.

Our next priority then, obviously, is to continue the transformation of our core lighting, lighting controls and components business as we grow our building technology efforts. We -- as Karen indicated, we don't feel like we're at the middle of this -- of the uncertainty of the pandemic. So we're obviously going to continue to be -- to be mindful of managing our balance sheet and our cash performance through this so that we maintain

as much flexibility as we can. And so then as we look forward, we'll report back in as we start to see beyond the horizon a little bit more on how we will deploy that cash. But again, we -- as we said last quarter, our priority is to deploy the cash for growth opportunities to make us a larger, stronger and more vibrant company.

Operator

Our next question comes from Deepa Raghavan with Wells Fargo.

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

Neil, can you talk through some of the items that surprised you positively this quarter versus when you announced maybe cost actions or hunkering down on the last call? Is that gross margins mostly? Or did even sales trends do better than your expectations?

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

Thanks, Deepa. Well, I mean, obviously, when we reported last, we were all embarking into this pandemic, and none of us knew exactly what was going to happen. And as we indicated, and I'm looking at Ricky across the table, we managed aggressively through this period, both our variable cost and our fixed costs, so that we could position ourselves both to thrive in the downturn, which I believe that we've demonstrated that we can do, and as I indicated, to continue to invest in our product portfolio so that we would have the products available when the market returns, which obviously has not yet. So I don't -- I wouldn't say that we were surprised by where we end up, but I would say that we are very pleased with the discipline with which we executed. And I want to start with the foundation of our supply chain.

So the -- our ability to take care of our associates so that they could continue to operate effectively was essential to us, largely staying open in all of our facilities, and being able to meet demand. So I believe we clearly took orders that we -- that others were unable to serve through this downturn and built on the strength of our supply chain. So I wouldn't call that surprising, but I would call that very pleasing. And then if you take those things as we look forward, we continue to apply the same logic now as we did when we were with you a quarter ago, which is that I don't believe any of us know what the economic outlook is going to be. So we're attempting to position ourselves so that we can operate effectively at these kind of market levels, that we have a product portfolio that is poised to benefit from a rebound in market activity, and that we can invest in and execute on the transformation that we've described. So I wouldn't say we're hugely surprised, but I would say that we are pleased.

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

Got it. How would you characterize June order trends so far? Are you seeing any pent-up demand in the channel at all as economies are opening up? And just curious if you can also talk through how March, April, May trended sequentially, that will be very helpful as well.

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

Ricky, I'll let you take that one.

Richard K. Reece - *Acuity Brands, Inc. - Executive VP & President of Acuity Brands Lighting*

Certainly. Yes, Deepa, I would say, answering your second question first, kind of be chronological here. March was actually an okay quarter. Obviously, the pandemic was later getting here to the U.S. and March was okay. And then when it became apparent, we saw major projects and so forth wanting to get their products as soon as possible, concerned about what may occur. And then we did see a slowdown in April and May, sequentially getting worse as construction sites were being closed. Particularly on the East Coast, you had New York and New Jersey and Boston and areas like that, that you couldn't even get on the sites and certain locations on the West Coast as well.

Here in June, we have seen virtually all of the construction sites open back up early in the month and started seeing a pickup in the demand for what we call stock and flow, as distributors now were feeling more confident, the job sites are open and needed to stock inventory and replenish inventory that may have been used throughout. The question mark now is, given the spikes that we were seeing in many places around the country and now starting to close down some of the activities -- retail primarily at the moment -- but we will see whether that expands into construction sites and so forth where that goes. But we are seeing some improvement here later in June. But the question mark is will that continue given the spike that, unfortunately, the country is experiencing in COVID cases in many spots around the country.

Operator

Our next question comes from Christopher Glynn with Oppenheimer.

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

On just curious on the Ushio arrangement, if -- what you could say about what the early indications for market reception might look like and if that's the only solution on the germicidal side that you think is viable for you steering occupancy?

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

Yes, I'll start, Ricky, and then if you'd dive in. Obviously, we're all looking at the possibility for germicidal UV and the -- its potential positive impacts on kind of helping us all get through this crisis. As you probably are aware, there are a number of different potential solutions. 222 is -- appears to be the most effective in the eradication of viruses and bacteria. But there are also other wavelengths, 254 for example, that provide opportunity as well. And so Ricky, you want to pick up on where we are kind of on Ushio and/or more broadly?

Richard K. Reece - *Acuity Brands, Inc. - Executive VP & President of Acuity Brands Lighting*

Yes. As you point out, Chris, the benefit of 222 besides being very effective in clinical testing is that it's not harmful to the skin and the eyes of humans. So you can be in the place. And therefore we are seeing a lot of interest in that capability. The 254, which is in the market today and then there's 405 that's been around for quite a while, do require people but 405 is not as effective against viruses and then the 254, you cannot be in the space. It is harmful to the skin and eyes.

So it's encouraging. There's still more clinical tests, Columbia University, others are doing testing. So it's not on the market commercially yet as there's more testing going on. But the interest that we are hearing is pretty great in applications that before the UV light wasn't an alternative because you had to be out of the space. So we're encouraged by it. Hopefully, the clinical tests will continue to be positive. And we like the arrangement we have with Ushio and the exclusivity that gives us here in the North American market for ambient lighting. So very encouraged and optimistic about it, but it -- still a bit to be determined.

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

And just curious if we could get an update on where you see the industry progress towards eventual stabilization of pricing levels and industry margin structures. I think in response to John Walsh's question, you indicated that in the immediate term, you may see more pricing pressure in the fourth quarter than the third, the way that's phasing in. But within a broader context of the industry's trajectory, if you could kind of link those thoughts together.

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

Yes. I'll take that. And then Ricky, if you want to add anything as we go through it. But I would say, as obviously I've done a deep dive on the industry as being new to it, and I would say that our comment about the immediate term is our expectation that competitors will try and respond to the downturn by lowering price to try and gain some share. So I believe as we demonstrated in this quarter, and Karen indicated, even with pricing pressure in this quarter we were able to deliver, and we were able to deliver gross margin in the process.

As we look forward, I believe that puts us in a position of strength from a pricing perspective. And by position of strength, I don't mean that we need to increase prices. I think that means we are in a position to continue to serve prices. And largely, our average sales price across all products is relatively consistent over the past periods, and we would expect that going forward. So I do think that we -- this pandemic is obviously going to put some turmoil into the industry, and we intend to compete with our service levels as we have done through this quarter and to manage our price, both so that we are effective in the marketplace, but that we also continue to cash the check as we've demonstrated in this quarter.

Operator

Our next question comes from Tim Wojs with Baird.

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

Nice job on margins.

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

Thanks, Tim.

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

Maybe just on -- I'm curious, just as you're talking with your agents, what are you hearing from them in terms of views on kind of new construction projects and maybe larger renovation projects that might be more in like the design stages or the developmental stages? Just trying to think of how your agent backlogs are kind of building as you look maybe 6, 9, 12 months out?

Richard K. Reece - *Acuity Brands, Inc. - Executive VP & President of Acuity Brands Lighting*

Yes, Tim, I would say it's somewhat inconsistent geographically. But generally, they're seeing good activity. Education, as we highlighted, and industrial continues to be strong. Logistic centers, warehouse, there's more and more people are ordering products online and so forth. And I think they're going to get accustomed to that, and that will continue. So we're seeing good activity there. Education is taking advantage, if you will, of the schools being empty to go forward to the extent that they have funds, to go ahead and take advantage of cost-saving, renovation opportunity, energy-saving opportunities. And then maybe someone looking at other areas to be able to function in this new world of the pandemic, how they need to redesign their space and so forth to have students back, whether it's the universities or it's the K-12 area. So we're seeing pretty good activity there.

As we indicated, retail has been in a big slowdown. But with UV, they're an area that are very interested in the UV for obvious reasons. And so a lot of activity there as our agents are talking to them in different ways of utilizing that capability. So there's good activity in that space.

Infrastructure is beginning to come back again. So that was more constant throughout and is going reasonably well also. So a little bit inconsistent geographically, but I would say the activity is good. The backlogs for most of the agents are solid. I've talked to distributors as well. Distributors are seeing a pickup in the stock and flow. So we're seeing replenishment orders come in at a pretty good pace. So we're seeing that activity picking

up. So it's encouraging. Again, as I mentioned before, a lot of this talk was before some of the spikes we just saw in the last week or 2 in the COVID cases. So we'll have to see whether some of the pickup that we've been experiencing and some of the activity will slow down as a result of the increased cases that many of the countries seen, but encouraging activity out there.

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

Okay, great. I appreciate all that color. And then I guess maybe just strategically, I know you're still working on just kind of the strategy around digital and Atrius. But do you think at this point, you'd be able to fund any incremental investments just from your existing cost base? Or do you think you need to make kind of incremental cost investments to accelerate some of the product development activities? I guess just how do you think about managing it -- that at this point?

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

Yes, we have not determined the answer to that question yet because we don't -- we can't -- we don't feel like we can effectively predict where the market levels are going to be during the pandemic. So as we've demonstrated this quarter, we can make some investment in transformation at the same time that we're performing at these levels. So -- and obviously, that will be our first course of action. But we reserve the right to increase that investment over time. Hopefully, our revenues in the core business will grow at the same pace. And so we'll cover that. But it's just -- those 2 aren't -- don't appear yet to be correlated. And so I think it's too early for us to say that definitively that we can do that. Obviously, we're going to try and do that, but it may not -- it's dependent on kind of the market demand for the core business.

Operator

Our next question comes from Ryan Merkel with William Blair.

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

I just want to go back to gross margins for next quarter. Just want to understand the comments. I know you said there's going to be variability, but you've got price pressure, and you mentioned the tariffs, but is the portfolio pruning and lower raws, is that going to continue? And do you think that offsets the pricing and the higher tariffs? So do you think gross margins can still rise year-over-year in the fourth quarter?

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

Well, I'll just -- you emphasize the elements that are driving the improvement in gross margin. One, is product portfolio. Two, is a lower input cost. Three, is the aggressive management of our variable costs. Those are balanced by things outside of our control, like tariffs returning, for example. So we feel good about where we are. There's a cap to how far we want to drive gross margins, obviously, due to competitive reasons. So -- but yes, we feel pretty good with where we are.

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

Okay. And then you mentioned disruption in the supply chain for certain components. How impactful is this? And is there visibility to improvement near term?

Richard K. Reece - *Acuity Brands, Inc. - Executive VP & President of Acuity Brands Lighting*

Yes. The disruption we had was earlier in our third quarter, and it was somewhat limited. We were fortunate that we had a pretty diverse supply chain, and it was very effective at looking at alternative sources of supply and so forth. And right now, if you look, we've virtually recovered in every area. So at the moment, shortage of components is not a huge issue for us.

Operator

Our next question comes from Jeff Sprague with Vertical Research.

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

First, just on back to kind of cost-related questions, which I guess dovetail back to that gross margin narrative most of us are focused on. If we think about the -- kind of the balance of temporary versus fixed, first, I'm wondering on the fixed side. Have all the kind of structural actions you intend to take, are those fully reflected in the results here that we see in the May quarter? And then second part of the same question is, is there a significant amount of temporary action in the quarter that, just by nature, comes back as we move into the next quarter and beyond? And if you're kind of willing to size that to any degree would be helpful.

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

Yes, I'll start and then Karen. Obviously, we have a supply chain footprint that is sized to a larger business. So we feel like we've got a lot of capacity in that supply chain. So we will -- we were already, and we will continue to evaluate that and make any adjustments as we see fit. The second point you mentioned on variable costs, obviously, we were pleased with the way we were able to manage our variable costs and as you know, variable costs don't manage themselves. So we were pleased with our ability to do that. So as we sit where we stand right now, we're positioned to continue to operate in this size market and volatile market situation with the ability both to scale up if demand returns and to continue to execute at these demand levels.

So as everybody is kind of asking the same question in a different way, which is, are these gross margins going to stick? We believe we are kind of where we are right now, and we'll continue to manage around these levels as we go forward. But again, what you hear in our answers is that none of us know what demand is going to look like for the next 3, 6, 9, 12 months. So we're positioning ourselves to attempt to be successful in whatever market environment presents itself to us.

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

And then somewhat related on the tariff side, what, if any, opportunity do you have here to kind of reposition that sourcing and kind of avoid that headwind?

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

I'll use that question as an opportunity to talk about what Ricky was mentioning on the component side, but -- which I think is -- we mentioned on the last call, which is that the adaptability of our supply chain, both to be able to source from fixed-goods suppliers in Asia as well as to manufacture here directly in North America and to add value and to make those potentially interchangeable, is something that we feel is a core strength of the company, and we're going to continue to take advantage of that. So that is -- we may not be able to pivot on -- inside a quarter on something like that, but over time, we believe that adaptability gives us the opportunity to continue to be successful, no matter kind of where the market starts to take us.

Operator

Today's final question will come from Brian Lee with Goldman Sachs.

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

Maybe just first on the price/mix dynamic in fiscal Q4. Since you guys called this out specifically, can you quantify kind of what range we should be expecting and this reverting back to sort of the low single-digit type of range in terms of the metric? And then just in terms of the gross margins, I know there's been a lot of questions there, but is your strategy to respond to these price actions? Or again, you've been prioritizing the margins; could we expect that there's some business you forego in this environment of tougher pricing in the near term?

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

Well, let me provide the strategic context for why we made the comment about pricing that we did. We expect as our competitors rebound from being shut down and they have a deeper potential hole to dig out of than we have, we expect them to be more aggressive in the marketplace. We're -- we believe we're out in front of them in that process. And the -- our service levels and our performance during this period should, to a certain extent, insulate us from a lot of those effects. So we're planning for that kind of low single digit, but we'll see where it shakes out.

As Karen indicated, in this quarter's experience, obviously, we were able to stay open and keep shipping. We were able to keep price in this general area. And we were able to shrink an astonishing amount of 18%, but probably less than the industry in that process. So that's -- it's more of the same in the fourth quarter. We're just highlighting the fact that we expect the competitive intensity to increase, and we believe that we're positioned to respond.

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

Okay. Fair enough. And then just a second question on volumes, and then I'll pass it on. The -- Ricky mentioned that specifically in June, I think stock inflow, you were starting to see some encouraging signs of pickup. Can you speak to maybe just on the new construction side because that's also a pretty big margin lever for you guys? You mentioned earlier in the call that there was a lot of postponed activity, delays. Are you seeing that coming back? Or have you seen any cancellations? Or kind of what's the backdrop in terms of how quickly you think some of the new construction side of the business could trend back here?

Richard K. Reece - *Acuity Brands, Inc. - Executive VP & President of Acuity Brands Lighting*

The new construction, Brian, has been slower to come back. As we said, they pulled forward some early in the third quarter. So they drained some of the backlog as they pulled some of that forward and all. But we are seeing a pickup. Education, we're right in the heart of the education construction cycle and that we're seeing good activity in that as well as in the industrial, as we've talked about. But it is a bit slower than what we've seen in the stock and flow side. We have not seen cancellations. So the slowness have been project delays.

Retail particularly -- have been delays because they don't want you in there. There's instances where we can't even get in the back office to get product that they're wanting to rebalance inventory and so forth, because they won't allow anyone but employees into their distribution centers and back of the house of their retail spaces. So retail is postponing, but we're not hearing cancellations. Remember, we're much more in the big boxes. So we're not as impacted by some of the department, the Macy's and some of those stores that are having probably a bigger challenge surviving through this pandemic area. So not a lot of cancellations. Really none major cancellation that comes to my mind, more delays and postponements on the new construction front. You've seen the architectural billing index; that has dropped significantly. So there clearly is a slowdown in activity in new construction as well. So that is slower than the stock and flow here later in the quarter.

Operator

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

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

Yes. So I'd like to summarize. Number one, we feel like we educate -- we operated effectively, excuse me, during a really challenging market environment. And we've attempted to position ourselves to be successful at this level of market demand as well as with a product portfolio that positions us to benefit from a rebound if and when that rebound occurs. So I appreciate all of the work that all of the associates of Acuity have done. Their dedication in the supply chain and the product areas through a challenging environment have positioned us so that we could deliver a relatively good quarter in a really bad environment and positions us well, hopefully, for the future. So thank you for your interest in our company, and we look forward to talking to you again soon.

Operator

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

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