

Equity Research

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FARGO

Price Target Change — October 4, 2023

Electrical Equipment & Multi-Industry

Acuity Brands, Inc. (AYI)

AYI: F2024 Outlook Ahead of Expectations

Our Call

AYI delivered a stronger than expected F4Q gross margin and F24 guide is better than we anticipated. We're raising estimates and our price target.

Destock headwinds are largely worked through and lead times have normalized to an average 20-30 days from book to bill. We get to the revenue guidance mid-point running normal ABL sequential trends, suggesting destock headwinds transition to macro softness. That's not unexpected, and we suspect it leaves upside risk in F2H when comping against destock.

Solid F24 guide: Revenue guidance of \$3.7-\$4.0B and adj EPS of \$13.00-\$14.50 came in ahead of our expected ranges of \$3.7-\$3.9B and \$12-\$14.

Gross margin strength: F23 adj. gross margin of 43.7% improved from 41.8% in F22, despite revenue down 1.3%. We calc implied gross margin in F24 down ~20bps y/y, maintaining a very strong level and well ahead of fears that pricing pressure could squeeze margins. AYI announced price increases on select controls products this quarter and will be strategic about price increases going forward. They may use price to win certain projects but won't be going after broad-based pricing changes.

Innovation progress: AYI refreshed 20% of their product portfolio in 2023. Back in January we noted that nearly the entire product portfolio had been refreshed over the prior three years. Product vitality remains a significant focus area and is running 3-5x faster than it historically did. Innovation supports share gain and is focused on verticals and product categories where AYI sees the best opportunities. Historically this has been across stock and flow, industrial and data center markets.

Share repo upside in 2024: Guidance has \$40-50M share repo. AYI ended F23 with ~\$400M in cash. We forecast FCF of \$456M in F24, with \$440M available for M&A / repo after dividends. We think M&A is focused on bolt-ons in ISG to acquire capabilities, which we'd expect to skew to small sized deals and leave capacity for upside on repurchases.

Estimates and price target: We've raised our F24 adj EPS estimate to \$13.80 from \$13.20. We have GM of 43.7% for F24. We have adj. op margin of 15.0% for F24, vs 14.3% previously. We're raising our price target to \$200, 14.5x our F24 EPS estimate, and ~13.5x F25.

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Rating	Overweight
Ticker	AYI
Price Target/Prior:	\$200.00/\$180.00
Upside/(Downside) to Target	11.7%
Price (10/04/2023)	\$179.00
52 Week Range	\$149.30 - 202.90
Shares Outstanding	31,192,406
Market Cap (MM)	\$5,583
Enterprise Value (MM)	\$5,681
Average Daily Volume	1,334,711
Average Daily Value (MM)	\$239
Dividend (NTM)	\$0.52
Dividend Yield	0.3%
Net Debt (MM) - last reported	\$98
ROIC - Current year est.	21%
3 Yr EPS CAGR from current year (unless otherwise noted)	11%

	2022A	2023A	2023A	2024E	2024E
\$ EPS		Curr.	Prior	Curr.	Prior
Q1 (Nov)	2.85 A	3.29 A	NC	3.11 E	3.14E
Q2 (Feb)	2.57 A	3.06 A	NC	3.05 E	2.83E
Q3 (May)	3.52 A	3.75 A	NC	3.73 E	3.56E
Q4 (Aug)	3.95 A	3.97 A	3.74E	3.91 E	3.69E
FY	12.83 A	14.05 A	13.82E	13.80 E	13.20E
P/E	14.0x	12.7x		13.0x	

Source: Company Data, Wells Fargo Securities estimates, and Refinitiv.
NA = Not Available, Volatility = Historical trading volatility

Wells Fargo Express Takeaways

Acuity Brands, Inc. (AYI) | Rating: Overweight | Price Target: \$200.00

Analyst: Joseph O'Dea

Financials

FY (Aug)	2022A	2023A	2024E
\$			
ESTIMATES			
EPS			
Q1	2.85 A	3.29 A	3.11 E
Q2	2.57 A	3.06 A	3.05 E
Q3	3.52 A	3.75 A	3.73 E
Q4	3.95 A	3.97 A	3.91 E
AN	12.83 A	14.05 A	13.80 E
Rev. (MM)	4,006.1 A	3,952.2 A	3,862.1 E
EBIT (MM)	588.1 A	597.4 A	580.2 E
EBITDA (MM)	641.9 A	648.5 A	630.2 E
FCF (MM)	259.8 A	511.4 A	456.2 E

WELLS FARGO vs. CONSENSUS

Consensus Estimate	12.83 A	13.81 A	13.21 E
Difference from Consensus		1.7%	4.5%

VALUATION

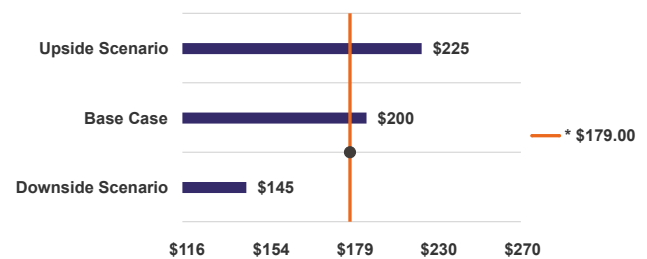
P/E	14.0x	12.7x	13.0x
EV/Revenue	1.4x	1.4x	1.5x
EV/EBIT	9.7x	9.5x	9.8x
EV/EBITDA	8.9x	8.8x	9.0x
EV/FCF	21.9x	11.1x	12.5x
FCF Yield	4.3%	8.5%	7.6%

Consensus Estimate: Consensus EPS Estimate; Source: Visible Alpha.
Source: Company Data, Wells Fargo Securities estimates, and Refinitiv.
NA = Not Available, NE = No Estimate

Investment Thesis

We think consistent execution measured by margin performance, a strong balance sheet, and solid cash generation deployed to M&A and buybacks all support a continued decline in the relative valuation discount formed from 2016 through 2020. Near term, that's more challenging, with tighter credit driving nonres cycle concerns and broad-based multiple compression. However, we think valuation already reflects a meaningful portion of downside risk in a nonres slowdown scenario. We rate the shares OW.

Risk vs. Reward – Upside/Downside Price Target Scenarios



*As of 10/04/23
Source: Wells Fargo Securities, LLC estimates and Refinitiv.

Base Case | \$200.00

- Our \$200 price target for AYI is ~14.5x P/E on F2024 and ~13.5x P/E on F2025.
- On F2024 P/E, this represents a mid 20% discount to our EEMI group trading at 19x.

Upside Scenario | \$225.00

- Our upside scenario price target is \$225.
- This is based on 15x our \$15 adj EPS estimate in F2025.
- Based on a 2-year trading range, AYI's stock price high is \$225 (Nov '21).
- Our F2025 estimate assumes revenue growth of +1% vs our F2023 estimate.

Downside Scenario | \$145.00

- Our downside scenario price target is \$145.
- Assuming revenue down 10% (vs WFe -2%) from F2023 and a 40% decremental operating margin, we get adj EPS of \$10.40 for 2024.
- The trough-on-trough P/E would be 14.1x.
- Based on a 2-year trading range, AYI's stock price low is \$146 (Jun '22).

Upcoming Catalysts

- We think F24 estimates already embed a notable slowdown. Confidence in a bottom can drive relative valuation expansion.
- F4Q confidence in end of destock headwinds
- Persistent gross margin performance strength can dent the bear case around pricing pressure risk.

Company Description

Acuity Brands, Inc. develops products and services spanning lighting, lighting controls, building management solutions, and location-aware applications. Acuity operates through two segments: Acuity Brands Lighting and Lighting Controls (ABL) and Intelligent Spaces Group (ISG). The company was founded in 2001 and is headquartered in Atlanta, GA, with operations across North America, Europe, and Asia.

F24 Modeling

We're modeling full-year F24 revenue at about the midpoint of the guidance range of \$3.7B - \$4.0B. We expect volume declines to drive the top-line, which we primarily bake into Independent sales network (down 3% y/y). We're also modeling Corporate Accounts down 12% y/y for F24. For F1Q24, we have ABL revenue down 9% q/q, more or less in-line with normal seasonality. We have ISG up 15% y/y on continued strength. We're modeling ABL adj. op margin down sequentially to 15.0% in F1Q24 from 16.8% in F4Q23. ABL adj. op margin was 14.7% in F1Q23. Management noted they don't expect margin to stay at the current level but will continue to expect strong performance. This puts our full-year F24 adj EPS at \$13.80, just above the midpoint of the \$13.00-\$14.50 guidance range.

Key F4Q Takeaways

F2024 Outlook

- ABL: sales down LSD-MSD
- ISG: continued mid-teens sales growth
- Expect same market conditions in lighting for the rest of this calendar year, potential for some improvement next calendar year, assumptions aren't relying on significant macro improvement
- Don't expect margin to stay at this record high level but will continue strong performance
- Capital allocation priority unchanged: 1) Investing in current businesses for organic growth; 2) M&A; 3) Maintain dividend; 4) Share repurchases (Guide ~\$40M-\$60M)
- Seasonality is getting closer to normal, management sees ABL down sequentially in F1Q/F2Q and up sequentially in F3Q/F4Q
- There is still some opportunity for WC gains on inventory but not to the magnitude seen in 2023

End-market Demand and Destock

- Choppy all over, strength in Retail, Direct network is comparatively strong, Resi is performing well, OEM business is down
- Well positioned to take advantage of infrastructure trends
- ABL is back to a more normalized order and ship rate, lead times back to 20-30 days

Pricing

- F1H23 was a balance of price and volume, while F2H23 was driven by price as volumes softened. The majority of price increases have lapsed, so volume will be the primary top-line driver going forward

Other

- \$13M charge: AYI booked a partial write-off for supplier warranty receivables on certain ABL outdoor lighting products sold from 2017-2019, the supplier stopped paying this quarter but management believes some is still collectible.
- Had higher commission rates in 4Q which hits SD&A and helps GM; one driver was strong controls sales.

Financials

Exhibit 1 - AYI Income Statement

Income Statement	2020	2021	1Q22	2Q22	3Q22	4Q22	2022	1Q23	2Q23	3Q23	4Q23	2023	1Q24e	2Q24e	3Q24e	4Q24e	2024e
(All amounts in millions of dollars)																	
Revenue by segment																	
Acuity Brands Lighting and Lighting Controls (ABL)	3,181	3,287	884	863	1,008	1,055	3,810	947	891	941	944	3,723	861	841	925	964	3,591
Intelligent Spaces Group (ISG)	157	190	46	50	58	61	216	57	58	66	72	253	65	67	76	83	291
Eliminations	(12)	(16)	(4)	(4)	(6)	(6)	(20)	(6)	(5)	(6)	(6)	(23)	(5)	(5)	(5)	(5)	(19)
Total Revenue	3,326	3,461	926	909	1,061	1,110	4,006	998	944	1,000	1,010	3,952	922	904	995	1,042	3,862
Segment operating earnings																	
Acuity Brands Lighting and Lighting Controls (ABL)	398	515	138	127	160	162	587	139	133	160	159	591	129	126	153	160	568
Intelligent Spaces Group (ISG)	15	26	6	6	14	15	40	12	11	13	14	50	13	13	15	16	57
Eliminations	(26)	(34)	(11)	(10)	(11)	(7)	(38)	(11)	(12)	(10)	(11)	(43)	(11)	(11)	(11)	(12)	(44)
Adj. Operating Profit (Non-GAAP)	398	506	133	123	163	170	588	140	132	163	162	597	131	128	156	164	580
Interest expense, net	23	23	6	6	6	7	25	7	6	4	3	19	3	3	3	3	13
Miscellaneous expense, net	6	8	0	(2)	(2)	(6)	(9)	(2)	(4)	1	2	(3)	0	0	0	0	0
Income before income taxes	427	475	127	119	158	169	572	136	130	158	158	582	128	125	153	161	567
Income tax expense	(100)	(103)	(26)	(28)	(37)	(38)	(128)	(28)	(31)	(38)	(33)	(130)	(30)	(29)	(36)	(36)	(133)
Adj. Net Income (Non-GAAP)	327	372	101	91	121	131	444	108	99	120	125	452	98	96	117	123	434
EPS (continuing)	\$8.27	\$10.16	\$2.85	\$2.57	\$3.52	\$3.95	\$12.83	\$3.29	\$3.06	\$3.75	\$3.97	\$14.05	\$3.11	\$3.05	\$3.73	\$3.91	\$13.80
Avg diluted shares outstanding	39.6	36.6	35.5	35.4	34.4	33.2	34.6	32.7	32.4	32.0	31.6	32.2	31.5	31.4	31.4	31.5	31.4
Revenue growth Y/Y	-9.4%	4.0%	16.9%	17.1%	17.9%	11.8%	15.7%	7.8%	3.8%	-5.7%	-9.0%	-1.3%	-7.6%	-4.2%	-0.5%	3.1%	-2.3%
Adj. operating margin	13.7%	14.6%	14.4%	13.5%	15.3%	15.3%	14.7%	14.0%	14.0%	16.3%	16.1%	15.1%	14.2%	14.2%	15.7%	15.8%	15.0%
Adj. EPS growth Y/Y	-13.7%	22.9%	40.3%	21.3%	26.8%	21.0%	26.3%	15.2%	18.9%	6.7%	0.5%	9.5%	-5.3%	-0.2%	-0.7%	-1.5%	-1.8%

Source: Company Filings, Wells Fargo Securities, LLC estimates

Investment Thesis, Valuation and Risks

Acuity Brands, Inc. (AYI)

Investment Thesis

We think consistent execution measured by margin performance, a strong balance sheet, and solid cash generation deployed to M&A and buybacks all support a continued decline in the relative valuation discount formed from 2016 through 2020. Near term, that's more challenging, with tighter credit driving nonres cycle concerns and broad-based multiple compression. However, we think valuation already reflects a meaningful portion of downside risk in a nonres slowdown scenario. We rate the shares OW.

Target Price Valuation for AYI: \$200.00 from \$180.00

- Our \$200 price target for AYI is ~14.5x P/E on F2024 and ~13.5x P/E on F2025.
- On F2024 P/E, this represents a mid 20% discount to our EEMI group trading at 19x.

Risks to Our Price Target and Rating for AYI

Risks to the downside:

Competitive pressure drives pricing headwinds and squeezes gross margins.

High interest rates and tighter credit availability lead to longer and deeper nonres slowdown than anticipated.

AYI's SD&A spending increases outpace revenue growth, causing incremental margins to contract and weighing on adj. operating margin performance.

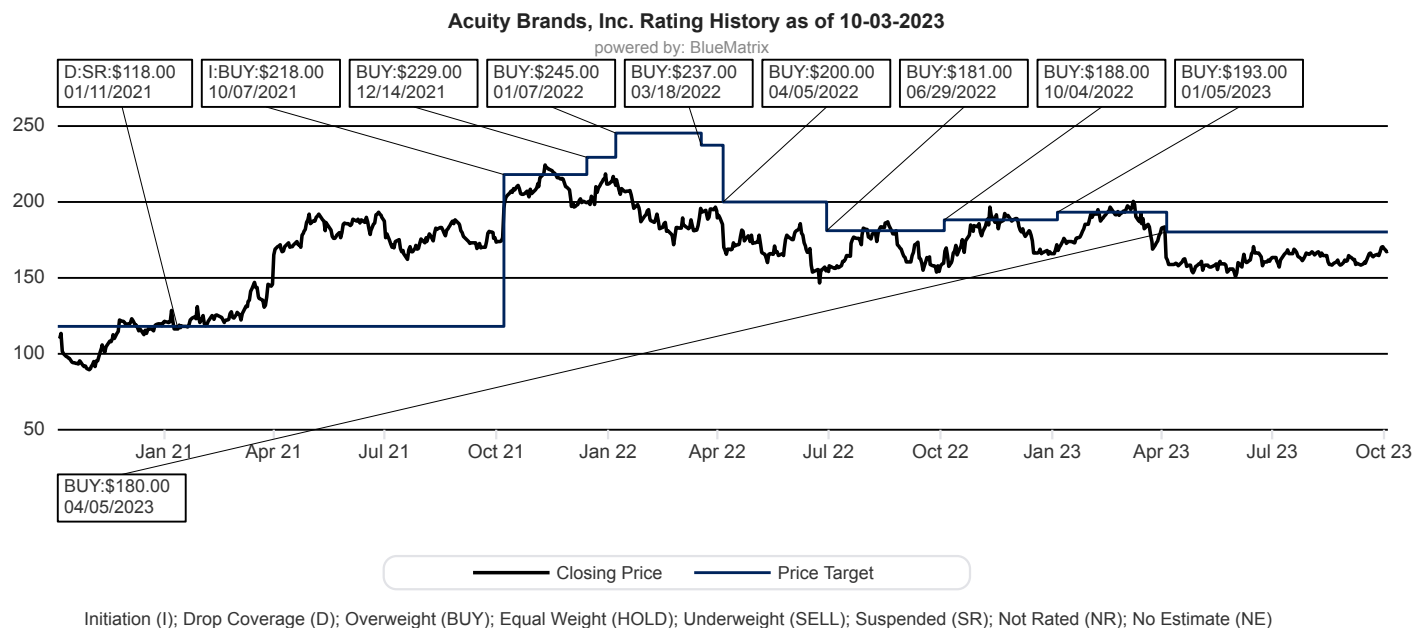
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