DIAMOND HILL INVESTMENT GROUP INC
Form 10-Q
May 01, 2019
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United States
Securities and Exchange Commission
Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2019
Commission file number 000-24498

DIAMOND HILL INVESTMENT GROUP, INC.

(Exact name of registrant as specified in its charter)

Ohio	65-0190407
(State of incorporation)	(I.R.S. Employer Identification No.)

325 John H. McConnell Blvd, Suite 200, Columbus, Ohio 43215
(Address of principal executive offices) (Zip Code)
(614) 255-3333
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes: x No: ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

Emerging growth company ¨
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes: ¨ No: x
The number of shares outstanding of the issuer’s common stock, as of April 30, 2019, is 3,494,778 shares.

DIAMOND HILL INVESTMENT GROUP, INC.

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PART I: FINANCIAL INFORMATION

ITEM 1: Consolidated Financial Statements
Diamond Hill Investment Group, Inc.
Consolidated Balance Sheets

	3/31/2019 (Unaudited)	12/31/2018
ASSETS		
Cash and cash equivalents	$82,132,927	$84,430,059
Cash held by noncontrolling shareholders	10,016,227	—
Investments	164,791,720	203,488,217
Accounts receivable	17,402,023	20,290,283
Prepaid expenses	2,526,105	2,372,712
Property and equipment, net of depreciation	6,329,166	3,680,472
Deferred taxes	11,956,745	11,466,100
Total assets	$295,154,913	$325,727,843
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Accounts payable and accrued expenses	$12,298,154	$15,561,491
Accrued incentive compensation	4,500,000	26,754,167
Income taxes payable	4,918,929	2,768,681
Deferred compensation	26,777,526	22,387,874
Total liabilities	48,494,609	67,472,213
Redeemable noncontrolling interest	36,249,454	62,679,687
Permanent Shareholders' equity		
Common stock, no par value 7,000,000 shares authorized; 3,494,599 issued and outstanding at March 31, 2019 (inclusive of 232,200 unvested shares); 3,499,285 issued and outstanding at December 31, 2018 (inclusive of 211,575 unvested shares)	124,484,045	124,933,060
Preferred stock, undesignated, 1,000,000 shares authorized and unissued	—	—
Deferred equity compensation	(23,656,774)	(22,008,054)
Retained earnings	109,583,579	92,650,937
Total permanent shareholders' equity	210,410,850	195,575,943
Total liabilities and shareholders' equity	$295,154,913	$325,727,843
Book value per share	$60.21	$55.89

The accompanying notes are an integral part of these consolidated financial statements.

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Diamond Hill Investment Group, Inc.
Consolidated Statements of Income (unaudited)

	Three Months Ended March 31, 2019	2018
REVENUES:		
Investment advisory	$30,512,718	$34,631,290
Mutual fund administration, net	2,066,655	3,150,712
Total revenue	32,579,373	37,782,002
OPERATING EXPENSES:		
Compensation and related costs	15,969,382	14,387,473
General and administrative	3,244,532	2,963,671
Sales and marketing	1,370,716	1,209,487
Mutual fund administration	861,040	1,017,419
Total operating expenses	21,445,670	19,578,050
NET OPERATING INCOME	11,133,703	18,203,952
Investment income (loss), net	14,284,877	(1,559,723)
INCOME BEFORE TAXES	25,418,580	16,644,229
Income tax expense	(5,862,733)	(3,702,100)
NET INCOME	19,555,847	12,942,129
Net (income) loss attributable to redeemable noncontrolling interest	(2,623,205)	47,332
NET INCOME ATTRIBUTABLE TO COMMON SHAREHOLDERS	$16,932,642	$12,989,461
Earnings per share attributable to common shareholders		
Basic	$4.85	$3.72
Diluted	$4.84	$3.72
Weighted average shares outstanding		
Basic	3,493,843	3,487,923
Diluted	3,496,534	3,491,938

The accompanying notes are an integral part of these consolidated financial statements.

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Diamond Hill Investment Group, Inc.
Consolidated Statements of Shareholders’ Equity and Redeemable Noncontrolling Interest (unaudited)

	Three Months Ended March 31, 2019					
	Shares Outstanding	Common Stock	Deferred Equity Compensation	Retained Earnings	Total	Redeemable Noncontrolling Interest
Balance at December 31, 2018	3,499,285	$124,933,060	$(22,008,054)	$92,650,937	$195,575,943	$62,679,687
Issuance of restricted stock grants	24,875	3,859,300	(3,859,300)	—	—	—
Amortization of restricted stock grants	—	—	1,521,974	—	1,521,974	—
Issuance of stock grants	24,048	3,655,296	—	—	3,655,296	—
Issuance of common stock related to 401k plan match	4,286	632,050	—	—	632,050	—
Forfeiture of restricted stock grants	(4,250)	(688,606)	688,606	—	—	—
Repurchase of common stock	(53,645)	(7,907,055)	—	—	(7,907,055)	—
Net income	—	—	—	16,932,642	16,932,642	2,623,205
Net redemptions of Consolidated Funds	—	—	—	—	—	(1,728,877)
Net deconsolidations of Company sponsored investments	—	—	—	—	—	(27,324,561)
Balance at March 31, 2019	3,494,599	$124,484,045	$(23,656,774)	$109,583,579	$210,410,850	$36,249,454

	Three Months Ended March 31, 2018					
	Shares Outstanding	Common Stock	Deferred Equity Compensation	Retained Earnings	Total	Redeemable Noncontrolling Interest
Balance at December 31, 2017	3,470,428	$118,209,111	$(19,134,963)	$73,369,672	$172,443,820	$20,076,806
Issuance of restricted stock grants	32,050	6,755,108	(6,755,108)	—	—	—
Amortization of restricted stock grants	—	—	1,378,923	—	1,378,923	—
Issuance of stock grants	20,153	4,109,197	—	—	4,109,197	—
Issuance of common stock related to 401k plan match	2,253	472,779	—	—	472,779	—
Shares withheld related to employee tax withholding	(2,427)	(501,564)	—	—	(501,564)	—
Forfeiture of restricted stock grants	(3,500)	(603,400)	603,400	—	—	—
Net income	—	—	—	12,989,461	12,989,461	(47,332)
Net subscriptions of consolidated funds	—	—	—	—	—	5,186,193

New consolidations of Company sponsored investments	—	—	—	—	—	16,444,640
Balance at March 31, 2018	3,518,957	$128,441,231	$(23,907,748)	$86,359,133	$190,892,616	$41,660,307

The accompanying notes are an integral part of these consolidated financial statements.

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Diamond Hill Investment Group, Inc.
Consolidated Statements of Cash Flows (unaudited)

	Three Months Ended March 31, 2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	$19,555,847	$12,942,129
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	282,565	285,823
Share-based compensation	2,154,024	1,851,702
Decrease in accounts receivable	1,714,531	347,488
Change in current income taxes	2,150,248	4,167,325
Change in deferred income taxes	(490,645)	(492,725)
Net (gains) losses on investments	(13,053,857)	2,994,792
Net change in securities held by Consolidated Funds	18,908,654	(35,143,135)
Decrease in accrued incentive compensation	(18,598,871)	(13,729,303)
Increase in deferred compensation	4,389,652	3,513,366
Other changes in assets and liabilities	(934,288)	4,438,764
Net cash provided by (used in) operating activities	16,077,860	(18,823,774)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(91,015)	(144,948)
Purchase of Company sponsored investments	(4,560,693)	(3,143,561)
Proceeds from sale of Company sponsored investments	2,683,935	1,148,162
Net cash used in investing activities	(1,967,773)	(2,140,347)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Value of shares withheld related to employee tax withholding	—	(501,564)
Net subscriptions received from redeemable noncontrolling interest holders	1,516,063	3,661,843
Repurchase of common stock	(7,907,055)	—
Net cash (used in) provided by financing activities	(6,390,992)	3,160,279
CASH[(a)]		
Net change during the period	7,719,095	(17,803,842)
At beginning of period	84,430,059	76,602,108
At end of period	$92,149,154	$58,798,266
Supplemental cash flow information:		
Income taxes paid	$4,203,130	$27,500
Supplemental disclosure of non-cash transactions:		
Common stock issued as incentive compensation	$3,655,296	$4,109,197
Charitable donation of corporate investments	—	1,989,803
Net subscriptions (redemptions) of ETF shares for marketable securities	(3,244,940)	1,524,340

(a) Cash includes cash and cash equivalents and cash held by noncontrolling shareholders.
The accompanying notes are an integral part of these consolidated financial statements.

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Diamond Hill Investment Group, Inc.
Notes to Consolidated Financial Statements (unaudited)
Note 1 Business and Organization
Diamond Hill Investment Group, Inc. (the "Company"), an Ohio corporation, derives its consolidated revenues and net income from investment advisory and fund administration services.
Diamond Hill Capital Management, Inc. ("DHCM"), an Ohio corporation, is a wholly owned subsidiary of the Company and a registered investment adviser. DHCM is the investment adviser to the Diamond Hill Funds (the "Funds"), a series of open-end mutual funds, private investment funds, an exchange traded fund (the "ETF"), and other institutional accounts. In addition, DHCM is administrator for the Funds.
Note 2 Significant Accounting Policies
Basis of Presentation
The accompanying unaudited condensed consolidated financial statements as of March 31, 2019 and December 31, 2018, and for the three-month periods ended March 31, 2019 and 2018, for Diamond Hill Investment Group, Inc. and its subsidiaries (referred to in these notes to the condensed consolidated financial statements as "the Company," "management," "we," "us," and "our") have been prepared in accordance with United States generally accepted accounting principles ("GAAP") and with the instructions to Form 10-Q and Article 10 of the Securities and Exchange Commission (the "SEC") Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair statement of the financial condition and results of operations at the dates and for the interim periods presented, have been included. The results of operations for any interim period are not necessarily indicative of the results of operations to be expected for any full fiscal year. These unaudited condensed consolidated financial statements and footnotes should be read in conjunction with the audited consolidated financial statements of the Company included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2018 (the "2018 Annual Report") as filed with the SEC.
Use of Estimates
The preparation of the condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions related to the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.
Reclassification
Certain prior period amounts and disclosures may have been reclassified to conform to the current period's financial presentation.
Principles of Consolidation
The accompanying consolidated financial statements include the operations of the Company and its controlled subsidiaries. All inter-company transactions and balances have been eliminated in consolidation.
The Company holds certain investments in the Funds and the ETF for general corporate investment purposes, to provide seed capital for newly formed strategies or to add capital to existing strategies. The Funds are organized in a series fund structure in which there are multiple mutual funds within one Trust. The Trust is an open-end investment company registered under the Investment Company Act of 1940, as amended (the"1940 Act"). The ETF is an individual series of ETF Series Solutions which is also an open-end investment company registered under the 1940 Act. Each of the individual mutual funds and the ETF represents a separate share class of a legal entity organized under the Trust. The Company performs its analysis at the individual mutual fund and ETF level and has concluded the mutual funds and ETF are voting rights entities ("VREs") because the structure of the investment product is such that the shareholders are deemed to have the power through voting rights to direct the activities that most significantly impact the entity's economic performance. To the extent material, these investment products are consolidated if Company ownership, directly or indirectly, represents a majority interest (greater than 50%). The Company records redeemable noncontrolling interests in consolidated investments for which the Company's ownership is less than 100%. The Company has consolidated the ETF, the Diamond Hill Core Bond Fund and the Diamond Hill Global

Fund

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(collectively the "Consolidated Funds") as of March 31, 2019. The Company deconsolidated the Diamond Hill High Yield Fund during the three months ended March 31, 2019, as the Company's ownership declined to less than 50%. DHCM is the managing member of Diamond Hill General Partner, LLC (the “General Partner”), which is the general partner of Diamond Hill Investment Partners, L.P. (“DHIP”) and Diamond Hill International Equity Fund, L.P. ("DHIEF"), each a limited partnership (collectively, the “LPs”) whose underlying assets consist primarily of marketable securities.

DHCM is wholly owned by the Company and is consolidated by us. Further, DHCM, through its control of the General Partner, has the power to direct each LP’s economic activities and the right to receive investment advisory fees that may be significant to the LPs.

The Company concluded it did not have a variable interest in DHIP as the fees paid to the General Partner are considered to contain customary terms and conditions as found in the market for similar products and the Company has no equity ownership in DHIP.

The Company concluded DHIEF was a variable interest entity ("VIE") as DHCM has disproportionately less voting interest than economic interest, given that the limited partners have full power to remove the Company as the General Partner due to the existence of substantive kick-out rights. In addition, substantially all of DHIEF's activities are conducted on behalf of the General Partner which has disproportionately few voting rights. The Company concluded it is not the primary beneficiary of DHIEF as we lack the power to control the entity due to the existence of single-party kick-out rights where the limited partners have the unilateral ability to remove the General Partner without cause. DHCM’s investments in DHIEF are reported as a component of the Company’s investment portfolio, valued at DHCM’s respective share of the net income or loss of DHIEF.

The LPs are not subject to lock-up periods and can be redeemed on demand. Gains and losses attributable to changes in the value of DHCM’s interests in the LPs are included in the Company’s reported investment income. The Company’s exposure to loss as a result of its involvement with the LPs is limited to the amount of its investments. DHCM is not obligated to provide, and has not provided, financial or other support to the LPs, other than its investments to date and its contractually provided investment advisory responsibilities. The Company has not provided liquidity arrangements, guarantees or other commitments to support the LPs’ operations, and the LPs’ creditors and interest holders have no recourse to the general credit of the Company.

Certain board members and employees of the Company invest in the LPs and are not subject to a management fee or an incentive fee. These individuals receive no remuneration as a result of their personal investment in the LPs. The capital of the General Partner is not subject to a management fee or an incentive fee.

Redeemable Noncontrolling Interest

Redeemable noncontrolling interest represents third-party interests in the Consolidated Funds. This interest is redeemable at the option of the investors and therefore is not treated as permanent equity. Redeemable noncontrolling interest is recorded at redemption value, which approximates the fair value each reporting period.

Segment Information

Management has determined that the Company operates in one business segment, providing investment management and administration services to mutual funds, institutional accounts, and private investment funds. Therefore, no disclosures relating to operating segments are presented in the Company's annual or interim financial statements.

Cash and Cash Equivalents

Cash and cash equivalents include demand deposits and money market mutual funds held by DHCM.

Cash Held by Noncontrolling Shareholders

As of March 31, 2019, there was approximately $22.7 million of cash held in the consolidated ETF of which $10.0 million was held by noncontrolling shareholders.

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Accounts Receivable
Accounts receivable are recorded when they are due and are presented on the balance sheet net of any allowance for doubtful accounts. Accounts receivable are written off when they are determined to be uncollectible. Any allowance for doubtful accounts is estimated based on the Company’s historical losses, existing conditions in the industry, and the financial stability of the individuals or entities that owe the receivable. No allowance for doubtful accounts was deemed necessary at March 31, 2019 or December 31, 2018. Accounts receivable from the Funds were $10.1 million as of March 31, 2019 and $9.4 million as of December 31, 2018.
Investments
Management determines the appropriate classification of its investments at the time of purchase and re-evaluates its determination at each reporting period.
Investments in the Funds we advise where the Company has neither control nor the ability to exercise significant influence, as well as securities held in the Consolidated Funds, are measured at fair value based on quoted market prices. Unrealized gains and losses are recorded as investment income (loss) in the Company's consolidated statements of income.
Investments classified as equity method investments represent investments in which the Company owns between 20-50% of the outstanding voting interests in the entity or when it is determined that the Company is able to exercise significant influence but not control over the investments. When using the equity method, the Company recognizes its respective share of the investee's net income or loss for the period which is recorded as investment income in the Company's consolidated statements of income.
Property and Equipment
Property and equipment, consisting of leasehold improvements, right-of use lease assets, computer equipment, furniture, and fixtures, are carried at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated lives of the assets.
Revenue Recognition – General
Revenue is recognized when performance obligations under the terms of a contract with a client are satisfied. The Company earns substantially all of its revenue from investment advisory and fund administration contracts.
Investment advisory and administration fees, generally calculated as a percentage of assets under management ("AUM"), are recorded as revenue as services are performed. In addition to fixed fees based on a percentage of AUM, certain client accounts also provide periodic variable rate fees.
Revenue earned during the three months ended March 31, 2019 and 2018 under contracts with clients include:

	Three Months Ended March 31, 2019		
	Investment advisory	Mutual fund administration, net	Total revenue
Proprietary funds	$23,579,877	$ 2,066,655	$25,646,532
Sub-advised funds and institutional accounts	6,932,841	—	6,932,841
	$30,512,718	$ 2,066,655	$32,579,373

	Three Months Ended March 31, 2018		
	Investment advisory	Mutual fund administration, net	Total revenue
Proprietary funds	$27,305,199	$ 3,150,712	$30,455,911
Sub-advised funds and institutional accounts	7,326,091	—	7,326,091
	$34,631,290	$ 3,150,712	$37,782,002

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Revenue Recognition – Investment Advisory Fees

The Company's investment advisory contracts have a single performance obligation (the investment advisory services provided to the client) as the promised services are not separately identifiable from other promises in the contracts and, therefore, are not distinct. All performance obligations to provide advisory services are satisfied over time and the Company recognizes revenue as time passes.

The fees we receive for our services under our investment advisory contracts are based on our AUM, which changes based on the value of securities held under each advisory contract. These fees are thereby constrained and represent variable consideration, and are excluded from revenue until the AUM on which our client is billed is no longer subject to market fluctuations.

Revenue Recognition – Variable Rate Fees

The Company manages certain client accounts that provide for variable rate fees. These fees are calculated based on client investment results over rolling five-year periods. The Company records variable rate fees at the end of the contract measurement period because the variable fees earned are constrained based on movements in the financial markets. During the three months ended March 31, 2019 and 2018 the Company recorded no variable rate fees. The table below shows AUM subject to variable rate fees and the amount of variable rate fees that would be recognized based upon investment results as of March 31, 2019:

	As of March 31, 2019	
	AUM subject to variable rate fees	Unearned variable rate fees
Contractual Period Ending:		
Quarter Ending September 30, 2019	$36,224,545	$670,128
Quarter Ending December 31, 2019	59,818,522	394,812
Quarter Ending March 31, 2020	12,607,612	—
Quarter Ending September 30, 2021	268,417,205	4,911,623
Total	$377,067,884	$5,976,563

The contractual end dates highlight the time remaining until the variable rate fees are scheduled to be earned. The amount of variable rate fees that would be recognized based upon investment results as of March 31, 2019, will increase or decrease based on future client investment results through the contractual period end. There can be no assurance that the unearned amounts will ultimately be earned.

Revenue Recognition – Mutual Fund Administration

DHCM has an administrative and transfer agency services agreement with the Funds under which DHCM performs certain services for each Fund. These services include performance obligations, such as mutual fund administration, fund accounting, transfer agency, and other related functions. These services are performed concurrently under our agreement with the Funds, and all performance obligations to provide these administrative services are satisfied over time, and the Company recognizes revenue as time passes. For performing these services each Fund pays DHCM a fee, which is calculated using an annual rate times the average daily net assets of each respective share class. These fees are thereby constrained and represent variable consideration, and are excluded from revenue until the AUM on which we bill the Funds is no longer subject to market fluctuations.

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The Funds have selected and contractually engaged certain vendors to fulfill various services to benefit the Funds' shareholders or to satisfy regulatory requirements of the Funds. These services include, among others, required shareholder mailings, federal and state registrations, and legal and audit services. DHCM, in fulfilling a portion of its role under the administration agreement with the Funds, acts as agent to pay these obligations of the Funds. Each vendor is independently responsible for fulfillment of the services it has been engaged to provide and negotiates fees and terms with the management and board of trustees of the Funds. The fee that each Fund pays to DHCM is reviewed annually by the Funds' board of trustees and specifically takes into account the contractual expenses that DHCM pays on behalf of the Funds. As a result, DHCM is not involved in the delivery or pricing of these services and bears no risk related to these services. Revenue has been recorded net of these Fund related expenses. In addition, DHCM advances the upfront commissions that are paid to brokers who sell Class C shares of the Funds. These advances are capitalized and amortized over 12 months to correspond with the repayments DHCM receives from the principal underwriter to recoup this commission advancement.

Mutual fund administration gross and net revenue are summarized below:

	Three Months Ended March 31, 2019	2018
Mutual fund administration:		
Administration revenue, gross	$5,402,728	$6,607,337
Fund related expense	(3,349,541)	(3,468,325)
Revenue, net of related expenses	2,053,187	3,139,012
DHCM C-Share financing:		
Broker commission advance repayments	65,212	96,478
Broker commission amortization	(51,744)	(84,778)
Financing activity, net	13,468	11,700
Mutual fund administration revenue, net	$2,066,655	$3,150,712

Income Taxes

The Company accounts for current and deferred income taxes through an asset and liability approach. Deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Deferred tax assets are reduced by a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

The Company is subject to examination by federal and applicable state and local jurisdictions for various tax periods. The Company's income tax positions are based on research and interpretations of the income tax laws and rulings in each of the jurisdictions in which it does business. Due to the subjectivity of interpretations of laws and rulings in each jurisdiction, the differences and interplay in tax laws among those jurisdictions, and the inherent uncertainty in estimating the final resolution of complex tax audit matters, the Company's estimates of income tax liabilities may differ from actual payments or assessments. The Company regularly assesses its position with regard to tax exposures and records liabilities for these uncertain tax positions and related interest and penalties, if any, according to the principles of FASB ASC 740, Income Taxes. The Company records interest and penalties within income tax expense on the income statement.

Earnings Per Share

Basic earnings per share ("EPS") excludes dilution and is computed by dividing net income by the weighted average number of common shares outstanding for the period, which includes participating securities. Diluted EPS reflects the potential dilution of EPS due to unvested restricted stock units. See Note 9.

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Newly Issued But Not Yet Adopted Accounting Guidance

In August 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2018-13, "Fair Value Measurements." This update makes certain removals from, changes to and additions to existing disclosure requirements for fair value measurement. ASU 2018-13 does not change fair value measurements already required or permitted by existing standards. ASU 2018-13 is effective for financial statements issued for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Management does not believe that adoption of ASU 2018-13 will materially impact the Company's financial statements.

Note 3 Investments

The following table summarizes the carrying value of these investments as of March 31, 2019 and December 31, 2018:

	As of March 31, 2019	December 31, 2018
Fair value investments:		
Securities held in Consolidated Funds[a]	$78,997,408	$153,730,480
Company sponsored investments	39,533,699	33,418,088
Company sponsored equity method investments	46,260,613	16,339,649
Total Investments	$164,791,720	$203,488,217

(a) Of the securities held in the Consolidated Funds as of March 31, 2019, $48.8 million were held directly by the Company and $30.2 million were held by noncontrolling shareholders. Of the securities held in the Consolidated Funds as of December 31, 2018, $84.7 million were held directly by the Company and $69.0 million were held by noncontrolling shareholders.

The Company deconsolidated the Diamond Hill High Yield Fund during the three months ended March 31, 2019. As of March 31, 2019, the Diamond Hill High Yield Fund was classified as an equity method investment.

In March of 2019, the Company determined to close and liquidate the ETF effective April 5, 2019. On March 26, 2019, the ETF liquidated its holdings and it held all cash as of March 31, 2019. The cash was distributed to all shareholders on April 5, 2019.

As of March 31, 2019, our equity method investments consisted of the Diamond Hill Research Opportunities Fund, the Diamond Hill High Yield Fund and the Diamond Hill International Equity Fund, and our ownership percentage in each of these investments was 28%, 39%, and 30%, respectively. The following table includes the condensed summary financial information from the Company's equity method investments as of and for the period ended March 31, 2019:

	As of March 31, 2019
Total assets	$171,333,153
Total liabilities	34,730,660
Net assets	136,602,493
DHCM's portion of net assets	46,260,613

	For the Three Months Ended March 31, 2019

Investment income	$1,373,481
Expenses	291,103
Net realized gains	398,296
Net change in unrealized appreciation	8,205,267
Net income	9,685,941
DHCM's portion of net income	3,415,624

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Note 4 Fair Value Measurements

The Company determines the fair value of our cash equivalents and certain investments using the following broad levels listed below:

Level 1 - Unadjusted quoted prices for identical instruments in active markets.

Level 2 - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-driven valuations in which all significant inputs are observable.

Level 3 - Valuations derived from techniques in which significant inputs are unobservable. We do not value any investments using Level 3 inputs.

These levels are not necessarily an indication of the risk or liquidity associated with investments.

The following table summarizes investments that are recognized in our consolidated balance sheet using fair value measurements (excludes investments classified as equity method investments) determined based upon the differing levels as of March 31, 2019:

	Level 1	Level 2	Level 3	Total
Cash equivalents	$68,572,210	$ —	$ —	$68,572,210
Fair value investments				
Securities held in Consolidated Funds[(a)]	16,967,373	62,030,035	—	$78,997,408
Company sponsored investments	39,533,699	—	—	$39,533,699

(a) Of the securities held in the Consolidated Funds as of March 31, 2019, $48.8 million were held directly by the Company and $30.2 million were held by noncontrolling shareholders.

Level 1 investments are comprised of investments in registered investment companies (mutual funds) or equity securities held in the Consolidated Funds and $68.6 million of investments in money market mutual funds owned by DHCM that the Company classifies as cash equivalents.

Level 2 investments are comprised of investments in debt securities held in the Consolidated Funds, which are valued by an independent pricing service using pricing techniques which take into account factors such as trading activity, readily available market quotations, yield, quality, coupon rate, maturity, type of issue, trading characteristics, call features, credit rates and other observable inputs.

The Company determines transfers between fair value hierarchy levels at the end of the reporting period. There were no transfers in or out of the levels during the three months ended March 31, 2019.

Changes to fair values of the investments are recorded in the Company’s consolidated statements of income as investment income (loss), net.

Note 5 Line of Credit

The Company has a committed Line of Credit Agreement (the "Credit Agreement") with a commercial bank that matures in March of 2020 and permits the Company to borrow up to $25.0 million. Borrowings under the Credit Agreement bear interest at a rate equal to LIBOR plus 1.50%. The Company pays a commitment fee on the unused portion of the facility, accruing at a rate per annum of 0.10%.

The Company has not borrowed under the Credit Agreement as of and for the three-month period ended March 31, 2019.

The proceeds of the Credit Agreement may be used by the Company and its subsidiaries for ongoing working capital needs, to seed new and existing investment strategies and for other general corporate purposes. The Credit Agreement contains representations, warranties and covenants that are customary for agreements of this type.

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Note 6 Compensation Plans
Share-Based Payment Transactions
The Company issues restricted stock units and restricted stock awards (collectively, "Restricted Stock") under its 2014 Equity and Cash Incentive Plan (the "2014 Plan"). Restricted stock units represent common shares which may be issued in the future, whereas restricted stock awards represent common shares issued and outstanding upon grant subject to vesting restrictions. The following table represents a roll-forward of outstanding Restricted Stock and related activity during the three months ended March 31, 2019:

	Shares	Weighted-Average Grant Date Price per Share
Outstanding Restricted Stock as of December 31, 2018	214,575	$ 177.22
Grants issued	24,875	155.15
Grants vested	—	—
Grants forfeited	(4,250)	162.03
Total Outstanding Restricted Stock as of March 31, 2019	235,200	$ 175.16

As of March 31, 2019, there were 242,681 common shares available for awards under the 2014 Plan.
Total deferred equity compensation related to unvested Restricted Stock grants was $23.7 million as of March 31, 2019. Compensation expense related to Restricted Stock grants is calculated based upon the fair market value of the common shares on grant date. The Company's policy is to adjust compensation expense for forfeitures as they occur. The recognition of compensation expense related to deferred compensation over the remaining vesting periods is as follows:

Nine Months Remaining In 2019	2020	2021	2022	2023	Thereafter	Total
$5,501,114	$6,146,135	$4,865,576	$3,878,442	$1,641,414	$1,624,093	$23,656,774

Stock Grant Transactions
The following table represents common shares issued as part of our incentive compensation program during the three months ended March 31, 2019 and 2018:

	Shares Issued	Grant Date Value
March 31, 2019	24,048	$3,655,296
March 31, 2018	20,153	4,109,197

Deferred Compensation Plans
The Company offers two deferred compensation plans, the Diamond Hill Fixed Term Deferred Compensation Plan and the Diamond Hill Variable Term Deferred Compensation Plan (collectively the “Plans”). Under the Plans, participants may elect to voluntarily defer, for a minimum of five years, certain incentive compensation, which the Company then contributes into the Plans. Each participant is responsible for designating investment options for assets they contribute, and the distribution paid to each participant reflects any gains or losses on the assets realized while in the Plans. Assets held in the Plans are included in the Company’s investment portfolio, and the associated obligation to participants is included in deferred compensation liability. Deferred compensation liability was $26.8 million and $22.4 million as of March 31, 2019 and December 31, 2018, respectively.
Note 7 Operating Lease
The Company currently leases office space of approximately 37,829 square feet at one location.
In February 2016, the FASB issued ASU 2016-02, "Leases", which, among other things, requires lessees to recognize most leases on-balance sheet. The Company adopted this ASU on its effective date, January 1, 2019, using a modified retrospective approach without restating prior comparative periods. Upon implementation, the Company recorded a

right-of use asset of

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approximately $2.9 million, which includes the lease liability amount less deferred rent liabilities and lease incentives received, and a lease liability of approximately $3.6 million related to our office lease. As of March 31, 2019, the carrying value of the right-of use asset, which is included in property and equipment, net of depreciation on the consolidated balance sheets, was approximately $2.8 million. As of March 31, 2019, the carrying value of the lease liability which is included in accounts payable and accrued expenses on the consolidated balance sheets, was approximately $3.5 million The adoption of this ASU had no impact on our consolidated statements of income and cash flows and there was no cumulative-effect adjustment required to opening retained earnings.

The following table summarizes the total lease and operating expenses for the three months ended March 31, 2019 and 2018:

	March 31, 2019	March 31, 2018
Three Months Ended	$252,073	$256,290

The approximate future minimum lease payments under the operating lease are as follows:

Future Minimum Lease Payments						
Nine Months Remaining In 2019	2020	2021	2022	2023	Thereafter	Total
$439,762	$614,721	$624,179	$624,179	$624,179	$780,223	$3,707,243

In addition to the above lease payments, the Company is also responsible for normal operating expenses of the property. These operating expenses were approximately $0.4 million in 2018, and are expected to be approximately the same in 2019.

Note 8 Income Taxes

The Company has determined its interim tax provision projecting an estimated annual effective tax rate.

For the three months ended March 31, 2019, the Company recorded income tax expense of $5.9 million, yielding an effective tax rate of 23.1%. The effective tax rate of 23.1% differed from the federal statutory tax rate of 21% due primarily to the additional income tax expense recorded in the state and city jurisdictions in which we do business including new jurisdictions in which we are filing in 2019. This is partially offset by the benefit attributable to redeemable noncontrolling interests. The provision for income taxes includes a benefit attributable to the fact that the Company's operations include the Consolidated Funds which are not subject to federal income taxes. Accordingly, a portion of the Company's earnings are not subject to corporate tax levels. Absent the benefit attributable to redeemable noncontrolling interests, the effective tax rate ("unconsolidated effective tax rate") would have been 25.7%.

For the three months ended March 31, 2018, the Company recorded income tax expense of $3.7 million, yielding an effective tax rate of 22.2%. The effective tax rate of 22.2% differed from the federal statutory tax rate of 21% due primarily to the additional income tax expense recorded in the state and city jurisdictions in which we do business.

The net temporary differences incurred to date will reverse in future periods as the Company generates taxable earnings. The Company believes it is more likely than not that the results of future operations will generate sufficient taxable income to realize the net deferred tax assets recorded. The Company records a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. As of March 31, 2019 and December 31, 2018, no valuation allowance was deemed necessary.

FASB ASC 740, Income Taxes, prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return and also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company recognizes tax benefits related to positions taken, or expected to be taken, on its tax returns, only if the positions are "more-likely-than-not" sustainable. Once this threshold has been met, the Company’s measurement of its expected tax benefits is recognized in its financial statements.

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During the three months ended March 31, 2019, the Company completed our open examination for tax years 2014 through 2016 with the New York State Department of Finance and Taxation. During the period the Company also filed a Voluntary Disclosure Agreement with the New York City Department of Finance. The Company remains under audit with the California Franchise Tax Board for the Company's 2015 and 2016 tax years.

The outcome of open examinations is not expected to have a material impact on the Company's financial statements. The Company believes that some of these audits and negotiations will conclude within the next 12 months and that any change in the amount of uncertain tax positions, including interest due to the settlement of audits would be immaterial.

The amount of uncertain tax positions as of March 31, 2019, which would impact the Company's effective tax rate if recognized and a reconciliation of the beginning and ending amounts of uncertain tax positions is as follows:

	Three Months Ended March 31, 2019
Uncertain tax positions, as of January 1, 2019	$2,982,337
Gross addition for tax positions of the current year	—
Gross additions for tax positions of prior years	—
Reductions of tax positions of prior years for:	
Lapses of applicable statutes of limitations	—
Settlements during the period	(2,331,711)
Changes in judgment/excess reserve	—
Uncertain tax positions, as of March 31, 2019	$650,626

The Company did not recognize additional interest and penalties during the three months ended March 31, 2019, related to uncertain tax positions.

Note 9 Earnings Per Share

The Company's common shares outstanding consist of all shares issued and outstanding, including unvested restricted shares. Basic and diluted EPS are calculated under the two-class method. Restricted stock units are considered dilutive. The following table sets forth the computation for basic and diluted EPS and reconciliation between basic and diluted shares outstanding:

	Three Months Ended March 31,	
	2019	2018
Net Income	$19,555,847	$12,942,129
Less: Net income attributable to redeemable noncontrolling interest	(2,623,205)	47,332
Net income attributable to common shareholders	$16,932,642	$12,989,461
Weighted average number of outstanding shares - Basic	3,493,843	3,487,923
Dilutive impact of restricted stock units	2,691	4,015
Weighted average number of outstanding shares - Diluted	3,496,534	3,491,938
Earnings per share attributable to common shareholders		
Basic	$4.85	$3.72
Diluted	$4.84	$3.72

Note 10 Commitments and Contingencies

The Company indemnifies its directors, officers and certain of its employees for certain liabilities that might arise from their performance of their duties to the Company. From time to time, the Company is involved in legal matters relating to claims arising in the ordinary course of business. There are currently no such matters pending that the Company believes could have a material adverse effect on its consolidated financial statements.

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Additionally, in the normal course of business, the Company enters into agreements that contain a variety of representations and warranties and which provide general indemnifications. Certain agreements do not contain any limits on the Company's liability and could involve future claims that may be made against the Company that have not yet occurred. Therefore, it is not possible to estimate the Company's potential liability under these indemnities. Further, the Company maintains insurance policies that may provide coverage against certain claims under these indemnities.

ITEM 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-looking Statements

Throughout this Quarterly Report on Form 10-Q, the Company may make forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, relating to such matters as anticipated operating results, prospects and levels of assets under management, technological developments, economic trends (including interest rates and market volatility), expected transactions and similar matters. The words "believe," "expect," "anticipate," "estimate," "should," "hope," "seek," "plan," "in similar expressions identify forward-looking statements that speak only as of the date thereof. While we believe that the assumptions underlying our forward-looking statements are reasonable, investors are cautioned that any of the assumptions could prove to be inaccurate and, accordingly, our actual results and experiences could differ materially from the anticipated results or other expectations expressed in our forward-looking statements. Factors that could cause such actual results or experiences to differ from results discussed in the forward-looking statements include, but are not limited to: the adverse effect from a decline in the securities markets; a decline in the performance of our products; changes in interest rates; changes in national and local economic and political conditions; the continuing economic uncertainty in various parts of the world; changes in government policy and regulation, including monetary policy; our inability to attract or retain key employees; unforeseen costs and other effects related to legal proceedings or investigations of governmental and self-regulatory organizations; and other risks identified from time-to-time in other public documents on file with the SEC.

General

The Company derives its consolidated revenue and net income from investment advisory and fund administration services provided by DHCM. DHCM is registered with the SEC as an investment adviser under the 1940 Act. DHCM sponsors, distributes, and provides investment advisory and related services to various clients through the Funds, institutional accounts, the ETF, and the LPs.

The Company's primary objective is to fulfill our fiduciary duty to our clients. Our secondary objective is to grow the intrinsic value of the Company in order to achieve an adequate long-term return for our shareholders.

Assets Under Management

Our revenue is derived primarily from investment advisory and administration fees. Investment advisory and administration fees paid to the Company are generally based on the value of the investment portfolios we manage and fluctuate with changes in the total value of our AUM. Substantially all of our AUM (92.1%) is valued based on readily available market quotations. AUM in the fixed income strategies (7.9%) is valued using evaluated prices from independent third-party providers. Fees are recognized in the period that the Company manages these assets.

Our revenues are highly dependent on both the value and composition of AUM. The following is a summary of our AUM by product and investment objective, and a roll-forward of the change in AUM, for the three months ended March 31, 2019 and 2018:

	Assets Under Management As of March 31,		
(in millions, except percentages)	2019	2018	% Change
Proprietary funds	$ 14,623	$ 15,717	(7)%
Sub-advised funds	1,601	1,576	2 %
Institutional accounts	4,656	4,636	— %

Total AUM	$ 20,880	$ 21,929	(5)%

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	Assets Under Management by Investment Strategy As of March 31,		
(in millions, except percentages)	2019	2018	% Change
Small Cap	$954	$1,429	(33)%
Small-Mid Cap	3,025	3,399	(11)%
Mid Cap	249	127	96 %
Large Cap	10,686	10,767	(1)%
All Cap Select	477	467	2 %
Long-Short	3,959	4,794	(17)%
Global/International	21	17	24 %
Short Duration Fixed Income	621	370	68 %
Core Fixed Income	58	48	21 %
Long Duration Fixed Income	54	—	NM
Corporate Credit	874	689	27 %
High Yield	76	44	73 %
(Less: Investments in affiliated funds)[(a)]	(174)	(222)	(22)%
Total AUM	$20,880	$21,929	(5)%

(a) Certain of the Funds own shares of the Diamond Hill Short Duration Total Return Fund. The Company reduces its total AUM by these investments held in this affiliated fund.

	Change in Assets Under Management For the Three Months Ended March 31,	
(in millions)	2019	2018
AUM at beginning of the period	$19,108	$22,317
Net cash inflows (outflows)		
proprietary funds	(309)	187
sub-advised funds	59	104
institutional accounts	(209)	(35)
	(459)	256
Net market appreciation (depreciation) and income	2,231	(644)
Increase (decrease) during the period	1,772	(388)
AUM at end of the period	$20,880	$21,929

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Consolidated Results of Operations

The following is a discussion of our consolidated results of operations.

(in thousands, except per share amounts and percentages)	Three Months Ended March 31, 2019	2018	% Change
Total revenue	$32,579	$37,782	(14)%
Net operating income	$11,134	$18,204	(39)%
Net operating income, as adjusted[(a)]	$13,546	$17,689	(23)%
Net income attributable to common shareholders	$16,933	$12,989	30%
Earnings per share attributable to common shareholders (Diluted)	$4.84	$3.72	30%
Operating profit margin	34 %	48 %	
Operating profit margin, as adjusted[(a)]	42 %	47 %	

(a) Net operating income, as adjusted, and operating profit margin, as adjusted, are non-GAAP performance measurements. See the Use of Supplemental Data as Non-GAAP Performance Measure section within this report.

Three Months Ended March 31, 2019 compared with Three Months Ended March 31, 2018

The Company generated net income attributable to common shareholders of $16.9 million ($4.84 per diluted share) for the three months ended March 31, 2019, compared with net income attributable to common shareholders of $13.0 million ($3.72 per diluted share) for the three months ended March 31, 2018. Revenue decreased $5.2 million period over period, primarily due to a decrease in average AUM. Operating expenses increased $1.9 million, primarily due to increases in deferred compensation expense (see additional information in Expense Discussion). The Company had $14.3 million in investment income due to market appreciation for the three months ended March 31, 2019, compared to investment loss of $1.6 million for the three months ended March 31, 2018.

Income tax expense increased $2.2 million from the three months ended March 31, 2018 to the three months ended March 31, 2019 due to the increase in pretax income and an increase of the Company's effective tax rate from 22.2% to 23.1%. The effective tax rate of 23.1% differed from the federal statutory tax rate of 21% due primarily to the additional income tax expense recorded in the state and city jurisdictions in which we do business, including new jurisdictions in which we are filing in 2019. This is partially offset by the benefit attributable to redeemable noncontrolling interests. The provision for income taxes includes a benefit attributable to the fact that the Company's operations include the Consolidated Funds which are not subject to federal income taxes. Accordingly, a portion of the Company's earnings are not subject to corporate tax levels. Absent the benefit attributable to redeemable noncontrolling interests, the effective tax rate would have been 25.7%.

Operating profit margin was 34% for the quarter ended March 31, 2019 and 48% for the quarter ended March 31, 2018. Operating profit margin, as adjusted, was 42% for the quarter ended March 31, 2019 and 47% for the quarter ended March 31, 2018. See Use of Supplemental Data as Non-GAAP Performance Measure section within this report. We expect that our operating margin will fluctuate from period to period based on various factors, including revenues; investment results; employee performance; staffing levels; gains and losses on investments held in deferred compensation plans; development of investment strategies, products, or channels; and industry comparisons.

Revenue

(in thousands, except percentages)	Three Months Ended March 31, 2019	2018	% Change
Investment advisory	$30,513	$34,631	(12)%
Mutual fund administration, net	2,066	3,151	(34)%
Total	$32,579	$37,782	(14)%

Investment Advisory Fees. Investment advisory fees decreased $4.1 million, or 12%, from the three months ended March 31, 2018 to the three months ended March 31, 2019. Investment advisory fees are calculated as a percentage of the market value of client accounts at contractual fee rates, which vary by investment product. The decrease in investment advisory fees was driven by a decrease of 8% in average AUM period over period and a decrease of two basis points in the average advisory fee rate from 0.62% for the three months ended March 31, 2018, to 0.60% for the three months ended March 31, 2019. The decrease in

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average advisory fee rate was driven by a shift in the mix of assets held in lower fee rate strategies during the three months ended March 31, 2019, compared to the three months ended March 31, 2018.

Mutual Fund Administration Fees. Mutual fund administration fees decreased $1.1 million, or 34%, from the three months ended March 31, 2018 to the three months ended March 31, 2019. Mutual fund administration fees include administration fees received from the Funds, which are calculated as a percentage of average Funds' AUM. The decrease was due to a reduction in the administration fee rates paid by the Funds and an 11% decrease in average Funds' AUM from the three months ended March 31, 2018 to the three months ended March 31, 2019. The table below summarizes the decreases in the administration fee rates during the periods indicated:

	Class A & C	Class I	Class Y
6/1/2017 - 2/27/2018	0.23%	0.18%	0.08%
2/28/2018 - 3/31/19	0.21%	0.17%	0.05%

Expenses

(in thousands, except percentages)	Three Months Ended March 31, 2019	2018	% Change
Compensation and related costs, excluding deferred compensation expense	$13,557	$14,902	(9)%
Deferred compensation expense (benefit)	2,412	(515)	NM
General and administrative	3,245	2,964	9 %
Sales and marketing	1,371	1,210	13 %
Mutual fund administration	861	1,017	(15)%
Total	$21,446	$19,578	10 %

Compensation and Related Costs, excluding deferred compensation expense. Employee compensation and benefits decreased by $1.3 million, or 9%, from the three months ended March 31, 2018 to the three months ended March 31, 2019. This decrease is due to a decrease in incentive compensation expense of $2.8 million, which was partially offset by an increase in salary and related benefits of $1.5 million. Incentive compensation expense can fluctuate significantly period over period as we evaluate investment performance, individual performance, Company performance and other factors.

Deferred Compensation expense (benefit). Deferred compensation expense (benefit) increased by $2.9 million from the three months ended March 31, 2018 to the three months ended March 31, 2019. The gain (loss) on deferred compensation plan investments increases (decreases) deferred compensation expense included in operating income. Deferred compensation expense (benefit) is offset by an equal amount in investment income (loss) below net operating income on the consolidated statements of income statement, and thus has no impact on net income attributable to the Company. During the three months ended March 31, 2019, there were gains on investments held in our deferred compensation plans of $2.4 million.

General and Administrative. General and administrative expenses increased by $0.3 million, or 9%, from the three months ended March 31, 2018 to the three months ended March 31, 2019. This increase was primarily due to increases in research expenses to support our investment team of $0.2 million and an increase in information technology expense of $0.1 million.

Sales and Marketing. Sales and marketing expenses increased by $0.2 million, or 13%, from the three months ended March 31, 2018 to the three months ended March 31, 2019. The increase was due to our branding and public relations initiatives primarily focused on our fixed income strategies.

Mutual Fund Administration. Mutual fund administration expenses decreased by $0.2 million, or 15%, from the three months ended March 31, 2018 to the three months ended March 31, 2019. Mutual fund administration expenses consist of both variable and fixed expenses. The variable expenses are based on Fund AUM and the number of shareholder accounts. The decrease was primarily due to a reduction in outsourced administration services.

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Liquidity and Capital Resources

Sources of Liquidity

Our current financial condition is highly liquid, with a significant amount of our assets comprised of cash and cash equivalents, investments, accounts receivable, direct investments in consolidated funds and other current assets. Our main source of liquidity is cash flows from operating activities, which are generated from investment advisory and mutual fund administration fees. Cash and cash equivalents, investments held directly by DHCM, accounts receivable, and other current assets represented $235.6 million and $238.4 million of total assets as of March 31, 2019 and December 31, 2018, respectively. We believe these sources of liquidity, as well as our continuing cash flows from operating activities, will be sufficient to meet our current and future operating needs for the next 12 months.

Uses of Liquidity

In line with the Company’s primary objective to fulfill our fiduciary duty to clients and secondary objective to achieve an adequate long-term return for shareholders, we anticipate our main uses of cash will be for operating expenses and seed capital to fund new and existing investment strategies.

Our board of directors and management regularly review various factors to determine whether we have capital in excess of that required for our business and the appropriate use of any excess capital. The factors considered include our investment opportunities, capital needed for investment strategies, risks, and future dividend and capital gain tax rates. Our board of directors has also authorized management to repurchase the Company's common shares having an aggregate purchase price up to $50.0 million, of which $34.9 million is remaining. The authority to repurchase shares may be exercised from time to time as market conditions warrant and is subject to regulatory considerations.

Working Capital

As of March 31, 2019, the Company had working capital of approximately $192.1 million, compared to $180.4 million at December 31, 2018. Working capital includes cash and cash equivalents, accounts receivable, investments, direct investments in Consolidated Funds, and other current assets of DHCM, net of accounts payable and accrued expenses, accrued incentive compensation, deferred compensation and other current liabilities of DHCM.

The Company has no debt, and we believe our available working capital is sufficient to cover current expenses and presently anticipated capital expenditures.

Below is a summary of securities owned by the Company as of March 31, 2019 and December 31, 2018.

	As of March 31, 2019	December 31, 2018
Corporate Investments:		
Diamond Hill Core Bond Fund	$38,235,523	$37,197,134
Diamond Hill High Yield Fund	27,628,562	25,931,879
Diamond Hill Mid Cap Fund	17,086,085	15,035,251
Diamond Hill Research Opportunities Fund	14,177,063	12,912,291
Diamond Hill Valuation-Weighted 500 ETF[(a)]	—	11,497,699
Diamond Hill Global Fund	9,490,570	8,482,790
Diamond Hill International Equity Fund, L.P.	1,162,949	1,057,445
Total Corporate Investments	107,780,752	112,114,489
Deferred Compensation Plan Investments in the Funds	26,777,526	22,387,874
Total investments held by DHCM	134,558,278	134,502,363
Redeemable noncontrolling interest in Consolidated Funds	30,233,442	68,985,854
Total Investment Portfolio	$164,791,720	$203,488,217

(a) In March of 2019, the ETF determined to close and liquidate the Fund after the close of business on April 5, 2019. On March 26, 2019 the ETF liquidated its holdings and it held all cash as of March 31, 2019. The cash was distributed to all shareholders on April 5, 2019.

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Cash Flow Analysis

Cash Flows from Operating Activities

The Company's cash flows from operating activities are calculated by adjusting net income to reflect other significant operating sources and uses of cash, certain significant non-cash items, such as share-based compensation, and timing differences in the cash settlement of operating assets and liabilities. We expect that cash flows provided by operating activities will continue to serve as our primary source of working capital in the near future.

For the three months ended March 31, 2019, net cash provided by operating activities totaled $16.1 million. Cash inflows provided by operating activities was primarily driven by net income of $19.6 million, the add back of share-based compensation of $2.2 million, depreciation of $0.3 million, and net redemptions of securities held in the underlying investment portfolios of the Consolidated Funds of $18.9 million. These cash inflows were partially offset by the decrease in accrued incentive compensation of $18.6 million, and the cash impact of timing differences in the settlement of assets and liabilities of $6.3 million. Absent the cash used by Consolidated Funds to purchase securities into their investment portfolios, cash flow used in operations was $4.7 million.

For the three months ended March 31, 2018, net cash used in operating activities totaled $18.8 million. Cash used in operating activities was primarily driven by net purchases of trading securities held in the underlying investment portfolio of the Consolidated Funds of $35.1 million and the payment of accrued incentive compensation of $13.7 million. These cash outflows were partially offset by net income of $12.9 million, the add back of share-based compensation of $1.9 million, depreciation of $0.3 million, and the cash impact of timing differences in the settlement of assets and liabilities of $15.0 million. Absent the cash used by Consolidated Funds to purchase securities into their investment portfolios, cash flow provided by operations would have been $9.8 million.

Cash Flows from Investing Activities

The Company's cash flows from investing activities consist primarily of capital expenditures and purchases and redemptions in our investment portfolio.

Cash flows used in investing activities totaled $2.0 million for the three months ended March 31, 2019. The Company purchased investments of $4.6 million and $0.1 million of property and equipment during the period. These cash outflows were partially offset by proceeds from the sale of investments of $2.7 million.

Cash flows used in investing activities totaled $2.1 million for the three months ended March 31, 2018. The Company purchased investments of $3.1 million and $0.1 million of property and equipment purchases during the period. These cash outflows were partially offset by proceeds from sale of investments of $1.1 million.

Cash Flows from Financing Activities

The Company's cash flows from financing activities consist primarily of the payment of special dividends, the repurchase of its common shares, shares withheld related to employee tax withholding, and distributions to, or contributions from, redeemable noncontrolling interest holders.

For the three months ended March 31, 2019, net cash used in financing activities totaled $6.4 million, consisting of net subscriptions received in the Consolidated Funds from redeemable noncontrolling interest holders of $1.5 million, which were partially offset by repurchases of the Company's common shares of $7.9 million.

For the three months ended March 31, 2018, net cash provided by financing activities totaled $3.2 million, consisting of net subscriptions received in the Consolidated Funds from redeemable noncontrolling interest holders of $3.7 million, partially offset by the value of shares withheld related to employee tax withholding of $0.5 million.

Supplemental Consolidated Cash Flow Statement

Our consolidated balance sheets reflect the investments and other assets and liabilities of the Consolidated Funds, as well as redeemable noncontrolling interests for the portion of the Consolidated Funds that are held by third-party investors. Although we can redeem our net interest in the Consolidated Funds at any time, we cannot directly access or sell the assets held by the Consolidated Funds to obtain cash for general operations. Additionally, the assets of the Consolidated Funds are not available to our general creditors.

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The following table summarizes the condensed cash flows for the three months ended March 31, 2019, that are attributable to Diamond Hill Investment Group, Inc. and to the Consolidated Funds, and the related eliminations required in preparing the consolidated statements.

	Three Months Ended March 31, 2019			
	Cash flow attributable to Diamond Hill Investment Group, Inc.	Cash flow attributable to Consolidated Funds	Eliminations	As reported on the Consolidated Statement of Cash Flows
Cash flows from Operating Activities:				
Net Income	$16,932,642	$6,224,058	$(3,600,853)	$19,555,847
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Depreciation	282,565	—	—	282,565
Share-based compensation	2,154,024	—	—	2,154,024
Net (gains)/losses on investments	(10,430,652)	(6,224,058)	3,600,853	(13,053,857)
Net change in securities held by Consolidated Funds	—	18,908,654	—	18,908,654
Other changes in assets and liabilities	(13,612,378)	1,843,005	—	(11,769,373)
Net cash provided by (used in) operating activities	(4,673,799)	20,751,659	—	16,077,860
Net cash used in investing activities	(2,423,904)	—	456,131	(1,967,773)
Net cash provided by (used in) financing activities	(7,907,055)	1,972,194	(456,131)	(6,390,992)
Net change during the period	(15,004,758)	22,723,853	—	7,719,095
Cash at beginning of period[(a)]	84,430,059	—	—	84,430,059
Cash at end of period[(a)]	$69,425,301	$22,723,853	$—	$92,149,154

(a) Cash includes cash and cash equivalents and cash held by noncontrolling shareholders.

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Use of Supplemental Data as Non-GAAP Performance Measure

As supplemental information, we are providing performance measures that are based on methodologies other than U.S. generally accepted accounting principles ("non-GAAP"). We believe the non-GAAP measures below are useful measures of our core business activities, are important metrics in estimating the value of an asset management business and may enable more appropriate comparison to our peers. These non-GAAP measures should not be a substitute for financial measures calculated in accordance with GAAP, and may be calculated differently by other companies. The following schedule reconciles GAAP measures to non-GAAP measures for the three months ended March 31, 2019 and 2018, respectively.

	Three Months Ended March 31,	
(in thousands, except percentages and per share data)	2019	2018
Total revenue	$32,579	$37,782
Net operating income, GAAP basis	$11,134	$18,204
Non-GAAP adjustment:		
Gains (losses) on deferred compensation plan investments, net[1]	2,412	(515)
Net operating income, as adjusted, non-GAAP basis[2]	13,546	17,689
Non-GAAP adjustment:		
Tax provision on net operating income, as adjusted, non-GAAP basis[3]	(3,484)	(3,923)
Net operating income, as adjusted, after tax, non-GAAP basis[4]	$10,062	$13,766
Net operating income, as adjusted after tax per diluted share, non-GAAP basis[5]	$2.88	$3.94
Diluted weighted average shares outstanding, GAAP basis	3,497	3,492
Operating profit margin, GAAP basis	34 %	48 %
Operating profit margin, as adjusted, non-GAAP basis[6]	42 %	47 %

[1] Gains (losses) on deferred compensation plan investments, net: The gain (loss) on deferred compensation plan investments, which increases (decreases) deferred compensation expense included in operating income, is removed from operating income in the calculation because it is offset by an equal amount in investment income (loss) below net operating income on the income statement, and thus has no impact on net income attributable to the Company.

[2] Net operating income, as adjusted: This non-GAAP measure represents the Company's net operating income adjusted to exclude the impact on compensation expense of gains and losses on investments in the deferred compensation plan.

[3] Tax provision on net operating income, as adjusted: This non-GAAP measure represents the tax provision excluding the impact of investment related activity and is calculated by applying the unconsolidated effective tax rate to net operating income, as adjusted.

[4] Net operating income, as adjusted, after tax: This non-GAAP measure deducts from the net operating income, as adjusted, the tax provision on net operating income, as adjusted.

[5] Net operating income, as adjusted after tax per diluted share: This non-GAAP measure was calculated by dividing the net operating income, as adjusted after tax, by diluted weighted average shares outstanding.

[6] Operating profit margin, as adjusted: This non-GAAP measure was calculated by dividing the net operating income, as adjusted, by total revenue.

Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements. We do not have any obligation under a guarantee contract, or a retained or contingent interest in assets or similar arrangement that serves as credit, liquidity or market risk support for such assets, or any other obligation, including a contingent obligation, under a contract that would be accounted for as a derivative instrument or arising out of a variable interest.

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Critical Accounting Policies and Estimates

For a summary of the critical accounting policies important to understanding the condensed consolidated financial statements see Note 2, Significant Accounting Policies, in the condensed consolidated financial statements contained in Part I, Item 1 of this filing and Critical Accounting Policies in Management's Discussion and Analysis of Financial Condition and Results of Operations in the 2018 Annual Report and Note 2, Significant Accounting Policies, in the 2018 Annual Report for further information.

ITEM 3: Quantitative and Qualitative Disclosures About Market Risk

There has been no material change in the information provided in Item 7A of the Company's 2018 Annual Report.

ITEM 4: Controls and Procedures

Management, including the Chief Executive Officer and the Chief Financial Officer, has conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Exchange Act) as of the end of the period covered by this quarterly report (the "Evaluation Date"). Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and to ensure that the information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure.

There have been no changes in the Company's internal control over financial reporting during the quarter ended March 31, 2019, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II: OTHER INFORMATION

ITEM 1: Legal Proceedings

From time to time, the Company is party to ordinary, routine litigation that is incidental to its business. There are currently no such matters pending that the Company believes could have a material adverse effect on its consolidated financial statements.

ITEM 1A: Risk Factors

There has been no material change to the information provided in Item 1A of the Company's 2018 Annual Report.

ITEM 2: Unregistered Sales of Equity Securities and Use of Proceeds

During the quarter ended March 31, 2019, the Company did not sell any common shares that were not registered under the Securities Act of 1933. The following table sets forth information regarding the Company's repurchase program of its common shares during the first quarter of fiscal year 2019:

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Period	Total Number of Shares Purchased for Employee Tax Withholdings[a]	Total Number of Shares Purchased as part of Publicly Announced Program[b]	Average Price Paid Per Share Purchased Under the Program	Purchase Price of Shares Purchased Under the Program	Aggregate Purchase Price Yet To Be Purchased Under the Program
January 1, 2019 through January 31, 2019	—	21,299	$ 155.28	$3,307,974	$39,462,777
February 1, 2019 through February 28, 2019	—	16,748	$ 145.22	$2,432,669	$37,030,108
March 1, 2019 through March 31, 2019	—	15,598	$ 138.86	$2,166,412	$34,863,696
Total	—	53,645		$7,907,055	

(a) The Company regularly withholds shares for tax payments due upon employee Restricted Stock vestings. During the quarter ended March 31, 2019, no shares for employee tax withholdings were purchased.

(b) The Company's current share repurchase program was announced on September 25, 2018. Our board of directors authorized management to repurchase up to $50,000,000 of the Company’s common shares in the open market and in private transactions in accordance with applicable securities laws. The Company’s share repurchase program will expire in September 2020.

The Company has entered into a Rule 10b5-1 repurchase plan in connection with its currently effective repurchase program. This plan is intended to qualify for the safe harbor under Rule 10b5-1 of the Securities Exchange Act of 1934. A Rule 10b5-1 plan allows a company to purchase its shares at times when it would not ordinarily be in the market due to its trading policies or the possession of material nonpublic information. Purchases may be made in the open market or through privately negotiated transactions. Purchases in the open market will be made in compliance with Rule 10b-18 under the Exchange Act. Because the repurchases under the 10b5-1 plan are subject to specified parameters and certain price, timing and volume restraints specified in the plan, there is no guarantee as to the exact number of shares that will be repurchased, or that there will be any repurchases at all pursuant to the plan.

Since the commencement of the repurchase program through March 31, 2019, the Company has repurchased 99,115 of the Company's common shares at a total cost of $15.1 million.

ITEM 3:	15.2	—	32.6			
Total current assets	239.3	815.9	—	190.4	—	1,245.6
Property, plant, and equipment, net	0.2	228.3	—	59.2	—	287.7
Goodwill	—	677.7	2.7	220.5	—	900.9
Intangible assets, net	—	235.5	109.8	103.5	—	448.8
Deferred income taxes	51.6	—	—	8.0	(56.2)	3.4
Other long-term assets	1.5	10.9	—	0.8	—	13.2
Investments in and amounts due from affiliates	1,500.3	330.4	234.2	—	(2,064.9)	—
Total assets	$1,792.9	$2,298.7	$346.7	$582.4	$(2,121.1)	$2,899.6
LIABILITIES AND STOCKHOLDERS’ EQUITY						
Current liabilities:						
Accounts payable	$0.9	$366.4	$—	$27.8	$—	$395.1
Current maturities of long-term debt	—	—	—	0.4	—	0.4
Other accrued liabilities	27.6	138.9	—	38.9	—	205.4
Total current liabilities	28.5	505.3	—	67.1	—	600.9
Long-term debt	—	353.1	—	3.4	—	356.5

Deferred income taxes	—	134.6	—	29.8	(56.2)	108.2
Other long-term liabilities	98.7	49.3	—	20.4	—	168.4
Amounts due to affiliates	—	—	—	128.8	(128.8)	—
Total stockholders’ equity	1,665.7	1,256.4	346.7	332.9	(1,936.1)	1,665.6
Total liabilities and stockholders’ equity	$1,792.9	$2,298.7	$346.7	$582.4	$(2,121.1)	$2,899.6

CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME
(In millions)

	Three Months Ended May 31, 2018					
	Parent	Subsidiary Issuer	Subsidiary Guarantor	Non-Guarantors	Consolidating Adjustments	Consolidated
Net sales:						
External sales	$—	$ 843.7	$ —	$ 100.3	$ —	$ 944.0
Intercompany sales	—	—	13.7	44.6	(58.3)	—
Total sales	—	843.7	13.7	144.9	(58.3)	944.0
Cost of products sold	—	476.6	—	118.6	(40.6)	554.6
Gross profit	—	367.1	13.7	26.3	(17.7)	389.4
Selling, distribution, and administrative expenses	11.2	240.7	0.8	38.6	(17.7)	273.6
Intercompany charges	(0.8)	0.7	—	0.1	—	—
Special charge	—	9.9	—	—	—	9.9
Operating (loss) profit	(10.4)	115.8	12.9	(12.4)	—	105.9
Interest expense, net	2.9	4.2	—	1.3	—	8.4
Equity earnings in subsidiaries	(82.8)	4.7	—	—	78.1	—
Miscellaneous income, net	—	(0.7)	—	(1.0)	—	(1.7)
Income (loss) before income taxes	69.5	107.6	12.9	(12.7)	(78.1)	99.2
Income tax (benefit) expense	(3.5)	31.3	1.6	(3.2)	—	26.2
Net income (loss)	73.0	76.3	11.3	(9.5)	(78.1)	73.0
Other comprehensive income (loss) items:						
Foreign currency translation adjustments	(7.6)	(7.6)	—	—	7.6	(7.6)
Defined benefit pension plans, net	1.9	1.4	—	0.5	(1.9)	1.9
Other comprehensive income items, net of tax	(5.7)	(6.2)	—	0.5	5.7	(5.7)
Comprehensive income (loss)	$67.3	$ 70.1	$ 11.3	$ (9.0)	$ (72.4)	$ 67.3

CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME
(In millions)

	Three Months Ended May 31, 2017					
	Parent	Subsidiary Issuer	Subsidiary Guarantor	Non-Guarantors	Consolidating Adjustments	Consolidated
Net sales:						
External sales	$—	$ 795.0	$ —	$ 96.6	$ —	$ 891.6
Intercompany sales	—	—	12.8	39.7	(52.5)	—
Total sales	—	795.0	12.8	136.3	(52.5)	891.6
Cost of products sold	—	446.6	—	104.3	(38.2)	512.7
Gross profit	—	348.4	12.8	32.0	(14.3)	378.9
Selling, distribution, and administrative expenses	11.4	213.4	0.9	35.5	(14.3)	246.9
Intercompany charges	(1.3)	0.1	—	1.2	—	—
Special charge	—	0.5	—	—	—	0.5
Operating (loss) profit	(10.1)	134.4	11.9	(4.7)	—	131.5
Interest expense, net	2.7	4.1	—	1.3	—	8.1
Equity earnings in subsidiaries	(90.5)	2.7	—	—	87.8	—
Miscellaneous (income) expense, net	—	(2.0)	—	0.8	—	(1.2)
Income (loss) before income taxes	77.7	129.6	11.9	(6.8)	(87.8)	124.6
Income tax (benefit) expense	(4.5)	44.2	4.2	(1.5)	—	42.4
Net income (loss)	82.2	85.4	7.7	(5.3)	(87.8)	82.2
Other comprehensive income (loss) items:						
Foreign currency translation adjustments	2.4	2.4	—	—	(2.4)	2.4
Defined benefit pension plans, net	2.0	0.7	—	0.7	(1.4)	2.0
Other comprehensive income items, net of tax	4.4	3.1	—	0.7	(3.8)	4.4
Comprehensive income (loss)	$86.6	$ 88.5	$ 7.7	$ (4.6)	$ (91.6)	$ 86.6

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ACUITY BRANDS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME
(In millions)

	Nine Months Ended May 31, 2018					
	Parent	Subsidiary Issuer	Subsidiary Guarantor	Non-Guarantors	Consolidating Adjustments	Consolidated
Net sales:						
External sales	$—	$2,328.3	$ —	$ 290.6	$ —	$ 2,618.9
Intercompany sales	—	—	38.2	129.3	(167.5)	—
Total sales	—	2,328.3	38.2	419.9	(167.5)	2,618.9
Cost of products sold	—	1,347.0	—	318.8	(121.4)	1,544.4
Gross profit	—	981.3	38.2	101.1	(46.1)	1,074.5
Selling, distribution, and administrative expenses	35.0	647.1	2.4	112.9	(46.1)	751.3
Intercompany charges	(2.7)	(0.1)	—	2.8	—	—
Special charge	—	10.7	—	—	—	10.7
Operating (loss) profit	(32.3)	323.6	35.8	(14.6)	—	312.5
Interest expense, net	8.2	12.2	—	4.1	—	24.5
Equity earnings in subsidiaries	(269.9)	2.6	—	0.1	267.2	—
Miscellaneous expense (income), net	—	1.3	—	(2.1)	—	(0.8)
Income (loss) before income taxes	229.4	307.5	35.8	(16.7)	(267.2)	288.8
Income tax (benefit) expense	(12.0)	58.5	4.7	(3.8)	—	47.4
Net income (loss)	241.4	249.0	31.1	(12.9)	(267.2)	241.4
Other comprehensive income (loss) items:						
Foreign currency translation adjustments	(15.6)	(15.6)	—	—	15.6	(15.6)
Defined benefit pension plans, net	5.3	3.9	—	1.4	(5.3)	5.3
Other comprehensive (loss) income items, net of tax	(10.3)	(11.7)	—	1.4	10.3	(10.3)
Comprehensive income (loss)	$231.1	$237.3	$ 31.1	$ (11.5)	$ (256.9)	$ 231.1

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ACUITY BRANDS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

CONDENSED CONSOLIDATING STATEMENTS OF COMPREHENSIVE INCOME
(In millions)

	Nine Months Ended May 31, 2017					
	Parent	Subsidiary Issuer	Subsidiary Guarantor	Non-Guarantors	Consolidating Adjustments	Consolidated
Net sales:						
External sales	$—	$2,254.0	$ —	$ 293.5	$ —	$ 2,547.5
Intercompany sales	—	—	36.0	128.3	(164.3)	—
Total sales	—	2,254.0	36.0	421.8	(164.3)	2,547.5
Cost of products sold	—	1,280.3	—	316.9	(124.0)	1,473.2
Gross profit	—	973.7	36.0	104.9	(40.3)	1,074.3
Selling, distribution, and administrative expenses	35.8	609.6	2.7	98.6	(40.2)	706.5
Intercompany charges	(3.3)	0.5	—	2.8	—	—
Special charge	—	1.7	—	—	—	1.7
Operating (loss) profit	(32.5)	361.9	33.3	3.5	(0.1)	366.1
Interest expense, net	8.2	12.1	—	4.0	—	24.3
Equity earnings in subsidiaries	(257.6)	(6.3)	—	0.2	263.7	—
Miscellaneous income, net	—	(8.5)	—	—	—	(8.5)
Income before income taxes	216.9	364.6	33.3	(0.7)	(263.8)	350.3
Income tax (benefit) expense	(14.3)	122.9	11.8	(1.3)	—	119.1
Net income	231.2	241.7	21.5	0.6	(263.8)	231.2
Other comprehensive income (loss) items:						
Foreign currency translation adjustments	(6.2)	(6.2)	—	—	6.2	(6.2)
Defined benefit pension plans, net	6.1	2.1	—	2.1	(4.2)	6.1
Other comprehensive (loss) income items, net of tax	(0.1)	(4.1)	—	2.1	2.0	(0.1)
Comprehensive income	$231.1	$237.6	$ 21.5	$ 2.7	$ (261.8)	$ 231.1

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CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
(In millions)

	Nine Months Ended May 31, 2018					
	Parent	Subsidiary Issuer	Subsidiary Guarantor	Non-Guarantors	Consolidating Adjustments	Consolidated
Net cash provided by operating activities	$253.6	$ 19.1	$ —	$ 28.0	$ —	$ 300.7
Cash flows from investing activities:						
Purchases of property, plant, and equipment	—	(21.9)	—	(10.3)	—	(32.2)
Investments in subsidiaries	(163.5)	—	—	—	163.5	—
Acquisition of businesses, net of cash acquired	—	(136.6)	—	(26.9)	—	(163.5)
Net cash used for investing activities	(163.5)	(158.5)	—	(37.2)	163.5	(195.7)
Cash flows from financing activities:						
Borrowings on credit facility	—	237.3	—	—	—	237.3
Repayments of borrowings on credit facility	—	(236.1)	—	—	—	(236.1)
Repayments of long-term debt	—	—	—	(0.3)	—	(0.3)
Proceeds from stock option exercises and other	1.6	—	—	—	—	1.6
Repurchases of common stock	(298.4)	—	—	—	—	(298.4)
Employee taxes on net settlement of equity awards	(7.2)	—	—	—	—	(7.2)
Intercompany capital	—	136.6	—	26.9	(163.5)	—
Dividends paid	(16.2)	—	—	—	—	(16.2)
Net cash (used for) provided by financing activities	(320.2)	137.8	—	26.6	(163.5)	(319.3)
Effect of exchange rates changes on cash	—	1.6	—	(4.1)	—	(2.5)
Net change in cash and cash equivalents	(230.1)	—	—	13.3	—	(216.8)
Cash and cash equivalents at beginning of period	237.7	—	—	73.4	—	311.1
Cash and cash equivalents at end of period	$7.6	$ —	$ —	$ 86.7	$ —	$ 94.3

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ACUITY BRANDS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
(In millions)

	Nine Months Ended May 31, 2017					
	Parent	Subsidiary Issuer	Subsidiary Guarantor	Non-Guarantors	Consolidating Adjustments	Consolidated
Net cash provided by operating activities	$157.7	$ 31.7	$ —	$ 8.6	$ —	$ 198.0
Cash flows from investing activities:						
Purchases of property, plant, and equipment	—	(44.3)	—	(10.9)	—	(55.2)
Proceeds from sale of property, plant, and equipment	—	0.1	—	5.4	—	5.5
Proceeds from sale of investment	—	13.2	—	—	—	13.2
Other investing activities	—	(0.2)	—	—	—	(0.2)
Net cash used for investing activities	—	(31.2)	—	(5.5)	—	(36.7)
Cash flows from financing activities:						
Issuance of long-term debt	—	—	—	1.1	—	1.1
Proceeds from stock option exercises and other	2.7	—	—	—	—	2.7
Repurchases of common stock	(357.9)	—	—	—	—	(357.9)
Employee taxes on net settlement of equity awards	(13.2)	—	—	—	—	(13.2)
Dividends paid	(17.2)	—	—	—	—	(17.2)
Net cash (used for) provided by financing activities	(385.6)	—	—	1.1	—	(384.5)
Effect of exchange rate changes on cash	—	(0.5)	—	0.2	—	(0.3)
Net change in cash and cash equivalents	(227.9)	—	—	4.4	—	(223.5)
Cash and cash equivalents at beginning of period	368.2	—	—	45.0	—	413.2
Cash and cash equivalents at end of period	$140.3	$ —	$ —	$ 49.4	$ —	$ 189.7

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The purpose of this discussion and analysis is to enhance the understanding and evaluation of the results of operations, financial position, cash flows, indebtedness, and other key financial information of Acuity Brands, Inc. (“Acuity Brands”) and its subsidiaries as of May 31, 2018 and for the three and nine months ended May 31, 2018 and 2017. The following discussion should be read in conjunction with the Consolidated Financial Statements and Notes to Consolidated Financial Statements included within this report. Also, please refer to the Company’s Annual Report on Form 10-K for the fiscal year ended August 31, 2017, filed with the Securities and Exchange Commission (the “SEC”) on October 26, 2017 (“Form 10-K”).

Overview

Company

Acuity Brands is the parent company of Acuity Brands Lighting, Inc. (“ABL”) and other subsidiaries (Acuity Brands, ABL, and such other subsidiaries are collectively referred to herein as the “Company”). The Company has its principal office in Atlanta, Georgia.

The Company is one of the world’s leading providers of lighting and building management solutions and services for commercial, institutional, industrial, infrastructure, and residential applications throughout North America and select international markets. The Company’s lighting and building management solutions include devices such as luminaires, lighting controls, controllers for various building systems, power supplies, prismatic skylights, and drivers, as well as integrated systems designed to optimize energy efficiency and comfort for various indoor and outdoor applications. Additionally, the Company continues to expand its solutions portfolio to provide a host of other economic benefits, including software and services that enable the Internet of Things (“IoT”). The Company's IoT solutions provide customers with access to robust data analytics; support the advancement of smart buildings, smart cities, and the smart grid; and allow businesses to develop custom applications to scale their operations. As of May 31, 2018, the Company operates 20 manufacturing facilities and seven distribution facilities along with three warehouses to serve its extensive customer base.

The Company does not consider acquisitions a critical element of its strategy but seeks opportunities to expand and enhance its portfolio of solutions, including the following transactions:

On May 1, 2018, using cash on hand and borrowings available under existing credit arrangements, the Company acquired IOTA Engineering, LLC (“IOTA”). IOTA is headquartered in Tucson, Arizona and manufactures highly engineered emergency lighting products and power equipment for commercial and institutional applications both in the U.S. and internationally.

On February 12, 2018, using cash on hand, the Company acquired Lucid Design Group, Inc (“Lucid”). Lucid is headquartered in Oakland, California and provides a data and analytics platform to make data-driven decisions to improve building efficiency and drive energy conservation and savings.

No acquisitions were completed during fiscal 2017.

Liquidity and Capital Resources

The Company’s principal sources of liquidity are operating cash flows generated primarily from its business operations, cash on hand, and various sources of borrowings. The ability of the Company to generate sufficient cash flow from operations or to access certain capital markets, including banks, is necessary to fund its operations and capital expenditures, pay dividends, repurchase shares, meet its obligations as they become due, and maintain compliance with covenants contained in its financing agreements.

The Company currently expects to invest approximately 1.5% of net sales in capital expenditures during fiscal 2018. For the first nine months of fiscal 2018, $32.2 million had been invested, primarily for equipment, tooling, facility enhancements, and new and enhanced information technology capabilities.

In March 2018, the Board of Directors (the “Board”) authorized the repurchase of up to six million shares of the Company's common stock. As of May 31, 2018, 0.8 million shares had been purchased under this authorization. The Company expects to repurchase the remaining shares available for repurchase on an opportunistic basis. The Company has repurchased a total of 2.0 million shares in fiscal 2018.

The Company's short-term cash needs are expected to include funding operations as currently planned, making anticipated capital investments, paying quarterly stockholder dividends as currently anticipated, paying principal and

interest on borrowings as currently scheduled, making required contributions to its employee benefit plans, funding possible acquisitions, and potentially repurchasing up to 5.2 million shares of its outstanding common stock as authorized by the Board. Management believes that the Company will be able to meet its liquidity needs over the next 12 months based on its cash on hand, current projections of cash flow from operations, and borrowing availability under recently executed financing arrangements. Additionally, management believes that the Company's cash flows from operations and sources of funding, including, but not limited to, future borrowings and capacity, will sufficiently support the long-term liquidity needs of the Company.

During June 2018, the Company entered into a new revolving credit facility and term loan facility. Refer to the Subsequent Events footnote in the Notes to Consolidated Financial Statements for further information.

Cash Flow

The Company uses available cash and cash flow from operations, borrowings on credit arrangements, and proceeds from the exercise of stock options to fund operations, capital expenditures, and acquisitions, to repurchase Company stock, and to pay dividends.

The Company's cash position at May 31, 2018 was $94.3 million, a decrease of $216.8 million from August 31, 2017. During the nine months ended May 31, 2018, the Company generated net cash flows from operations of $300.7 million. Cash generated from operating activities, as well as cash on-hand, was used during the nine months ended May 31, 2018 primarily to repurchase two million shares of the Company's outstanding common stock for $298.4 million, to fund acquisitions of $163.5 million, to fund capital expenditures of $32.2 million, to pay dividends to stockholders of $16.2 million, and to pay employee taxes on the net settlement of equity awards of $7.2 million.

The Company generated $300.7 million of cash flow from operating activities during the nine months ended May 31, 2018 compared with $198.0 million in the prior-year period, an increase of $102.7 million, due primarily to lower operating working capital requirements, reduced variable incentive payments for prior year performance, and decreased payments for income taxes. Operating working capital (calculated by adding accounts receivable plus inventories, and subtracting accounts payable-net of acquisitions and the impact of foreign exchange rate changes) decreased approximately $3.0 million during the first nine months of fiscal 2018 compared to a $34.4 million increase during the first nine months of fiscal 2017. The increase in inventory during the nine months ended May 31, 2018 was due primarily to customer expansion in the home center/showroom channel, new product launches, and a buildup of finished goods to support committed projects in the corporate accounts channel. This increase in inventory was mostly offset by a corresponding increase in accounts payable during the same period.

Management believes that investing in assets and programs that will over time increase the overall return on its invested capital is a key factor in driving stockholder value. The Company invested $32.2 million and $55.2 million in the first nine months of fiscal 2018 and 2017, respectively, primarily related to investments in new equipment, tooling, facility enhancements, and information technology. The Company expects to invest approximately 1.5% of net sales primarily for new equipment, tooling, facility enhancements, and information technology capabilities during fiscal 2018.

Capitalization

The current capital structure of the Company is comprised principally of senior unsecured notes and equity of its stockholders. Total debt outstanding was $358.0 million and $356.9 million at May 31, 2018 and August 31, 2017, respectively, and consisted primarily of fixed-rate obligations.

On December 8, 2009, ABL issued $350.0 million of senior unsecured notes due in fiscal 2020 (the "Unsecured Notes") in a private placement transaction. The Unsecured Notes were subsequently exchanged for SEC-registered notes with substantially identical terms. The Unsecured Notes bear interest at a rate of 6% per annum and were issued at a price equal to 99.797% of their face value and for a term of 10 years. See the Debt footnote of the Notes to Consolidated Financial Statements for more information.

On June 29, 2018, the Company entered into a credit agreement ("Credit Agreement") with a syndicate of banks that provides the Company with a $400.0 million five-year unsecured revolving credit facility ("New Revolving Credit Facility") and a $400.0 million unsecured delayed draw term loan facility ("Term Loan Facility"). On June 29, 2018, the Company had $90.4 million borrowings outstanding under the New Revolving Credit Facility and no borrowings under the Term Loan Facility. The Company was in compliance with all financial covenants under the Credit

Agreement as of June 29, 2018. At June 29, 2018, the Company had additional borrowing capacity under the Credit Agreement of $704.3 million under the most restrictive covenant in effect at the time, which represents the full amount of the New Revolving Credit Facility and the Term Loan Facility less the outstanding letters of credit of $5.3 million issued and $90.4 million in borrowings on the New Revolving Credit Facility. As of June 29, 2018, the Company had outstanding

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letters of credit totaling $10.2 million, primarily for securing collateral requirements under the Company's casualty insurance programs and for providing credit support for the Company's industrial revenue bond, including $5.3 million issued under the New Revolving Credit Facility. See the Debt and Subsequent Events footnotes of the Notes to Consolidated Financial Statements for more information.

During the first nine months of fiscal 2018, the Company's consolidated stockholders' equity decreased $65.2 million to $1.60 billion at May 31, 2018, from $1.67 billion at August 31, 2017. The decrease was due primarily to share repurchases, the payment of dividends, shares withheld for employee taxes on vested restricted stock grants, and foreign currency translation adjustments, partially offset by net income earned in the period, stock issuances resulting primarily from the exercise of stock options, and amortization of pension plan prior service costs and actuarial losses. The Company's debt to total capitalization ratio (calculated by dividing total debt by the sum of total debt and total stockholders' equity) was 18.3% and 17.6% at May 31, 2018 and August 31, 2017, respectively. The ratio of debt, net of cash, to total capitalization, net of cash, was 14.1% at May 31, 2018 and 2.7% at August 31, 2017.

Dividends

Acuity Brands paid dividends on its common stock of $16.2 million and $17.2 million ($0.39 per share) during the nine months ended May 31, 2018 and 2017, respectively. All decisions regarding the declaration and payment of dividends by Acuity Brands are at the discretion of the Board and are evaluated regularly in light of the Company's financial condition, earnings, growth prospects, funding requirements, applicable law, and any other factors the Board deems relevant.

Results of Operations

Third Quarter of Fiscal 2018 Compared with Third Quarter of Fiscal 2017

The following table sets forth information comparing the components of net income for the three months ended May 31, 2018 and 2017 (in millions except per share data):

	Three Months Ended			
	May 31, 2018	May 31, 2017	Increase (Decrease)	Percent Change
Net sales	$944.0	$891.6	$ 52.4	5.9 %
Cost of products sold	554.6	512.7	41.9	8.2 %
Gross profit	389.4	378.9	10.5	2.8 %
Percent of net sales	41.3 %	42.5 %	(120) bps	
Selling, distribution, and administrative expenses	273.6	246.9	26.7	10.8 %
Special charge	9.9	0.5	9.4	NM
Operating profit	105.9	131.5	(25.6)	(19.5)%
Percent of net sales	11.2 %	14.7 %	(350) bps	
Other expense (income):				
Interest expense, net	8.4	8.1	0.3	3.7 %
Miscellaneous income, net	(1.7)	(1.2)	(0.5)	NM
Total other expense	6.7	6.9	(0.2)	NM
Income before income taxes	99.2	124.6	(25.4)	(20.4)%
Percent of net sales	10.5 %	14.0 %	(350) bps	
Income tax expense	26.2	42.4	(16.2)	(38.2)%
Effective tax rate	26.4 %	34.0 %		
Net income	$73.0	$82.2	$ (9.2)	(11.2)%
Diluted earnings per share	$1.80	$1.90	$ (0.10)	(5.3)%

NM - not meaningful

Net sales were $944.0 million for the three months ended May 31, 2018 compared with $891.6 million reported for the three months ended May 31, 2017, an increase of $52.4 million, or 5.9%. For the three months ended May 31, 2018, the Company reported net income of $73.0 million, a decrease of $9.2 million, or 11.2%, compared with $82.2

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million for the three months ended May 31, 2017. For the third quarter of fiscal 2018, diluted earnings per share decreased 5.3% to $1.80 compared with $1.90 reported in the year-ago period.

The following table reconciles certain U.S. generally accepted accounting principles (“U.S. GAAP”) financial measures to the corresponding non-U.S. GAAP measures referred to in the discussion of the Company’s results of operations, which exclude the impact of acquisition related items, excess inventory adjustments, amortization of acquired intangible assets, share-based payment expense, and special charges associated primarily with continued efforts to streamline the organization. Although the impacts of some of these items have been recognized in prior periods and could recur in future periods, management typically excludes these charges during internal reviews of performance and uses these non-U.S. GAAP measures for baseline comparative operational analysis, decision making, and other activities. These non-U.S. GAAP financial measures, including adjusted gross profit and margin, adjusted selling, distribution, and administrative (“SD&A”) expenses, adjusted operating profit and margin, adjusted net income, and adjusted diluted earnings per share, are provided to enhance the user’s overall understanding of the Company’s current financial performance. Specifically, the Company believes these non-U.S. GAAP measures provide greater comparability and enhanced visibility into the Company's results of operations. The non-U.S. GAAP financial measures should be considered in addition to, and not as a substitute for or superior to, results prepared in accordance with U.S. GAAP.

(In millions, except per share data)	Three Months Ended			
	May 31, 2018	May 31, 2017	Increase (Decrease)	Percent Change
Gross profit	$389.4	$378.9		
Add-back: Acquisition-related items (1)	0.5	—		
Add-back: Excess inventory (2)	3.1	—		
Adjusted gross profit	$393.0	$378.9	$ 14.1	3.7 %
Percent of net sales	41.6 %	42.5 %	(90)	bps
Selling, distribution, and administrative expenses	$273.6	$246.9		
Less: Amortization of acquired intangible assets	(7.2)	(8.2)		
Less: Share-based payment expense	(7.6)	(8.1)		
Less: Acquisition-related items (1)	(1.6)	—		
Adjusted selling, distribution, and administrative expenses	$257.2	$230.6	$ 26.6	11.5 %
Percent of net sales	27.2 %	25.9 %	130	bps
Operating profit	$105.9	$131.5		
Add-back: Amortization of acquired intangible assets	7.2	8.2		
Add-back: Share-based payment expense	7.6	8.1		
Add-back: Acquisition-related items (1)	2.1	—		
Add-back: Excess inventory (2)	3.1	—		
Add-back: Special charge	9.9	0.5		
Adjusted operating profit	$135.8	$148.3	$ (12.5)	(8.4)%
Percent of net sales	14.4 %	16.6 %	(220)	bps
Net income	$73.0	$82.2		
Add-back: Amortization of acquired intangible assets	7.2	8.2		
Add-back: Share-based payment expense	7.6	8.1		
Add-back: Acquisition-related items (1)	2.1	—		
Add-back: Excess inventory (2)	3.1	—		
Add-back: Special charge	9.9	0.5		
Total pre-tax adjustments to net income	29.9	16.8		
Income tax effects	(7.0)	(5.9)		
Adjusted net income	$95.9	$93.1	$ 2.8	3.0 %
Diluted earnings per share	$1.80	$1.90		
Adjusted diluted earnings per share	$2.37	$2.15	$ 0.22	10.2 %

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(1) Acquisition-related items include profit in inventory and professional fees.
(2) Excess inventory related to the closure of a facility.

Net Sales

Net sales for the three months ended May 31, 2018 increased 5.9% compared with the prior-year period due primarily to an increase of approximately 10% in sales volume and a combined 1% favorable impact of acquired revenues from acquisitions and foreign exchange rate changes, partially offset by the unfavorable impact of changes in product prices and the mix of products sold ("price/mix") of approximately 5%. The increase in net sales was due primarily to greater shipments of Atrius-based luminaires to customers in certain key vertical applications and increased sales in the infrastructure/utility channel, partially offset by lower shipments for larger commercial projects due to continued tepid conditions within the North American non-residential lighting market. Unfavorable price/mix reflected changes in both product mix, which included substitutions to certain products with lower price points, and sales channel mix, which included declines in generally higher priced solutions, primarily for larger commercial projects. Price/mix was also impacted by lower pricing on certain luminaires, reflecting increased competition in more basic, lesser-featured

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products. Sales of LED-based products accounted for over two-thirds of total net sales during the third quarter of fiscal 2018 and approximately two-thirds of total net sales during the third quarter of fiscal 2017. Due to the changing dynamics of the Company's product portfolio, including the increase of integrated lighting and building management solutions, it is not possible to precisely quantify or differentiate the individual components of volume, price, and mix.

Gross Profit

Gross profit for the third quarter of fiscal 2018 increased $10.5 million, or 2.8%, to $389.4 million compared with $378.9 million in the prior-year period. Gross profit margin decreased 120 basis points to 41.3% for the three months ended May 31, 2018 compared with 42.5% in the prior-year period. Gross profit margin was lower than the prior-year period due primarily to unfavorable price/mix, increased wages, and additional reserves for excess inventory related to the closure of a facility, partially offset by higher sales volumes, productivity improvements, and lower quality costs. Adjusted gross profit margin for the three months ended May 31, 2018 declined 90 basis points to 41.6% compared with 42.5% in the prior year period.

Operating Profit

SD&A expenses for the three months ended May 31, 2018 were $273.6 million compared with $246.9 million in the prior-year period, an increase of $26.7 million, or 10.8%. The increase in SD&A expenses was due primarily to higher employee related costs, including additional headcount from acquisitions, increased freight charges and commissions to support greater sales volume, and higher professional fees related to recent acquisitions. SD&A expenses for the third quarter of fiscal 2018 were 29.0% of net sales compared with 27.7% for the prior-year period. Adjusted SD&A expenses for the three months ended May 31, 2018 were $257.2 million (27.2% of net sales) compared with $230.6 million (25.9% of net sales) in the prior-year period.

The Company recognized pre-tax special charges of $9.9 million during the third quarter of fiscal 2018 compared with pre-tax special charges of $0.5 million recorded during the third quarter of fiscal 2017. Further details regarding the Company's special charges are included in the Special Charge footnote of the Notes to Consolidated Financial Statements.

Operating profit for the third quarter of fiscal 2018 was $105.9 million (11.2% of net sales) compared with $131.5 million (14.7% of net sales) for the prior-year period, a decrease of $25.6 million, or 19.5%. The decrease in operating profit was primarily due to the impact of price/mix on gross profit, higher SD&A expenses, and increased special charges, partially offset by higher sales volumes.

Adjusted operating profit decreased by $12.5 million, or 8.4%, to $135.8 million for the third quarter of fiscal 2018 compared with $148.3 million for the third quarter of fiscal 2017. Adjusted operating profit margin decreased 220 basis points to 14.4% for the third quarter of fiscal 2018 compared with 16.6% for the year-ago period.

Other Expense (Income)

Other expense (income) consists principally of net interest expense and net miscellaneous income, which includes gains and losses associated with foreign currency-related transactions and non-operating gains and losses. Interest expense, net, was $8.4 million and $8.1 million for the three months ended May 31, 2018 and 2017, respectively. The Company reported net miscellaneous income of $1.7 million and $1.2 million for the three months ended May 31, 2018 and 2017, respectively.

Income Taxes and Net Income

The Company’s effective income tax rate was 26.4% and 34.0% for the three months ended May 31, 2018 and 2017, respectively. The effective income rate for the three months ended May 31, 2018 was significantly impacted by the provisions of the TCJA, which was enacted during the second quarter of fiscal 2018. Further details regarding the TCJA are included in the Income Taxes footnote of the Notes to Consolidated Financial Statements. The Company currently estimates that the Company’s blended consolidated effective income tax rate, before any discrete items, will approximate 26% to 28% for the remainder of fiscal 2018 and 23% to 25% for fiscal 2019.

Net income for the third quarter of fiscal 2018 decreased $9.2 million to $73.0 million from $82.2 million reported for the prior-year period. The decrease in net income resulted primarily from increased SD&A expenses and special charges incurred during the quarter, partially offset by a smaller provision for income taxes. Diluted earnings per share for the three months ended May 31, 2018 decreased $0.10 to $1.80 compared with diluted earnings per share of $1.90 for the prior-year period.

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Adjusted net income for the third quarter of fiscal 2018 was $95.9 million compared with $93.1 million in the prior-year period, which represented an increase of $2.8 million, or 3.0%. Adjusted diluted earnings per share for the three months ended May 31, 2018 increased $0.22, or 10.2%, to $2.37 compared with $2.15 for the prior-year period.

First Nine Months of Fiscal 2018 Compared with First Nine Months of Fiscal 2017

The following table sets forth information comparing the components of net income for the nine months ended May 31, 2018 and 2017 (in millions except per share data):

	Nine Months Ended			
	May 31, 2018	May 31, 2017	Increase (Decrease)	Percent Change
Net sales	$2,618.9	$2,547.5	$ 71.4	2.8 %
Cost of products sold	1,544.4	1,473.2	71.2	4.8 %
Gross profit	1,074.5	1,074.3	0.2	— %
Percent of net sales	41.0 %	42.2 %	(120) bps	
Selling, distribution, and administrative expenses	751.3	706.5	44.8	6.3 %
Special charge	10.7	1.7	9.0	NM
Operating profit	312.5	366.1	(53.6)	(14.6)%
Percent of net sales	11.9 %	14.4 %	(250) bps	
Other expense (income)				
Interest expense, net	24.5	24.3	0.2	0.8 %
Miscellaneous income, net	(0.8)	(8.5)	7.7	NM
Total other expense	23.7	15.8	7.9	NM
Income before income taxes	288.8	350.3	(61.5)	(17.6)%
Percent of net sales	11.0 %	13.8 %	(280) bps	
Income tax expense	47.4	119.1	(71.7)	NM
Effective tax rate	16.4 %	34.0 %		
Net income	$241.4	$231.2	$ 10.2	4.4 %
Diluted earnings per share	$5.85	$5.29	$ 0.56	10.6 %

NM - not meaningful

Net sales were $2.62 billion for the nine months ended May 31, 2018 compared with $2.55 billion reported for the nine months ended May 31, 2017, an increase of $71.4 million, or 2.8%. For the nine months ended May 31, 2018, the Company reported net income of $241.4 million, an increase of $10.2 million, or 4.4%, compared with $231.2 million for the nine months ended May 31, 2017. For the first nine months of fiscal 2018, diluted earnings per share increased 10.6% to $5.85 compared with $5.29 reported in the year-ago period.

The following table reconciles certain U.S. GAAP financial measures to the corresponding non-U.S. GAAP measures referred to in the discussion of the Company’s results of operations, which exclude the impact of acquisition-related items, excess inventory adjustments, certain manufacturing inefficiencies, amortization of acquired intangible assets, share-based payment expense, special charges associated primarily with continued efforts to streamline the organization, certain discrete income tax benefits of the TCJA, and the sale of an investment in an unconsolidated affiliate. These non-U.S. GAAP financial measures, including adjusted gross profit and margin, adjusted SD&A expenses, adjusted operating profit and margin, adjusted other expense, adjusted net income, and adjusted diluted earnings per share, are provided to enhance the user’s overall understanding of the Company’s current financial performance. Specifically, the Company believes these non-U.S. GAAP measures provide greater comparability and enhanced visibility into the results of operations. The non-U.S. GAAP financial measures should be considered in addition to, and not as a substitute for or superior to, results prepared in accordance with U.S. GAAP.

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(In millions, except per share data)	Nine Months Ended May 31, 2018	May 31, 2017	Increase (Decrease)	Percent Change
Gross profit	$1,074.5	$1,074.3		
Add-back: Acquisition-related items (1)	0.5	—		
Add-back: Manufacturing inefficiencies (2)	—	1.6		
Add-back: Excess inventory (3)	3.1	—		
Adjusted gross profit	$1,078.1	$1,075.9	$ 2.2	0.2 %
Percent of net sales	41.2 %	42.2 %	(100)	bps
Selling, distribution, and administrative expenses	$751.3	$706.5		
Less: Amortization of acquired intangible assets	(20.5)	(21.9)		
Less: Share-based payment expense	(24.4)	(24.1)		
Less: Acquisition-related items (1)	(1.8)	—		
Adjusted selling, distribution, and administrative expenses	$704.6	$660.5	$ 44.1	6.7 %
Percent of net sales	26.9 %	25.9 %	100	bps
Operating profit	$312.5	$366.1		
Add-back: Amortization of acquired intangible assets	20.5	21.9		
Add-back: Share-based payment expense	24.4	24.1		
Add-back: Acquisition-related items (1)	2.3	—		
Add-back: Manufacturing inefficiencies (2)	—	1.6		
Add-back: Excess inventory (3)	3.1	—		
Add-back: Special charge	10.7	1.7		
Adjusted operating profit	$373.5	$415.4	$ (41.9)	(10.1)%
Percent of net sales	14.3 %	16.3 %	(200)	bps
Other expense	$23.7	$15.8		
Add-back: Gain on sale of investment in unconsolidated affiliate	—	7.2		
Adjusted other expense	$23.7	$23.0	$ 0.7	3.0 %
Net income	$241.4	$231.2		
Add-back: Amortization of acquired intangible assets	20.5	21.9		
Add-back: Share-based payment expense	24.4	24.1		
Add-back: Acquisition-related items (1)	2.3	—		
Add-back: Manufacturing inefficiencies (2)	—	1.6		
Add-back: Excess inventory (3)	3.1	—		
Add-back: Special charge	10.7	1.7		
Less: Gain on sale of investment in unconsolidated affiliate	—	(7.2)		
Total pre-tax adjustments to net income	61.0	42.1		
Income tax effect	(15.7)	(14.7)		
Less: Discrete income tax benefits of the TCJA (4)	(31.2)	—		
Adjusted net income	$255.5	$258.6	$ (3.1)	(1.2)%
Diluted earnings per share	$5.85	$5.29		
Adjusted diluted earnings per share	$6.19	$5.92	$ 0.27	4.6 %

(1) Acquisition-related items include profit in inventory and professional fees.
(2) Incremental costs incurred due to manufacturing inefficiencies directly related to the closure of a facility.

(3) Excess inventory related to the closure of a facility.
(4) Discrete income tax benefits of the TCJA include provisional estimates recognized within Income tax expense on the Consolidated Statements of Comprehensive Income. See Income Taxes footnote within the Notes to Consolidated Financial Statements for additional details.

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Net Sales

Net sales for the nine months ended May 31, 2018 increased $71.4 million, or 2.8%, compared with the prior-year period due primarily to an increase in sales volume of approximately 5% and the favorable impact from foreign exchange rate changes of approximately 1%, partially offset by the unfavorable impact of changes in price/mix of approximately 3%. The increase in net sales was due primarily to greater shipments of Atrius-based luminaires to customers in certain key vertical applications and increased sales in the infrastructure/utility channel, partially offset by lower shipments through the home center/showroom sales channel and certain international channels as well as for larger commercial projects due to continued tepid conditions within the North American non-residential lighting market. Unfavorable price/mix reflected changes in both product mix, which included substitutions to certain products with lower price points, and sales channel mix, which included declines in generally higher priced solutions, primarily for commercial projects. Price/mix was also impacted by lower pricing on certain luminaires, reflecting increased competition in more basic, lesser-featured products. Sales of LED-based luminaires during the first nine months of both fiscal 2018 and fiscal 2017 accounted for approximately two-thirds of total net sales. Due to the changing dynamics of the Company's product portfolio, including the increase of integrated lighting and building management solutions, it is not possible to precisely quantify or differentiate the individual components of volume, price, and mix.

Gross Profit

Gross profit for the first nine months of fiscal 2018 increased $0.2 million compared to the prior-year period. Gross profit margin decreased to 41.0% for the nine months ended May 31, 2018 compared with 42.2% in the prior-year period. Gross profit margin was lower than the prior-year period primarily due to unfavorable price/mix, increased wages, and additional reserves for excess inventory related to the closure of a facility. These declines were partially offset by higher sales volumes, productivity improvements, and lower quality costs. Adjusted gross profit for the nine months ended May 31, 2018 was $1.078 billion (41.2% of net sales) compared with $1.076 billion (42.2% of net sales) in the prior-year period.

Operating Profit

SD&A expenses for the nine months ended May 31, 2018 were $751.3 million compared with $706.5 million in the prior-year period, an increase of $44.8 million, or 6.3%. The increase in SD&A expenses was primarily due to higher employee related costs, including additional headcount from acquisitions, increased freight charges and commissions to support greater sales volume, higher professional fees related to recent acquisitions, and to a lesser degree, certain other operating expenses. SD&A expenses for the first nine months of fiscal 2018 were 28.7% of net sales compared with 27.7% for the prior-year period. Adjusted SD&A expenses for the nine months ended May 31, 2018 were $704.6 million (26.9% of net sales) compared with $660.5 million (25.9% of net sales) in the prior-year period.

The Company recognized a pre-tax special charge of $10.7 million during the first nine months of fiscal 2018, compared with a pre-tax special charge of $1.7 million during the first nine months of fiscal 2017. Further details regarding the Company's special charges are included in the Special Charge footnote of the Notes to Consolidated Financial Statements.

Operating profit for the first nine months of fiscal 2018 was $312.5 million compared with $366.1 million for the prior-year period, a decrease of $53.6 million, or 14.6%. The decrease in operating profit was due primarily to an increase in SD&A expenses and a higher special charge.

Adjusted operating profit decreased by $41.9 million, or 10.1%, to $373.5 million for the first nine months of fiscal 2018 compared with $415.4 million for the first nine months of fiscal 2017. Adjusted operating profit margin for the first nine months of fiscal 2018 decreased 200 basis points to 14.3% compared with 16.3% in the year-ago period.

Other Expense (Income)

Other expense (income) consists principally of net interest expense and net miscellaneous income, which includes gains and losses associated with foreign currency-related transactions. Interest expense, net, was $24.5 million for the nine months ended May 31, 2018 compared with $24.3 million for the nine months ended May 31, 2017. The Company reported net miscellaneous income of $0.8 million in the first nine months of fiscal 2018 compared with net miscellaneous income of $8.5 million in the prior-year period. Net miscellaneous income for the nine months ended May 31, 2017 included a $7.2 million gain associated with the sale of an investment in an unconsolidated affiliate.

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Income Taxes and Net Income

The Company’s effective income tax rate was 16.4% and 34.0% for the nine months ended May 31, 2018 and 2017, respectively. The effective income rate for the nine months ended May 31, 2018 was significantly impacted by the TCJA, which was enacted during the second quarter of fiscal 2018. Further details regarding the TCJA are included in the Income Taxes footnote of the Notes to Consolidated Financial Statements.

Net income for the first nine months of fiscal 2018 increased $10.2 million to $241.4 million from $231.2 million reported for the prior-year period. The increase in net income resulted primarily from the benefit from income taxes recognized related to the TCJA, partially offset by a decrease in operating profit and lower miscellaneous income. Diluted earnings per share for the nine months ended May 31, 2018 increased $0.56 to $5.85 compared with diluted earnings per share of $5.29 for the prior-year period.

Adjusted net income for the first nine months of fiscal 2018 was $255.5 million compared with $258.6 million in the prior-year period, which represented a decrease of $3.1 million, or 1.2%. Adjusted diluted earnings per share for the nine months ended May 31, 2018 increased $0.27, or 4.6%, to $6.19 compared with $5.92 for the prior-year period.

Outlook

Management continues to believe the execution of the Company's strategy will provide attractive opportunities for profitable growth over the long-term. The Company's strategy is to capitalize on market growth and share gain opportunities by continuing to expand and leverage its industry-leading lighting and building management solutions portfolio, coupled with its extensive market presence and financial strength, to produce attractive financial performance over the long-term. These opportunities include serving its traditional new construction and renovation markets as well as leveraging its unique, technology driven solutions portfolio to capture market share in the nascent, but rapidly growing, market for data capture, analytics, and other services, transforming buildings and campuses from cost centers to strategic assets.

Third-party forecasts and leading indicators suggest that demand in the North American lighting market, the Company’s primary market, will improve modestly in second half of calendar 2018 following several quarters of weak demand. Recent softness in the lighting industry has created a challenging environment for management to deliver financial performance in the short term while, at the same time, continuing to invest in attractive longer-term opportunities. Management expects to continue to outperform the growth rates of the markets that the Company serves by executing its strategies focused on growth opportunities for new construction and renovation projects, expansion into underpenetrated geographies and channels, and growth from the continued introduction of new lighting and building management solutions as part of the Company’s integrated, tiered solutions strategy.

Management expects the pricing environment to continue to be challenging in portions of the market, particularly for more basic, lesser-featured products sold through certain sales channels as well as shifts in product mix, both of which are expected to continue to negatively impact net sales and margins. Management expects to continue to introduce products and solutions to more effectively compete in these portions of the market and to accelerate programs to reduce product costs in order to maintain the Company’s competitiveness and drive improved profitability.

During the third quarter of fiscal 2018, the Company recognized a pre-tax special charge of $9.9 million, primarily related to the planned consolidation of certain facilities and associated reduction in employee workforce. The special charge consisted primarily of severance and employee-related benefit costs. The Company also recorded a $3.1 million charge during the third quarter of fiscal 2018 to reserve for raw material inventory located at one of the facilities where production activities will cease because it would not be cost effective to relocate that inventory. Management expects to incur additional costs in future periods associated with the closing of facilities, primarily attributable to early lease termination costs and relocation costs. Annual savings realized from the streamlining activities, once fully completed, are expected to exceed the amount of the special charge and will be reinvested in activities to support higher-growth opportunities as well as drive improved profitability.

On June 29, 2018, the Company entered into a new credit agreement with a syndicate of banks that increased the Company’s borrowing capacity under such agreement from $250 million to $800 million. The increase in borrowing capacity provides the Company with the resources to accommodate the current stock repurchase program of which 5.2 million shares remain available for repurchase. The extent and timing of actual stock repurchases will be subject to various factors, including stock price, company performance, expected future market conditions, and other possible uses of cash, including acquisitions. The Company may increase its leverage to accommodate the stock repurchase program.

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Management expects the TCJA that was passed on December 22, 2017, to favorably impact the Company’s net income, diluted earnings per share, and cash flows in future periods, due primarily to the reduction in the federal corporate tax rate from 35% to 21% effective for periods beginning January 1, 2018. Additionally, positive business sentiment and other favorable aspects of the new tax law could incentivize additional investments in facilities and infrastructure in the U.S. that may increase future demand in the end-markets that the Company serves. Management currently estimates that the Company’s blended consolidated effective income tax rate (“tax rate”) for full-year fiscal 2018 will approximate 26% to 28% before discrete items, compared with nearly 35% for the prior year. Management currently estimates that the fiscal 2019 tax rate will approximate 23% to 25% before discrete items. The aforementioned tax related estimates may differ from actual results, possibly materially, due to changes in interpretations of the TCJA and assumptions made by the Company, as well as guidance that may be issued and actions the Company may take as a result of the TCJA.

Notwithstanding the TCJA, a great amount of rhetoric and debate remains regarding a wide range of policy options with respect to monetary, regulatory, and trade, amongst others, that the U.S. federal government has and may pursue, including the recent imposition of tariffs on certain imports and continuing discussions on amending or terminating North American Free Trade Agreement (“NAFTA”). Certain of the components used in the Company’s products are impacted by the recently imposed tariffs on China imports but the Company does not currently believe it will have a material adverse financial effect. Any future policy changes that may be implemented could have a positive or negative consequence on the Company’s financial performance depending on how the changes would influence many factors, including business and consumer sentiment. While management is proactively identifying and evaluating potential contingency options under various policy scenarios, it is too early to comment or speculate at this time on the potential ramification of these endless scenarios.

From a longer term perspective, management expects that the Company’s addressable markets have the potential to experience solid growth over the next decade, particularly as energy and environmental concerns come to the forefront along with emerging opportunities for digital lighting to play a key role in the IoT through the use of intelligent networked lighting and building automation systems that can collect and exchange data to increase efficiency as well as provide a host of other economic benefits resulting from data analytics. Management remains positive about the future prospects of the Company and its ability to outperform the markets it serves.

Critical Accounting Estimates

Management’s Discussion and Analysis of Financial Condition and Results of Operations addresses the financial condition and results of operations as reflected in the Company’s Consolidated Financial Statements, which have been prepared in accordance with U.S. GAAP. As discussed in the Description of Business and Basis of Presentation footnote of the Notes to Consolidated Financial Statements, the preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expense during the reporting period. On an ongoing basis, management evaluates its estimates and judgments, including those related to revenue recognition; inventory valuation; amortization and the recoverability of long-lived assets, including goodwill and intangible assets; share-based payment expense; medical, product warranty and recall, and other reserves; retirement benefits; and litigation. Management bases its estimates and judgments on its substantial historical experience and other relevant factors, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates. Management discusses the development of accounting estimates with the Company’s Audit Committee of the Board.

There have been no material changes in the Company’s critical accounting estimates during the current period. For a detailed discussion of significant accounting policies that may involve a higher degree of judgment, please refer to the Company’s Form 10-K.

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Cautionary Statement Regarding Forward-Looking Information

This filing contains forward-looking statements within the meaning of the federal securities laws. Statements made herein that may be considered forward-looking include statements incorporating terms such as “expects,” “believes,” “intends,” “anticipates,” and similar terms that relate to future events, performance, or results of the Company. In addition, the Company, or the executive officers on the Company’s behalf, may from time to time make forward-looking statements in reports and other documents the Company files with the SEC or in connection with oral statements made to the press, current and potential investors, or others. Forward-looking statements include, without limitation: (a) the Company’s projections regarding financial performance, liquidity, capital structure, capital expenditures, investments, share repurchases, and dividends; (b) expectations about the impact of any changes in demand as well as volatility and uncertainty in general economic conditions and the pricing environment; (c) external forecasts projecting the North American lighting and building management solutions market growth rate and growth in the Company's addressable markets; (d) the Company's ability to execute and realize benefits from initiatives related to streamlining its operations, capitalize on growth opportunities, expand in key markets as well as underpenetrated geographies and channels, and introduce new lighting and building management solutions; (e) the Company’s estimate of its fiscal 2018 and 2019 tax rates, as well as the impact of the TCJA on the Company's financial position, results of operations, and cash flows; (f) the Company’s estimate of future amortization expense; (g) the Company’s ability to achieve its long-term financial goals and measures and outperform the markets its serves; (h) the impact to the Company of changes in the political landscape and related policy changes, including monetary, regulatory, and trade policies; and (i) the Company's expectations about the resolution of trade compliance, securities class action, and/or other legal matters. You are cautioned not to place undue reliance on any forward-looking statements, which speak only as of the date of this quarterly report. Except as required by law, the Company undertakes no obligation to publicly update or release any revisions to these forward-looking statements to reflect any events or circumstances after the date of this quarterly report or to reflect the occurrence of unanticipated events. The Company’s forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from the historical experience of the Company and management’s present expectations or projections. These risks and uncertainties include, but are not limited to, customer and supplier relationships and prices; competition; ability to realize anticipated benefits from initiatives taken and timing of benefits; market demand; litigation and other contingent liabilities; and economic, political, governmental, and technological factors affecting the Company. Also, additional risks that could cause the Company’s actual results to differ materially from those expressed in the Company’s forward-looking statements are discussed in Part I, Item 1a. Risk Factors of the Company's Form 10-K, and are specifically incorporated herein by reference.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

General. The Company is exposed to market risks that may impact its Consolidated Balance Sheets, Consolidated Statements of Comprehensive Income, and Consolidated Statements of Cash Flows due primarily to fluctuations in interest rates, foreign exchange rates, and commodity prices. There have been no material changes to the Company’s exposure from market risks from those disclosed in Part II, Item 7a. Quantitative and Qualitative Disclosures About Market Risk of the Company’s Form 10-K.

Item 4. Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to reasonably ensure that information required to be disclosed in the reports filed or submitted by the Company under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission (the “SEC”) rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to reasonably ensure that information required to be disclosed by the Company in the reports filed under the Exchange Act is accumulated and communicated to management, including the principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

As required by SEC rules, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures as of May 31, 2018. This evaluation was carried out under the supervision and with the participation of management, including the principal executive officer and principal financial officer. Based on this evaluation, these officers have concluded that the design and operation of the Company’s disclosure controls and procedures are effective at a reasonable assurance level as of May 31, 2018. However, because all disclosure procedures must rely to a significant degree on actions or decisions made by employees throughout the organization, such as reporting of material events, the Company and its reporting officers believe that they cannot provide absolute assurance that all control issues and instances of fraud or errors and omissions, if any, within the Company will be

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detected. Limitations within any control system, including the Company’s control system, include faulty judgments in decision-making or simple errors or mistakes. In addition, controls can be circumvented by an individual, by collusion between two or more people, or by management override of the control. Because of these limitations, misstatements due to error or fraud may occur and may not be detected.

During the nine months ended May 31, 2018, the Company completed its acquisitions of IOTA Engineering, LLC (“IOTA”) and Lucid Design Group, Inc (“Lucid”). SEC guidance permits management to omit an assessment of an acquired business' internal control over financial reporting from management's assessment of internal control over financial reporting for a period not to exceed one year from the date of the acquisition. Accordingly, management has not assessed IOTA's or Lucid's internal control over financial reporting as of May 31, 2018. Excluding the acquisitions, there have been no changes in the Company’s internal control over financial reporting that occurred during the Company’s most recent completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.The Company began integrating IOTA and Lucid into its existing control procedures from their respective dates of acquisition. The Company does not anticipate the integration of the acquired companies to result in changes that would materially affect its internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On January 3, 2018, a shareholder filed a class action complaint in the United States District Court for the District of Delaware against the Company and certain of its officers on behalf of all persons who purchased or otherwise acquired the Company’s stock between June 29, 2016 and April 3, 2017. On February 20, 2018, a different shareholder filed a second class action complaint in the same venue against the same parties on behalf of all persons who purchased or otherwise acquired the Company’s stock between October 15, 2015 and April 3, 2017. A motion to consolidate the cases has been filed and is presently pending, unopposed. The cases were transferred on April 30, 2018, to the United States District Court for the Northern District of Georgia. The complaints allege that the defendants violated the federal securities laws by making false or misleading statements and/or omitting to disclose material adverse facts that (i) concealed known trends negatively impacting sales of the Company’s products and (ii) overstated the Company’s ability to achieve profitable sales growth. The plaintiffs seek class certification, unspecified monetary damages, costs, and attorneys’ fees. The Company disputes the allegations in the complaints and intends to vigorously defend against the claims. Estimating an amount or range of possible losses resulting from litigation proceedings is inherently difficult, particularly where the matters involve indeterminate claims for monetary damages and are in the stages of the proceedings where key factual and legal issues have not been resolved. For these reasons, the Company is currently unable to predict the ultimate timing or outcome of or reasonably estimate the possible losses or a range of possible losses resulting from the matters described above. The Company is insured, in excess of a self-retention, for Directors and Officers liability.

The Company is subject to various other legal claims arising in the normal course of business, including, but not limited to, patent infringement, product liability claims, and employment matters. The Company is self-insured up to specified limits for certain types of claims, including product liability, and is fully self-insured for certain other types of claims, including environmental, product recall, and patent infringement. Based on information currently available, it is the opinion of management that the ultimate resolution of any such pending and threatened legal proceedings will not have a material adverse effect on the financial condition, results of operations, or cash flows of the Company. However, in the event of unexpected future developments, it is possible that the ultimate resolution of any such matters, if unfavorable, could have a material adverse effect on the financial condition, results of operations, or cash flows of the Company in future periods. The Company establishes reserves for legal claims when the costs associated with the claims become probable and can be reasonably estimated. The actual costs of resolving legal claims may be substantially higher than the amounts reserved for such claims. However, the Company cannot make a meaningful estimate of actual costs to be incurred that could possibly be higher or lower than the amounts reserved.

Information regarding reportable legal proceedings is contained in Part I, Item 3. Legal Proceedings in the Company’s Form 10-K. Information set forth in this report’s Commitments and Contingencies footnote of the Notes to Consolidated Financial Statements describes any legal proceedings that became reportable during the quarter ended May 31, 2018, and updates any descriptions of previously reported legal proceedings in which there have been material developments during such quarter. The discussion of legal proceedings included within the Commitments and Contingencies footnote of the Notes to Consolidated Financial Statements is incorporated into this Item 1 by reference.

Item 1a. Risk Factors

There have been no material changes in the Company’s risk factors from those disclosed in Part I, Item 1a. Risk Factors of the Company’s Form 10-K.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

In March 2018, the Board authorized the repurchase of up to six million shares of the Company's common stock. The Company has repurchased a total of 2.0 million shares in fiscal 2018. The following table reflects activity related to equity securities purchased by the Company during the quarter ended May 31, 2018:

Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maximum Number of Shares that May Yet Be Purchased Under the Plans
3/1/2018 through 3/31/2018	—	$—	—	6,000,000
4/1/2018 through 4/30/2018	800,000	$130.12	800,000	5,200,000
5/1/2018 through 5/31/2018	—	$—	—	5,200,000
Total	800,000	$130.12	800,000	5,200,000

Item 5. Other Information

Creation of a Direct Financial Obligation

On June 29, 2018, the Company entered into a credit agreement (“Credit Agreement”) with a syndicate of banks, consisting of JP Morgan as the administrative agent and other lenders as parties thereto, that provides the Company with a $400.0 million five-year unsecured revolving credit facility (“New Revolving Credit Facility”) and a $400.0 million unsecured delayed draw term loan facility (“Term Loan Facility”). Available borrowings under the Credit Agreement may be used for general corporate purposes, working capital, refinancing indebtedness under the prior Revolving Credit Facility, share repurchases, and non-hostile acquisitions.

The New Revolving Credit Facility replaced the Company's $250.0 million Revolving Credit Facility with a syndicate of banks,consisting of JP Morgan as the administrative agent and other lenders as parties thereto, which was scheduled to mature on August 27, 2019. Generally, amounts outstanding under the New Revolving Credit Facility allow for borrowings to bear interest at either the Eurocurrency Rate or the base rate at the Company's option. Eurocurrency Rate advances can be denominated in a variety of currencies, including U.S. Dollars, and amounts outstanding bear interest at a periodic fixed rate equal to the LIBOR for the applicable currency plus an applicable margin. The Eurocurrency applicable margin is based on the Company’s leverage ratio, as defined in the Credit Agreement, with such margin ranging from 1.000% to 1.375%. Base Rate advances bear interest at an alternate base rate plus an applicable margin. The base rate applicable margin is based on the Company’s leverage ratio, as defined in the Credit Agreement, with such margin ranging from 0.0% to 0.375%.

The Term Loan Facility allows for borrowings to be drawn over a one-year period ending June 29, 2019, utilizing up to four separate installments, and are U.S. dollar denominated. Borrowings under the Term Loan Facility will amortize in equal quarterly installments of 2.5% per year in year one, 2.5% per year in year two, 5.0% per year in year three, 5.0% per year in year four, and 7.5% per year in year five. Any remaining borrowings under the Term Loan Facility are due and payable in full on June 29, 2023. The Term Loan Facility allows for borrowings to bear interest at either a Eurocurrency Rate or the base rate, at the Company’s option. Eurocurrency Rate advances can be denominated in a variety of currencies, including U.S. Dollars, and amounts outstanding bear interest at a periodic fixed rate equal to LIBOR for the applicable currency plus an applicable margin. The Eurocurrency applicable margin is based on the Company’s leverage ratio, as defined in the Credit Agreement, with such margin ranging from 0.875% to 1.250%. Base Rate advances bear interest at an alternate base rate plus an applicable margin. The base rate applicable margin is based on the Company’s leverage ratio, as defined in the Credit Agreement, with such margin ranging from 0.0% to 0.25%.

The Company is required to pay certain fees in connection with the Credit Agreement, including administrative service fees and annual facility fees. The annual facility fee is payable quarterly, in arrears, and is determined by the Company's leverage ratio as defined in the Credit Agreement. The facility fee ranges from 0.125% to 0.250% of the aggregate $800.0 million commitment of the lenders under the Credit Agreement.

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The Credit Agreement contains contains customary covenants regarding the preservation and maintenance of our corporate existence, material compliance with laws, payment of taxes, and maintenance of insurance and of our properties.The Credit Agreement contains financial covenants, including a minimum interest expense coverage ratio ("New Minimum Interest Expense Coverage Ratio") and a leverage ratio ("New Maximum Leverage Ratio") of total indebtedness to EBITDA, as such terms are defined in the Credit Agreement. These ratios are computed at the end of each fiscal quarter for the most recent 12-month period. The Credit Agreement generally allows for a New Minimum Interest Expense Coverage Ratio of 2.50 and a New Maximum Leverage Ratio of 3.50, subject to certain conditions defined in the financing agreement. The Credit Agreement includes customary events of default, including, but not limited to, the failure to pay any interest, principal or fees when due, the failure to perform any covenant or agreement, inaccurate or false representations or warranties, insolvency or bankruptcy, change of control, the occurrence of certain ERISA events and judgment defaults.

Declaration of Dividend

On June 29, 2018, the Board declared a quarterly dividend of $0.13 per share. The dividend is payable on August 1, 2018 to stockholders of record on July 18, 2018.

Item 6. Exhibits

Exhibits are listed on the Index to Exhibits.

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INDEX TO EXHIBITS

EXHIBIT 3	(a)	Restated Certificate of Incorporation of Acuity Brands, Inc. (formerly Acuity Brands Holdings, Inc.), dated as of September 26, 2007.	Reference is made to Exhibit 3.1 of registrant's Form 8-K as filed with the Commission on September 26, 2007, which is incorporated herein by reference.
	(b)	Certificate of Amendment of Acuity Brands, Inc. (formerly Acuity Brands Holdings, Inc.), dated as of September 26, 2007.	Reference is made to Exhibit 3.2 of registrant's Form 8-K as filed with the Commission on September 26, 2007, which is incorporated herein by reference.
	(c)	Certificate of Amendment to the Restated Certificate of Incorporation of Acuity Brands, Inc., dated as of January 6, 2017.	Reference is made to Exhibit 3.C of registrant's Form 10-Q as filed with the Commission on January 9, 2017, which is incorporated herein by reference.
	(d)	Amended and Restated Bylaws of Acuity Brands, Inc., dated as of January 6, 2017.	Reference is made to Exhibit 3.D of registrant's Form 10-Q as filed with the Commission on January 9, 2017, which is incorporated herein by reference.
EXHIBIT 10	(1)	Five-Year Credit Agreement dated June 29, 2019.	Filed with the Commission as part of this Form 10-Q.
EXHIBIT 31	(a)	Certification of the Chief Executive Officer of the Company pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed with the Commission as part of this Form 10-Q.
	(b)	Certification of the Chief Financial Officer of the Company pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	Filed with the Commission as part of this Form 10-Q.
EXHIBIT 32	(a)	Certification of the Chief Executive Officer of the Company pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Filed with the Commission as part of this Form 10-Q.
	(b)	Certification of the Chief Financial Officer of the Company pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Filed with the Commission as part of this Form 10-Q.
EXHIBIT 101		The following financial information from the Company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2018, filed on July 3, 2018, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Cash Flows, and (iv) the Notes to Consolidated Financial Statements.	Filed with the Commission as part of this Form 10-Q.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ACUITY BRANDS, INC.

Date:	July 3, 2018	By:	/S/ VERNON J. NAGEL
			VERNON J. NAGEL
			CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER
Date:	July 3, 2018	By:	/S/ RICHARD K. REECE
			RICHARD K. REECE
			EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER (Principal Financial and Accounting Officer)