ACUITY BRANDS INC
Form 10-K
October 30, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended August 31, 2007.

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to .

Commission file number 001-16583.

ACUITY BRANDS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**58-2632672**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
1170 Peachtree Street, N.E., Suite 2400,	
Atlanta, Georgia	**30309-7676**

(Address of principal executive offices)	**(Zip Code)**

(404) 853-1400

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Securities Exchange Act of 1934:

Title of Each Class	Name of Each Exchange on which Registered
Common Stock ($0.01 Par Value)	**New York Stock Exchange**
Preferred Stock Purchase Rights	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: None

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Indicate by checkmark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by checkmark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer x	Accelerated Filer ¨	Non-accelerated Filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x

Based on the closing price of the Registrant s common stock of $55.37 as quoted on the New York Stock Exchange on February 28, 2007, the aggregate market value of the voting stock held by nonaffiliates of the registrant, was $2,398,789,471.

The number of shares outstanding of the registrant s common stock, $0.01 par value, was 42,246,456 shares as of October 26, 2007.

DOCUMENTS INCORPORATED BY REFERENCE

Location in Form 10-K	Incorporated Document
Part II, Item 5	Proxy Statement for 2007 Annual Meeting of Stockholders
Part III, Items 10, 11, 12, 13, and 14	Proxy Statement for 2007 Annual Meeting of Stockholders

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PART I

Item 1. ***Business***

Overview

Acuity Brands, Inc. (Acuity Brands or the Company) is a holding company that owns and manages two businesses that serve distinctive markets lighting equipment and specialty products. The Company was incorporated in 2001 under the laws of the State of Delaware. The lighting equipment segment designs, produces, and distributes a broad array of indoor and outdoor lighting fixtures for commercial and institutional, industrial, infrastructure, and residential applications for various markets throughout North America and select international markets. The specialty products segment is a producer, marketer, and service provider of a wide range of cleaning and maintenance solutions for commercial, industrial, institutional, and consumer end-markets primarily throughout North America and Europe. Of the Company s fiscal 2007 net sales of approximately $2.5 billion, the lighting equipment segment generated approximately 78% of total net sales while the specialty products segment provided the remaining 22%. Financial information relating to the Company s segments for the past three fiscal years is included in Note 13 of the *Notes to Consolidated Financial Statements* included in this report.

Specialty Products Business Spin-off

On July 23, 2007, the Company announced its intention to separate its lighting and specialty products businesses by spinning off the specialty products business of Acuity Specialty Products Group, Inc. into an independent, publicly traded company named Zep Inc. to Acuity Brands stockholders (the spin-off). The Board of Directors of Acuity Brands approved the completion of the spin-off on September 28, 2007, subject to the setting of the record date and the distribution date by the Executive Committee of the Board of Directors. The Executive Committee established the record date and distribution date for the spin-off on October 6, 2007.

Prior to the spin-off, the Company engaged in an internal restructuring, including a holding company reorganization. As part of the internal restructuring, the business that had previously been conducted by Acuity Specialty Products Group, Inc. was merged into the parent company and was subsequently transferred to Acuity Specialty Products, Inc. (ASP). ASP is now a wholly-owned subsidiary of Zep Inc., which is in turn a direct, wholly-owned subsidiary of Acuity Brands, Inc.

Acuity Brands expects to distribute pro rata to its stockholders all of the shares of Zep Inc. common stock by means of a stock dividend on October 31, 2007 (the distribution). The stock dividend of one share of Zep common stock for every two shares of Acuity Brands common stock will be paid pro rata to holders of Acuity Brands common stock who hold their shares at the close of business on October 17, 2007, which is the record date for the distribution. No fractional shares of Zep common stock will be distributed. Instead of fractional shares, Zep stockholders will receive cash. Following the distribution, Acuity Brands will not own any shares of Zep, and Zep will be an independent public company. The spin-off is intended to be tax-free to affected shareholders, and the Company has received a favorable ruling from the Internal Revenue Service as well as an opinion from its external counsel supporting the spin-off s tax-free status. The stock of Zep Inc. is to be listed on the New York Stock Exchange under the ticker symbol ZEP .

Zep Inc. filed a registration statement on Form 10 with the Securities and Exchange Commission, which was declared effective on October 11, 2007. The financial presentation of Zep Inc. in the Form 10 differs from the financial presentation of the Acuity Specialty Products segment in Acuity Brands financial statements primarily due to adjustments made to reflect the allocation of corporate expenses. The basis of presentation herein remains unaffected by the decision to spin-off the specialty products business as the related distribution will not be transacted until October 31, 2007. However, after the October 31, 2007, distribution date, the Acuity Specialty Products segment will be reflected as discontinued operations in all periods presented within Acuity Brands financial statements in accordance with Statements of Financial Standards No. 144: *Accounting for the Impairment or Disposal of Long-Lived Assets*.

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Business Segments

Acuity Brands Lighting

The lighting equipment business of Acuity Brands is operated by Acuity Brands Lighting (ABL). ABL is one of the world s leading providers of lighting fixtures for new construction, renovation, and facility maintenance applications. Products include a full range of indoor and outdoor lighting for commercial and institutional (C&I), industrial, infrastructure, and residential applications. ABL manufactures or procures lighting products in the United States, Mexico, Europe, and China. These products are marketed under numerous brand names, including Lithonia Lighting®, Holophane®, Gotham®, Hydrel®, Peerless®, Antique Street Lamps, Carandini®, American Electric Lighting®, SpecLight®, Metal Optics®, and Mark Architectural Lighting®. ABL manufactures products in 14 plants in North America and three plants in Europe.

Principal customers include electrical distributors, retail home improvement centers, national accounts, electric utilities, municipalities, and lighting showrooms located in North America and select international markets. In North America, ABL s products are sold through independent sales agents and factory sales representatives who cover specific geographic areas and market segments. Products are delivered through a network of distribution centers, regional warehouses, and commercial warehouses using both common carriers and a company-owned truck fleet. To serve international customers, ABL employs a sales force that utilizes distribution methods to meet specific individual customer or country requirements. In fiscal 2007, North American sales accounted for approximately 96% of ABL s net sales. See Note 13 of the *Notes to Consolidated Financial Statements* for more information concerning the domestic and international net sales of the Company.

Industry Overview

The current size of the North American lighting fixture market is estimated at $10.6 billion. The North American lighting fixture market consists of non-portable lighting fixtures as defined by the National Electrical Manufacturers Association and lighting related products such as emergency lighting equipment, poles, controls, and modular wiring systems. The U.S. market represents approximately 87% of the North American market. The Company estimates that the top four manufacturers (including Acuity Brands Lighting) represent approximately 54% of the total North American lighting market. The remainder of the market is made up of an estimated 1,200 lighting manufacturers.

The primary demand driver for ABL s core businesses is non-residential construction, which includes a broad range of commercial, institutional, and industrial buildings. Construction spending on infrastructure projects such as highways, streets, and urban developments also has a material impact on the demand for ABL s infrastructure-focused products. Demand for ABL s retail lighting products is highly dependent on economic drivers such as consumer spending and discretionary income, along with housing construction and home improvement spending.

Based on industry data for 2007, new construction accounts for approximately 84% of non-residential contract award values, while renovations account for approximately 16%, though this mix can vary depending on economic conditions. Major trends that can impact the industry include the development of new technologies for lamps, ballasts, and electronic light sources, more effective optical designs, federal and state regulatory requirements for updated energy codes, energy tax legislation, and design technologies addressing environmental sustainability.

There has been a significant increase in the size and relative presence of the retail home improvement center segment in the past several years. In addition, imports of foreign-sourced lighting fixtures continue to grow, driven by both the foreign production of U.S. manufacturers and imports of low-cost fixtures primarily from Asian manufacturers. Consolidation remains a key trend in the electrical industry. Recent announcements of combinations among electrical distributors are evidence of this continuing trend.

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Products

Acuity Brands Lighting produces a wide variety of lighting fixtures used in the following applications:

Commercial & Institutional Applications are represented by stores, hotels, offices, schools, and hospitals, as well as other government and public buildings. Products that serve these applications include recessed, surface and suspended fluorescent lighting products, recessed downlighting, and track lighting, as well as special application lighting products. The outdoor areas associated with these application products are addressed by a variety of outdoor lighting products, such as area and flood lighting, decorative site lighting, and landscape lighting.

Industrial Applications primarily include warehouses and manufacturing facilities. The lighting equipment business serves these applications with a variety of glass and acrylic high intensity discharge (HID) and fluorescent lighting products.

Infrastructure Applications include highways, tunnels, airports, railway yards, and ports. Products that serve these applications include street, area, high-mast, off-set roadway, and sign lighting.

Residential Applications are addressed with a combination of decorative fluorescent and downlighting products, as well as utilitarian fluorescent products.

Other Applications & Products Other products include emergency lighting fixtures, which are primarily used in non-residential buildings, and lighting control and flexible wiring systems.

In addition to these product offerings, ABL provides services enabling customers to more effectively and efficiently manage their lighting assets. In fiscal 2007, ABL introduced the marketplace to Remote Operations Asset Management (ROAM), an innovative service utilizing Machine to Machine (M2M) wireless network technology that allows utilities and municipalities to monitor and control their lighting systems and provide savings in energy and maintenance operations. ABL also offers turn-key labor renovation services that leverage ABL s technological advances to reduce the customer s operational lighting costs and financially justify the renovation of existing facilities with outdated lighting systems. These services are provided in the commercial, industrial, retail, manufacturing and warehousing markets.

Lighting fixtures for numerous applications in a multitude of industry segments accounted for approximately 66%, 67%, and 65% of total consolidated net sales for Acuity Brands in fiscal years 2007, 2006, and 2005, respectively. This does not include sales related to items such as wiring products, controls, and emergency lighting.

Sales and Marketing

Sales. ABL calls on customers in the North American market with separate sales forces targeted at delivering appropriate products and services to specific customer, channel, and geographic segments. These sales forces consist of approximately 220 company-employed salespeople and a network of approximately 160 independent sales agencies, each of which employs numerous salespeople. ABL also operates two separate European sales forces and an international sales group coordinating export sales outside of North America and Europe.

Marketing. ABL markets its products to a multitude of end users through a broad spectrum of marketing and promotional vehicles, including direct customer contact, trade shows, on-site training, print advertising in industry publications, product brochures, and other literature, as well as the internet and other electronic media. On-site training is conducted at dedicated product training facilities in Conyers, Georgia and Austin, Texas. Additionally, in fiscal 2007 Holophane relocated and expanded its Light and Vision training center in Ohio. Acuity Brands Lighting also opened its Center for Light + Space during fiscal 2007, a new direct sales and marketing office dedicated to serving the New York City lighting market. New York continues to grow in importance in the world of lighting, with its influence accelerating around the country and the world. New technologies, new products and new applications are changing the industry, and Acuity Brands Lighting now offers lighting designers, architects, engineers, contractors and distributors the most efficient service with this new direct-to-market structure designed exclusively for this

key metro area.

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Customers

Customers of Acuity Brands Lighting include electrical distributors, retail home improvement centers, national accounts, electric utilities, utility distributors, municipalities, contractors, catalogs, and lighting showrooms. In addition, there are a variety of other buying influences, which for any given project could represent a significant influence in the product specification process. These generally include contractors, engineers, architects, and lighting designers.

A single customer of Acuity Brands Lighting, The Home Depot, accounted for approximately 15% of net sales of ABL during fiscal years 2007, 2006, and 2005, respectively. Approximately 85% of product purchased by The Home Depot is resold to end-users in the home improvement market as ABL serves both residential and commercial consumer needs of this customer. The remainder of product sourced to The Home Depot is installed in that retail center s new and existing facilities. The loss of The Home Depot s business could temporarily adversely affect the Company s results of operations.

Manufacturing

Acuity Brands Lighting operates 17 manufacturing facilities, including eight facilities in the United States, six facilities in Mexico, and three facilities in Europe. ABL utilizes a blend of internal and outsourced manufacturing processes and capabilities to fulfill a variety of customer needs in the most cost-effective manner. Critical processes, such as reflector forming and anodizing and high-end glass production, are primarily performed at company-owned facilities, offering the ability to differentiate end-products through superior capabilities. Other critical components, such as lamps, sockets, and ballasts, are purchased primarily from outside vendors. Investment is focused on improving capabilities, product quality, and manufacturing efficiency. The integration of local suppliers factories and warehouses also provides an opportunity to lower ABL-owned component inventory while maintaining high service levels through frequent just-in-time deliveries. ABL also utilizes contract manufacturing from U.S., Asian, and European sources for certain products and purchases certain finished goods, including poles, to complement its area lighting fixtures and a variety of residential and commercial lighting equipment. Net sales of product manufactured by others currently accounts for approximately 23% of the total net sales of ABL. Of total product manufactured by ABL, U.S. operations produce approximately 43%; Mexico produces approximately 53%; and Europe produces approximately 4%. ABL has one supplier of significance and purchased approximately $73.1 million in finished goods from this supplier in 2007. However, the Company believes that sourcing alternatives currently available to ABL serve to mitigate exposure that would otherwise exist due to ABL s utilization of this supplier.

During fiscal years 2002 through 2006, management focused on certain initiatives to make the Company more globally competitive. One of these initiatives at ABL related to enhancing its global supply chain and included the consolidation of certain manufacturing facilities into more efficient locations. During those years, ABL closed ten facilities as part of this initiative. This initiative, the Manufacturing Network Transformation (MNT), resulted in increased production in international locations, primarily Mexico, and greater sourcing from its network of worldwide vendors. Total square footage used for manufacturing at ABL was reduced by approximately 23% over those fiscal years as a result of MNT and other programs.

Distribution

Products are delivered through a network of strategically located distribution centers, regional warehouses, and commercial warehouses in North America using both common carriers and a company-owned truck fleet. For international customers, distribution methods are adapted to meet individual customer or country requirements.

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Research and Development

Research and development efforts at ABL are targeted toward the development of products with an ever-increasing performance-to-cost ratio and energy efficiency, while close relationships with lamp, ballast, and LED manufacturers are maintained to understand technology enhancements and incorporate them in ABL s fixture designs. ABL operates five separate product development model facilities, incorporating eight photometers for testing and optimizing fixture photometric performance. The Conyers, Georgia lab is approved by the National Voluntary Laboratory Accreditation Program for both fluorescent and high intensity discharge fixtures. For fiscal years 2007, 2006, and 2005, research and development expense at ABL totaled $31.3 million, $30.0 million, and $27.1 million, respectively.

Competition

The lighting equipment industry served by ABL is highly competitive, with the largest suppliers serving many of the same markets and competing for the same customers. Competition is based on numerous factors, including brand name recognition, price, product quality, design and energy efficiency, customer relationships, and service capabilities. Primary competitors in the lighting industry include Cooper Industries Ltd., The Genlyte Group Incorporated, and Hubbell Incorporated. The Company estimates that the four largest lighting manufacturers (including ABL) have approximately a 54% share of the total North American lighting market.

Acuity Specialty Products

The specialty products business of Acuity Brands is operated by Acuity Specialty Products (ASP). ASP is a leading producer, marketer, and service provider of a wide range of cleaning and maintenance solutions for commercial, industrial, institutional, and consumer end-markets. ASP s product portfolio includes anti-bacterial and industrial hand care products, cleaners, degreasers, deodorizers, disinfectants, floor finishes, sanitizers, and pest and weed control products. ASP s products and services are marketed under well recognized and established brand names, such as Zep®, Zep Commercial®, Enforcer®, and Selig, some of which have been in existence for more than 70 years. Customers are reached through an experienced, international organization composed of approximately 1,600 sales representatives, supported by highly skilled research and development and technical services teams, who collectively provide creative solutions for ASP s customers diverse cleaning and maintenance needs by utilizing their extensive product expertise and providing customized value-added services that the Company believes distinguish ASP among its competitors.

Through ASP s direct sales organization, convenient, highly effective cleaning and maintenance solutions are provided to approximately 350,000 customers in a broad array of commercial, industrial, and institutional end-markets, including transportation, food processing and service, manufacturing, government, and housekeeping. These customers include government entities and businesses ranging from small sole proprietorships to large corporations. In addition, ASP s products are sold to contractors, small business owners, and homeowners who want to purchase professional strength cleaning products through large and small home improvement retailers. The home improvement channel is supported by sales and management personnel who focus on customers such as The Home Depot, Wal-Mart, Ace Hardware, True Value, Lowe s, and Menard s. In fiscal 2007, North American sales accounted for approximately 92% of ASP s net sales. See Note 13 of the *Notes to Consolidated Financial Statements* for more information concerning the domestic and international net sales of the Company.

Industry Overview

According to the 2006 Kline Group report, the United States commercial, industrial, and institutional cleaning chemicals market is an estimated $9.6 billion market. The Company believes it is one of the top four market leaders, which together hold slightly more than 40% of the total market share. The market is highly fragmented and is served by hundreds of regional and niche participants who sell either directly to end-users or

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through distributors. Approximately two-thirds of the market is currently served through distributors while one-third of the market is currently served through direct sales. ASP is a market leader in the direct sales channel and the significant majority of the specialty products business historical revenues have come from this channel. In general, the commercial, industrial, and institutional end-market enjoys growth consistent with GDP due to favorable end-market demographics, increasing government regulations, health and safety concerns, and consumer demand for cleanliness.

Additionally, based on company estimates and industry research, ASP estimates that the total size of the retail cleaning chemicals market is approximately $5.5 billion. This market is served through channels including grocery, mass merchandisers, home improvement, drug, and other specialty retailers. ASP primarily sells through the home improvement channel, which only serves a portion of the overall retail cleaning chemicals market. The Company believes sales through the home improvement channel are experiencing above market growth as customers diversify their purchasing locations.

While consumption of cleaning and maintenance products is somewhat discretionary, in health-driven, sophisticated markets such as North America and Western Europe, health and safety regulations and customer expectations buffer demand downturns. Increased legislation regulating food, health, and safety requires increased frequency of use, thus fueling increases in demand. Health and safety regulations are also shrinking the pool of available chemicals. Together, these trends are driving demand and development of improved product formulations and application methods. Also, the Company believes end-users in ASP s markets are beginning to demand more effective and efficient products. Additionally, many corporate buyers are increasing centralized corporate buying activities and consolidating their respective purchases and suppliers.

Products

ASP produces a wide range of cleaning and maintenance solutions for commercial, industrial, institutional, and consumer customers with more than 2,300 unique formulations that are used in manufacturing products for its customers. These include:

Transportation Applications include products for automotive repair facilities, car washes, public transport, car rental facilities and trains, among others.

Food Processing and Preparation Applications include products for farms, meat processing facilities, bakeries, grocery stores, and full and quick-serve restaurants.

Manufacturing Applications include products for professional maintenance and engineering staff in manufacturing, pharmaceutical and mining industries.

Government Applications include products for federal, state and local government agencies, including cities, school districts, military, and police and fire departments.

Housekeeping Applications include products for hospitality, healthcare, entertainment, and other janitorial housekeeping products.

Contractors and Small Business Owners Applications include products for small business owners, contractors, and homeowners.

Sales of specialty chemical products, excluding items sold to facilitate the use of chemicals, accounted for approximately 19% of total consolidated net sales for Acuity Brands during fiscal years 2007 and 2006, and 20% of total consolidated net sales during fiscal year 2005.

Sales and Services

Sales. The sales organization at ASP consists of approximately 1,600 sales representatives worldwide. The compensation model is primarily commission-based. Net sales are largely dependent on the hiring, training, and retention of the commissioned sales representatives.

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The ASP sales organization covers the U.S., Canada, Italy, Belgium, Luxemburg, and the Netherlands, and certain other smaller markets. The commercial, industrial, and institutional end-markets are serviced primarily through approximately 1,174 sales representatives in the United States, 142 sales representatives in Canada and 268 sales representatives throughout Europe, supplemented by a complement of customer and technical service personnel. ASP s customers in the home improvement channel are served by approximately 50 salaried sales and management personnel.

Services. The specialty products business has a well-trained and experienced sales team, supported by their highly skilled research and development, and technical services teams that provide creative customized solutions for their customers diverse cleaning and maintenance needs. ASP provides value-added services to customers on application uses, safety aspects, product selection, specific formulations, inventory management, customer employee training, and equipment and dispensers. Accordingly, ASP s customers benefit from a more effective solution that includes a total cost of ownership for their cleaning and maintenance needs that the Company believes is superior to their competitors offerings.

Customers

ASP sells cleaning and maintenance solutions directly to approximately 350,000 customers. Customers focused in the commercial, industrial, and institutional end markets are responsible for approximately 85% of ASP s net sales. The remainder of ASP s net sales are attributable to customers accessed through the home improvement retail channel. ASP s commercial, industrial, and institutional customers include government entities and businesses ranging from small sole proprietorships to the largest corporations in the U.S. These customers operate within various markets, including food processing and preparation, transportation, industrial, hospitality, government, and contractors. In addition, ASP s cleaning and maintenance solutions are sold to contractors, small business owners, and homeowners who want to purchase professional strength cleaning products through home improvement retailers such as The Home Depot, Wal-Mart, Ace Hardware, True Value, Lowe s, and Menard s.

A single customer of Acuity Specialty Products, The Home Depot, accounted for approximately 13% of net sales of ASP during fiscal year 2007, and 12% of net sales during fiscal years 2006 and 2005, respectively. The loss of that customer could temporarily adversely affect ASP s results of operations.

Manufacturing

ASP manufactures products at six facilities located in the United States, Canada, the Netherlands, and Italy. The three U.S. facilities produce approximately 89% of manufactured product; the Canadian facility produces approximately 7%; and the two European facilities produce approximately 4%. Certain finished goods purchased from contract manufacturers and finished goods suppliers supplement the manufactured product line. Sales of outsourced product currently account for approximately 19% of the net sales volume of ASP. Outsourced product is predominately manufactured in the U.S. Management does not believe the loss of any one supplier of outsourced product would have a material adverse impact on the results of operations of ASP.

Distribution

Products sold to commercial, industrial, and institutional end-markets are shipped from 46 strategically located branch warehouses throughout North America and Europe, which are supplied directly from ASP s production facilities and by one large distribution center in Atlanta, Georgia. The products sold to home improvement retailers are distributed nationwide from the Emerson, Georgia plant and one other warehouse. Products are primarily delivered through common and local carriers.

Research and Development

At ASP, research and development is directed at developing product systems that provide comprehensive solutions for broad-based customer applications. Additionally, efforts to enhance existing formulations by utilizing new raw materials or combinations of raw materials have resulted in both new and improved products.

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Special emphasis has been placed on the development of green products based on renewable and environmentally preferred raw materials. Technical expertise is employed to move proven technologies into new applications. Research and development expense at ASP for fiscal years 2007, 2006, and 2005, excluding technical services, was $2.3 million, $2.3 million, and $2.2 million, respectively.

Competition

The cleaning and maintenance solutions industry served by ASP is highly competitive. Overall, competition is fragmented in the commercial, industrial, and institutional end-markets, with numerous local and regional operators selling directly to customers, distributors, and a few national competitors. Many of these competitors offer products in some, but not all, of the markets served by ASP. Competition is based primarily on brand name recognition, price, product quality, and customer service. Competitors in the commercial, industrial, and institutional end-market include but are not limited to Ecolab, Inc., JohnsonDiversey, Inc., NCH Corporation, Rochester Midland Corporation, and State Chemical Manufacturing Company. Many companies compete within the broader retail market for cleaning chemical products including but not limited to Church & Dwight Co., Inc., Procter and Gamble, Reckitt Benckiser plc, S.C. Johnson & Sons, Inc., Sunshine Makers, Inc., and The Clorox Company. ASP also competes in the home improvement channel with pest control companies such as Bayer, A.G., Spectrum Brands, Inc., and The Scott s Company. Furthermore, barriers to entry and expansion in the industry are low, which may lead to additional competitive pressure in the future.

Environmental Regulation

The operations of the Company are subject to numerous comprehensive laws and regulations relating to the generation, storage, handling, transportation, and disposal of hazardous substances as well as solid and hazardous wastes, and to the remediation of contaminated sites. In addition, permits and environmental controls are required for certain of the Company s operations to limit air and water pollution, and these permits are subject to modification, renewal, and revocation by issuing authorities. On an ongoing basis, Acuity Brands allocates considerable resources including investments in capital and operating costs relating to environmental compliance. Environmental laws and regulations have generally become stricter in recent years. The cost of responding to future changes may be substantial. See Item 3: *Legal Proceedings* for a discussion of certain environmental matters.

Raw Materials

The products produced by Acuity Brands require certain raw materials, including aluminum, plastics, electrical components, solvents, surfactants, other petroleum-based materials and components, and certain grades of steel. For example, Acuity Brands Lighting purchases approximately 116,000 tons of steel and aluminum on an annual basis depending on various factors including product mix. The use of steel and aluminum is not integral to the manufacturing processes of Acuity Specialty Products. The Company estimates that on a consolidated basis approximately 8% of purchased raw materials are petroleum-based. Acuity Brands purchases most raw materials on the open market and relies on third parties for the sourcing of some finished goods. Accordingly, the cost of products sold may be affected by changes in the market price of the above-mentioned raw materials or the sourcing of finished goods. Due to the mix of purchases (raw materials, components parts, and finished goods), timing of price increases, and other economic and competitive forces within the supply chain, it is not possible to determine the financial impact of changes in the market price of these raw materials.

Acuity Brands does not expect to engage in significant commodity hedging transactions for raw materials, though the Company has and will continue to commit to purchase certain materials for a period of up to twelve months. Significant increases in the prices of Acuity Brands products due to increases in the cost of raw materials could have a negative effect on demand for products and on profitability. While the Company has generally been able to pass along these increases in cost in the form of higher selling prices for its products, the higher selling prices have lagged behind the increases in cost as seen in fiscal 2005. There can be no assurance that future disruptions in either supply or price of these materials will not negatively affect future results.

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Each business constantly monitors and investigates alternative suppliers and materials based on numerous attributes including quality, service, and price. Additionally, each business has conducted internet auctions as a method of competitive bidding. The Company s ongoing efforts to improve the cost effectiveness of its products and services may result in a reduction in the number of its suppliers. A reduction in the number of suppliers could cause increased risk associated with reliance on a limited number of suppliers for certain raw materials, component parts (such as ballasts), and finished goods.

Backlog Orders

The Company produces and stocks quantities of inventory at key distribution centers and warehouses throughout North America. ASP satisfies a significant portion of customer demand within 24 to 48 hours from the time a customer s order is placed and, therefore, sales order backlogs for the specialty products business are not material. ABL ships approximately 40% of sales orders during the month that those orders are placed. Sales order backlogs of the lighting equipment business, believed to be firm as of August 31, 2007 and 2006, were $180.6 million and $176.0 million, respectively. This increase in backlog is net of a decrease in past due backlog resulting from improved delivery performance.

Patents, Licenses and Trademarks

Acuity Brands owns or has licenses to use various domestic and foreign patents and trademarks related to its products, processes, and businesses. These intellectual property rights, particularly the trademarks relating to the products of Acuity Brands, are important factors for its businesses. To protect these proprietary rights, Acuity Brands relies on copyright, patent, trade secret, and trademark laws. Despite these protections, unauthorized parties may attempt to infringe on the intellectual property of Acuity Brands. Management of Acuity Brands is not aware of any such material unauthorized use or of any pending claims where Acuity Brands does not have the right to use any intellectual property material to the businesses of Acuity Brands. While patents and patent applications in the aggregate are important to the competitive position of Acuity Brands, no single patent or patent application is material to the Company.

Seasonality and Cyclicality

The businesses of Acuity Brands exhibit some seasonality, with net sales being affected by the impact of weather and seasonal demand on construction and installation programs, as well as the annual budget cycles of major customers. Because of these seasonal factors, Acuity Brands has experienced, and generally expects to experience, its highest sales in the last two quarters of each fiscal year.

A significant portion of the net sales of ABL relates to customers in the new construction and renovation industries, primarily for commercial and institutional applications. The new construction industry is cyclical in nature and subject to changes in general economic conditions. Volume has a major impact on the profitability of ABL and Acuity Brands as a whole. In addition, net sales at ASP are dependent on the retail, wholesale, and industrial markets and demand for these markets is generally associated with GDP in the United States. Economic downturns and the potential decline in key construction markets and demand for specialty chemicals may have a material adverse effect on the net sales and operating income of Acuity Brands.

International Operations

Acuity Brands manufactures and assembles products at numerous facilities, some of which are located outside the United States. Approximately 57% and 11% of the products manufactured by the lighting equipment and specialty products segments, respectively, are manufactured outside the United States.

Of total product manufactured by ABL, approximately 53% is produced in Mexico. Most of these operations are authorized to operate as Maquiladoras by the Ministry of Economy of Mexico. Maquiladora status allows Acuity Brands to import certain items from the United States into Mexico duty-free, provided that such items, after processing, are re-exported from Mexico within 18 months. Maquiladora status, which is renewed

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every year, is subject to various restrictions and requirements, including compliance with the terms of the Maquiladora program and other local regulations. Many companies have established Maquiladora operations, increasing demand for labor, particularly skilled labor and professionals. This increase in demand, from new and existing Maquiladora operations, has resulted in increased labor costs and could result in increased labor costs in the future. Acuity Brands may be required to make additional investments in automated equipment to partially offset potential increase in labor and wage costs.

The Company s initiatives to become more globally competitive include streamlining each segment s global supply chain by reducing the number of manufacturing facilities and enhancing the Company s worldwide procurement and sourcing capabilities. Management believes these initiatives will result in increased production in international locations, primarily Mexico, and will result in increased worldwide procurement and sourcing of certain raw materials, component parts, and finished goods. As a consequence, economic, political, military, or other events in a country where the Company manufactures, procures, or sources a significant amount of raw materials, component parts, or finished goods, could interfere with the Company s operations and negatively impact the Company s business.

For fiscal year 2007, net sales outside the U.S. represented approximately 11% and 20% of the total net sales of the lighting equipment and specialty products businesses, respectively. See Note 13 of the *Notes to Consolidated Financial Statements* for additional information regarding the geographic distribution of net sales, operating profit, and long-lived assets.

Information Concerning Acuity Brands

The Company makes its Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K (and all amendments to these reports), together with all reports filed pursuant to Section 16 of the Securities Exchange Act of 1934 by the Company s officers, directors, and beneficial owners of 10% or more of the Company s common stock, available free of charge through the SEC Filings link on the Company s website, located at www.acuitybrands.com, as soon as reasonably practicable after they are filed with or furnished to the SEC. Information included on the Company s website is not incorporated by reference into this Annual Report on Form 10-K. The Company s reports are also available at the Securities and Exchange Commission s Public Reference Room at 100 F. Street, NE, Washington, DC 20549 or on their website at www.sec.gov.

Additionally, the Company has adopted a written Code of Ethics and Business Conduct that applies to all of the Company s directors, officers, and employees, including its principal executive officer and senior financial officers. This Code of Ethics and Business Conduct is being filed as Exhibit 14 to this Annual Report on Form 10-K. The Code of Ethics and Business Conduct and the Company s Corporate Governance Guidelines are available free of charge through the Corporate Governance link on the Company s website. Additionally, the Statement of Responsibilities of Committees of the Board and the Statement of Rules and Procedures of Committees of the Board, which contain the charters for the Company s Audit Committee, Compensation Committee, and Governance Committee, and the rules and procedures relating thereto, are available free of charge through the Corporate Governance link on the Company s website. Each of the Code of Ethics and Business Conduct, the Corporate Governance Guidelines, the Statement of Responsibilities of Committees of the Board, and the Statement of Rules and Procedures of Committees of the Board is available in print to any stockholder of the Company that requests such document by contacting the Company s Investor Relations department.

Employees

Acuity Brands employs approximately 10,000 people, of whom approximately 6,400 are employed in the United States, 2,700 in Mexico, 350 in Canada, and 550 in other international locations, including Europe and the Asia/Pacific region. Union recognition and collective bargaining arrangements are in place, covering approximately 4,400 persons (including approximately 2,100 in the United States). The Company believes that it has a good relationship with both its unionized and non-unionized employees.

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Item 1a. ***Risk Factors***

This filing contains forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995. A variety of risks and uncertainties could cause Acuity Brands actual results to differ materially from the anticipated results or other expectations expressed in the Company s forward-looking statements. See Cautionary Statement Regarding Forward-Looking Statements on page 42. The risks and uncertainties include risks related to the spin-off of the specialty products business as well as risks related to the Company s continuing operations both prior to and following the spin-off. These risks include, without limitation:

Risks Related to the Spin-off of Acuity Specialty Products Group, Inc.

Failure of the distribution to qualify as a tax-free transaction could result in substantial liability.

Acuity Brands has received a private letter ruling from the Internal Revenue Service to the effect that, among other things, the spin-off (including certain related transactions) qualifies as tax-free to Acuity Brands, Zep Inc., and Acuity Brands stockholders for United States federal income tax purposes under section 355 and related provisions of the Internal Revenue Code. Although a private letter ruling generally is binding on the Internal Revenue Service, if the factual assumptions or representations made in the private letter ruling request are untrue or incomplete in any material respect, then Acuity Brands will not be able to rely on the ruling. Moreover, the Internal Revenue Service will not rule on whether a distribution of shares satisfies certain requirements necessary to obtain tax-free treatment under section 355 of the Internal Revenue Code. Rather, the private letter ruling is based upon representations by Acuity Brands that those requirements have been satisfied, and any inaccuracy in those representations could invalidate the ruling.

Acuity Brands has received an opinion of King & Spalding LLP, counsel to Acuity Brands, to the effect that, with respect to the requirements referred to above on which the Internal Revenue Service will not rule, those requirements will be satisfied. The opinion is based on, among other things, certain assumptions and representations as to factual matters made by Acuity Brands and Zep Inc. which, if untrue or incomplete in any material respect, could jeopardize the conclusions reached by counsel in its opinion. The opinion is not binding on the Internal Revenue Service or the courts, and the Internal Revenue Service or the courts may not agree with the opinion.

If the spin-off fails to qualify for tax-free treatment, a substantial corporate tax would be payable by Acuity Brands, measured by the difference between (1) the aggregate fair market value of the shares of Zep common stock on the date of the spin-off and (2) Acuity Brands adjusted tax basis in the shares of Zep common stock on the date of the spin-off. The corporate level tax would be payable by Acuity Brands. However, Zep has agreed under certain circumstances to indemnify Acuity Brands for this tax liability. In addition, under the applicable Treasury regulations, each member of Acuity Brands consolidated group at the time of the spin-off (including Zep) is severally liable for such tax liability.

Furthermore, if the spin-off does not qualify as tax-free, each Acuity Brands stockholder generally would be taxed as if he or she had received a cash distribution equal to the fair market value of the shares of Zep common stock on the date of the spin-off.

Even if the spin-off otherwise qualifies as tax-free, Acuity Brands nevertheless could incur a substantial corporate tax liability under section 355(e) of the Internal Revenue Code, if 50 percent or more of the stock of Acuity Brands or Zep were to be acquired as part of a plan (or a series of related transactions) that includes the distribution. For this purpose, any acquisitions of the stock of Acuity Brands or of Zep stock that occur within two years before or after the spin-off are presumed to be part of such a plan, although Acuity Brands may be able to rebut that presumption. If such an acquisition of the stock of Acuity Brands or of Zep stock triggers the application of section 355(e), Acuity Brands would recognize taxable gain as described above, but the spin-off would generally remain tax-free to the Acuity Brands stockholders. If acquisitions of Zep s stock trigger the application of section 355(e), Zep would be obligated to indemnify Acuity Brands for the resulting corporate-level tax liability.

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The combined post-spin-off value of Acuity Brands and Zep shares may not equal or exceed the pre-spin-off value of Acuity Brands shares.

After the spin-off, Acuity Brands common stock will continue to be listed and traded on the New York Stock Exchange. Zep will also list its common stock on the New York Stock Exchange. There can be no assurances that the combined trading prices of Acuity Brands common stock and Zep common stock after the spin-off, as adjusted for any changes in the combined capitalization of both companies, will be equal to or greater than the trading price of Acuity Brands common stock prior to the spin-off. Until the market has fully evaluated the business of Acuity Brands without Zep s business, the price at which Acuity Brands common stock trades may fluctuate significantly. Similarly, until the market has fully evaluated Zep s business, the price at which Zep common stock trades may fluctuate significantly, and shareholders may not realize the full benefit of the spin-off.

Risks Related to the Business of Acuity Brands, Inc.

General business and economic conditions may affect the Company s results from operations.

The Company operates in a highly competitive environment that is affected by a number of factors. Demand for its product offerings is sensitive to both volatility within the non-residential construction and other industrial markets, and to the effect of consolidation of the Company s competitors. Changes in interest and foreign currency exchange rates could impair the Company s ability to effectively access capital markets. The Company s primary competitors have the ability to drive both pricing and product innovation within the marketplace. These competitive pressures may affect the Company s ability to achieve desired volume growth and profitability levels under its current pricing models, which could adversely impact results from operations.

Acuity Brands is subject to risks related to operations outside the United States.

The Company has substantial operations outside the United States. Net sales outside the United States represented approximately 13% of the Company s total net sales for the fiscal year ended August 31, 2007. Furthermore, as of August 31, 2007, approximately 57% of ABL s and 11% of ASP s products were manufactured outside the United States. The Company s operations as well as those of key vendors are therefore subject to regulatory, economic, political, military, and other events in countries where these operations are located. In addition to the risks that are common to both the Company s U.S. and non-U.S. operations, the Company faces risks related to its foreign operations including but not limited to foreign currency fluctuations; unstable political, economic, financial, and market conditions; trade restrictions; and increases in tariffs and taxes. Some of these risks have affected the business of Acuity Brands in the past and may have a material adverse effect on the Company s business, financial condition, results of operations, and cash flows in the future.

Acuity Brands is subject to a broad range of environmental, health, and safety laws and regulations in the jurisdictions in which it operates, and the Company may be exposed to substantial environmental, health, and safety costs and liabilities.

Acuity Brands is subject to a broad range of environmental, health, and safety laws and regulations in the jurisdictions in which the Company operates. These laws and regulations impose increasingly stringent environmental, health, and safety protection standards and permitting requirements regarding, among other things, air emissions, wastewater storage, treatment, and discharges, the use and handling of hazardous or toxic materials, waste disposal practices, and the remediation of environmental contamination and working conditions for the Company s employees. Some environmental laws, such as Superfund, the Clean Water Act, and comparable laws in U.S. states and other jurisdictions world-wide, impose joint and several liability for the cost of environmental remediation, natural resource damages, third party claims, and other expenses, without regard to the fault or the legality of the original conduct, on those persons who contributed to the release of a hazardous substance into the environment. These laws may impact the manufacture and distribution of the Company s products and place restrictions on the products the Company can sell in certain geographical locations.

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The costs of complying with these laws and regulations, including participation in assessments and remediation of contaminated sites and installation of pollution control facilities, have been, and in the future could be, significant. In addition, these laws and regulations may also result in substantial environmental liabilities associated with divested assets, third party locations, and past activities. The Company has established reserves for environmental remediation activities and liabilities where appropriate. However, the cost of addressing environmental matters (including the timing of any charges related thereto) cannot be predicted with certainty, and these reserves may not ultimately be adequate, especially in light of potential changes in environmental conditions, changing interpretations of laws and regulations by regulators and courts, the discovery of previously unknown environmental conditions, the risk of governmental orders to carry out additional compliance on certain sites not initially included in remediation in progress, the Company s potential liability to remediate sites for which provisions have not previously been established and the adoption of more stringent environmental laws. Such future developments could result in increased environmental costs and liabilities and could require significant capital and other ongoing expenditures, any of which could have a material adverse effect on the Company s financial condition or results. In addition, the presence of environmental contamination at the Company s properties could adversely affect its ability to sell property, receive full value for a property, or use a property as collateral for a loan.

Acuity Brands may develop unexpected legal contingencies or lose insurance coverage.

Acuity Brands is subject to various claims, including legal claims arising in the normal course of business. The Company is insured up to specified limits for certain types of claims with a self-insurance retention of $0.5 million per occurrence, including toxic tort and other product liability claims, and is fully self-insured for certain other types of claims, including employment practices, environmental, product recall, commercial disputes, patent infringement, and errors and omissions. Acuity Brands 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 or lower than the amounts reserved for such claims. In the event of unexpected future developments, it is possible that the ultimate resolutions of such matters, if unfavorable, could have a material adverse effect on the Company s results of operations, financial position or cash flows. In addition, Acuity Brands cannot guarantee that it will be able to maintain current levels of insurance coverage for all matters that are currently insured for costs that the Company considers to be reasonable. The Company s insurance coverage is negotiated on an annual basis, and insurance policies in the future may have coverage exclusions that could cause claim related costs to rise.

Acuity Brands results may be adversely affected by fluctuations in the cost or availability of raw materials.

The Company utilizes a variety of raw materials and components in its production process including petroleum based chemicals, steel, copper, ballasts, and aluminum. For example, Acuity Brands Lighting purchases approximately 116,000 tons of steel and aluminum on an annual basis depending on various factors including ABL s product mix. The Company estimates that approximately 8% of the raw materials purchased are petroleum-based. Failure to effectively manage future increases in the costs of these items could adversely affect the ability to achieve operating margins acceptable to shareholders. There can be no assurance that future raw material price increases will be successfully passed through to customers. The Company sources these goods from a number of suppliers and is, therefore, reasonably insulated from risks affecting any one supplier. Profitability and volume could be negatively impacted by limitations inherent within the supply chain of certain of these materials, including competitive, governmental, legal, natural disasters, and other events that could impact both supply and price.

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Acuity Brands may pursue future growth through strategic acquisitions which may not yield anticipated benefits.

The Company has previously endeavored, and may again endeavor to improve the business through strategic acquisitions. The Company will gain from such activity only to the extent that it can effectively leverage the assets, including personnel, and operating processes of the acquired businesses. Uncertainty is inherent within the acquisition process, and unforeseen circumstances arising from future acquisitions could offset their anticipated benefits. Any of these factors could adversely affect the Company s results of operations, including its ability to generate positive operating cash flows.

Technological developments by competitors could affect the Company s operating profit margins and sales volume.

Acuity Brands Lighting is highly engaged in the investigation, development, and implementation of new technologies. Securing key partnerships and alliances, including having access to technologies generated by others and the obtaining of appropriate patents, play a significant role in protecting Acuity Brands intellectual property and development activities. However, the continual development of new technologies (e.g., LEDs and lamp ballast systems) by existing and new source suppliers looking for either direct market access or partnership with competing large manufacturers, coupled with significant associated exclusivity and/or patent activity, could adversely affect the Company s, and specifically ABL s, ability to sustain operating profit margin and desirable levels of volume.

Acuity Brands may be unable to sustain significant customer relationships.

Relationships forged with customers, including The Home Depot, which represent approximately 15% and 13% of the total net sales from ABL and ASP, respectively, are directly impacted by the Company s ability to deliver high quality products and service. Acuity Brands does not have a written contract obligating The Home Depot to purchase its products. The loss of or substantial decrease in the volume of purchases by The Home Depot would harm the Company s sales and profitability. Innovation in design and technology achieved by competitors could have a negative impact on customer acceptance of the Company s products. Additionally, the Company sources many materials and components used in its production processes from third-party suppliers. The Company has recently incurred recall costs associated with faulty items purchased from third-party suppliers. While the Company anticipates reimbursement for the majority of the recall costs, the inability to effectively manage customer relationships during the recall process could have an adverse effect on the Company s ability to maintain desired levels of profitability and volume.

If Acuity Brands products are improperly manufactured, packaged, or labeled or become adulterated, it may need to recall those items and may experience product liability claims if consumers are injured.

Acuity Brands may need to recall some of its products if they are improperly manufactured, packaged, or labeled or if they become adulterated. The Company s quality control procedures relating to the raw materials, including packaging, that it receives from third-party suppliers as well as the Company s quality control procedures relating to its products after those products are designed, manufactured or formulated and packaged may not be sufficient. Acuity Brands has previously initiated product recalls as a result of potentially faulty components, assembly, installation, and packaging of its products, and widespread product recalls could result in significant losses due to the costs of a recall, the destruction of product inventory, and lost sales due to the unavailability of product for a period of time. Acuity Brands may also be liable if the use of any of its products causes injury, and could suffer losses from a significant product liability judgment against the Company. A significant product recall or product liability case could also result in adverse publicity, damage to the Company s reputation, and a loss of consumer confidence in its products, which could have a material adverse effect on the Company s business, financial results, and cash flow.

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Acuity Brands could be adversely affected by disruptions of its operations.

Breakdown of equipment or other events, including catastrophic events such as war or natural disasters, leading to production interruptions in the Company s plants could have a material adverse effect on its financial results. Further, because many of the Company s customers are, to varying degrees, dependent on planned deliveries from the Company s plants, those customers that have to reschedule their own production or delay opening a facility due to the Company s missed deliveries could pursue financial claims against Acuity Brands. The Company may incur costs to correct any of these problems, in addition to facing claims from customers. Further, the Company s reputation among actual and potential customers may be harmed, resulting in a loss of business. While the Company maintains insurance policies covering, among other things, physical damage, business interruptions and product liability, these policies may not cover all losses and the Company could incur uninsured losses and liabilities arising from such events, including damage to its reputation, loss of customers, and suffer substantial losses in operational capacity, any of which could have a material adverse effect on its financial results and cash flow.

The Company s lighting equipment business is heavily dependent on the strength of construction activity.

Sales activity within the lighting equipment industry depends significantly on the level of activity in new construction, additions, and renovations. Demand for non-residential construction is driven by many factors, including but not limited to the availability of credit, fluctuation of interest rates, accessibility to public financing, and trends in vacancy rates and rent values. Demand for new residential construction and remodeling is also affected by the fluctuation of interest rates and the availability of credit as well as the supply of existing homes, price appreciation, and household formation rates. Significant decreases in either residential or non-residential construction activity could significantly impact the Company s results of operations.

Acuity Brands is heavily dependent on the strength of construction activity, and this dependency will increase with the spin-off of its specialty products business.

Of Acuity Brands fiscal 2007 net sales of approximately $2.5 billion, the lighting equipment segment generated approximately 78% of total net sales while the specialty products segment provided the remaining 22%. Sales activity within the lighting equipment industry depends significantly on the level of activity in new construction, additions and renovations. Demand for non-residential construction is driven by many factors, including but not limited to general economic activity, the availability of credit, fluctuation of interest rates, and trends in vacancy rates and rent values. Demand for new residential construction and remodeling is also affected by the fluctuation of interest rates and the availability of credit as well as the supply of existing homes, price appreciation and household formation rates.

Acuity Brands exposure to the above listed trends affecting its lighting business has, to a degree, been buffered by the operations of its specialty products business. While some seasonality is inherent to the specialty products business, ASP s performance remains generally unaffected by trends isolated to construction markets. Acuity Brands announced plans in July 2007 to separate the lighting and specialty chemical businesses by spinning off Acuity Specialty Products into an independent public company. During the past five years, ASP s annual contribution to its parent s operating cash flows, net of investing activity, has averaged approximately $37 million. The specialty products business has been responsible for approximately 22-25% of the consolidated parent company s revenues over that period. Additionally, the specialty products business has contributed to the profitability of the consolidated entity; the specialty products group s operating profit and operating profit margins during the previous five years have averaged approximately $41 million and 7.7%, respectively, excluding any allocation of corporate costs. In fiscal 2008, Acuity Brands, with Acuity Brands Lighting as its sole operating subsidiary, will proceed without the benefit from operations previously conducted by ASP. Therefore, Acuity Brands exposure to activity within the non-residential and residential construction markets will no longer be mitigated, to any extent, by the operations of its chemical business. Significant decreases non-residential construction activity and, to a lesser extent, retail construction activity could significantly impact the Company s future results of operations.

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Risks Related to Ownership of Acuity Brands Common Stock

The market price and trading volume of the Company s shares may be volatile.

The market price of the Company s common shares could fluctuate significantly for many reasons, including for reasons unrelated to the Company s specific performance, such as reports by industry analysts, investor perceptions, or negative announcements by customers, competitors or suppliers regarding their own performance, as well as general economic and industry conditions. For example, to the extent that other large companies within Acuity Brands industries experience declines in their share price, the Company s share price may decline as well. In addition, when the market price of a company s shares drops significantly, shareholders often institute securities class action lawsuits against the company. A lawsuit against us could cause us to incur substantial costs and could divert the time and attention of the Company s management and other resources.

Item 2. ***Properties***

The general corporate offices of Acuity Brands are located in Atlanta, Georgia. Because of the diverse nature of operations and the large number of individual locations, it is neither practical nor meaningful to describe each of the operating facilities owned or leased by the Company. The following listing summarizes the significant facility categories by business:

Division	Owned	Leased	Nature of Facilities
Lighting Equipment	12	5	Manufacturing Facilities
		7	Warehouses
	1	5	Distribution Centers
	7	25	Offices
Specialty Products	4	2	Manufacturing Facilities
	3	38	Warehouses/Branches
		2	Distribution Centers
		7	Offices

The following table provides additional geographic information related to Acuity Brands manufacturing facilities:

	United States	Canada	Mexico	Europe	Total
Lighting Equipment					
Owned	6		5	1	12
Leased	2		1	2	5
Specialty Products					
Owned	3			1	4
Leased		1		1	2
Total	11	1	6	5	23

None of the individual properties of Acuity Brands is considered to have a value that is significant in relation to the assets of Acuity Brands as a whole. Though a loss at certain facilities could have an impact on the Company s ability to serve the needs of its customers, the Company believes that the financial impact would be partially mitigated by various insurance programs in place. Acuity Brands believes that its properties are well maintained and are in good operating condition and that its properties are suitable and adequate for its present needs. The Company believes that it has additional capacity available at most of its production facilities and that it could increase production without substantial capital expenditures. As noted above, initiatives related to enhancing the global supply chain in the lighting equipment segment may continue to result in the consolidation

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of certain manufacturing facilities. However, the Company believes that the remaining facilities will have sufficient capacity to serve the current and projected needs of the customers of ABL.

Item 3. ***Legal Proceedings***

General

Acuity Brands is subject to various legal claims arising in the normal course of business, including patent infringement and product liability claims. Acuity Brands 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 employment practices, environmental, product recall, and patent infringement. Based on information currently available, it is the opinion of management that the ultimate resolution of pending and threatened legal proceedings will not have a material adverse effect on the financial condition, results of operations, or cash flows of Acuity Brands. 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 Acuity Brands in future periods. Acuity Brands 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.

Environmental Matters

The operations of the Company are subject to numerous comprehensive laws and regulations relating to the generation, storage, handling, transportation, and disposal of hazardous substances as well as solid and hazardous wastes and to the remediation of contaminated sites. In addition, permits and environmental controls are required for certain of the Company s operations to limit air and water pollution, and these permits are subject to modification, renewal, and revocation by issuing authorities. On an ongoing basis, Acuity Brands invests capital and incurs operating costs relating to environmental compliance. Environmental laws and regulations have generally become stricter in recent years. The cost of responding to future changes may be substantial. Acuity Brands establishes reserves for known environmental claims when the costs associated with the claims become probable and can be reasonably estimated. The actual cost of environmental issues may be substantially higher or lower than that reserved due to difficulty in estimating such costs.

In June 2007, ASP reached a final resolution of the investigation by the United States Department of Justice (DOJ) of certain environmental issues at ASP s primary manufacturing facility, located in Atlanta, Georgia. The DOJ s investigation focused principally on past conduct involving the inaccurate reporting of certain wastewater sampling results to the City of Atlanta (City) and conduct that interfered with the City s efforts to sample ASP s wastewater pretreatment plant effluent. Consistent with the tentative resolution of this matter announced in April 2007, ASP entered a guilty plea to one felony count of failure to comply with its wastewater permit, agreed to pay a fine of $3.8 million, and be subject to a three-year probation period incorporating a compliance agreement with the Environmental Protection Agency (EPA); however, effective upon the spin-off, Zep Inc. will be substituted for Acuity Brands, Inc. in the compliance agreement and Acuity Brands, Inc. will have no further obligations thereunder. Under the compliance agreement, the Company will be required to maintain an enhanced compliance program relating to ASP. The Company recorded an additional $1.8 million charge in the second quarter of fiscal 2007 to reflect the entire $3.8 million fine. The resolution of this matter is not expected to lead to a material loss of ASP s business, any disruption of ASP s production, or materially higher operating costs at ASP. However, in the event of a material breach of the compliance agreement by ASP, those consequences could occur.

ASP is currently a party to, or otherwise involved in, legal proceedings in connection with state and federal Superfund sites. With respect to each of the currently active sites which it does not own and where it has been

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named as a responsible party or a potentially responsible party (PRP), the Company believes its liability is immaterial, based on information currently available, due to its limited involvement at the site and/or the number of viable PRPs.

With respect to the only active site involving property which ASP does own and where it has been named as a PRP a property on Seaboard Industrial Boulevard in Atlanta, Georgia the Company and the current and former owners of adjoining properties have reached agreement to share the expected costs and responsibilities of implementing an approved corrective action plan under the Georgia Hazardous Response Act (HSRA) to periodically monitor the property for a period of five years ending in 2009. Subsequently, in connection with the DOJ investigation, the EPA and the Company each analyzed samples taken from certain sumps at the Seaboard facility. The sample results from some of the sump tests indicated the presence of certain hazardous substances. As a result, the Company notified the Georgia Environmental Protection Division and is conducting additional soil and groundwater studies pursuant to HSRA.

Based on the results to date of the above-mentioned soil and groundwater studies, ASP plans to conduct voluntary remediation of the site. ASP s current estimate is it will expend between $1.0 million and $7.5 million for the voluntary remediation of the site over approximately the next five years, and in May 2007 accrued a pre-tax liability of $5.0 million representing its best estimate of costs associated with remediation and other related groundwater issues. Further sampling and engineering studies could cause ASP to revise the current estimate. ASP believes that additional expenditures after five years of remediation may be necessary and that those expenditures could range up to an additional $10.0 million during the subsequent twenty-five year period. It may be appropriate to capitalize certain of the expenditures that might be incurred in this twenty-five year period. ASP arrived at the current estimates on the basis of preliminary studies prepared by two, independent third party environmental consulting firms. The actual cost of remediation will vary depending upon the results of additional testing and geological studies, the success of initial remediation efforts in the first five years addressing the most significant areas of contamination, the rate at which site conditions may change, and the requirements of the Environmental Protection Division of the State of Georgia.

Item 4. ***Submission of Matters to a Vote of Security Holders***

No matters were submitted for a vote of the security holders during the three months ended August 31, 2007.

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PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities***

The common stock of Acuity Brands is listed on the New York Stock Exchange under the symbol AYI. At October 26, 2007, there were 4,976 stockholders of record. The following table sets forth the New York Stock Exchange high and low sale prices and the dividend payments for Acuity Brands common stock for the periods indicated.

	Price per Share		Dividends
	High	**Low**	**Per Share**
2007			
First Quarter	$ 54.48	$ 42.31	$ 0.15
Second Quarter	$ 60.18	$ 48.71	$ 0.15
Third Quarter	$ 62.16	$ 51.57	$ 0.15
Fourth Quarter	$ 66.89	$ 46.95	$ 0.15
2006			
First Quarter	$ 31.96	$ 26.75	$ 0.15
Second Quarter	$ 40.42	$ 31.00	$ 0.15
Third Quarter	$ 44.35	$ 37.91	$ 0.15
Fourth Quarter	$ 45.18	$ 35.31	$ 0.15

The information required by this item with respect to equity compensation plans is included under the caption *Disclosure with Respect to Equity Compensation Plans* in the Company s proxy statement for the annual meeting of stockholders to be held January 10, 2008, to be filed with the Securities and Exchange Commission pursuant to Regulation 14A, and is incorporated herein by reference.

The following table reflects activity related to equity securities purchased by the Company during the quarter ended August 31, 2007:

Period	Total Number of Shares Purchased	Average Price per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
6/01/07 6/30/07		$		368,300
7/01/07 7/31/07		$		368,300
8/01/07 8/31/07	376,900	$ 52.40	376,900	1,991,400
Total	376,900	$ 52.40	376,900	1,991,400

(1) On August 14, 2007, the Company received authorization from the Board of Directors for the repurchase of up to an additional two million shares of the Company s common stock. Of the 376,900 shares purchased during the fourth quarter of fiscal 2007, 270,000 shares were purchased under the Company s 10b5-1 stock purchase plans at an average price of $53.75. Unless terminated earlier by resolution of the Board of Directors, the program will expire when the Company has purchased all shares authorized for repurchase under the program.

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Item 6. ***Selected Financial Data***

The following table sets forth certain selected consolidated financial data of Acuity Brands which have been derived from the *Consolidated Financial Statements* of Acuity Brands for each of the five years in the period ended August 31, 2007. The historical information may not be indicative of the Company s future performance. The information set forth below should be read in conjunction with *Management s Discussion and Analysis of Financial Condition and Results of Operations* and the *Consolidated Financial Statements* and the notes thereto. Prior to November 30, 2001, Acuity Brands was a wholly-owned subsidiary of National Service Industries, Inc. (NSI) owning and operating the lighting equipment and specialty products businesses. Acuity Brands was spun off from NSI into a separate publicly traded company with its own management and Board of Directors through a tax-free distribution (Distribution) of 100% of the outstanding shares of common stock of Acuity Brands on November 30, 2001.

	Years Ended August 31,				
	2007	2006	2005	2004	2003
	(In thousands, except per-share data)				
Net sales	$ 2,530,668	$ 2,393,123	$ 2,172,854	$ 2,104,167	$ 2,049,308
Net income	148,054	106,562	52,229	67,214	47,782
Basic earnings per share	3.48	2.43	1.21	1.60	1.15
Diluted earnings per share	3.37	2.34	1.17	1.56	1.15
Cash and cash equivalents	222,816	88,648	98,533	14,135	16,053
Total assets	1,612,508	1,444,116	1,442,215	1,356,452	1,284,113
Long-term debt (less current maturities)	371,027	371,252	371,736	390,210	391,469
Total debt	371,323	371,895	372,303	395,721	445,808
Stockholders equity	671,966	542,259	541,793	477,977	408,294
Cash dividends declared per common share	0.60	0.60	0.60	0.60	0.60

On July 23, 2007, the Company announced its intention to separate its lighting and specialty products businesses by spinning off the specialty products business of Acuity Specialty Products Group, Inc. into an independent, publicly traded company named Zep Inc. to Acuity Brands stockholders (the spin-off). The Board of Directors of Acuity Brands approved the completion of the spin-off on September 28, 2007, subject to the setting of the record date and the distribution date by the Executive Committee of the Board of Directors. The Executive Committee established the record date and distribution date for the spin-off on October 6, 2007.

Prior to the spin-off, the Company engaged in an internal restructuring, including a holding company reorganization. As part of the internal restructuring, the business that had previously been conducted by Acuity Specialty Products Group, Inc. was merged into its parent company and was subsequently transferred to Acuity Specialty Products, Inc. (ASP). ASP is now a wholly-owned subsidiary of Zep Inc., which is in turn a direct, wholly-owned subsidiary of Acuity Brands, Inc.

Zep Inc. filed a registration statement on Form 10 with the Securities and Exchange Commission, which was declared effective on October 11, 2007. The financial presentation of Zep Inc. in the Form 10 differs from the financial presentation of the Acuity Specialty Products segment in Acuity Brands financial statements primarily due to adjustments made to reflect the allocation of corporate expenses. The basis of presentation herein remains unaffected by the decision to spin-off the specialty products business as the related distribution will not be transacted until October 31, 2007. However, after the October 31, 2007 distribution date, the Acuity Specialty Products segment will be reflected as discontinued operations in all periods presented within Acuity Brands financial statements in accordance with Statements of Financial Standards No. 144: *Accounting for the Impairment or Disposal of Long-Lived Assets*.

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Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion should be read in conjunction with the *Consolidated Financial Statements* and related notes included within this report. References made to years are for fiscal year periods. Dollar amounts are in thousands, except share and per-share data and as indicated.

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 and its subsidiaries for the years ended August 31, 2007, 2006, and 2005. For a more complete understanding of this discussion, please read the *Notes to Consolidated Financial Statements* included in this report.

Overview

Company

Acuity Brands, Inc. (Acuity Brands or the Company) is a holding company that owns and manages two businesses that serve distinctive markets lighting equipment and specialty products. The lighting equipment segment designs, produces, and distributes a broad array of indoor and outdoor lighting fixtures for commercial and institutional, industrial, infrastructure, and residential applications for various markets throughout North America and select international markets. The specialty products segment is a producer, marketer, and service provider of a wide range of cleaning and maintenance solutions for commercial, industrial, institutional, and consumer end-markets primarily throughout North America and Europe. Acuity Brands, with its principal office in Atlanta, Georgia, employs approximately 10,000 people worldwide.

Acuity Brands Lighting (ABL), produces a broad array of indoor and outdoor lighting fixtures for commercial and institutional, industrial, infrastructure, and residential applications for various markets throughout North America and select international markets. ABL is one of the world s leading providers of lighting fixtures, with a broad, highly configurable product offering, consisting of roughly 500,000 active products as part of over 2,000 product groups that are sold to approximately 5,000 customers. ABL operates 23 factories and distribution facilities along with seven warehouses to serve its extensive customer base. Acuity Specialty Products (ASP) is a leading producer of specialty chemical products including cleaners, deodorizers, sanitizers, and pesticides for industrial and institutional, commercial, and residential applications primarily for various markets throughout North America and Europe. ASP has more than 2,300 unique formulations that are used in manufacturing products for its customers, operates six plants, and serves over 350,000 customers through a network of distribution centers and warehouses. While Acuity Brands has been publicly held as a stand-alone company for more than five years, the two segments that make up the Company have long histories and well-known brands.

Specialty Products Business Spin-off

The Board of Directors and management of Acuity Brands regularly review business conducted by Acuity Brands to ensure that resources are deployed and activities are pursued in the best interests of its stockholders. Management of Acuity Brands began discussing potential divestiture strategies relating to Acuity Brands specialty products business, including a potential sale of the business or a spin-off, in the fall of 2006. On July 23, 2007, the Company announced its intention to separate its lighting and specialty products businesses by spinning off the business of Acuity Specialty Products Group, Inc. into an independent, publicly traded company to Acuity Brands shareholders (the spin-off). The Board of Directors of Acuity Brands approved the completion of the previously announced spin-off on September 28, 2007, subject to the setting of the record date and the distribution date by the Executive Committee of the Board of Directors. The Executive Committee established the record date and distribution date for the spin-off on October 6, 2007. Plans to spin-off Acuity Specialty Products were ultimately pursued to allow the lighting and chemical businesses of Acuity Brands the financial and operational flexibility to separately take advantage of significant growth opportunities facing their respective businesses, which the Company believes is in the best interest of its stockholders.

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Prior to the spin-off, the Company engaged in an internal restructuring, including a holding company reorganization. As part of the internal restructuring, the business that had previously been conducted by Acuity Specialty Products Group, Inc. was merged into its parent company and was subsequently transferred to Acuity Specialty Products, Inc. (ASP). ASP is now a wholly-owned subsidiary of Zep Inc., which is in turn a direct, wholly-owned subsidiary of Acuity Brands, Inc.

Zep Inc. (Zep) will be listed on the New York Stock Exchange under the ticker symbol ZEP. Acuity Brands expects to distribute pro rata to its stockholders all of the shares of Zep common stock by means of a stock dividend on October 31, 2007. The stock dividend of one share of Zep common stock for every two shares of Acuity Brands common stock will be paid pro rata to holders of Acuity Brands common stock who hold their shares at the close of business on October 17, 2007, which is the record date for the distribution. No fractional shares of Zep common stock will be distributed. Instead of fractional shares, Zep stockholders will receive cash. Following the distribution, Acuity Brands will not own any shares of Zep, and Zep will be an independent public company. The spin-off is intended to be tax free to affected shareholders, and the Company has received a favorable ruling from the Internal Revenue Service as well as a favorable opinion of external tax counsel supporting the spin-off s tax-free status. To facilitate the separation of Zep Inc. from its parent, Acuity Brands will provide certain services to Zep Inc. during a transition period following completion of the spin-off. Additionally, the Company and Zep Inc. will enter into commercially reasonable service agreements in the normal course of business. As of August 31, 2007, Acuity Brands has incurred $2.1 million of incremental professional fees associated with the spin-off.

Zep Inc. filed a registration statement on Form 10 with the Securities and Exchange Commission, which was declared effective on October 11, 2007. The financial presentation of Zep Inc. in the Form 10 differs from the financial presentation of the Acuity Specialty Products segment in Acuity Brands financial statements primarily due to adjustments made to reflect the allocation of corporate expenses. The basis of presentation herein remains unaffected by the decision to spin-off the specialty products business as the related distribution will not be transacted until October 31, 2007. However, after the October 31, 2007 distribution date, the Acuity Specialty Products segment will be reflected as discontinued operations in all periods presented within Acuity Brands financial statements in accordance with Statements of Financial Standards No. 144: *Accounting for the Impairment or Disposal of Long-Lived Assets*.

Strategy

Throughout 2007, Acuity Brands made significant progress towards key initiatives designed to enhance and streamline its operations, including its product development and service capabilities, to create a stronger, more effective organization that is capable of consistently achieving its long-term financial goals, which are as follows:

- Generating consolidated operating margins in excess of 10%;
- Growing earnings per share in excess of 15% per annum;
- Providing a return on stockholders equity of 20% or better;
- Maintaining the Company s debt to total capitalization ratio below 40%; and
- Generating cash flow from operations less capital expenditures that is in excess of net income.

Acuity Brands, with ABL as its lone operating subsidiary after the spin-off, will pursue the above-stated goals on a continuing operations basis. To increase the probability for the Company to achieve these financial goals, management will continue to implement programs to enhance its capabilities at providing unparalleled customer service, creating a globally competitive cost structure by eliminating non-value added activities, lowering transaction costs, improving productivity, and introducing new and innovative products more rapidly and cost effectively. In addition, the Company has invested considerable resources to teach and train associates to utilize tools and techniques that accelerate success in these key areas as well as to create a culture that demands excellence through continuous improvement. The expected outcome of these activities will be to better position the Company to deliver on its full potential, to provide a platform for future growth opportunities, and to allow the Company to

achieve its long-term financial goals. See the *Outlook* section below for additional information.

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Liquidity and Capital Resources

Principal sources of liquidity for the Company are operating cash flows generated primarily from its business segments and various sources of borrowings. The ability of the Company to generate sufficient cash flow from operations and access certain capital markets, including banks, is necessary for the Company to fund its operations, to pay dividends, to meet its obligations as they become due, and to maintain compliance with covenants contained in its financing agreements. The Company s ongoing liquidity will depend on a number of factors, including available cash resources, cash flow from operations, compliance with covenants contained in certain of its financing agreements, and its ability to access capital markets.

Based on its cash on hand, availability under existing financing arrangements, and current projections of cash flow from operations, the Company believes that it will be able to meet its liquidity needs over the next twelve months. These needs will include funding its operations as currently planned, making anticipated capital investments, funding foreseen improvement initiatives, repaying borrowings as currently scheduled, paying quarterly stockholder dividends as currently anticipated, making required contributions into the Company s benefit plans, and repurchasing shares of the Company s outstanding common stock as authorized by the Company s Board of Directors. The Company s Board of Directors has authorized the repurchase of eight million shares of the Company s outstanding common stock, of which approximately six million had been acquired as of August 31, 2007. The Company, with ABL as its sole operating subsidiary, currently expects to invest approximately $35.0 million to $40.0 million for equipment, tooling, and new and enhanced information technology capabilities during fiscal 2008. The Company expects to contribute approximately $3.4 million in fiscal 2008 to fund its defined benefit plans.

Looking beyond fiscal 2008, the Company has $160.0 million of public notes scheduled to mature during January 2009 and $200.0 million of public notes scheduled to mature eighteen months later during 2010. The Company believes that it will be able to either refinance or retire these notes as they come due based on current cash balances; the recently executed $250.0 million 5-year Revolving Credit Facility maturing in October 2012; its $75.0 million Receivables Facility, which may be renewed annually; and future cash provided by operations.

Cash Flow

Acuity Brands uses available cash and cash flow from operations as well as proceeds from the exercise of stock options to fund operations and capital expenditures, to repurchase stock, to fund acquisitions, and to pay dividends. The Company applied $43.5 million of available cash towards acquisitions during fiscal year 2007. While the Company received $26.5 million in cash from stock issuances during fiscal year 2007, these receipts were more than offset by returns to shareholders in the form of repurchases of the Company s common stock of $45.0 million and the payment of $26.4 million in dividends. In spite of these events, cash and cash equivalents at fiscal year-end totaled $222.8 million, an increase of $134.2 million since the beginning of the fiscal year.

In fiscal 2007, cash flow provided by operating activities totaled $241.2 million compared with $155.9 million and $137.1 million reported in 2006 and 2005, respectively. Cash flow provided by operating activities increased in 2007 compared with 2006 by $85.3 million or 54.7% due primarily to higher net income of $41.5 million, increased accrued liabilities of $49.1 million, and a $15.7 million decrease in cash required to fund consolidated operating working capital needs (operating working capital is calculated by adding accounts receivable, net, plus inventories, and subtracting accounts payable). The increase in accrued liabilities was due to several factors, the largest of which are as follows: greater accrued compensation of $14.9 million, which includes commissions and bonuses associated with positive operating performance; increased accrued taxes payable of $12.4 million, which was attributable to greater earnings and the timing of related payments; increased costs related to certain environmental matters totaling $5.0 million; increased costs of $3.7 million related to the Company s property and casualty insurance programs; and other legal and professional fees primarily related to the spin-off of Acuity Specialty Products. Fluctuations in operating working capital are discussed below.

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 spent $36.9 million and $28.6 million in 2007 and 2006, respectively, primarily for new tooling, machinery, equipment, and information technology. The Company continues to invest appropriately in these items primarily to improve productivity and

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product quality, increase manufacturing efficiencies, and enhance customer service capabilities in each segment. As noted above, the Company, with ABL as its sole operating subsidiary, expects capital spending in 2008 to range between $35.0 million and $40.0 million, due primarily to greater anticipated investment in equipment and tooling for new products as well as for further enhancement of its information technology capabilities. The Company believes that these investments will enhance its operations and financial performance in the future. In the fourth quarter of fiscal 2007 the Company applied $43.5 million of available cash towards acquiring substantially all of the assets and assuming certain liabilities of Mark Lighting Fixture Company, Inc. This transaction is discussed further in Note 9 of the *Notes to the Consolidated Financial Statements*.

Consolidated working capital at August 31, 2007 was $397.6 million compared with $309.9 million at August 31, 2006, an increase of $87.7 million. The increase in working capital in 2007 compared with 2006 was due primarily to the $134.2 million increase in cash and cash equivalents, partially offset by a $17.2 million decrease in inventory and a $28.7 million increase in other current liabilities. Almost half of the increase in other current liabilities was attributable to taxes payable, and the primary components of the remainder of the difference have been discussed above. The decrease in inventory was achieved through the successful implementation of certain inventory management initiatives at select locations of both the lighting and chemical businesses, and was aided by record selling performance in the last quarter of fiscal 2007. Operating working capital decreased by approximately $11.8 million to $333.5 million at August 31, 2007 from $345.3 million at August 31, 2006. Decreased operating working capital levels resulted from the successful implementation of inventory and payables management initiatives coupled with continued favorable development of receivables collections. Operating working capital as a percentage of net sales at the end of fiscal 2007 decreased to 13.2% from 14.4% in fiscal 2006. At August 31, 2007, the current ratio (calculated as total current assets divided by total current liabilities) of the Company was 1.8 compared with 1.7 at August 31, 2006.

During the course of the previous five years, Acuity Specialty Products annual contribution to its parent company s aggregate operating and investing cash flows has averaged $37 million (amount is net of estimated corporate overhead costs). On October 31, 2007 (the distribution date), Acuity Brands will enter into a distribution agreement with Zep Inc. The distribution agreement will provide for the principal corporate transactions required to affect the spin-off. Pursuant to this distribution agreement, Zep Inc. will draw upon its credit facilities and remit a dividend to Acuity Brands in the amount of $62.5 million on the distribution date. Acuity Brands intends to use proceeds from this dividend to fund currently authorized share repurchases or to reduce its outstanding indebtedness. The distribution agreement further provides that after the spin-off, Acuity Brands will remit to Zep Inc. an amount equal to the positive net cash flow generated by Zep Inc. during the period from September 1, 2007 until the distribution date (less any cash in excess of $5.0 million held by Zep Inc. on the distribution date). Therefore, effective September 1, 2007, Acuity Brands will cease to benefit from positive operating cash flow generated by its specialty products business.

Contractual Obligations

The following table summarizes the Company s contractual obligations at August 31, 2007:

		Payments Due by Period			
	Total	Less than One Year	1 to 3 Years	4 to 5 Years	After 5 Years
Long-Term Debt (1)	$ 371,323	$ 296	$ 359,869	$	$ 11,158
Interest Obligations (2)	162,509	33,761	59,028	18,792	50,928
Operating Leases (3)	92,461	23,181	33,694	21,381	14,205
Purchase Obligations (4)	107,874	103,391	3,832	651	
Other Long-term Liabilities (5)	52,309	4,605	12,055	12,242	23,407
Total	$ 786,476	$ 165,234	$ 468,478	$ 53,066	$ 99,698

(1) These amounts (which represent the amounts outstanding at August 31, 2007) are included in the Company s *Consolidated Balance Sheets*. See Note 4: Long-Term Debt and Lines of Credit for additional information regarding debt and other matters.

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(2) These amounts represent the expected future interest payments on debt held by the Company at August 31, 2007 and the Company s loans related to its corporate-owned life insurance policies (COLI). The substantial majority of interest payments on debt included in this table is based on a fixed rate. COLI-related interest payments included in this table are estimates. These estimates are based on various assumptions, including age at death, loan interest rate, and tax bracket. The amounts in this table do not include COLI-related payments after ten years due to the difficulty in calculating a meaningful estimate that far in the future. Note that payments related to debt and the COLI are reflected on the Company s *Consolidated Statements of Cash Flows*.
(3) The Company s operating lease obligations are described in Note 7: Commitments and Contingencies.
(4) Purchase obligations include commitments to purchase goods or services that are enforceable and legally binding and that specify all significant terms, including open purchase orders.
(5) These amounts are included in the Company s *Consolidated Balance Sheets* and largely represent other liabilities for which the Company is obligated to make future payments under certain long-term incentive programs. Estimates of the amounts and timing of these amounts are based on various assumptions, including expected return on plan assets, interest rates, stock price fluctuations, and other variables. The amounts in this table do not include amounts related to future funding obligations under the defined benefit pension plans. The amount and timing of these future funding obligations are subject to many variables and also depend on whether or not the Company elects to make contributions to the pension plans in excess of those required under ERISA. Such voluntary contributions may reduce or defer the funding obligations absent those contributions. See Note 3: Pension and Profit Sharing Plans for additional information.

Capitalization

The current capital structure of the Company is comprised principally of senior notes and the equity of its stockholders. As of August 31, 2007, the Company had no amounts outstanding under its asset-backed securitization program or borrowings under the Revolving Credit Facility discussed below. Total debt outstanding at August 31, 2007, was $371.3 million compared with $371.9 million at August 31, 2006, and consisted mainly of fixed rate, long-term debt.

The Company maintains an agreement (Receivables Facility) to borrow, on an ongoing basis, funds secured by undivided interests in a defined pool of trade accounts receivable of ABL and ASP. There were no outstanding borrowings at August 31, 2007 and 2006 under the Receivables Facility, which expired in October 2007. On October 19, 2007, the Company entered into separate Receivables Facility agreements (the ABL Receivables Facility and the Zep Receivables Facility , together referred to as the Receivables Facilities) in preparation of the spin-off of Zep Inc. The Receivables Facilities are for a one-year period with similar terms and conditions as the previous Receivables Facility. The ABL Receivables Facility allows for borrowings of funds up to $75.0 million, on an ongoing basis, secured by undivided interests in a defined pool of trade accounts receivable of ABL. The Zep Receivables Facility allows for borrowings of funds up to $40.0 million, on an ongoing basis, secured by undivided interests in a defined pool of trade accounts receivable of ASP.

On April 2, 2004, the Company executed a $200.0 million revolving credit facility (Revolving Credit Facility), which matures in January 2009. The Company was in compliance with all financial covenants and had no outstanding borrowings at August 31, 2007 and 2006 under the Revolving Credit Facility. On October 19, 2007, the Company executed both a $250.0 million revolving credit facility (Acuity Revolving Credit Facility) and a $100.0 million revolving credit facility (Zep Revolving Credit Facility). The revolving credit facilities were executed to facilitate the spin-off of Zep Inc. The revolving credit facilities replaced the Company s $200.0 million revolving credit facility which was scheduled to mature in January 2009. The Company will write-off approximately $0.3 million of deferred financing costs in connection with this replacement. The new revolving credit facilities both mature in October 2012. Both revolving credit facilities contain financial covenants including a leverage ratio (Maximum Leverage Ratio) of total indebtedness to EBITDA (earnings before interest, taxes, depreciation and amortization expense), as such terms are defined in the Acuity Revolving Credit Facility agreement and the Zep Revolving Credit Facility agreement, and a minimum interest coverage ratio. These ratios are computed at the end of each fiscal quarter for the most recent 12-month period. Both the Zep Receivables Facility and the Zep Revolving Credit Facility will be assigned to and fully assumed by Zep Inc. upon the execution of the spin-off of Acuity Brands specialty products segment.

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Acuity Brands has $160.0 million of public notes scheduled to mature during January 2009 and $200.0 million of public notes scheduled to mature eighteen months later during 2010. As of August 31, 2007, Acuity Brands, ABL, and ASP were each obligors under the notes. In connection with the subsidiary reorganization transactions, Acuity Specialty Products Group, Inc. has subsequently been released from its obligations under the notes. The Company believes that it will be able to either refinance or retire these notes as they come due based on current cash balances; the recently executed $250.0 million 5-year Revolving Credit Facility maturing in October 2012; its $75.0 million ABL Receivables Facility, which may be renewed annually; and future cash provided by operations. See Note 4 of the *Notes to the Consolidated Financial Statements* where each of the Company s credit facilities is discussed in further detail.

During 2007, the Company s consolidated stockholders equity increased $129.7 million, or 23.9%, to $672.0 million compared with $542.3 million in the prior year. Stockholders equity increased primarily due to increased net income earned in the current year period, the effect of which was partially offset by the impact of net stock activity and the payment of dividends. The Company s debt to total capitalization ratio (calculated by dividing total debt by the sum of total debt and total stockholders equity) as of August 31, 2007 was 35.6% compared with 40.7% as of August 31, 2006. The ratio of debt, net of cash, to total capitalization, net of cash, was 18.1% at August 31, 2007, and 34.3% at August 31, 2006. The aforementioned spin-off of the Company s specialty products business will affect the resulting Acuity Brands debt to equity relationship. Post-spin and assuming the proceeds from the spin related dividend are applied toward share repurchases, Acuity Brands debt to total capitalization ratio could approximate 40%, and its debt, net of cash, to total capitalization, net of cash, could approximate 21%.

Dividends

The Company paid cash dividends on common stock of $26.4 million ($0.60 per share) during 2007 compared with $26.9 million ($0.60 per share) in 2006. Acuity Brands has announced that it plans to pay quarterly dividends on its common stock at an initial annual rate of $0.52 per share following the spin-off. After taking into account the distribution ratio of one share of Zep common stock for every two shares of Acuity Brands common stock, the combined initial post-distribution dividend rates for Zep shares and Acuity Brands shares is identical to the dividend rate paid on Acuity Brands shares in the quarter ended August 31, 2007. All decisions regarding the declaration and payment of dividends by Acuity Brands are at the discretion of the Board of Directors of Acuity Brands and will be evaluated from time to time in light of Acuity Brands financial condition, earnings, growth prospects, funding requirements, applicable law, and any other factors the Company s board deems relevant.

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Results of Operations

Fiscal 2007 Compared with Fiscal 2006

The following table sets forth information comparing the components of net income for the year ended August 31, 2007 with the year ended August 31, 2006:

(in millions)	Years Ended August 31, 2007	2006	Percent Change
Net Sales	$ 2,530.7	$ 2,393.1	5.7%
Gross Profit	1,069.9	970.0	10.3%
Percent of net sales	*42.3%*	*40.5%*	
Operating Profit	256.9	197.4	30.2%
Percent of net sales	*10.2%*	*8.2%*	
Income before Provision for Taxes	227.9	163.8	39.2%
Percent of net sales	*9.0%*	*6.8%*	
Net Income	$ 148.1	$ 106.6	38.9%

Consolidated Results

Consolidated net sales were $2,530.7 million in 2007 compared with $2,393.1 million reported in 2006, an increase of $137.5 million, or 5.7%. For the year ended August 31, 2007, the Company reported net income of $148.1 million compared with $106.6 million earned in 2006. Diluted earnings per share were $3.37 in 2007 as compared with $2.34 reported in 2006, an increase of 44.0%.

Consolidated Net Sales

Net sales increased approximately 6.7% and 2.5% at ABL and ASP, respectively. The growth in net sales was due primarily to favorable pricing at both the lighting and specialty products businesses, greater shipments of products offered by the lighting business, and benefits from foreign currency fluctuation. Improved pricing and an enhanced mix of products sold accounted for more than three quarters of the $137.5 million increase in consolidated net sales. Favorable fluctuation in foreign currency exchange rates contributed $12.1 million to net sales in fiscal 2007. Sales generated by both business units in the third and fourth quarters of fiscal 2007 outpaced those generated in the first half of the fiscal year due to the seasonal nature of the Company s business. Also, second quarter net sales generated by both business units are typically adversely impacted by the decreased demand associated with inventory rebalancing efforts routinely undertaken by certain of the Company s distribution and retail customers towards the end of those customers fiscal years.

Consolidated Gross Profit

(in millions)	Years Ended August 31, 2007	2006	Increase (Decrease)	Percent Change
Net Sales	$ 2,530.7	$ 2,393.1	$ 137.5	5.7%
Cost of Products Sold	1,460.8	1,423.1	37.7	2.6%
Percent of net sales	*57.7%*	*59.5%*		
Gross Profit	$ 1,069.9	$ 970.0	$ 99.9	10.3%
Percent of net sales	*42.3%*	*40.5%*		

Consolidated gross profit margins increased to 42.3% of net sales in 2007 from 40.5% reported in 2006. Gross profit increased $99.9 million, or 10.3% to $1,069.9 million in 2007 compared with $970.0 million in 2006. The improvement in gross profit and gross profit margin was largely attributable to improved pricing at

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both segments, incremental margins on overall volume growth, and a better mix of products sold at ABL including new, more energy efficient products introduced over the last three years. These gains more than offset increases in raw materials and component costs as well as increases associated with employee wages and related benefits. Costs associated with raw materials and component parts increased more than $24 million during 2007 compared with the prior year.

Consolidated Operating Profit

(in millions)	Years Ended August 31, 2007	2006	Increase (Decrease)	Percent Change
Gross Profit	$ 1,069.9	$ 970.0	$ 99.9	10.3%
Percent of net sales	*42.3%*	*40.5%*		
Selling, Distribution, and Administrative Expenses	813.0	772.3	40.6	5.3%
Impairment Charge		0.3	(0.3)	(100)%
Operating Profit	$ 256.9	$ 197.4	$ 59.5	30.2%
Percent of net sales	*10.2%*	*8.2%*		

Consolidated operating expenses were $813.0 million in fiscal 2007 compared with $772.3 million in 2006, which represented an increase of $40.6 million. Operating expenses that typically vary directly with sales, such as commissions paid to the Company s sales force, bonuses designed to reward the profitable growth of revenues, and freight pertaining to shipments to customers increased approximately $30 million in 2007 from the prior year. Operating expenses were also negatively affected by merit based and inflationary wage increases of approximately $10.5 million as well as an increase in the cost of the Company s property and casualty insurance programs.

Additionally, operating expenses were impacted by four partially offsetting events occurring during fiscal 2007. In April 2007, ABL received a $6.6 million pre-tax cash payment (net of related legal costs) as settlement for a commercial dispute involving reimbursement of warranty and product liability costs associated with a product line purchased from a third party in fiscal year 2001 (the commercial dispute). In May 2007, ASP recorded a $5.0 million pre-tax charge representing the Company s best estimate of costs associated with a company-initiated remediation plan for groundwater contamination identified at ASP s primary manufacturing facility located in Atlanta, Georgia. In June 2007, the Company reached final resolution with regard to a previously disclosed investigation into certain of ASP s environmental practices, and a $1.8 million charge was recorded during the year by the specialty products business in connection with this settlement. Environmental matters affecting the Company are discussed further in Note 7 of the *Notes to Consolidated Financial Statements.* Finally, professional fees incurred as of August 31, 2007, related to the spin-off of the Company s specialty products totaled $2.1 million. While operating costs in total increased during fiscal 2007 compared with fiscal 2006, operating expenses as a percentage of net sales declined 20 basis points to 32.1% from 32.3% in the prior year.

Consolidated operating profit was $256.9 million (10.2% of net sales) in fiscal 2007 compared with $197.4 million (8.2% of net sales) reported in 2006, an increase of $59.5 million, or 200 basis points. The increase in operating profit in 2007 was due primarily to the increase in gross profit, partially offset by higher operating expenses as described above.

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Consolidated Income Before Provision for Taxes

(in millions)	Years Ended August 31, 2007	2006	Increase (Decrease)	Percent Change
Operating Profit	$ 256.9	$ 197.4	$ 59.5	30.2%
Percent of net sales	*10.2%*	*8.2%*		
Other Expense (Income)				
Interest Expense, net	30.1	33.2	(3.1)	(9.3)%
Miscellaneous Expense (Income)	(1.1)	0.4	(1.5)	(356.9)%
Total Other Expense (Income)	29.0	33.7	(4.6)	13.7%
Income before Provision for Taxes	$ 227.9	$ 163.8	$ 64.1	39.2%
Percent of net sales	*9.0%*	*6.8%*		

Other expense for Acuity Brands was made up primarily of interest expense. Interest expense, net, was $30.1 million and $33.2 million in 2007 and 2006, respectively. Interest expense, net, decreased 9.3% in 2007 compared with 2006 due primarily to greater interest income earned on higher invested cash balances.

Consolidated Provision for Income Taxes and Net Income

(in millions)	Years Ended August 31, 2007	2006	Increase (Decrease)	Percent Change
Income before Provision for Taxes	$ 227.9	$ 163.8	$ 64.1	39.2%
Percent of net sales	*9.0%*	*6.8%*		
Provision for Income Taxes	79.8	57.2	22.6	39.6%
Effective tax rate	*35.0%*	*34.9%*		
Net Income	$ 148.1	$ 106.6	$ 41.5	38.9%

Net income for 2007 increased $41.5 million to $148.1 million from $106.6 million reported in 2006. The increase in net income resulted primarily from the above-noted increase in operating profit, partially offset by higher tax expense.

The effective income tax rate reported by the Company was 35.0% and 34.9% in 2007 and 2006, respectively. The current period tax rate was adversely affected by an increase in certain costs that are not deductible when computing taxable income including professional fees associated with the anticipated spin-off of the specialty products business as well as fines associated with the settlement of certain environmental matters. The tax rate of Acuity Brands, with ABL as its sole operating subsidiary, is expected to approximate 35% following the spin-off.

Acuity Brands Lighting

Net Sales

Acuity Brands Lighting reported net sales of approximately $1,964.8 million and $1,841.0 million for the years ending August 31, 2007, and 2006, respectively, an increase of $123.7 million, or 6.7%. The increase in net sales was due primarily to higher selling prices, enhanced mix of products sold, sales of new products, and increased shipments due largely to volume growth in key non-residential markets. More than three quarters of the increase in net sales was due to improved pricing and an enhanced mix of product sold. Pricing actions taken by ABL were made necessary by increases in raw material and component costs as well as inflationary cost increases. Net sales also benefited from favorable foreign currency fluctuation of $7.4 million. Additionally, operations of the newly acquired Mark Lighting contributed $3.5 million to the growth of ABL s net sales in fiscal 2007. The purchase of Mark Lighting is discussed further in Note 9 of the *Notes to Consolidated Financial Statements.* The backlog at ABL of $180.6 million at August 31, 2007 represented an increase of $4.6 million

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over the prior year and was reflective of continued strength in order rates resulting from improved market conditions and successful pricing strategies. This increase in backlog is net of a decrease in past due backlog resulting from improved delivery performance.

Gross Profit

Gross profit margins at ABL increased to 37.9% of net sales in 2007 from 35.5% in 2006. Gross profit increased $91.5 million, or 14.0% to $744.3 million in 2007 compared with $652.8 million in 2006. The improvement in gross profit and gross profit margin was largely attributable to ABL s improved pricing, incremental margins on overall volume growth, and a better mix of products sold including new, more energy efficient products introduced over the last three years. These gains more than offset raw materials and component costs increases in excess of $20 million as well as increases in costs associated with employee wages and related benefits.

Operating Profit

Operating profit at ABL increased $69.7 million, or 38.4% in 2007 to $251.1 million from $181.4 million reported in 2006. Operating profit margins advanced more than 290 basis points to 12.8% in 2007 from 9.9% in 2006. In addition to the increase in gross profit discussed above, operating profit and margin were favorably impacted during fiscal 2007 by a $6.6 million (amount is net of related legal costs) cash settlement pertaining to a commercial dispute involving reimbursement of warranty and product liability costs associated with a product line purchased from a third party in fiscal year 2001. All amounts received and legal costs incurred in connection with this cash settlement were recorded within *Selling, Distribution, and Administrative Expenses* on the *Consolidated Statements of Operations*. These gains were partially offset by a $25.0 million increase in costs that typically vary with sales including commissions paid to ABL s sales force, bonuses designed to reward profitable growth of revenues, and freight pertaining to shipments to customers; by the more than $20 million increase in costs associated with raw materials and components; and by increased costs related to efforts to improve productivity and customer service.

Acuity Specialty Products

Net Sales

Net sales at ASP were $565.9 million in 2007 compared with $552.1 million in 2006, representing an increase of $13.8 million or 2.5%. The increase in net sales was due to more favorable price realization captured in all of ASP s markets, and, to a lesser extent the effect of foreign currency translation on international sales. Higher selling prices and foreign currency fluctuation favorably impacted net sales in 2007 by approximately $11.9 million and $4.7 million, respectively. These benefits were partially offset by lower overall unit volume of approximately $3.4 million as greater shipments to ASP s European customer base were more than offset by volume declines in its domestic markets. Volume within the domestic commercial, industrial, and institutional end market was negatively impacted by softening demand from customers concentrated in the transportation and food industries. Demand from home improvement retail channel customers was adversely affected by those customers inventory rebalancing efforts.

Gross Profit

Gross profit at ASP increased $8.4 million, or 2.6% to $325.6 million in fiscal 2007 compared with $317.2 million in the year-ago period. Improvement in gross profit was driven primarily by the pricing gains that resulted in $11.9 million of the total increase in net sales. The benefits from higher sales were partially offset by raw material and related freight cost increases of almost $4 million compared with the same period in fiscal 2006. While the cost of raw materials increased compared with the same period in the previous year, the rate of increase decelerated during fiscal 2007. Gross profit margin of 57.5% in fiscal 2007 remained consistent with that of the prior fiscal year.

Operating Profit

Operating profit at ASP decreased $9.2 million, or 18.8%, in 2007 to $39.6 million from $48.8 million reported in 2006. Operating profit margins were 7.0% in 2007 compared with 8.8% in 2006. While gross profit increased during the current year, these gains were more than offset by several items affecting operating profit. Operating profit and margins in 2007 were adversely impacted by costs associated with environmental matters affecting ASP. In May 2007, ASP recorded a $5.0 million pre-tax charge representing the Company s best estimate of costs associated with a company-initiated remediation plan for groundwater contamination identified at ASP s primary manufacturing facility located in Atlanta, Georgia. In June 2007, the Company reached final resolution with regard to a previously disclosed investigation into certain of ASP s environmental practices, and a $1.8 million charge was recorded during the year by the specialty products business in connection with this settlement. Environmental matters affecting the Company are discussed further in Note 7 of the *Notes to Consolidated Financial Statements.* Additionally, operating profit was negatively affected by a $3.7 million increase in the cost of the ASP s property and casualty insurance programs; by the almost $4 million increase in costs associated with raw materials and components; and by a $3.1 million increase in costs that typically vary with sales including commissions paid to ASP s sales force, bonuses designed to reward profitable growth of revenues, and freight pertaining to shipments to customers. The adverse impact of these increased expenses on operating profit was only partially offset by the benefits of higher net sales.

Corporate

Corporate expenses increased approximately $1.0 million or 3.0% to $33.7 million in 2007 from the $32.8 million reported in 2006. Prior to June 2006, several of the Company s share-based award programs were subject to variable accounting treatment, which resulted in the recording of additional expense during periods of significant stock price appreciation. During the fourth quarter of fiscal 2006, the Company amended these programs, and by doing so is no longer required to record additional expense related to stock price appreciation. The savings associated with amending these programs was more than offset by an approximate $2.5 million increase in professional fees (of which $2.1 million were incurred in connection with the anticipated spin-off of Acuity Specialty Products) and by an increase in incentive compensation that is designed to compensate individuals who contribute to the positive performance of the Company.

Fiscal 2006 Compared with Fiscal 2005

The following table sets forth information comparing the components of net income for the year ended August 31, 2006 with the year ended August 31, 2005:

(in millions)	**Years Ended August 31,**		**Percent**
	2006	**2005**	**Change**
Net Sales	$ 2,393.1	$ 2,172.9	10.1%
Gross Profit	970.0	848.5	14.3%
Percent of net sales	*40.5%*	*39.1%*	
Operating Profit	197.4	106.7	84.9%
Percent of net sales	*8.2%*	*4.9%*	
Income before Provision for Taxes	163.8	74.8	118.8%
Percent of net sales	*6.8%*	*3.4%*	
Net Income	$ 106.6	$ 52.2	104.0%

Consolidated Results

Consolidated net sales were $2,393.1 million in 2006 compared with $2,172.9 million reported in 2005, an increase of $220.3 million, or 10.1%. For the year ended August 31, 2006, the Company reported net income of $106.6 million compared with $52.2 million earned in 2005. Diluted earnings per share were $2.34 in 2006 as compared with $1.17 reported in 2005, an increase of 100%.

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Consolidated Net Sales

Net sales increased approximately 12.4% and 3.2% at ABL and ASP, respectively, in spite of soft economic conditions in certain key markets, particularly for the first half of the year. More than half of the growth in net sales at ABL resulted from volume expansion and new product introductions, with the remainder attributable to improved pricing and product mix. Favorable fluctuation in foreign currency exchange rates contributed $6.8 million to net sales in fiscal 2006. At ASP, the increase in net sales was due primarily to higher selling prices in both the commercial, industrial, and institutional end-market and retail end-market. Sales generated by both business units in the third and fourth quarters of fiscal 2006 outpaced those generated in the first half of the fiscal year due to the seasonal nature of the Company s business. Also, second quarter net sales generated by both business units are typically adversely impacted by the decreased demand associated with inventory rebalancing efforts routinely undertaken by certain of the Company s distribution and retail customers towards the end of those customers fiscal years.

Consolidated Gross Profit

(in millions)	**Years Ended August 31,** 2006	2005	**Increase (Decrease)**	**Percent Change**
Net Sales	$ 2,393.1	$ 2,172.9	$ 220.3	10.1%
Cost of Products Sold	1,423.1	1,324.3	98.8	7.5%
Percent of net sales	*59.5%*	*60.9%*		
Gross Profit	$ 970.0	$ 848.5	$ 121.5	14.3%
Percent of net sales	*40.5%*	*39.1%*		

Consolidated gross profit margins increased to 40.5% of net sales in 2006 from 39.1% reported in 2005. Gross profit increased $121.5 million, or 14.3% to $970.0 million in 2006 compared with $848.5 million in 2005 due primarily to the additional profit contribution from greater shipments, higher pricing, and improved productivity. Pricing actions taken by the Company over the last twelve months, improved productivity, and a better mix of products sold have allowed the Company to restore gross profit and margin to historical levels following previous declines that resulted primarily from rapidly rising costs, including for materials, which preceded these pricing actions. The Company experienced rising costs for many items including healthcare, freight, insurance, and compensation. Additionally, costs associated with raw materials and component parts increased more than $30 million in 2006 as compared with 2005.

Consolidated Operating Profit

(in millions)	**Years Ended August 31,** 2006	2005	**Increase (Decrease)**	**Percent Change**
Gross Profit	$ 970.0	$ 848.5	$ 121.5	14.3%
Percent of net sales	*40.5%*	*39.1%*		
Selling, Distribution, and Administrative Expenses	772.3	718.1	54.2	7.5%
Special Charge		23.0	(23.0)	
Impairment Charge	0.3	0.7	(0.4)	(56.0)%
Operating Profit	$ 197.4	$ 106.7	$ 90.7	84.9%
Percent of net sales	*8.2%*	*4.9%*		

Consolidated operating expenses were $772.6 million (32.3% of net sales) compared with $741.8 million (34.1% of net sales) in 2005. Operating expenses for the year-ago period included a pretax special charge of $23.0 million, reflecting costs of programs to streamline operations, improve customer service, and reduce transaction costs. The Company believes that it has generally realized its targeted annualized savings rate of

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$50.0 million at the end of fiscal 2006 with regard to these programs. Operating expenses in 2006 increased from the prior year primarily as a result of a $43.2 million increase in costs that typically vary directly with sales, such as commissions paid to the Company s sales force, bonuses designed to reward the profitable growth of revenues, and freight pertaining to shipments to customers. Also contributing to the increase were expenses related to incentive compensation, including costs associated with share-based compensation, as well as costs related to efforts to improve productivity and customer service and training and development for associates. While total operating expenses in 2006 increased compared with 2005, operating expense as a percentage of net sales in 2006 declined 180 basis points to 32.3% from 34.1% in the prior year.

Consolidated operating profit was $197.4 million (8.2% of net sales) in 2006 compared with $106.7 million (4.9% of net sales) reported in 2005, an increase of $90.7 million, or 84.9%. Operating profit in 2005 included the aforementioned $23.0 million special charge. The increase in operating profit in 2006 was due primarily to the increase in gross profit, partially offset by higher operating expenses as described above.

Consolidated Income Before Provision for Taxes

(in millions)	Years Ended August 31, 2006	2005	Increase (Decrease)	Percent Change
Operating Profit	$ 197.4	$ 106.7	$ 90.7	84.9%
Percent of net sales	*8.2%*	*4.9%*		
Other Expense (Income)				
Interest Expense, net	33.2	35.7	(2.5)	(7.0)%
Miscellaneous Expense (Income)	0.4	(3.8)	4.2	111.1%
Total Other Expense (Income)	33.7	31.9	1.7	5.5%
Income before Provision for Taxes	$ 163.8	$ 74.8	$ 88.9	118.8%
Percent of net sales	*6.8%*	*3.4%*		

Other expense for Acuity Brands was made up primarily of interest expense. Interest expense, net, was $33.2 million and $35.7 million in 2006 and 2005, respectively. Interest expense, net, decreased 7.0% in 2006 compared with 2005 due to lower debt balances over the course of the year in comparison with 2005 and greater interest income due to an increase in invested cash balances, partially offset by a higher weighted-average interest rate.

Consolidated Provision for Income Taxes and Net Income

(in millions)	Years Ended August 31, 2006	2005	Increase (Decrease)	Percent Change
Income before Provision for Taxes	$ 163.8	$ 74.8	$ 88.9	118.8%
Percent of net sales	*6.8%*	*3.4%*		
Provision for Income Taxes	57.2	22.6	34.6	153.0%
Effective tax rate	*34.9%*	*30.2%*		
Net Income	$ 106.6	$ 52.2	$ 54.4	104.0%

Net income for 2006 increased $54.4 million to $106.6 million from $52.2 million reported in 2005, which included the pre-tax special charge of $23.0 million. The increase in net income resulted primarily from the above noted increase in operating profit, partially offset by higher tax expense.

The effective income tax rate reported by the Company was 34.9% and 30.2% in 2006 and 2005, respectively. The fiscal 2005 tax rate included the benefit of certain non-recurring credits associated with both the

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Company s Mexican operations and state tax benefits. The fiscal 2006 tax rate was affected by certain long- term tax strategies involving the Company s Mexican operations as well as by the current year repatriation of undistributed earnings from certain of the Company s foreign subsidiaries done as part of the American Jobs Creation Act of 2004.

Acuity Brands Lighting

Net Sales

Acuity Brands Lighting reported net sales of approximately $1,841.0 million and $1,637.9 million for the years ending August 31, 2006, and 2005, respectively, an increase of $203.1 million, or 12.4%. The increase in net sales during 2006 was due primarily to greater unit volume, better pricing, and a more favorable mix of products sold. More than half of the increase in net sales was due to greater shipments resulting from improved customer service levels, new product introductions, and increased demand in the non-residential construction market. The effect of foreign currency fluctuation favorably impacted net sales in the current year by $4.2 million. The backlog at ABL of $176.0 million at August 31, 2006 represented an increase of $23.8 million over the prior year and was reflective of continued strength in order rates resulting from improved market conditions and successful pricing strategies. This increase in backlog is net of a decrease in past due backlog resulting from improved delivery performance.

Gross Profit

Gross profit margins at ABL increased to 35.5% of net sales in 2006 from 32.8% in 2005. Gross profit increased $116.1 million, or 21.6% to $652.8 million in 2006 compared with $536.7 million in 2005 due primarily to the additional profit contribution from greater shipments, higher pricing that more than offset increased costs for certain raw materials and component parts, and improved productivity. The Company experienced rising costs for many items including healthcare, freight, insurance, and compensation. Additionally, costs associated with raw materials and component parts increased more than $22 million in 2006 as compared with 2005.

Operating Profit

Operating profit at ABL increased $86.8 million, or 91.8% in 2006 to $181.4 million from $94.6 million reported in 2005. Operating profit margins improved to 9.9% in 2006 from 5.8% in 2005. Operating profit in 2005 included $15.7 million of the above noted special charge. In addition to the absence of the special charge, operating profit in 2006 was positively impacted by profit contribution from the greater shipments and improved pricing and mix mentioned above as well as benefits from programs implemented to streamline operations, improve customer service, and reduce transaction costs. These benefits were partially offset by a $35.5 million increase in costs that typically vary with sales including commissions paid to ABL s sales force, bonuses designed to reward profitable growth of revenues, and freight pertaining to shipments to customers; by the more than $22 million increase in costs associated with raw materials and components; and by increased costs related to efforts to improve productivity and customer service.

Acuity Specialty Products

Net Sales

Net sales at ASP were $552.1 million in 2006 compared with $535.0 million in 2005, representing an increase of $17.1 million, or 3.2%. The increase in net sales was due to higher selling prices in the domestic industrial and institutional and retail channels, and, to a lesser extent the effect of foreign currency translation on international sales. Higher selling prices and foreign currency fluctuation favorably impacted net sales in fiscal year 2006 by approximately $20.5 million and $2.6 million, respectively. These benefits were partially offset by overall lower unit volume of approximately $3.5 million, which was experienced primarily in the commercial, industrial, and institutional end-market. Volume within this end-market was affected by the Company s separation from certain lower margin customers.

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Gross Profit

Gross profit at ASP increased $5.4 million, or 1.7%, to $317.2 million in 2006 compared with $311.8 million in 2005. Gross profit benefited from the contributions of higher selling prices that resulted in ASP s overall $17.1 million increase in net sales. Gross profit margins declined 80 basis points to 57.5% of net sales in fiscal 2006 from 58.3% reported in 2005. In fiscal 2006 gross profit and gross profit margin were negatively affected by continuing raw material and related freight cost increases. Costs associated with raw materials and related freight increased approximately $9 million in fiscal 2006 compared with fiscal 2005. These increased costs followed a fiscal year during which the costs of certain commodities utilized in ASP s manufacturing process had already reached record highs. Also, increased costs for labor, waste disposal, and utilities adversely impacted gross profit and related margin by $2.1 million in fiscal 2006 compared with the prior fiscal year. Although the total dollar amount of the impact of certain of these factors was offset by higher selling prices, the gross profit margin percentage was reduced due to the magnitude of the above mentioned increases.

Operating Profit

Operating profit at ASP increased $6.5 million, or 15.4%, in 2006 to $48.8 million from $42.3 million reported in 2005. Operating profit margins improved to 8.8% in 2006 from 7.9% in 2005. Operating profit in 2005 included $3.6 million of the above mentioned special charge. In addition to the absence of the special charge, operating profit was positively impacted by the $20.5 million profit contribution from pricing, benefits from programs implemented to streamline operations, and benefits from cost containment programs. The pricing actions taken by ASP were necessary to offset increases in raw material and component part costs of almost $9 million. The benefits of higher selling prices and the aforementioned programs were further offset by a $4.7 million increase in costs that typically vary with sales including commissions paid to ASP s sales force, bonuses designed to reward profitable growth of revenues, and freight pertaining to shipments to customers; by increased consulting fees of $2.3 million related to ASP s productivity improvement initiatives; by increased legal expenses of $1.6 million related to environmental matters; and by a pre-tax charge of $1.2 million related to a product recall due to defective containers purchased from a vendor.

Corporate

Corporate expenses increased to $32.8 million in 2006 from $30.2 million reported in 2005 (which included $3.8 million of the special charge discussed above). The benefit from the absence of the special charge was more than offset by an increase in incentive compensation, including expense related to share-based compensation. The increase in share-based compensation expense was due primarily to the effect of higher current year stock price appreciation on Company-wide restricted stock incentives and other share-based programs and to increased expense related to the Company s adoption of SFAS No. 123(R). During the fourth quarter of fiscal year 2006, the Company amended its share-based award programs subject to variable accounting treatment, and by doing so will no longer be required to record additional expense related to stock price appreciation. See further information in Note 6 of *Notes to Consolidated Financial Statements*.

Financial Impact of Spin-off of Specialty Products Business

In 2007 Acuity Brands acted upon a key objective to create greater strategic clarity by narrowing the focus of the organization to markets where it enjoys clear competitive advantages and where it believes it can more effectively allocate its considerable resources to fully capitalize on opportunities within those markets. With that goal in mind, Acuity Brands announced plans in July 2007 to separate the lighting and specialty chemical businesses by spinning off Acuity Specialty Products into an independent public company. During the past five years, Acuity Specialty Products annual contribution to its parent s operating cash flows, net of investing activity, has averaged approximately $37 million. The specialty products business has been responsible for approximately 22-25% of the consolidated parent company s revenues over that period. Additionally, the Acuity Specialty Products business has contributed to the profitability of the consolidated entity; the specialty products group s operating profit and operating profit margins during the previous five years have averaged approximately $41 million and 7.7%, respectively excluding any allocation of corporate costs. In 2008 Acuity Brands, with

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Acuity Brands Lighting as its sole operating subsidiary, will proceed without the benefit from operations previously conducted by Acuity Specialty Products. However, Acuity Brands believes that by separating its lighting and chemical businesses, each business will be better able to tailor its own investment strategy to its individual cash flows and capital structure, while creating tighter alignment between the performance of each business and the expectations of its stockholders.

On October 31, 2007 (the distribution date), Acuity Brands will enter into a distribution agreement with Zep Inc. The distribution agreement will provide for the principal corporate transactions required to affect the spin-off. Pursuant to this distribution agreement, Zep Inc. will draw upon its credit facilities and remit a dividend to Acuity Brands in the amount of $62.5 million on the distribution date. Acuity Brands intends to use proceeds from this dividend to fund currently authorized share repurchases or to reduce its outstanding indebtedness. The distribution agreement further provides that after the spin-off, Acuity Brands will remit to Zep Inc. an amount equal to the positive net cash flow generated by Zep Inc. during the period from September 1, 2007 until the distribution date (less any cash in excess of $5.0 million held by Zep Inc. on the distribution date). Therefore, effective September 1, 2007, Acuity Brands will cease to benefit from positive operating cash flow generated by the specialty products business.

As a result of the spin-off of the specialty products business, certain corporate costs previously incurred by Acuity Brands, Inc. will be eliminated. Additionally, subsequent to the distribution, the Company, with ABL as its sole operating subsidiary, intends to simplify its structure with the intent to reduce certain consolidated costs of the corporate office and ABL. The Company expects to record a special charge in the first quarter of fiscal year 2008 related to this simplification of organizational structure, due primarily to the reduction of personnel and the early termination costs associated with vacating leased office space. While the amount of the charge has not yet been finalized, it is expected to total at least $8 million on a pre-tax basis. The Company estimates that, on an annual basis, cost reductions resulting from the spin-off and the simplification of the organizational structure will be at least $14 million. The benefit from these measures will most likely not be fully realized until two years following the spin-off. Management expects to conclude this review of its organizational structure, along with associated costs and benefits, during the first quarter of fiscal 2008. Also, the Company expects to incur in the first quarter of fiscal 2008 additional professional fees and other non-recurring costs related to the spin-off of approximately $4.5 million.

Outlook

The consolidated results of Acuity Brands for the year ended August 31, 2007, reflect benefits from favorable pricing strategies required to offset continued increases in costs, including certain raw materials and component parts, as well as programs designed to improve customer service and productivity; additional sales of higher margin products; and greater sales volume. Acuity Brands ability to successfully execute these programs along with other continuous improvement initiatives allowed the Company to again deliver record operating results to its shareholders.

Looking forward to fiscal 2008 and beyond, management is optimistic about the future prospects of Acuity Brands, with Acuity Brands Lighting as its sole operating subsidiary. However, in the shorter term the Company expects to face challenges such as continued cost pressures for certain raw materials, component parts, fuel, and employee related matters including health care. Also, Acuity Brands is highly dependent on the non-residential, and, to a lesser degree, the residential construction markets, which may be significantly impacted by the turmoil in the global credit markets during the summer and fall of 2007. A key factor in delivering positive results in 2008 while facing these external challenges will be management s ability to continue to execute on and realize benefit from investments in programs intended to drive future profitable growth, including those that enhance customer service, improve productivity, expand access to market, and allow for the innovation of new products.

While these shorter term challenges may be considerable, management continues to be optimistic regarding its continued ability to deliver increasing value to shareholders in 2008 through the profitable growth

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opportunities at Acuity Brands Lighting, its sole operating business. A number of existing factors support the position that volume within the non-residential construction market could grow in the low single digits during fiscal 2008. For example, the recent rebound in non-residential building awards and other measures such as the Architecture Billings Index suggest demand for lighting fixtures will continue it positive trend. Other current conditions supporting a positive long-term growth trend in the non-residential construction market include, but are not limited to, favorable trends in commercial vacancy and rent rates, as well as increased government spending on infrastructure projects such as highways, though these have recently begun to level off. Acuity Brands Lighting is encouraged by success attained in and the opportunity afforded by the retrofit market as its commercial, retail, and industrial customers become increasingly interested in more efficient lighting fixtures that serve to reduce energy consumption while creating an enhanced aesthetic environment. Management will continue to proactively position Acuity Brands Lighting to better leverage ABL s market presence through investments that enhance its go-to-market programs and strengthen its geographic footprint, which should aid in generating new unit sales volume. With proper execution and the continuation of positive growth within the non-residential construction sector, Acuity Brands expects to continue to grow in key markets by accelerating new product introductions and improving service and quality. Assuming no dramatic change in the current condition of the Company s key markets, management expects in fiscal 2008 to meet or exceed its long-term financial goals of generating consolidated operating profit margins in excess of 10%, growing diluted earnings per share in excess of 15%, providing a return on stockholder s equity of 20% or better, and generating cash flow from operations less capital expenditures in excess of net income.

Accounting Standards Yet to Be Adopted

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159). SFAS No. 159 permits companies, at their election, to measure specified financial instruments and warranty and insurance contracts at fair value on a contract-by-contract basis, with changes in fair value recognized in earnings each reporting period. The election, called the fair value option, will enable some companies to reduce the volatility in reported earnings caused by measuring related assets and liabilities differently, and it is easier than using the complex hedge-accounting requirements in SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, to achieve similar results. Subsequent changes in fair value for designated items will be required to be reported in earnings in the current period. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and is therefore effective for the Company beginning in fiscal year 2009. The Company is currently assessing the effect of implementing this guidance, which is dependent upon the nature and extent of eligible items elected to be measured at fair value upon initial application of the standard. However, Acuity Brands does not expect the adoption of SFAS No. 159 to have a material impact on the Company s results of operations and financial position.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 establishes a single authoritative definition of fair value, establishes a framework for measuring fair value, and expands disclosure requirements pertaining to fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years, and is therefore effective for the Company beginning in fiscal 2009. The Company is currently evaluating the impact that this guidance will have on its results of operations and financial position.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing a recognition threshold and measurement attribute for the financial statement implications of tax positions taken or expected to be taken in a company s tax return. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, and disclosure of such positions. FIN 48 is effective for fiscal years beginning after December 15, 2006, and is therefore effective for the Company in fiscal 2008. Acuity Brands is in the process of finalizing its evaluation of the impact that adopting FIN 48 will have on the Company s results of operations, however at this time the Company does not expect the impact to materially affect its operations.

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In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* (SFAS No. 155), which amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133) and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS No. 140). SFAS No. 155 simplifies the accounting for certain derivatives embedded in other financial instruments by allowing them to be accounted for as a whole if the holder elects to account for the instrument on a fair value basis. SFAS No. 155 also clarifies and amends certain other provisions of SFAS No. 133 and SFAS No. 140. SFAS No. 155 is effective for all financial instruments acquired, issued, or subject to a remeasurement event occurring in fiscal years beginning after September 15, 2006, and is therefore effective for the Company in fiscal year 2008. Earlier adoption is permitted, provided companies have not yet issued financial statements, including interim periods, for that fiscal year. The Company does not expect the adoption of SFAS No. 155 to have a material impact on the Company s results of operations and financial position.

Accounting Standards Adopted in Fiscal 2007

In June 2006, the FASB issued Emerging Issues Task Force (EITF) 06-03, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation)* (EITF 06-03). The consensus reached in EITF 06-03 provides that the presentation of taxes assessed by a governmental authority that are directly imposed on revenue-producing transactions (e.g. sales, use, value added and excise taxes) between a seller and a customer on either a gross basis (included in revenues and costs) or on a net basis (excluded from revenues) is an accounting policy decision that should be disclosed. In addition, for any such taxes that are reported on a gross basis, the amounts of those taxes should be disclosed in interim and annual financial statements for each period for which an income statement is presented if those amounts are significant. EITF 06-03 is effective for interim and annual reporting periods beginning after December 15, 2006, and thus became effective for Acuity Brands during the third quarter of fiscal 2007. As a matter of accounting policy, the Company records all taxes within the scope of EITF 06-03 on a net basis.

In September 2006, the FASB issued SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS No. 158). SFAS No. 158 requires an employer to: (a) recognize in its statement of financial position the funded status of a benefit plan; (b) measure defined benefit plan assets and obligations as of the end of the employer s fiscal year (with limited exceptions); and (c) recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise but are not recognized as components of net periodic benefit costs pursuant to prior existing guidance. The provisions governing recognition of the funded status of a defined benefit plan and related disclosures became effective for the Company at the end of fiscal year 2007. For additional information about the impact of SFAS 158 on the Company s defined pension and profit sharing plans, refer to Note 3 of the *Notes to Consolidated Financial Statements.* The requirement to measure plan assets and benefit obligations as of the date of the employer s fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008, and is therefore effective for the Company in fiscal year 2009. The Company measures the funded status of its employee benefit plans as of May 31 each year, and does not anticipate the future change in measurement date to August 31 will have a material impact on the Company s results of operations and financial position.

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 C*onsolidated Financial Statements*, which have been prepared in accordance with U.S. generally accepted accounting principles. As discussed in Note 1 of the *Notes to Consolidated Financial Statements*, the preparation of financial statements in conformity with U.S. generally accepted accounting principles 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

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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 inventory valuation; depreciation, amortization and the recoverability of long-lived assets, including intangible assets; share-based compensation expense; medical, product warranty, and other reserves; litigation; and environmental matters. 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. See Note 2 of the *Notes to Consolidated Financial Statements* for a summary of the accounting policies of Acuity Brands.

The management of Acuity Brands believes the following represent the Company s critical accounting estimates:

Inventories

Inventories include materials, direct labor, and related manufacturing overhead, and are stated at the lower of cost (on a first-in, first-out or average-cost basis) or market. Management reviews inventory quantities on hand and records a provision for excess or obsolete inventory primarily based on estimated future demand and current market conditions. A significant change in customer demand or market conditions could render certain inventory obsolete and thus could have a material adverse impact on the Company s operating results in the period the change occurs.

Long-Lived and Intangible Assets and Goodwill

Acuity Brands reviews goodwill and intangible assets with indefinite useful lives for impairment on an annual basis or on an interim basis if an event occurs that might reduce the fair value of the long-lived asset below its carrying value. All other long-lived and intangible assets are reviewed for impairment whenever events or circumstances indicate that the carrying amount of the asset may not be recoverable. An impairment loss would be recognized based on the difference between the carrying value of the asset and its estimated fair value, which would be determined based on either discounted future cash flows or other appropriate fair value methods. The evaluation of goodwill and intangibles with indefinite useful lives for impairment requires management to use significant judgments and estimates including, but not limited to, projected future net sales, operating results, and cash flow of each of the Company s businesses.

Although management currently believes that the estimates used in the evaluation of goodwill and intangibles with indefinite lives are reasonable, differences between actual and expected net sales, operating results, and cash flow could cause these assets to be deemed impaired. If this were to occur, the Company would be required to charge to earnings the write-down in value of such assets, which could have a material adverse effect on the Company s results of operations and financial position, but not its cash flow from operations.

Specifically, Acuity Brands has three unamortized trade names with an aggregate carrying value of approximately $67.0 million. Management estimates the fair value of these unamortized trade names using a fair value model based on discounted future cash flows. Future cash flows associated with each of the Company s unamortized trade names are calculated by applying a theoretical royalty rate a willing third party would pay for use of the particular trade name to estimated future net sales. The present value of the resulting after-tax cash flow is management s current estimate of the fair value of the trade names. This fair value model requires management to make several significant assumptions, including estimated future net sales, the royalty rate, and the discount rate.

Differences between expected and actual results can result in significantly different valuations. If future operating results are unfavorable compared with forecasted amounts, the Company may be required to reduce the theoretical royalty rate used in the fair value model. A reduction in the theoretical royalty rate would result in lower expected, future after-tax cash flow in the valuation model. Accordingly, an impairment charge would be

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recorded at that time. At August 31, 2007, the estimated fair value of the Company s trade names significantly exceeds the aggregate carrying values of those assets.

Self-Insurance

It is the policy of Acuity Brands to self-insure, up to certain limits, traditional risks including workers compensation, comprehensive general liability, and auto liability. The Company s self-insured retention for each claim involving workers compensation, comprehensive general liability (including toxic tort and other product liability claims), and auto liability is limited to $0.5 million per occurrence of such claims. A provision for claims under this self-insured program, based on the Company s estimate of the aggregate liability for claims incurred, is revised and recorded annually. The estimate is derived from both internal and external sources including but not limited to the Company s independent actuary. Acuity Brands is also self-insured up to certain limits for certain other insurable risks, primarily physical loss to property ($0.5 million per occurrence) and business interruptions resulting from such loss lasting three days or more in duration. Insurance coverage is maintained for catastrophic property and casualty exposures as well as those risks required to be insured by law or contract. Acuity Brands is fully self-insured for certain other types of liabilities, including employment practices, environmental, product recall, and patent infringement and errors and omissions. The actuarial estimates are subject to uncertainty from various sources, including, among others, changes in claim reporting patterns, claim settlement patterns, judicial decisions, legislation, and economic conditions. Although Acuity Brands believes that the actuarial estimates are reasonable, significant differences related to the items noted above could materially affect the Company s self-insurance obligations, future expense and cash flow.

The Company is also self-insured for the majority of its medical benefit plans. The Company estimates its aggregate liability for claims incurred by applying a lag factor to the Company s historical claims and administrative cost experience. The appropriateness of the Company s lag factor is evaluated and revised, if necessary, annually. Although management believes that the current estimates are reasonable, significant differences related to claim reporting patterns, plan designs, legislation, and general economic conditions could materially affect the Company s medical benefit plan liabilities, future expense and cash flow.

Share-Based Compensation Expense

On September 1, 2005, the Company adopted SFAS No. 123(R), which requires compensation cost relating to share-based payment transactions be recognized in the financial statements based on the estimated fair value of the equity or liability instrument issued. The Company adopted SFAS No. 123(R) using the modified prospective method and applied it to the accounting for the Company s stock options and restricted shares, and share units representing certain deferrals into the Director Deferred Compensation Plan or the Supplemental Deferred Savings Plan (both of which are discussed further in Note 6 of *Notes to Consolidated Financial Statements*). Under the modified prospective method, share-based expense recognized after adoption includes: (a) share-based expense for all awards granted prior to, but not yet vested as of September 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, and (b) share-based expense for all awards granted subsequent to September 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). The Company recorded $13.3 million, $14.0 million, and $9.4 million of share-based expense for the years ended August 31, 2007, 2006, and 2005, respectively. Prior to September 1, 2005, as permitted by SFAS 123, the Company accounted for share-based payments to employees using Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) and, therefore, recorded no share-based expense for employee stock options. Results for prior periods have not been restated. The Company continues to account for any awards with graded vesting on a straight-line basis.

SFAS No. 123(R) does not specify a preference for a type of valuation model to be used when measuring fair value of share-based payments, and the Company continues to employ the Black-Scholes model in deriving the fair value estimates of such awards. SFAS No. 123(R) requires forfeitures of share-based awards to be estimated at time of grant and revised in subsequent periods if actual forfeitures differ from initial estimates.

Therefore, expense related to share-based payments recognized in fiscal 2006 and 2007 has been reduced for estimated forfeitures. The Company s assumptions used in the Black-Scholes model remain otherwise unaffected by the implementation of this pronouncement. As of August 31, 2007, there was $28.7 million of total unrecognized compensation cost related to unvested restricted stock. That cost is expected to be recognized over a weighted-average period of 2.6 years. As of August 31, 2007, there was $2.6 million of total unrecognized compensation cost related to unvested options. That cost is expected to be recognized over a weighted-average period of two years. The cumulative effect of adoption of SFAS No. 123(R) in fiscal 2006 was insignificant to the Company s results of operations. Forfeitures are estimated based on historical experience. If factors change causing different assumptions to be made in future periods, compensation expense recorded pursuant to SFAS No. 123(R) may differ significantly from that recorded in the current period. See Notes 2 and 6 of *Notes to Consolidated Financial Statements* for more information regarding the assumptions used in estimating the fair value of stock options as well as for the financial implications associated with the adoption of SFAS No. 123(R).

Product Warranty

Acuity Brands records an allowance for the estimated amount of future warranty costs when the related revenue is recognized, primarily based on historical experience of identified warranty claims. Excluding costs related to recalls due to faulty components provided by third parties, historical warranty costs have been within expectations. However, there can be no assurance that future warranty costs will not exceed historical amounts. If actual future warranty costs exceed historical amounts, additional allowances may be required, which could have a material adverse impact on the Company s operating results and cash flow in future periods.

Litigation

Acuity Brands recognizes expense for legal claims when payments associated with the claims become probable and can be reasonably estimated. Due to the difficulty in estimating costs of resolving legal claims, actual costs may be substantially higher or lower than the amounts reserved.

Environmental Matters

The Company recognizes expense for known environmental claims when payments associated with the claims become probable and the costs can be reasonably estimated. The actual cost of resolving environmental issues may be higher or lower than that reserved primarily due to difficulty in estimating such costs and potential changes in the status of government regulations. The Company is self-insured for most environmental matters.

Cautionary Statement Regarding Forward-Looking Information

This filing contains forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995. Statements made herein that may be considered forward-looking include statements incorporating terms such as expects, believes, intends, anticipates and simila terms that relate to future events, performance, or results of the Company, including, without limitation, statements made relating to: (a) the expected lack of engagement in significant commodity hedging transactions for raw materials and advanced purchases of certain materials; (b) the expected impact of increases in the cost of raw materials or a reduction in the number of suppliers on the Company s operations; (c) the seasonality of the business; (d) the expected impact of the Company s initiatives to become more globally competitive; (e) the activities that will be implemented to help the Company achieve its long-term goals, the expected outcome of these activities, and the Company s progress towards those goals; (f) the potential impact of the loss of certain of the Company s facilities and the related impact of various insurance programs in place; (g) the ability to increase production without substantial capital expenditures; (h) the Company s expectations regarding liquidity and availability under its financing arrangements to fund its operations as currently planned and its anticipated capital investment and profit improvement initiatives, debt payments, dividend payments, potential repurchase of up to an additional million shares of the Company s outstanding common stock, and required contributions into its defined benefit plans; (i) the planned spending of approximately $40 million to $45 million for new plant and equipment and new and enhanced information technology capabilities at both businesses during 2008; (j) the expected contribution by the Company to fund its defined benefit plans and the planned payment of annual dividends in 2008 consistent with those paid in 2007; (k) the expected realization of benefits from the additional actions to

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accelerate its efforts to streamline and improve its operations and to enhance the efficiencies of its facilities, the timing of the realization of those benefits, and the impact on fiscal 2008; (l) the expected effective income tax rate in fiscal 2008; (m) external forecasts that are projecting unit volume growth in calendar 2007 in the non-residential construction industry and the impact on the Company s unit volume; (n) the impact of accounting standards yet to be adopted on the results of operations and financial position; (o) the impact of changes in critical accounting estimates on the results of operations; and (p) the expected benefits to the Company and its stockholders of the spin-off; (q) the tax-free nature of the distribution of Zep common stock to stockholders of Acuity Brands in the spin-off; (r) the intention to simplify the Company s structure subsequent to the spin-off of its specialty products business, and any estimates pertaining to potential costs and/or savings from these actions; (s) statements estimating the amount of professional expected to be incurred in fiscal 2008 in connection with the spin-off; (t) statements regarding the Company s debt to equity relationship subsequent to the spin-off; (u) the optimism surrounding Acuity Brands future prospects after the spin-off; (v) the non-residential and residential construction markets susceptibility to turmoil in the global credit markets; (w) the Company s belief that key to delivering positive results in 2008 will be the ability to continue to execute on and realize benefit from investments in various programs; (x) the Company s belief that conditions exist that could lead to growth in the non-residential construction market in 2008; (y) management s intent to proactively position ABL to better leverage ABL s market presence; (z) the belief that opportunity exists within the retrofit market; (aa) the expectation for Acuity Brands growth in key markets by accelerating new product introductions and improving service and quality; (bb) management s expectations to meet or exceed its long-term financial goals assuming no dramatic change in the current condition of the Company s key markets. You are cautioned not to place undue reliance on any forward looking statements, which speak only as of the date of this annual report. Except as required by law, the Company undertake 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 annual report or to reflect the occurrence of unanticipated events. A variety of risks and uncertainties could cause the Company s actual results to differ materially from the anticipated results or other expectations expressed in the Company s forward-looking statements. A number of those risks are discussed above in Item 1a.: *Risk Factors*.

Item 7a. *Quantitative and Qualitative Disclosures about Market Risk*

General. Acuity Brands is exposed to market risks that may impact the *Consolidated Balance Sheets*, *Consolidated Statements of Operations*, and *Consolidated Statements of Cash Flows* due primarily to changing interest rates and foreign exchange rates. The following discussion provides additional information regarding the market risks of Acuity Brands.

Interest Rates. Interest rate fluctuations expose the variable-rate debt of Acuity Brands to changes in interest expense and cash flows. The variable-rate debt of Acuity Brands, primarily long-term industrial revenue bonds, amounted to $11.5 million at August 31, 2007. Based on outstanding borrowings at year end, a 10% increase in market interest rates at August 31, 2007, would have resulted in a de minimus amount of additional annual after-tax interest expense. A fluctuation in interest rates would not affect interest expense or cash flows related to the $359.9 million publicly traded fixed-rate notes, the Company s primary debt. A 10% increase in market interest rates at August 31, 2007, would have decreased the fair value of these notes by approximately $4.4 million. See Note 4 of the *Notes to Consolidated Financial Statements*, contained in this Form 10-K, for additional information regarding the Company s long-term debt.

Foreign Exchange Rates. The majority of net sales, expense, and capital purchases of Acuity Brands are transacted in U.S. dollars. However, exposure with respect to foreign exchange rate fluctuation exists due to the Company s operations in Canada, where a portion of products sold are sourced from the United States. A hypothetical decline in the Canadian dollar of 10% would negatively impact operating profit by approximately $8.0 million. Also, a portion of the goods sold in the United States are manufactured in Mexico. A hypothetical 10% increase in the Mexican peso would negatively impact operating profits by approximately $4.9 million. The impact of these hypothetical currency fluctuations has been calculated in isolation from any response the Company would undertake to address such exchange rate changes in the Company s foreign markets.

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Item 8. ***Financial Statements and Supplementary Data***

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MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

ACUITY BRANDS, INC.

The management of Acuity Brands, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) and 15d-15(f) promulgated under the Securities Exchange Act of 1934. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company s management assessed the effectiveness of the Company s internal control over financial reporting as of August 31, 2007. In making this assessment, the Company s management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Based on this assessment, management believes that, as of August 31, 2007, the Company s internal control over financial reporting is effective.

The Company s independent registered public accounting firm has issued an audit report on this assessment of the Company s internal control over financial reporting. This report dated October 25, 2007 appears on page 48 of this Form 10-K.

/s/ Vernon J. Nagel	/s/ Richard K. Reece
Vernon J. Nagel	Richard K. Reece
Chairman, President, and	Executive Vice President and
Chief Executive Officer	Chief Financial Officer

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Acuity Brands, Inc.

We have audited the accompanying consolidated balance sheets of Acuity Brands, Inc. as of August 31, 2007 and 2006, and the related consolidated statements of operations, stockholders equity and comprehensive income, and cash flows for each of the three years in the period ended August 31, 2007. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These consolidated financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Acuity Brands, Inc. at August 31, 2007 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended August 31, 2007, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 3 to the consolidated financial statements, during the year ended August 31, 2007, the Company adopted the recognition and disclosure provisions of Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statement Nos. 87, 88, 106, and 132(R).

As discussed in Note 2 to the consolidated financial statements, during the year ended August 31, 2006, the Company began recording share-based expense in accordance with Statement of Financial Accounting Standards No. 123(R) Share-Based Payment .

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Acuity Brands, Inc. s internal control over financial reporting as of August 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated October 25, 2007 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Atlanta, Georgia

October 25, 2007

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Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting

The Board of Directors and Stockholders

Acuity Brands, Inc.

We have audited Acuity Brands, Inc. s internal control over financial reporting as of August 31, 2007, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Acuity Brands, Inc. s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Acuity Brands, Inc. maintained, in all material respects, effective internal control over financial reporting as of August 31, 2007, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Acuity Brands, Inc. as of August 31, 2007 and 2006, and the related consolidated statements of operations, stockholders equity and comprehensive income, and cash flows for each of the three years in the period ended August 31, 2007 of Acuity Brands, Inc. and our report dated October 25, 2007 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Atlanta, Georgia

October 25, 2007

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ACUITY BRANDS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per-share data)

	August 31, 2007	August 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 222,816	$ 88,648
Accounts receivable, less reserve for doubtful accounts of $4,864 at August 31, 2007, and $6,205 at August 31, 2006	388,646	379,622
Inventories	192,070	209,319
Deferred income taxes	21,772	22,456
Prepayments and other current assets	42,681	37,600
Total current assets	867,985	737,645
Property, plant, and equipment, at cost:		
Land	12,562	12,436
Buildings and leasehold improvements	172,620	167,488
Machinery and equipment	391,961	396,874
Total property, plant, and equipment	577,143	576,798
Less accumulated depreciation and amortization	363,405	365,529
Property, plant, and equipment, net	213,738	211,269
Other assets:		
Goodwill	384,809	346,188
Intangible assets	118,892	120,287
Deferred income taxes	2,165	5,752
Defined benefit plan intangible assets	2,587	693
Other long-term assets	22,332	22,282
Total other assets	530,785	495,202
Total assets	$ 1,612,508	$ 1,444,116
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current maturities of long-term debt	$ 296	$ 643
Accounts payable	247,176	243,593
Accrued compensation	79,835	69,360
Accrued pension liabilities, current	1,268	1,120
Other accrued liabilities	141,821	113,078
Total current liabilities	470,396	427,794
Long-term debt, less current maturities	371,027	371,252
Accrued pension liabilities, less current portion	22,043	28,448
Deferred income taxes	12,491	12,974

Self-insurance reserves, less current portion	16,404	14,774
Other long-term liabilities	48,181	46,615
Commitments and contingencies (see *Note 7*)		
Stockholders equity:		
Preferred stock, $0.01 par value, 50,000,000 shares authorized, none issued		
Common stock, $0.01 par value, 500,000,000 shares authorized; 49,323,225 issued and 43,314,625 outstanding at August 31, 2007; and 48,062,506 issued and 43,062,506 outstanding at August 31, 2006	493	481
Paid-in capital	611,701	560,973
Retained earnings	313,850	192,155
Accumulated other comprehensive loss items	(9,513)	(16,492)
Treasury stock, at cost, 6,008,600 shares at August 31, 2007	(244,565)	(194,858)
Total stockholders equity	671,966	542,259
Total liabilities and stockholders equity	$ 1,612,508	$ 1,444,116

The accompanying *Notes to Consolidated Financial Statements* are an integral part of these statements.

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ACUITY BRANDS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per-share data)

	Years Ended August 31,		
	2007	2006	2005
Net Sales	$ 2,530,668	$ 2,393,123	$ 2,172,854
Cost of Products Sold	1,460,775	1,423,096	1,324,311
Gross Profit	1,069,893	970,027	848,543
Selling, Distribution, and Administrative Expenses	812,958	772,326	718,134
Special Charge			23,000
Impairment Charge		292	664
Operating Profit	256,935	197,409	106,745
Other Expense (Income):			
Interest expense, net	30,140	33,231	35,731
Gain on sale of businesses			(538)
Miscellaneous (income) expense, net	(1,092)	425	(3,280)
Total Other Expense	29,048	33,656	31,913
Income before Provision for Income Taxes	227,887	163,753	74,832
Provision for Income Taxes	79,833	57,191	22,603
Net Income	$ 148,054	$ 106,562	$ 52,229
Earnings Per Share:			
Basic Earnings per Share	$ 3.48	$ 2.43	$ 1.21
Basic Weighted Average Number of Shares Outstanding	42,585	43,884	43,135
Diluted Earnings per Share	$ 3.37	$ 2.34	$ 1.17
Diluted Weighted Average Number of Shares Outstanding	43,897	45,579	44,752
Dividends Declared per Share	$ 0.60	$ 0.60	$ 0.60

The accompanying *Notes to Consolidated Financial Statements* are an integral part of these statements.

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ACUITY BRANDS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Years Ended August 31,								
	2007	**2006**	**2005**						
Cash Provided by (Used for) Operating Activities:									
Net income	$ 148,054	$ 106,562	$ 52,229						
Adjustments to reconcile net income to net cash provided by (used for) operating activities:									
Depreciation and amortization	38,405	39,012	41,075						
Excess tax benefits from share-based payments	(15,360)	(17,282)							
Loss (gain) on the sale of property, plant, and equipment	(207)	1,041	(1,871)						
Gain on sale of business			(538)						
Deferred income taxes	3,400	1,473	(2,239)						
Other non-cash charges	8,958	7,287	9,110						
Change in assets and liabilities, net of effect of acquisitions and divestitures -									
Accounts receivable	(5,514)	(33,853)	(12,869)						
Inventories	18,627	6,169	)	1,958	(10)	1,948			
Fee and commission income	313	78	10	142	-	(57)	486	(20)	466
Other revenues	-	-	-	1	-	-	2	(1)	1
Total revenues	**3,022**	**2,478**	**1,709**	**683**	**82**	**(153)**	**7,821**	**(141)**	**7,680**
Inter-segment revenues	*4*	-	-	*70*	*79*				

EUR millions	Americas	The Netherlands	United Kingdom	New Markets	Holding and other activities	Eliminations	Segment Total	Joint ventures and associates eliminations	Consolidated
Three months ended March 31, 2013									
Underlying earnings before tax geographically	**307**	**114**	**21**	**60**	**(38)**	**-**	**464**	**(19)**	**445**
Fair value items	(225)	(73)	(3)	(3)	25	-	(279)	16	(263)
Realized gains / (losses) on investments	46	63	1	2	-	-	112	-	112
Impairment charges	(16)	(8)	-	(10)	-	-	(34)	-	(34)
Impairment reversals	16	-	-	-	-	-	16	-	16
Other income / (charges)	(5)	-	5	(4)	-	-	(4)	-	(4)
Run-off businesses	(10)	-	-	-	-	-	(10)	-	(10)
Income before tax	**113**	**96**	**24**	**45**	**(13)**	**-**	**265**	**(3)**	**262**
Income tax (expense) / benefit	(2)	(15)	(9)	(16)	1	-	(41)	3	(38)
Net income	**111**	**81**	**15**	**29**	**(12)**	**-**	**224**	**-**	**224**
Inter-segment underlying earnings	*(46)*	*(14)*	*(14)*	*67*	*7*				
Revenues									
Life insurance gross premiums	1,545	2,015	1,732	350	-	(19)	5,623	(142)	5,481
Accident and health insurance	444	123	-	58	2	(2)	625	(7)	618

General insurance	-	128	-	40	-	-	168	-	168
Total gross premiums	**1,989**	**2,266**	**1,732**	**448**	**2**	**(21)**	**6,416**	**(149)**	**6,267**
Investment income	841	548	580	65	84	(83)	2,035	(22)	2,013
Fee and commission income	297	82	26	134	-	(59)	480	(14)	466
Other revenues	1	-	-	1	1	-	3	(1)	2
Total revenues	**3,128**	**2,896**	**2,338**	**648**	**87**	**(163)**	**8,934**	**(186)**	**8,748**
Inter-segment revenues	*5*	-	-	*73*	*85*				

Non-IFRS measures

For segment reporting purposes the following non-IFRS financial measures are included: underlying earnings before tax, income tax and income before tax. These non-IFRS measures are calculated by consolidating on a proportionate basis Aegon s joint ventures and associated companies. Aegon believes that its non-IFRS measures provide meaningful information about the underlying results of Aegon s business, including insight into the financial measures that Aegon s senior management uses in managing the business.

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Among other things, Aegon s senior management is compensated based in part on Aegon s results against targets using the non-IFRS measures presented here. While many other insurers in Aegon s peer group present substantially similar non-IFRS measures, the non-IFRS measures presented in this document may nevertheless differ from the non-IFRS measures presented by other insurers. There is no standardized meaning to these measures under IFRS or any other recognized set of accounting standards. Readers are cautioned to consider carefully the different ways in which Aegon and its peers present similar information before comparing them.

Aegon believes the non-IFRS measures shown herein, when read together with Aegon s reported IFRS financial statements, provide meaningful supplemental information for the investing public to evaluate Aegon s business after eliminating the impact of current IFRS accounting policies for financial instruments and insurance contracts, which embed a number of accounting policies alternatives that companies may select in presenting their results (i.e. companies can use different local GAAPs to measure the insurance contract liability) and that can make the comparability from period to period difficult.

The reconciliation from underlying earnings before tax to income before tax, being the most comparable IFRS measure, is presented in the tables in this note.

Underlying earnings

Underlying earnings reflect our profit from underlying business operations and exlude components that relate to accounting mismatches that are dependent on market volatility or relate to events that are considered ouside the normal course of business. Below we describe items that are excluded from underlying earnings.

Fair value items

Fair value items include the over- or underperformance of investments and guarantees held at fair value for which the expected long-term return is included in underlying earnings. Changes to these long-term return assumptions are also included in the fair value items.

In addition, hedge ineffectiveness on hedge transactions, fair value changes on economic hedges without natural offset in earnings and for which no hedge accounting is applied and fair value movements on real estate are included under fair value items.

Certain assets held by Aegon Americas, Aegon The Netherlands and Aegon UK are carried at fair value and managed on a total return basis, with no offsetting changes in the valuation of related liabilities. These include assets such as investments in hedge funds, private equities, real estate (limited partnerships), convertible bonds and structured products. Underlying earnings exclude any over- or underperformance compared to management s long-term expected return on assets.

Based on current holdings and asset returns, the long-term expected return on an annual basis is 8-10%, depending on asset class, including cash income and market value changes. The expected earnings from these asset classes are net of deferred policy acquisition costs (DPAC) where applicable.

In addition, certain products offered by Aegon Americas contain guarantees and are reported on a fair value basis, including the segregated funds offered by Aegon Canada and the total return annuities and guarantees on variable annuities of Aegon USA. The earnings on these products are impacted by movements in equity markets and risk-free interest rates. Short-term developments in the financial markets may therefore cause volatility in earnings. Included in underlying earnings is a long-term expected return on these products and excluded is any over- or underperformance compared to management s expected return.

The fair value movements of certain guarantees and the fair value change of derivatives that hedge certain risks on these guarantees of Aegon The Netherlands and Variable Annuities Europe (included in New Markets) are excluded from underlying earnings, and the long-term expected return for these guarantees is set at zero.

Holding and other activities include certain issued bonds that are held at fair value through profit or loss (FVTPL). The interest rate risk on these bonds is hedged using swaps. The fair value movement resulting from changes in Aegon s credit spread used in the valuation of these bonds are excluded from underlying earnings and reported under fair value items.

Realized gains or losses on investments

Includes realized gains and losses on available-for-sale investments, mortgage loans and other loan portfolios.

Impairment charges/reversals

Includes impairments and reversals on available-for-sale debt securities and impairments on shares including the effect of deferred policyholder acquisition costs, mortgage loans and loan portfolios at amortized cost and associates respectively.

Other income or charges

Other income or charges is used to report any items which cannot be directly allocated to a specific line of business. Also items that are outside the normal course of business are reported under this heading.

Other charges include restructuring charges that are considered other charges for segment reporting purposes because they are outside the normal course of business. In the condensed consolidated interim financial statements, these charges are included in operating expenses.

Run-off businesses

Includes underlying results of business units where management has decided to exit the market and to run-off the existing block of business. Currently, this line includes the run-off of the institutional spread-based business, structured settlements blocks of business, Bank-Owned and Corporate-Owned Life Insurance (BOLI/COLI) business, and the sale of the life reinsurance business in the United States. Aegon has other blocks of business for which sales have been discontinued and of which the earnings are included in underlying earnings.

Share in earnings of joint ventures and associates

Earnings from Aegon s joint ventures and Aegon s associates are reported on an underlying earnings basis.

3.2 Investments geographically

Amounts included in the tables on investments geographically are presented on an IFRS-basis.

									amounts in million EUR (unless otherwise stated)
Americas USD	United Kingdom GBP	March 31, 2014	Americas	The Netherlands	United Kingdom	New Markets	Holding & other activities	Eliminations	Total EUR
		Investments							
2,046	95	Shares	1,485	328	115	32	31	(1)	1,990
80,426	8,936	Debt securities	58,351	20,120	10,809	3,025	-	-	92,305
11,056	1	Loans	8,021	25,080	1	514	-	-	33,616
11,852	53	Other financial assets	8,599	323	64	32	104	-	9,121
1,011	-	Investments in real estate	733	801	-	1	-	-	1,535
106,391	**9,084**	**Investments general account**	**77,190**	**46,652**	**10,989**	**3,603**	**135**	**(1)**	**138,567**
1,737	13,012	Shares	1,260	8,555	15,740	324	-	(8)	25,871
6,523	9,422	Debt securities	4,733	17,607	11,398	291	-	-	34,028
97,123	21,801	Unconsolidated investment funds	70,466	-	26,371	5,826	-	-	102,663
376	2,992	Other financial assets	273	393	3,619	10	-	-	4,295
-	864	Investments in real estate	-	-	1,045	-	-	-	1,045
105,760	**48,091**	**Investments for account of policyholders**	**76,732**	**26,555**	**58,172**	**6,450**	**-**	**(8)**	**167,903**
212,150	**57,176**	**Investments on balance sheet**	**153,922**	**73,207**	**69,161**	**10,054**	**135**	**(9)**	**306,470**
159,808	**277**	**Off balance sheet investments third parties**	**115,945**	**974**	**335**	**57,899**	**-**	**-**	**175,154**
371,958	**57,453**	**Total revenue generating investments**	**269,867**	**74,182**	**69,496**	**67,953**	**135**	**(9)**	**481,624**
		Investments							
87,965	8,939	Available-for-sale	63,822	20,302	10,813	3,041	9	-	97,986
11,056	1	Loans	8,021	25,080	1	514	-	-	33,616
112,118	47,372	Financial assets at fair value through profit or loss	81,345	27,025	57,303	6,497	126	(9)	172,287
1,011	864	Investments in real estate	733	801	1,045	1	-	-	2,580
212,150	**57,176**	**Total investments on balance sheet**	**153,922**	**73,207**	**69,161**	**10,054**	**135**	**(9)**	**306,470**
13	-	Investments in joint ventures	10	819	-	621	-	-	1,450
117	17	Investments in associates	85	19	20	358	-	-	482
29,767	4,412	Other assets	21,597	21,803	5,337	2,953	31,959	(30,742)	52,912
242,048	**61,604**	**Consolidated total assets**	**175,614**	**95,848**	**74,518**	**13,986**	**32,094**	**(30,751)**	**361,314**

									amounts in million EUR (unless otherwise stated)
Americas USD	United Kingdom GBP	December 31, 2013	Americas	The Netherlands	United Kingdom	New Markets	Holding & other activities	Eliminations	Total EUR
		Investments							
2,007	46	Shares	1,456	447	55	45	36	(2)	2,036
78,719	8,719	Debt securities	57,125	19,095	10,479	2,812	-	-	89,511
11,289	1	Loans	8,192	24,708	1	508	-	-	33,409
11,418	173	Other financial assets	8,286	293	208	30	103	-	8,920
993	-	Investments in real estate	721	810	-	1	-	-	1,532
104,425	**8,938**	**Investments general account**	**75,780**	**45,354**	**10,743**	**3,396**	**139**	**(2)**	**135,409**
1,804	12,792	Shares	1,309	8,450	15,375	297	-	(8)	25,423
6,675	9,643	Debt securities	4,844	16,791	11,590	307	-	-	33,531
94,950	21,776	Unconsolidated investment funds	68,905	-	26,173	5,744	-	-	100,822

230	3,062	Other financial assets	167	405	3,680	9	-	-	4,261
-	828	Investments in real estate	-	-	996	-	-	-	996
103,659	**48,101**	**Investments for account of policyholders**	**75,224**	**25,646**	**57,813**	**6,357**	**-**	**(8)**	**165,032**
208,084	**57,039**	**Investments on balance sheet**	**151,004**	**70,999**	**68,556**	**9,754**	**139**	**(10)**	**300,441**
155,179	**239**	**Off balance sheet investments third parties**	**112,611**	**994**	**287**	**60,951**	**-**	**-**	**174,843**
363,262	**57,277**	**Total revenue generating investments**	**263,616**	**71,993**	**68,843**	**70,705**	**139**	**(10)**	**475,285**
		Investments							
86,347	8,892	Available-for-sale	62,661	19,452	10,687	2,827	8	-	95,635
11,289	1	Loans	8,192	24,708	1	508	-	-	33,409
109,455	47,318	Financial assets at fair value through profit or loss	79,430	26,029	56,872	6,418	131	(10)	168,870
993	828	Investments in real estate	721	810	996	1	-	-	2,528
208,084	**57,039**	**Total investments on balance sheet**	**151,004**	**70,999**	**68,556**	**9,754**	**139**	**(10)**	**300,441**
-	-	Investments in joint ventures	-	819	-	607	-	-	1,426
112	16	Investments in associates	81	19	20	350	1	-	470
31,112	4,227	Other assets	22,577	17,067	5,080	2,936	32,327	(30,561)	49,430
239,307	**61,282**	**Consolidated total assets**	**173,663**	**88,903**	**73,656**	**13,647**	**32,466**	**(30,571)**	**351,767**

4. Premium income and premium to reinsurers

EUR millions	Q1 2014	Q1 2013
Gross		
Life	4,479	5,481
Non-Life	786	786
Total	**5,265**	**6,267**
Reinsurance		
Life	645	671
Non-Life	78	90
Total	**722**	**761**

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5. Investment income

EUR millions	Q1 2014	Q1 2013
Interest income	1,697	1,691
Dividend income	220	292
Rental income	30	30
Total investment income	**1,948**	**2,013**
Investment income related to general account	1,394	1,384
Investment income for account of policyholders	553	629
Total	**1,948**	**2,013**

6. Results from financial transactions

EUR millions	Q1 2014	Q1 2013
Net fair value change of general account financial investments at FVTPL other than derivatives	69	144
Realized gains and (losses) on financial investments	110	113
Gains and (losses) on investments in real estate	(5)	(15)
Net fair value change of derivatives	89	(265)
Net fair value change on for account of policyholder financial assets at FVTPL	1,946	7,743
Net fair value change on investments in real estate for account of policyholders	6	(10)
Net foreign currency gains and (losses)	6	2
Net fair value change on borrowings and other financial liabilities	7	19
Total	**2,228**	**7,731**

Net fair value change on for accounts of policyholder financial assets at FVTPL is offset by amounts in the Claims and benefits line reported in note 7 - Benefits and expenses.

7. Benefits and expenses

EUR millions	Q1 2014	Q1 2013
Claims and benefits	9,332	16,193
Employee expenses	475	512
Administration expenses	276	249
Deferred expenses	(317)	(314)
Amortization charges	247	241
Total	**10,013**	**16,881**

Claims and benefits includes claims and benefits in excess of account value for products for which deposit accounting is applied and the change in valuation of liabilities for insurance and investment contracts. In addition, commissions and expenses and premium paid to reinsurers are included. Claims and benefits fluctuates mainly as a result of changes in technical provisions resulting from fair value changes on for account of policyholder financial assets included in Results from financial transactions (note 6).

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8. Impairment charges/(reversals)

EUR millions	Q1 2014	Q1 2013
Impairment charges / (reversals) comprise:		
Impairment charges on financial assets, excluding receivables [1]	22	40
Impairment reversals on financial assets, excluding receivables [1]	(12)	(16)
Impairment charges / (reversals) on non-financial assets and receivables	(2)	1
Total	**8**	**25**
Impairment charges on financial assets, excluding receivables, from:		
Debt securities and money market instruments	5	13
Loans	16	27
Total	**22**	**40**
Impairment reversals on financial assets, excluding receivables, from:		
Debt securities and money market instruments	(10)	(14)
Loans	**(2)**	**(2)**
Total	**(12)**	**(16)**

[1] Impairment charges / (reversals) on financial assets, excluding receivables, are excluded from underlying earnings before tax for segment reporting (refer to note 3).

9. Intangible assets

EUR millions	Mar. 31, 2014	Dec. 31, 2013
Goodwill	210	211
VOBA	1,695	1,768
Future servicing rights	236	239
Software	47	50
Other	4	4
Total intangible assets	**2,192**	**2,272**

10. Investments

EUR millions	Mar. 31, 2014	Dec. 31, 2013
Available-for-sale (AFS)	97,986	95,635
Loans	33,616	33,409
Financial assets at fair value through profit or loss (FVTPL)	5,429	4,833
Financial assets, excluding derivatives	**137,032**	**133,877**
Investments in real estate	1,535	1,532
Total investments for general account, excluding derivatives	**138,567**	**135,409**

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Total financial assets, excluding derivatives

	AFS	FVTPL	Loans	Total
Shares	749	1,240	-	1,990
Debt securities	90,621	1,684	-	92,305
Money market and other short-term investments	5,449	700	-	6,149
Mortgages	-	-	29,638	29,638
Private loans	-	-	1,785	1,785
Deposits with financial institutions	-	-	149	149
Policy loans	-	-	1,911	1,911
Other	1,167	1,804	134	3,105
March 31, 2014	**97,986**	**5,429**	**33,616**	**137,032**

	AFS	FVTPL	Loans	Total
Shares	787	1,250	-	2,036
Debt securities	88,162	1,350	-	89,511
Money market and other short-term investments	5,524	449	-	5,974
Mortgages	-	-	29,245	29,245
Private loans	-	-	1,783	1,783
Deposits with financial institutions	-	-	292	292
Policy loans	-	-	1,955	1,955
Other	1,163	1,784	135	3,082
December 31, 2013	**95,635**	**4,833**	**33,409**	**133,877**

11. Investments for account of policyholders

EUR millions	Mar. 31, 2014	Dec. 31, 2013
Shares	25,871	25,423
Debt securities	34,028	33,531
Money market and short-term investments	967	850
Deposits with financial institutions	2,842	3,006
Unconsolidated investment funds	102,663	100,822
Other	487	404
Total investments for account of policyholders at fair value through profit or loss, excluding derivatives	**166,858**	**164,037**
Investment in real estate	1,045	996
Total investments for account of policyholders	**167,903**	**165,032**

12. Derivatives

The movements in derivative balances mainly result from changes in interest rates and other market movements during the period.

13. Fair value

The following tables provide an analysis of financial instruments recorded at fair value on a recurring basis by level of the fair value hierarchy:

Fair value hierarchy *EUR millions*	Level I	Level II	Level III	Total
As at March 31, 2014				
Financial assets carried at fair value				
Available-for-sale investments				
Shares	159	272	318	749
Debt securities	22,068	65,481	3,072	90,621
Money markets and other short-term instruments	-	5,449	-	5,449
Other investments at fair value	25	331	811	1,167
March 31, 2014	**22,252**	**71,533**	**4,202**	**97,986**
Fair value through profit or loss				
Shares	1,064	177	-	1,240
Debt securities	72	1,603	9	1,684
Money markets and other short-term instruments	95	605	-	700
Other investments at fair value	1	574	1,230	1,804
Investments for account of policyholders [1]	100,481	64,450	1,927	166,858
Derivatives	32	16,650	283	16,965
March 31, 2014	**101,744**	**84,058**	**3,449**	**189,251**
Total financial assets at fair value	**123,995**	**155,591**	**7,651**	**287,238**
Financial liabilities carried at fair value				
Investment contracts for account of policyholders [2]	13,267	19,738	115	33,120
Borrowings [3]	513	497	-	1,010
Derivatives	28	13,072	1,665	14,765
Total financial liabilities at fair value	**13,807**	**33,308**	**1,780**	**48,895**
As at December 31, 2013				
Financial assets carried at fair value				
Available-for-sale investments				
Shares	202	262	322	787
Debt securities	20,815	64,184	3,162	88,162
Money markets and other short-term instruments	-	5,524	-	5,524
Other investments at fair value	25	312	826	1,163
December 31, 2013	**21,043**	**70,282**	**4,310**	**95,635**
Fair value through profit or loss				
Shares	1,120	130	-	1,250
Debt securities	64	1,268	17	1,350
Money markets and other short-term instruments	95	354	-	449
Other investments at fair value	-	567	1,217	1,784
Investments for account of policyholders [1]	99,040	63,008	1,989	164,037
Derivatives	69	13,134	328	13,531
December 31, 2013	**100,388**	**78,461**	**3,552**	**182,401**
Total financial assets at fair value	**121,431**	**148,744**	**7,862**	**278,036**
Financial liabilities carried at fair value				
Investment contracts for account of policyholders [2]	12,872	19,641	114	32,628
Borrowings [3]	517	500	-	1,017

Derivatives	24	10,383	1,431	11,838
Total financial liabilities at fair value	**13,413**	**30,524**	**1,545**	**45,482**

[1] The investments for account of policyholders included in the table above represents those investments carried at fair value through profit or loss.
[2] The investment contracts for account of policyholders included in the table above represents those investment contracts carried at fair value.
[3] Total borrowings on the statement of financial position contain borrowings carried at amortized cost that are not included in the above schedule.

Significant transfers between Level I, Level II and Level III

Aegon s policy is to record transfers of assets and liabilities between Level I, Level II and Level III at their fair values as of the beginning of each reporting period.

The table below shows transfers between Level I and II for financial assets and financial liabilities recorded at fair value on a recurring basis during the first quarter, ended March 31, 2014.

Fair value transfers				
EUR millions	Q1 2014		Full Year 2013	
	Transfers Level I to Level II	Transfers Level II to Level I	Transfers Level I to Level II	Transfers Level II to Level I
Financial assets carried at fair value available-for-sale investments				
Shares	-	-	-	1
Debt securities	-	67	1	209
Total	**-**	**67**	**2**	**210**
Fair value through profit or loss				
Investments for account of policyholders	324	-	-	263
Total	**324**	**-**	**-**	**263**
Total financial assets at fair value	**324**	**67**	**2**	**473**

Transfers are identified based on transaction volume and frequency, which are indicative of an active market.

Movements in Level III financial instruments measured at fair value

The following table summarizes the change of all assets and liabilities measured at estimated fair value on a recurring basis using significant unobservable inputs (Level III), including realized and unrealized gains (losses) of all assets and liabilities and unrealized gains (losses) of all assets and liabilities still held at the end of the respective period.

Roll forward of Level III financial instruments	January 1, 2014	Total gains / losses in income statement [1]	Total gains / losses in OCI [2]	Purchases	Sales	Settlements	Net exchange differences	Reclass-ification	Transfers from Level I and Level II	Transfers to Level I and Level II	March 31, 2014	Total unrealized gains and losses for the period recorded in the P&L for instruments held at March 31, 2014 [3]
Financial assets carried at fair value available-for-sale investments												
Shares	322	6	(1)	12	(20)	-	-	-	-	(1)	318	-
Debt securities	3,162	8	35	287	(88)	(50)	(2)	-	81	(361)	3,072	-

Other investments at fair value	826	(26)	(7)	27	(14)	(1)	-	-	7	-	811	-
	4,310	**(13)**	**28**	**326**	**(122)**	**(52)**	**(3)**	**-**	**88**	**(361)**	**4,202**	**-**
Fair value through profit or loss												
Debt securities	17	-	-	-	-	(8)	-	-	-	-	9	1
Other investments at fair value	1,217	16	-	7	(54)	-	-	-	45	-	1,230	16
Investments for account of policyholders	1,989	28	-	42	(65)	-	1	-	77	(145)	1,927	32
Derivatives	328	(69)	-	-	-	-	1	23	-	-	283	(77)
	3,552	**(25)**	**-**	**49**	**(119)**	**(8)**	**2**	**23**	**122**	**(145)**	**3,449**	**(28)**
Financial liabilities carried at fair value												
Investment contracts for account of policyholders	(114)	(1)	-	-	-	-	-	-	-	-	(115)	(1)
Derivatives	(1,431)	(194)	-	-	(18)	-	1	(23)	-	-	(1,665)	(180)
	(1,545)	**(196)**	**-**	**-**	**(17)**	**-**	**1**	**(23)**	**-**	**-**	**(1,780)**	**(181)**

[1] Includes impairments and movements related to fair value hedges. Gains and losses are recorded in the line item results from financial transactions of the income statement.

[2] Total gains and losses are recorded in line items Gains/ (losses) on revaluation of available-for-sale investments and (Gains)/ losses transferred to the income statement on disposal and impairment of available-for-sale investment of the statement of other comprehensive income.

[3] Total gains / (losses) for the period during which the financial instrument was in Level III.

During the first quarter of 2014, Aegon transferred certain financial instruments from Level II to Level III of the fair value hierarchy. The reason for the change in level was that the market liquidity for these securities decreased, which led to a change in market observability of prices. Prior to transfer, the fair value for the Level II securities was determined using observable market transactions or corroborated broker quotes respectively for the same or similar instruments. The amount of assets and liabilities transferred to Level III was EUR 210 million (full year 2013: EUR 785 million). Since the transfer, all such assets have been valued using valuation models incorporating significant non market-observable inputs or uncorroborated broker quotes.

Similarly, during the first quarter of 2014, Aegon transferred certain financial instruments from Level III to other levels of the fair value hierarchy. The change in level was mainly the result of a return of activity in the market for these securities and that for these securities the fair value could be determined using observable market transactions or corroborated broker quotes for the same or similar instruments. Transfers from Level III amounted to EUR 506 million (full year 2013: EUR 756 million).

The table below presents information about the significant unobservable inputs used for recurring fair value measurements for certain Level III financial instruments.

Overview of significant unobservable inputs

EUR millions	Carrying amount March 31, 2014	Valuation technique [1]	Significant unobservable input [2]	Range (weighted average)
Financial assets carried at fair value available-for-sale investments				
Shares	193	Broker quote	n.a.	n.a.
	126	Other	n.a.	n.a.
	318			
Debt securities				
	2,513	Broker quote	n.a.	n.a.
	128	Discounted cash flow	Discount rate	3% - 8% (6.93%)
	218	Discounted cash flow	Credit spread	0.4% - 2.8% (2.01%)
	213	Other	n.a.	n.a.
	3,072			
Other investments at fair value				
Tax credit investments	676	Discounted cash flow	Discount rate	8.4%
Other	135	Other	n.a.	n.a.
	811			
March 31, 2014	**4,202**			
Fair value through profit or loss				
Debt securities	9	Other	n.a.	n.a.
	9			
Other investments at fair value				
Investment funds	1,204	Net asset value	n.a.	n.a.
Other	26	Other	n.a.	n.a.
	1,230			
Derivatives [3]				
Longevity swap	117	Discounted cash flow	Mortality	n.a.
Other	82	Other	n.a.	n.a.
	200			
March 31, 2014	**1,439**			
Total financial assets at fair value [3]	**5,641**			
Financial liabilities carried at fair value				
Derivatives				
Embedded derivatives in insurance contracts	1,496	Discounted cash flow	Credit spread	0.4%
Other	169	Other	n.a.	n.a.
Total financial liabilities at fair value	**1,665**			

[1] Other in the table above (column Valuation technique) includes investments for which the fair value is uncorroborated and no broker quote is received.
[2] Not applicable (n.a.) has been included when no significant unobservable assumption has been identified and used.
[3]

Investments for account of policyholders are excluded from the table above and from the disclosure regarding reasonably possible alternative assumptions. Policyholder assets, and their returns, belong to policyholders and do not impact Aegon s net income or equity. The effect on total assets is offset by the effect on total liabilities. Derivatives exclude derivatives for account of policyholders amounting to EUR 83 million.

The description of Aegon s methods of determining fair value is included in the consolidated financial statements 2013. For reference purposes, the valuation techniques included in the table above are described in more detail below:

Shares

When available, Aegon uses quoted market prices in active markets to determine the fair value of its investments in shares. Fair values for unquoted shares are estimated using observations of the price/earnings or price/cash flow ratios of quoted companies considered comparable to the companies being valued. Valuations are adjusted to account for company-specific issues and the lack of liquidity inherent in an unquoted investment. Illiquidity adjustments are generally based on available market evidence. In addition, a variety of other factors are reviewed by management, including, but not limited to, current operating performance, changes in market outlook and the third-party financing environment.

Available-for-sale shares include shares in a Federal Home Loan Bank (FHLB) for an amount of EUR 94 million that are measured at par, which are reported as part of Other. A FHLB has implicit financial support from the United States government. The redemption value of the shares is fixed at par and they can only be redeemed by the FHLB.

Debt securities

Debt securities comprise of residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), asset-backed securities (ABS), corporate bonds and sovereign debt. Details on the fair value measurement for these specific types of debt securities are provided below.

Valuations of RMBS, CMBS and ABS are monitored and reviewed on a monthly basis. Valuations per asset type are based on a pricing hierarchy which uses a waterfall approach that starts with market prices from indices and follows with third-party pricing services or brokers. The pricing hierarchy is dependent on the possibilities of corroboration of the market prices. If no market prices are available, Aegon uses internal models to determine fair value. Significant inputs included in the internal models are generally determined based on relative value analyses, which incorporate comparisons to instruments with similar collateral and risk profiles. Market standard models may be used to model the specific collateral composition and cash flow structure of each transaction. The most significant unobservable input is illiquidity premium which is embedded in the discount rate. The weighted average discount rate used in valuation of ABS has increased to 6.93% (December 31, 2013: 6.62%). Broker quoted debt securities include ABS for an amount of EUR 1,997 million (December 31, 2013: EUR 2,030).

Valuations of corporate bonds are monitored and reviewed on a monthly basis. The pricing hierarchy is dependent on the possibility of corroboration of market prices when available. If no market prices are available, valuations are determined by a discounted cash flow methodology using an internally calculated yield. The yield is comprised of a credit spread over a given benchmark. In all cases, the benchmark is an observable input. The credit spread contains both observable and unobservable inputs. Aegon starts by taking an observable credit spread from a similar bond of the given issuer, and then adjusts this spread based on unobservable inputs. These unobservable inputs may include subordination, liquidity and maturity differences. The weighted average credit spread used in valuation of corporate bonds has decreased to 2.01% (December 31, 2013: 2.33%).

When available, Aegon uses quoted market prices in active markets to determine the fair value of its sovereign debt investments. When Aegon cannot make use of quoted market prices, market prices from indices or quotes from third-party pricing services or brokers are used.

Tax credit investments

The fair value of tax credit investments is determined by using a discounted cash flow valuation technique. This valuation technique takes into consideration projections of future capital contributions and distributions, as well as future tax credits and the tax benefits of future operating losses. The present value of these cash flows is calculated by applying a discount rate. In general, the discount rate is determined based on the cash outflows for the investments and the cash inflows from the tax credits/tax benefits (and the timing of those cash flows). These inputs are unobservable in the market place. The discount rate used in valuation of tax credit investments has increased to 8.4% (December 31, 2013: 8.2%).

Investment funds

Investment funds include real estate funds, private equity funds and hedge funds. The fair values of investments held in non-quoted investment funds are determined by management after taking into consideration information provided by the fund managers. Aegon reviews the valuations each month and performs analytical procedures and trending analyses to ensure the fair values are appropriate.

Derivatives

Where quoted market prices are not available, other valuation techniques, such as option pricing or stochastic modeling, are applied. The valuation techniques incorporate all factors that a typical market participant would consider and are based on observable market data when available. Models are validated before they are used and calibrated to ensure that outputs reflect actual experience and comparable market prices.

Fair values for exchange-traded derivatives, principally futures and certain options, are based on quoted market prices in active markets. Fair values for over-the-counter (OTC) derivatives represent amounts estimated to be received from or paid to a third party in settlement of these instruments. These derivatives are valued using pricing models based on the net present value of estimated future cash flows, directly observed prices from exchange-traded derivatives, other OTC trades, or external pricing services. Most valuations are derived from swap and volatility matrices, which are constructed for applicable indices and currencies using current market data from many industry standard sources. Option pricing is based on industry standard valuation models and current market levels, where applicable. The pricing of complex or illiquid instruments is based on internal models or an independent third party. For long-dated illiquid contracts, extrapolation methods are applied to observed market data in order to estimate inputs and assumptions that are not directly observable. To value OTC derivatives, management uses observed market information, other trades in the market and dealer prices.

Some OTC derivatives are so-called longevity derivatives. The payout of longevity derivatives is linked to publicly available mortality tables. The derivatives are measured using the present value of the best estimate of expected payouts of the derivative plus a risk margin. The best estimate of expected payouts is determined using best estimate of mortality developments. Aegon determined the risk margin by stressing the best estimate mortality developments to quantify the risk and applying a cost-of-capital methodology. The most significant unobservable input for these derivatives is the (projected) mortality development.

Aegon normally mitigates counterparty credit risk in derivative contracts by entering into collateral agreements where practical and in ISDA master netting agreements for each of the Group s legal entities to facilitate Aegon s right to offset credit risk exposure. Changes in the fair value of derivatives attributable to changes in counterparty credit risk were not significant.

Embedded derivatives in insurance contracts including guarantees

Certain bifurcated guarantees for minimum benefits in insurance and investment contracts are carried at fair value. These guarantees include guaranteed minimum withdrawal benefits (GMWB) in the United States, United Kingdom and Japan which are offered on some variable annuity products and are also assumed from a ceding company; minimum interest rate guarantees on insurance products offered in the Netherlands, including group pension and traditional products; and guaranteed minimum accumulation benefits on segregated funds sold in Canada.

Since the price of these guarantees is not quoted in any market, the fair values of these guarantees are calculated as the present value of future expected payments to policyholders less the present value of assessed rider fees attributable to the guarantees. Given the complexity and long-term nature of these guarantees which are unlike instruments available in financial markets, their fair values are determined by using stochastic techniques under a variety of market return scenarios. A variety of factors are considered including credit spread, expected market rates of return, equity and interest rate volatility, correlations of market returns, discount rates and actuarial assumptions. The most significant unobservable factor is credit spread. The credit spread used in the valuations of embedded derivatives in insurance contracts remained stable at 0.4% .

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The expected returns are based on risk-free rates. Aegon added a premium to reflect the credit spread as required. The credit spread is set by using the credit default swap (CDS) spreads of a reference portfolio of life insurance companies (including Aegon), adjusted to reflect the subordination of senior debt holders at the holding company level to the position of policyholders at the operating company level (who have priority in payments to other creditors). Aegon s assumptions are set by region to reflect differences in the valuation of the guarantee embedded in the insurance contracts.

Since many of the assumptions are unobservable and are considered to be significant inputs to the liability valuation, the liability included in future policy benefits has been reflected within Level III of the fair value hierarchy.

Effect of reasonably possible alternative assumptions

The effect of changes in unobservable inputs on fair value measurement as reported in the 2013 consolidated financial statements of Aegon has not changed significantly as per March 31, 2014.

Fair value information about financial instruments not measured at fair value

The following table presents the carrying values and estimated fair values of financial assets and liabilities, excluding financial instruments which are carried at fair value on a recurring basis.

Fair value information about financial instruments not measured at fair value

EUR millions	Carrying amount March 31, 2014	Total estimated fair value March 31, 2014	Carrying amount December 31, 2013	Total estimated fair value December 31, 2013
Assets				
Mortgage loans - held at amortized cost	29,638	34,192	29,245	32,869
Private loans - held at amortized cost	1,785	1,940	1,783	1,888
Other loans - held at amortized cost	2,194	2,194	2,381	2,381
Liabilities				
Trust pass-through securities - held at amortized cost	123	117	135	122
Subordinated borrowings - held at amortized cost	45	81	44	62
Borrowings held at amortized cost	12,023	12,343	11,003	11,291
Investment contracts - held at amortized cost	13,322	13,636	14,079	14,387

Financial instruments for which carrying value approximates fair value

Certain financial instruments that are not carried at fair value are carried at amounts that approximate fair value, due to their short-term nature and generally negligible credit risk. These instruments include cash and cash equivalents, short-term receivables and accrued interest receivable, short-term liabilities, and accrued liabilities. These instruments are not included in the table above.

14. Deferred expenses

EUR millions	Mar. 31, 2014	Dec. 31, 2013
DPAC for insurance contracts and investment contracts with discretionary participation features	9,138	9,229
Deferred cost of reinsurance	412	421
Deferred transaction costs for investment management services	359	356
Total deferred expenses	**9,909**	**10,006**

15. Share capital

EUR millions	Mar. 31, 2014	Dec. 31, 2013
Share capital - par value	325	325
Share premium	8,375	8,375
Total share capital	**8,701**	**8,701**
Share capital - par value		
Balance at January 1	325	319
Issuance	-	84
Withdrawal	-	(82)
Share dividend	-	5
Balance	**325**	**325**
Share premium		
Balance at January 1	8,375	8,780
Withdrawal	-	(400)
Share dividend	-	(5)
Balance	**8,375**	**8,375**

Basic and diluted earnings per share

EUR millions	Q1 2014	Q1 2013
Earnings per share (EUR per share)		
Basic earnings per common share	0.16	0.09
Basic earnings per common share B	-	-
Diluted earnings per common share	0.16	0.09
Diluted earnings per common share B	-	-
Earnings per share calculation		
Net income attributable to equity holders of Aegon N.V.	392	224
Preferred dividend	-	-
Coupons on other equity instruments	(46)	(49)
Earnings attributable to common shares and common shares B	345	175
Earnings attributable to common shareholders	343	175
Earnings attributable to common shareholders B	2	-
Weighted average number of common shares outstanding (in million)	2,090	1,943
Weighted average number of common shares B outstanding (in million)	579	-

Diluted earnings per share is calculated by adjusting the average number of shares outstanding for share options. During 2014 and 2013, the average share price did not exceed the exercise price of these options. As a result, diluted earnings per share do not differ from basic earnings per share.

Dividend

It will be proposed to the Annual General Meeting of Shareholders on May 21, 2014, absent unforeseen circumstances, to pay a dividend for the year 2013 of EUR 0.22 per common share and EUR 0.0055 per common share B. After taking into account the interim dividend 2013 of EUR

0.11 per common share and EUR 0.00275 per common share B, this will result in a final dividend of EUR 0.11 per common share and EUR 0.00275 per common share B.

The interim dividend 2013 was paid in cash or stock at the election of the shareholder. Stock dividend amounted to one new Aegon common share for every 50 common shares held. The stock dividend and cash dividend were approximately equal in value. The interim dividend was payable as of September 13, 2013. The interim dividend 2013 for common shares B was fully paid in cash.

16. Other equity instruments

On March 15, 2014, Aegon redeemed junior perpetual capital securities with a coupon of 6.875% issued in 2006. The junior perpetual capital securities were originally issued at par with a carrying value of EUR 438 million. The principal amount of USD 550 million (EUR 396 million) was repaid with accrued interest. The cumulative foreign currency result at redemption was recorded directly in retained earnings.

17. Borrowings

EUR millions	Mar. 31, 2014	Dec. 31, 2013
Debentures and other loans	12,758	11,830
Commercial paper	144	135
Short-term deposits	12	16
Bank overdrafts	118	39
Total borrowings	**13,033**	**12,020**

Debentures and other loans

Included in Debentures and other loans is EUR 1,010 million relating to borrowings measured at fair value (2013: EUR 1,017 million).

On March 13, 2014, Aegon executed a transaction under the Dutch SAECURE program to sell Class A mortgage backed securities (RMBS) amounting to EUR 1.4 billion. SAECURE 14 NHG consists of 2 tranches:

- EUR 343 million of class A1 notes with an expected weighted average life of 2 years and priced with a coupon of three month Euribor plus 0.40%; and
- EUR 1,024 million of class A2 notes with an expected weighted average life of 5 years and priced with a coupon of three month Euribor plus 0.72% .

Commercial paper, Short-term deposits and Bank overdrafts vary with the normal course of business.

18. Commitments and contingencies

In late March, consumer interest group Vereniging Woekerpolis.nl filed a new claim against Aegon in court. The claim relates to a range of unit-linked products of Aegon, challenging a variety of elements of these products on multiple legal grounds. At this time it is not practicable for Aegon to quantify a range or maximum liability, if any.

There have been no other material changes in contingent assets and liabilities as reported in the 2013 consolidated financial statements of Aegon.

19. Acquisitions / divestments

There were no significant acquisitions or divestments during the first quarter of 2014.

20. Events after the balance sheet date

Optas

Aegon and BPVH a foundation representing Dutch harbor workers and employers have reached an agreement on removing restrictions on the capital of the harbor workers former pension fund Optas. This agreement, announced on April 14, 2014, ends a dispute that began when the Optas pension fund was transformed into an insurance company, which was subsequently acquired by Aegon in 2007.

Aegon and BPVH have agreed to jointly file a request with the Dutch court to remove the restriction on the capital of Optas. Upon the court granting this request, Aegon will make a payment of EUR 80 million to BPVH, as well as offering harbor workers more favorable pension conditions. In addition, over the coming years Aegon will contribute up to EUR 20 million to help mitigate the effect of an announced reduction in the tax-free pension allowance in the Netherlands. The compensation is not recognized in these condensed consolidated interim financial statements.

Capital market transactions

On April 25, 2014, Aegon issued EUR 700 million of subordinated notes, first callable on April 25, 2024 and maturing on April 25, 2044. The coupon will be fixed at 4% until the first call date and floating thereafter.

On April 28, 2014, Aegon announced that it will call for the redemption of perpetual capital securities with a coupon of 7.25% issued in 2007. The redemption will be effective June 15, 2014, when the principal amount of USD 1,050 million will be repaid with accrued interest.

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Disclaimers

Cautionary note regarding non-IFRS measures

This document includes the non-IFRS financial measures: underlying earnings before tax, income tax and income before tax. These non-IFRS measures are calculated by consolidating on a proportionate basis Aegon s joint ventures and associated companies. The reconciliation of these measures to the most comparable IFRS measures is provided in note 3 Segment information of Aegon s Condensed Consolidated Interim Financial Statements. Aegon believes that its non-IFRS measures, together with the IFRS information, provide meaningful information about the underlying operating results of Aegon s business including insight into the financial measures that senior management uses in managing the business.

Local currencies and constant currency exchange rates

This document contains certain information about Aegon s results and financial condition presented in USD for the Americas and GBP for the United Kingdom, because those businesses operate and are managed primarily in those currencies. None of this information is a substitute for or superior to financial information about Aegon presented in EUR, which is the currency of Aegon s primary financial statements.

Forward-looking statements

The statements contained in this document that are not historical facts are forward-looking statements as defined in the US Private Securities Litigation Reform Act of 1995. The following are words that identify such forward-looking statements: aim, believe, estimate, target, intend, may, expect, anticipate, predict, project, counting on, plan, continue, want, forecast, goal, should, would, is confident, will, and similar expressions as they relate to Aegon. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Aegon undertakes no obligation to publicly update or revise any forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which merely reflect company expectations at the time of writing. Actual results may differ materially from expectations conveyed in forward-looking statements due to changes caused by various risks and uncertainties. Such risks and uncertainties include but are not limited to the following:

t Changes in general economic conditions, particularly in the United States, the Netherlands and the United Kingdom;
t Changes in the performance of financial markets, including emerging markets, such as with regard to:
  The frequency and severity of defaults by issuers in Aegon s fixed income investment portfolios;
  The effects of corporate bankruptcies and/or accounting restatements on the financial markets and the resulting decline in the value of equity and debt securities Aegon holds; and
  The effects of declining creditworthiness of certain private sector securities and the resulting decline in the value of sovereign exposure that Aegon holds;
t Changes in the performance of Aegon s investment portfolio and decline in ratings of Aegon s counterparties;
t Consequences of a potential (partial) break-up of the euro;
t The frequency and severity of insured loss events;
t Changes affecting longevity, mortality, morbidity, persistence and other factors that may impact the profitability of Aegon s insurance products;
t Reinsurers to whom Aegon has ceded significant underwriting risks may fail to meet their obligations;
t Changes affecting interest rate levels and continuing low or rapidly changing interest rate levels;
t Changes affecting currency exchange rates, in particular the EUR/USD and EUR/GBP exchange rates;
t Changes in the availability of, and costs associated with, liquidity sources such as bank and capital markets funding, as well as conditions in the credit markets in general such as changes in borrower and counterparty creditworthiness;
t Increasing levels of competition in the United States, the Netherlands, the United Kingdom and emerging markets;
t Changes in laws and regulations, particularly those affecting Aegon s operations, ability to hire and retain key personnel, the products Aegon sells, and the attractiveness of certain products to its consumers;
t Regulatory changes relating to the insurance industry in the jurisdictions in which Aegon operates;
t

Changes in customer behavior and public opinion in general related to, among other things, the type of products also Aegon sells, including legal, regulatory or commercial necessity to meet changing customer expectations;

- Acts of God, acts of terrorism, acts of war and pandemics;
- Changes in the policies of central banks and/or governments;
- Lowering of one or more of Aegon s debt ratings issued by recognized rating organizations and the adverse impact such action may have on Aegon s ability to raise capital and on its liquidity and financial condition;
- Lowering of one or more of insurer financial strength ratings of Aegon s insurance subsidiaries and the adverse impact such action may have on the premium writings, policy retention, profitability and liquidity of its insurance subsidiaries;
- The effect of the European Union s Solvency II requirements and other regulations in other jurisdictions affecting the capital Aegon is required to maintain;
- Litigation or regulatory action that could require Aegon to pay significant damages or change the way Aegon does business;
- As Aegon s operations support complex transactions and are highly dependent on the proper functioning of information technology, a computer system failure or security breach may disrupt Aegon s business, damage its reputation and adversely affect its results of operations, financial condition and cash flows;
- Customer responsiveness to both new products and distribution channels;
- Competitive, legal, regulatory, or tax changes that affect profitability, the distribution cost of or demand for Aegon s products;
- Changes in accounting regulations and policies or a change by Aegon in applying such regulations and policies, voluntarily or otherwise, may affect Aegon s reported results and shareholders equity;
- The impact of acquisitions and divestitures, restructurings, product withdrawals and other unusual items, including Aegon s ability to integrate acquisitions and to obtain the anticipated results and synergies from acquisitions;
- Catastrophic events, either manmade or by nature, could result in material losses and significantly interrupt Aegon s business; and
- Aegon s failure to achieve anticipated levels of earnings or operational efficiencies as well as other cost saving initiatives.

Further details of potential risks and uncertainties affecting Aegon are described in its filings with the Netherlands Authority for the Financial Markets and the US Securities and Exchange Commission, including the Annual Report. These forward-looking statements speak only as of the date of this document. Except as required by any applicable law or regulation, Aegon expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in Aegon s expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

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Aegon s Q1 2014 press release and Financial Supplement are available on aegon.com.

About Aegon

Aegon s roots go back more than 150 years to the first half of the nineteenth century. Since then, Aegon has grown into an international company, with businesses in more than 25 countries in the Americas, Europe and Asia. Today, Aegon is one of the world s leading financial services organizations, providing life insurance, pensions and asset management. Aegon s purpose is to help people take responsibility for their financial future. More information: aegon.com.