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EDITED TRANSCRIPT

AYI.N - Q2 2024 Acuity Brands Inc Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Good morning, and welcome to the Acuity Brands Fiscal 2024 Second Quarter Earnings Call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to Charlotte McLaughlin, Vice President of Investor Relations. Charlotte, please go ahead.

Charlotte McLaughlin - Acuity Brands, Inc. - VP of IR

Good morning, and welcome to the Acuity Brands Fiscal 2024 Second Quarter Earnings Call. On the call with me this morning is Neil Ashe, our Chairman, President and Chief Executive Officer; and Karen Holcom, our Senior Vice President and Chief Financial Officer.

Today's call will include updates on our strategic progress and on our fiscal 2024 2nd quarter performance. There will be an opportunity for Q&A at the end of this call. As a reminder, some of our comments today may be forward-looking statements. We intend these forward-looking statements to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, as detailed on Slide 2 of the accompanying presentation. Reconciliations of certain non-GAAP financial metrics with their corresponding GAAP measures are available in our 2024 second quarter earnings release and supplemental presentation, both of which are available on our Investor Relations website at www.investors.acuitybrands.com. Thank you for your interest in Acuity brands.

I will now turn the call over to Neil Ashe.

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

Thank you, Charlotte, and thank you all for joining us this morning. Our fiscal 2024 second quarter was another quarter of solid execution. We increased our adjusted operating profit, adjusted operating profit margin and adjusted diluted earnings per share. We generated strong free cash flow, and we allocated capital effectively to drive value. Both our Lighting and our Intelligence Spaces businesses delivered strong financial performance. In ABL, we increased adjusted operating profit by $3 million on $47 million less sales and increased the adjusted operating profit margin 120 basis points to 16.2%. This performance is the cumulative result of the changes that we have made to the business over the last 4 years.

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We have made the business more predictable, repeatable and scalable by executing on our strategy to increase product vitality, elevate service levels, use technology to improve and differentiate both our products and how we operate the business and by driving productivity. During the second quarter, we continue to make progress on our strategy. By focusing on the needs of our customers, we are elevating our service through our differentiated portfolios.

Contractor Select is about 300 of our most popular products that are used in common everyday lighting applications. These products are designed to be resold and are in stock at retailers and electrical distributors. Through high levels of product vitality, we have been able to create a portfolio that offers quality products that our customers want at competitive prices, while at the same time, allowing our distributor partners to carry less inventory. Design Select is comprised of products that are configurable and allow customers to easily select the products needed for their projects.

We are less than a year into launching the first wave of Design Select, and we are continuing to expand the product families and configurations available. The reception so far has been positive. A recent project in California is a great example, where a customer needed indoor fixtures, outdoor fixtures and lighting controls.

Using options from the Design Select portfolio, we were able to meet the unique product combination of the project, ensure it was there when the customer needed it, and then it was easy for the contractor to install. The remainder of our product portfolio is Made-to-Order. These are specialty products or solutions made for specific applications, such as national accounts that satisfy all of the wants and needs of the Lyon Design community.

At the same time, we continue to make investments for future growth. In the second quarter, we expanded our horticulture product solutions. We added the Arize family of products to our existing Verjure line in order to take advantage of a growing market. Arize is a collection of professional grade LED horticulture luminaires, that are compatible with our in-line air wireless controls and are used in commercial greenhouses, indoor cultivation and vertical farming. This small investment accelerates our product portfolio efforts in this attractive vertical. This approach to investment in ABL is the right one, as evidenced by the value being realized in our OPTOTRONIC driver and component business. We acquired OPTOTRONIC in 2021 in order to control more of the technology in our luminaires, to expand our OEM channel and to take greater control of our electronic supply chain.

Today, we are one of the top driver suppliers to the lighting industry and to ourselves as we manufacture the majority of our drivers for our own products. This control not only offers us a financial benefit but also offers us greater engineering flexibility during the design and development process that is core to our product vitality efforts. This quarter, we introduced the IVO family of shallow recessed downlights from Gotham which is a new platform of vendor downlights that have compact design for use in confined spaces that replace the traditional canned recess lighting fixtures.

IVO can be used in most nonresidential settings in both new construction and renovation. The Compact Design and high efficiency options deliver real value for our customers, while the use of less steel, less aluminum and less plastic drives margin for us. Finally, this quarter, several of our brands were recognized by the industry. Our Aculux, Eureka, Hydrel, Luminis and Peerless brands were awarded 9 good design awards from the Chicago Atemi Use of architecture and design.

We were awarded 11, 2023 product innovation awards by Architectural Products Magazine for impressive innovation in terms of form, functionality and sustainability. And 14 of our luminaires were selected across multiple product categories by the LIT Design Award for exemplifying outstanding creativity and innovation. Now moving to our Intelligence Spaces Group. Our mission in our Intelligence Spaces business is to make spaces smarter, safer and greener through our strategy of connecting the edge to the cloud. Distech has the best edge control devices on the market, while Atrius will be the best in cloud applications.

At Distech, we are focused on expanding our addressable market in 2 ways. The first is geographic and the second is increasing what we can control in a built space. As part of our geographic expansion, this quarter we added additional systems integrator capacity in Australia, and we released Atrius Sustainability and Atrius Energy in France. Our independent SIs are key to the organic expansion of our Spaces business. We partner with the best SIs in specific geographies to sell our full suite of Distech and Atrius product portfolios. Our Atrius applications are making a difference for

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our customers. Atrius sustainability is an automation tool that captures, categorizes and reports on carbon emissions, while Atrius Energy facilitates the reduction of energy and carbon usage by allowing facilities teams to benchmark their usage and prepare for upcoming reporting obligations.

Our Atrius energy and sustainability applications are gaining recognition. Commercial Property Executive magazine named Atrius, an innovative technology winner in its annual influence awards. And CREtech selected Atrius as a finalist in its real estate tech awards that on our technology vendors that are advancing solutions for commercial buildings.

Now turning to the outlook for the remainder of the year. We are performing well. We are satisfying customers, expanding margins and generating strong free cash flow. The order rates in both our Lighting business and our Spaces business are growing year-over-year. In our Lighting business, we are back to typical lead times and absent the impact of sales from excess backlog last year, we would be experiencing sales growth. In our Lighting and Lighting Controls business, our strategy drives strong execution, and we are focused on returning the business to growth in a normalized environment, while leveraging our fixed costs and generating strong cash flow. In our Spaces business, we will continue to grow geographically and by adding to what we can control in a build space.

Karen will outline what that means for our second half outlook after giving you an update on our second quarter performance. Karen?

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

Thank you, Neil, and good morning to everyone on the call. As Neil said, we continue to execute well. In our fiscal second quarter, we increased our adjusted operating profit, improved our adjusted operating profit margin and increased our adjusted diluted earnings per share while generating strong cash flow.

We continue to allocate capital effectively while making progress on our strategic priorities. For total AYI, we generated net sales in the second quarter of $906 million, which was $38 million or 4% lower than the prior year as a result of the lower net sales in our ABL business. This was partially offset by continued growth in the ISG business of 17% in the quarter.

We continue to deliver year-over-year margin improvement. During the quarter, our adjusted operating profit increased by $8 million on lower net sales, and we expanded adjusted operating profit margin to 15.5%, an increase of approximately 150 basis points from the prior year. This increase was driven largely by the significant year-over-year improvement in our gross profit margin as we continue to execute our strategy and drive margins through product vitality, the management of price and cost and productivity improvements.

During the quarter, our adjusted diluted earnings per share of $3.38 increased $0.32 or 11% over the prior year, primarily a result of higher net income and to a lesser extent, lower shares outstanding due to share repurchases. In ABL, net sales were $844 million in the quarter. A decrease of around 5% compared with the prior year, driven by declines across all of our channels. As Neil mentioned previously, our order rate in ABL continues to grow year-over-year, meaning absent the sales last year from the excess backlog, ABL would have experienced sales growth. ABL's adjusted operating profit increased 2% to $136 million on lower net sales while we delivered adjusted operating profit margin of 16.2%, a 120 basis point improvement over the prior year.

ISG's net sales for the second quarter were $68 million, an increase of 17% as Distech continued to grow and Q2 term performed as we expected. ISG's adjusted operating profit was $14 million with the adjusted operating profit margin at 21%, a 240 basis point improvement over the prior year. Now turning to our year-to-date cash flow performance. We generated $293 million of cash flow from operating activities in the first half of the year, down slightly from the same period last year. We continue to allocate capital consistent with our priorities. Year-to-date, we invested $29 million in capital expenditures. We acquired the assets of Arize horticulture lighting, we increased our dividend per share 15% and allocated approximately $68 million to repurchase over 370,000 shares.

In January, our Board of Directors authorized the additional repurchase of up to 3 million shares of common stock, bringing the outstanding authorization to approximately 4 million shares. Since the beginning of the fourth quarter of fiscal 2020, we have repurchased approximately 9.5 million shares at an average price of about $145 per share, which was funded by organic cash flow. This amounts to about 24% of the then shares outstanding. We had a strong first half performance. We delivered improved margins and increased adjusted diluted earnings per share.

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We generated strong cash flow from operations and continued to allocate capital effectively. While it is not our practice to address our outlook during the year, our performance in the first half was very strong and we are raising our full year expectations for EPS. We now expect our 2024 adjusted diluted earnings per share range to be between $14.75 and $15.50.

Thank you for joining us today. I will now pass you over to the operator to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Joe O'Dea with Wells Fargo.

Joseph John O'Dea - Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst

So first question, I'll group kind of 2 in 1, but I wanted to ask about infrastructure and SG&A. And really, the angle is, are you seeing evidence that some of the changes in the commissions that you implemented last year are translating to better wins at this point? You can talk about the infrastructure pipeline a little bit. As well as just when you see where SG&A is as a percent of sales, opportunities that you see there, either volume leverage or cost down?

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

Okay. Great. Joe, thank you. So first of all, on infrastructure, we're feeling good about our positioning for the larger projects that are coming down the pipe. I think everyone is recognizing that they are coming down on a longer-term basis than anyone would like. We'd like them to be here today, but orders are strong, but shipments and sales will be spread out over the next year or 2. So there will be a continued impact from infrastructure and we're confident we'll get at least our fair share, and we're working to get a disproportionate share. So we feel like that's a good opportunity for us going forward. We also feel, to your question, we positioned ourselves well from an execution perspective.

So first, around products for -- that are necessary to win those projects. And then the combination and the interrelationship between our direct sales network and our independent sales network as we approach those. So we feel good about those. As it relates to specific SG&A spending, obviously, we're in a position this year where we are -- our performance is -- appears different than it would normally and the reason for that is the excess sales from backlog in last year. So we're confident that, #1, we'll return the lighting business to growth. And that #2, when we do that, the combination of the increased margin performance we've demonstrated at the gross margin level, as well as our ability to leverage SG&A costs going forward will continue to expand margins in that business. So it's not insignificant achievement to expand margins on lower sales, obviously. And so we're looking forward to that business being -- returning to normalized growth.

Joseph John O'Dea - Wells Fargo Securities, LLC, Research Division - Senior Equity Analyst

I appreciate it. And then also just wanted to touch on cash and deployment. The cash balance at this point is approaching $600 million. And how you're thinking about sort of repurchase activity, any revisions to that within the guidance framework as well as with the higher cash balance, just what we should interpret within that and perhaps strength of the M&A kind of pipeline if you're seeing more opportunities out there?

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

Yes, Joe, thanks for that. Overall, we are really pleased with our cash flow performance this quarter or this year-to-date period, we've generated $263 million of free cash flow. So really strong cash flow performance. It's driven a lot by our margin performance, which is contributing to the higher net income versus -- despite the lower sales. So overall, really pleased with that.

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When we look at our capital allocation priorities, we've been really clear over time that it's first to invest in the business for growth, second to invest in M&A, which we've done. Over the past few years, we've made some small but -- relatively small but strategic acquisitions with OPTOTRONIC with KE2 Therm and now with the Arize horticulture assets. So really pleased with the progress we've made there. Maybe you noticed we did increase our dividend by 15% this quarter. So excited to see that increase. And then finally, share repurchases. We've demonstrated when the share price is high, we buy less and when the share price is low, we buy a lot more. So this quarter, we've repurchased cumulative 24% of our shares outstanding. And this year-to-date period, it's been at about $180 a share. So feel really good about where we are from our capital allocation priorities.

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

Karen, I'll build on that just for a second. So we feel really good about the -- our ability to generate value through capital allocation. So first, on the M&A pipeline, we -- our focus continues to be on expanding the Intelligence Spaces group. We have a good pipeline of both small, medium and large-sized acquisitions.

As Karen mentioned, we've done really well with the acquisitions that we've Made-to-Order, and we're patient. So we don't feel an obligation to move until we find the right opportunity that is going to have the right impact at the right valuation. Second, as Karen mentioned, we increased the dividend. We did that because we can. We can continue to -- we can afford to pay the dividend at a higher rate and achieve the strategic opportunities that we perceive. And finally, we've demonstrated on our repurchase almost 1/4 of the company at very attractive prices.

As Karen mentioned, that when the stock price is lower, we'll buy more and when the stock price is less, we'll buy higher. So when you put it all back together, we view capital allocation as a strategic lever for us to generate value, and we feel really good about our progress on that so far.

Operator

Our next question comes from the line of Ryan Merkel with William Blair.

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

I wanted to ask first on the new ETS guide. What does it assume for sales for the full year? Neil, you mentioned orders are growing and you expect to return the Lighting business to grow in the second half. Can you just talk about that a little bit more?

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

Sure. I -- so first of all, we're really pleased with our performance so far this year. It's -- as you know, it's not our practice to address guidance other than in the beginning of the year. It's our preference to define an outlook at the beginning of the year and then to execute against it.

Our first quarter performance, obviously that was really strong, largely driven by the margin performance. As we look forward for the remainder of the year, we -- obviously, we planned conservatively, given all of the uncertainties going on in the world. So we were appropriately conservative in our plan, and we're adjusting our performance as we perform for the rest of the year. The Lighting business will perform as we expect going forward, I would extend that line to be more than just the back half of the year, but as we return that to growth over a normalized period. So the rest of this year, next year, and beyond.

So we feel really good about how we're going to do that as well. It will take a minute for us to continue to work through kind of the inflated sales from last year. But when you look at the performance over a longer period of time on a multiyear stack or where we are in the lighting business, we feel really good about that. So we did not change the revenue guidance. So we feel confident we're within that range, and we're really pleased with our performance from a profitability perspective.

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

Got it. All right. And then I wanted to ask on ISG, really nice growth. Just high level, are you seeing a lot more interest in controls? And are there any drivers of that, that may be new?

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

Yes. So thanks for that question, and I'm going to use it as an opportunity to kind of explain 2 things, if you'll allow me, Ryan. First is that we have a very strong Controls business in the Lighting business. So Acuity Brands Lighting is one of the largest, if not the largest control player for Lighting Controls, specifically. And Distech is OEM provider to Acuity Brands Lighting for those controls. Specifically, now as it relates to our performance on ISG, we feel really good about our strategy there of growth.

We're expanding the addressable market for Distech and we're seeing disproportionate demand there for 2 reasons. One is, I think it's fair to say our controls in sensors at Distech are perceived to be the highest quality in the marketplace. So they're very attractive to building owners and facilities managers because it gives them more flexibility than many other solutions. So they have -- because they're open protocol, and because we have open SI distribution, they have the opportunity to be confident that, that investment will carry them forward in an attractive way.

We also feel really good about our ability to add more things that we can control, so KE2 Therm is a great example where we acquired effectively products which fit into the Distech portfolio, work within the broader Distech ecosystem and open up additional verticals like retail, convenience stores, et cetera, that have high refrigeration needs. So we feel good about that strategy going forward. So Distech has been taking share in each of the markets which it competes in and now we have the opportunity to expand the market i competes in, #1, and expand the number of things that it controls.

And then finally, when you connect the edge to the cloud, which is the Atrius data layer that we have been building, it allows us to take the data that all of those sensors and controls generate and present it to the cloud in a manner in which applications can be built, which make a difference in those build spaces. So we feel really good about the business that we're building there. We think we're building a really valuable technology business.

Operator

Our next question comes from the line of Christopher Glynn with Oppenheimer & Company.

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

I wanted to dive into some of the implications for Contractor Select and Design Select. That manner of product management or categorization internally, would you consider that the backbone of your productivity momentum?

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

I think it's a big part of it, Chris. So -- and to spend just another minute on Contractor Select. So our strategy with Contractor Select is to make it the brand of choice for retail and electrical distribution with high product vitality at appropriate prices with high service levels, largely for distributors. And as I mentioned, it's built to be stocked and resold. So designed to be stocked and resold. And we -- it's a very constrained number of SKUs.

The -- what that's allowed us to do is to build a very consistent relationship with the distribution and retail community. And what that has done is provided us with a foundation and easy for them to choose. And it's worth noting that there's a lot in it for them, too, because we've created a portfolio that allows them to have less inventory on hand and satisfy the needs of their customers at an appropriate price, they're able to drive significantly higher returns on investment in the execution of their business.

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So at the same margins, they're making significantly more money as a result. So yes, it's been a really important part of that product portfolio. The second thing is we've raised the margin portfolio of that -- we've raised the margin of that portfolio, excuse me, to much more consistent levels with where we are now. So that's driven some of our margin performance.

With Design Select, we're really just getting started. So where Contractor Select is designed to be resold, contract -- or Design Select is designed such that options can be chosen so that you can -- a specifier has the opportunity to choose from options to configure the products and the projects that they need. As we mentioned in the script, we're at the early days of this. So this will be a multiyear process, but it is changing how both specifiers think about our portfolio and how we think about the execution of that portfolio. The majority of our business though remains Made-to-Order. And so that Made-to-Order -- its Made-to-Order made to order for a reason, so the specifiers can make the choices that they need so that they can satisfy large projects, we can satisfy national accounts, we can -- there are a lot of different pieces of that puzzle.

We asked -- Joe asked about infrastructure earlier. We won the relight of the city of Philadelphia. That's a good example of a made-to-order project. We made some changes to our product portfolio to satisfy some of their specific needs, and we can roll those out. So when you take those altogether, then we're -- everything is operating at a higher margin profile and it's set and it's doing a much better job of satisfying very specific end user needs in the marketplace.

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

The extension of that question, you've talked a lot about ability to choose and select the projects you want to be on considering all the productivity you're generating that you just elaborated on. Do you see consistent widening of the aperture moving ahead in terms of what's attractive to you to select within the overall lighting market?

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

Well, we feel very good about how we're positioned competitively. So we -- obviously, we pay close attention to our competitors to the -- and we generally think about this from a windshield perspective as you indicated, like which projects we want to select. So we're obviously competitive on the Contractor Select side. We're doing really well there. We've been competitive on the project side. So there are a handful of examples where we've passed on projects because we don't like the margin profile, and we're happy for our competitors to execute on those at a lower margin profile, and especially given that their margin profiles are already lower than ours.

So when we do not select those projects, that means someone else has selected those projects, and they're executing them at a lower margin than we have and at a lower margin than we would accept. So as we look going forward, we still see the opportunity then to build on that to grow, both on the business that we already have as well as when we add and we add new verticals. So horticulture is a great example. As you know, there was -- 2 or 3 years ago, there was a rush to invest in that vertical. And people invested a significant amount of money, multiple companies did too to try and pursue that vertical. We identified that vertical then as an attractive vertical. We just didn't think it was worth the level of investment that would -- that the market was asking for at that time.

So what we did instead was we started organically. We built a product portfolio from scratch, organically designed from scratch, built from the ground up. And now we've started with the Arize portfolio to add to that and to add to the distribution of that, which gives us a greenlight opportunity to grow in a vertical that, over the long term, we think will be attractive and with a measured level of investment. So when you put that all together, we're choosing where we want to compete in the marketplace, we are demonstrating the ability to do that through product and service innovation as well as through our management of price and margin.

Operator

Our next question comes from the line of Jeffrey Sprague with Vertical Research.

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

Maybe just address a little bit more kind of the geographic expansion how you're -- which geographies you're choosing to target the bandwidth of the company to kind of execute on that? And is this something where we could see a higher level of activity from this point forward?

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

Yes. Thanks, Jeff. So our geographic expansion is focused on the Intelligence Spaces Group. So it's worth pointing out that the standards are mostly global for the Distech product portfolio and the edge to cloud opportunity, the application for Atrius are global. So that gives us the opportunity to expand without having to create new product portfolios with some small exceptions, which are not available to us like Germany, for example. As a result, we are building on the strength there to roll that out. So we have strength in North America, obviously, that's our home market. We are probably half penetrated where we think we can be in the U.S. And so obviously, the bigger markets will invest for growth there. We're also successful in France. I think in the last quarter, we identified we have really high market share in France.

We're now expanding into more of Europe, so -- and well through the U.K. and other markets. And then we're focused on markets that look like that. So Australia, we added SI capacity. We'll be looking for ways over the course of kind of the next 6 to 12 months to figure out how to accelerate that expansion for ISG geographically. Our aspiration for that business unit is that it is a global unit that makes spaces smarter, safer and greener through a combination of edge to cloud, edge controls and sensors devices and the cloud or applications that do something with the data that those sensors and controls generate. So yes, you can expect us to be focused on expanding that business globally. And we're basically in North America and France at this point. So there's a big opportunity there.

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

Great. And then perhaps for Karen. Neil, you can take it too, of course. Just we've gotten this far in the Q&A without any real discussion of price. I know you're not going to talk about price specifically, but maybe just give us a little bit of update and kind of the tone of the market, what you're doing there? And transportation costs were a big topic to the good last quarter. Are you seeing any significant changes there with kind of the chaos and global shipping, everything that's going on?

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

Chaos is a good word, Karen. Why don't you address pricing?

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

I'll address some of the pricing. So Jeff, overall, we continue to be really pleased with our gross profit performance. And that really is resulting from what we've talked about on the call already is the strategic management of price and being able to get the value for our products that they deserve in the marketplace. While at the same time, we are working on input costs with our suppliers.

We've seen some benefits this quarter in steel and electronics. So that's helping us. And then freight is continuing to benefit year-over-year. So overall, we feel the focus on our portfolio segmentation that we talked about with Contractor Select, Design Select and Made-to-Order helps us on strategically price the products and get the value that they deserve in the marketplace.

Operator

Our next question comes from the line of Bobby Schultz with Baird.

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Robert J. Schultz - Robert W. Baird & Co. Incorporated, Research Division - Research Analyst

I've been I think, 3 quarters now where you've posted 45% plus gross margins. How should we think about the sustainability of those margins into the second half year and then looking into 2025?

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

Yes. Thanks, Bobby. So as I mentioned when we were talking about our adjustment to our EPS guidance, we feel really good about our performance. And I'll build on Karen's answer to Jeff's question about price and margin, which is that we are managing our pricing such that we're realizing the value for -- that our products are providing in the marketplace. And on the input cost, we're doing 2 things. One is our product vitality efforts are changing the amount of content that is in each of our products and how we ship those products. So more products can be shipped on the same pallet. So I mentioned the IVO in my opening comments, that's a really innovative product in the marketplace because it's roughly half the size or less of what it is replacing, #1, which obviously means there's a lot less content.

It also means that we can fit a lot more on a pallet as we ship those around North America. And then third, it delivers significant value to the installers because of significant patented innovation and how the -- it is constructed at the job site. So the ability to use one housing basically to put in different lighting. So that's a great example of a product that delivers real value to the entire value chain. And the combination of all those things has gotten us to the margin levels where we are right now. So yes, we feel good about our margin performance. It will go up a little -- or up or down a little from quarter to quarter, but we feel really good about kind of the structural improvement of our margin performance. And our team has demonstrated significant dexterity and the ability to deliver on that in all kinds of different market conditions. And so we feel like we're on a journey here, we're not at a destination, and we're pleased with our performance.

Robert J. Schultz - Robert W. Baird & Co. Incorporated, Research Division - Research Analyst

Got it. And then I wanted to ask on data centers, what is your exposure there today? And kind of what are you seeing in that market right now?

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

So we have 2 exposures to data centers. So on a good news front, data centers have lighting. So one might think that they could operate in the dark, but they don't. So that's a very attractive opportunity and continues to be for the Lighting business. On the Controls side, we are -- Distech is flat spec into some of the largest data scalers, so as their control of choice. There are 2 different kinds of controls in data centers. So we focus on digital controls and so that doesn't -- that means not the entire market is addressable for us, but the market that is addressable for us is growing as we build on those global scalers. We are -- we had another win on that front where over the course of the quarter where we converted a large Asian data center operator to our way of control and so that will be a multiyear opportunity for us going forward. So we're exposed to the data center opportunity in both of our segments, both the Lighting segment as well as the Spaces segment.

Operator

Our next question comes from the line of Chris Snyder with UBS.

Christopher M. Snyder - UBS Investment Bank, Research Division - Analyst

I wanted to ask about the back half guidance. It seems to me that it calls for gross margin to be kind of similar, maybe slightly lower than what we just saw in fiscal Q2, that 45.5%. So I guess, is that right interpretation? And then, what are some of the puts and takes on that because it does seem like there is some volume leverage here from the second quarter to the back half?

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

Yes. Thanks, Chris. Karen can help you after call on building your model, but I'll talk qualitatively about how we're thinking about the back half of the year and build on some of my comments earlier. Our lighting business is strong. We are competing effectively in the marketplace. We are demonstrating that the market is valuing what we are selling from a product perspective. We're demonstrating that we can innovate on a product portfolio and deliver what is -- what our innovative products to the marketplace that are more valuable to the marketplace and more profitable for us. And we've demonstrated that we're managing input costs, material costs in a rapidly changing environment, whether it's electronics or freight or steel or any of the different things.

So if we feel really good about the continued performance of -- our continued margin performance, excuse me. So as you look to the back half of the year and more importantly to the year after and the year after that and the year after that, we're on a mission to continue to make this a much more predictable, repeatable, scalable business on the Lighting side and a growth business on the Intelligence Spaces side and to use capital then to expand that portfolio. So we feel fine about the -- we feel good about the guidance for the remainder of the year and we feel even better about the year after and the year after that.

Christopher M. Snyder - UBS Investment Bank, Research Division - Analyst

I appreciate that. And maybe just following up on the market competition points. Do you feel like the lighting industry is less competitive from a price standpoint than it was 5 years ago? Or is it that Acuity is being more selective and shying away from the most competitive aspects of the market? And then what you guys have done with Contractor Select is kind of raising the gross margin floor? Just kind of any thoughts on that.

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

Yes. So I wasn't here 5 years ago, so I can't address that, but I will address kind of how we've performed over the last 4 years, which is, I would say that, obviously, we're the largest in the industry. We have the highest margins in the industry. We have the highest product vitality in the industry. We have raised the floor on margins with Contractor Select. We are innovating with Design Select and our new portfolio. So our performance is objectively very strong. That makes us a much more formidable competitor to the marketplace, no matter who you are, whether you're a large competitor, you're a small competitor, whether you're housed in North America or somewhere else, we're just a significantly stronger competitor than we were 4 years ago. And so that puts us in a position to have significantly more control over our destiny. And we're demonstrating that control in our performance.

And so -- and we think this is a good point to build on. So we will continue to press our advantage on the lighting side. So I would answer your question by saying something that we said when the market was really choppy, which is that we control what we can control, we are controlling more of what's happening in the marketplace as a result of our strategy and the execution of that strategy and the cumulative performance and the impact of that.

Christopher M. Snyder - UBS Investment Bank, Research Division - Analyst

I appreciate that. And if I could just squeeze one last one in. And I know it's hard to call a cycle, but I'd be interested, Neil, in where you think we are in this nonresidential construction cycle? Activity is still pretty healthy. A lot of the leading indicators are, I wouldn't say terribly negative, but on the more negative side. Do you feel like that cycle pressure on the horizon or that -- maybe you already felt that with a lot of the destock? Just any thoughts on it, I appreciate it.

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

Yes, sure, Chris. I think the cycle question has been a really hard one because we collectively -- and by that, I mean the economy, industry, et cetera, has been thrown so many curveballs over the course of the last 3 years. So I feel like we've lived kind of multiple years in a single year or a single period. So it's hard to call it as a normal historical cycle. So obviously, we had the shutdown. Then we had the bullwhip of projects and activity that

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was waiting to be executed, which led to increased backlogs, which we accelerated to satisfy which happened last year, and you see a little bit of the hangover impact on our sales growth this year.

We've been looking at the market on a multiyear basis, though. So when you look at first the market on a multiyear basis, it really does start to normalize. It doesn't look like there's any kind of boom and bust cycle. It looks like there was just a fair amount of business that got executed last year that maybe would have normally been executed this year. And so as we look forward, we are -- and I've mentioned this on the call before, we do a fair amount of data analysis, and I think we're pretty good at it. And we're outperforming the regression analysis of what we would expect to do.

So we are -- our performance is a contributor to where we are. As we think about the cycle going forward, we strive for normalcy. We don't feel like we need a really super-hot environment or -- and we've demonstrated we can execute in a relatively cool environment. So kind of where are we on the cycle front? I would say that our data indicates that lighting moves earlier than the other parts of the industry. There are a thousand reasons for that to have happened, but that has been borne out in other people's performance. And we feel good about kind of where we are from an order rate perspective.

We've seen that relationship between lighting and other industries between ABL and the Spaces Group with Distech. So in Distech, we're also outperforming what the market's expectations are. So we're outperforming where our SIs expect to be, which means we're taking share there also. So then as we look forward, what we strive for is a more normalized environment. I'm not confident calling a cycle because I don't think this is a normal cycle or it doesn't look like cycles that were sleep studies that we've had in the past.

Taking now 3 steps back. Our Lighting and Lighting Controls business grows consistently over time on a compounded annual growth rate and our Spaces group is taking share, and we're building something pretty special there. So net-net, we feel like we can execute in any environment. I don't want to play kind of Fed governor and try and figure out where we are from a cycle perspective other than to say, we're going to control what we can control. We feel really good about where we are from the Lighting and Lighting Controls business. We feel really good about where we are from the Spaces business, and we've got a lot of capital to grow our platform.

Operator

Our next question comes from the line of Jeff Osborne with TD Cowen.

Jeffrey David Osborne - TD Cowen, Research Division - MD & Senior Research Analyst

Neil, maybe just a follow-up on the prior question. In terms of -- I think the last earnings call, you touched on a rebound in larger projects visible in 2025. I'm just curious what the CRM system showing for the larger projects. And then historically, I think larger projects were considerably more profitable than the Contractor Select and some of the more commoditized projects that you've greatly improved the profitability of. Would you expect as the potential rebound of those larger projects flows through, that there's a disproportionate mix shift in profitability?

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

Yes, thanks. As I said, so if we focus on the kind of -- large projects is big bucket. So let's talk about kind of infrastructure on the one hand and then we'll talk about kind of traditional large projects on the other. So on the infrastructure side, there's obviously still a significant amount of capital that's going to run through what others are calling the mega projects. And we're confident we'll get our fair share of those and hopefully, a disproportionate share. And from a mix perspective, that is an attractive piece of business, we price fairly there. So we're delivering value to basically the citizens who are funding those. So we feel good about that. At the same time, we can operate in the margin portfolio that we expect. Then within kind of larger projects, there are a number of other kind of private sector impacts of that also.

So impact of the CHIPS Act and our ability to light fabs, to light data centers, to deliver control, obviously, those are all consistently attractive margin pieces of business for us. We're scaling in industrial as a lot of reshoring is happening in the U.S. And so the mix of our portfolio is, however, tighter

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from a margin perspective. As we indicated earlier, effectively, the floor has been raised on the Contractor Select portfolio and we will price fairly to the -- for citizens that are funding the infrastructure, and we'll continue to deliver the performance that we're demonstrating.

Jeffrey David Osborne - TD Cowen, Research Division - MD & Senior Research Analyst

Got it. And then just one for Karen on the Contractor Select and Design Select portfolios. Does that, by definition, sort of require more investment in inventory than you might have had in the few years past?

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

So for Contractor Select and Design Select, when we look at the inventory levels, first on Contractor Select, the 300 of the kind of most common everyday lighting products. We stock those here, but then also our distributors. But given the high turnover with that portfolio, it allows our distributors to carry less inventory and also for us to carry less inventory. So that doesn't really have a higher requirement. On Design Select, we are able to manage those inventory levels effectively and improve our turns.

So neither of those should have a negative impact on our working capital inventory going forward. And in fact, if you look at our inventory days over the course of time, we are -- we've improved our inventory turns versus last year and versus kind of over -- from our high point and certainly over last year when we reduced it and then continue to have room to improve. So we feel really good about where we are on our inventory and don't believe that, that should have a negative impact. And if anything, some of that should improve our ability around our raw materials going forward.

Operator

And I'm showing no further questions in the queue at this time. I'd like to turn the call back to Neil Ashe for any closing remarks.

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

Thank you. Thank you all for joining us this morning. We are -- as we said in our comments and in the questions, we're really pleased with our performance. Our team is executing really well. We feel confident in where the Lighting and Lighting Controls business is for this year and beyond, we feel like our growth opportunity on the Spaces side is clear, and we're executing against it. And we've demonstrated that we can create real value with capital allocation. And so we'll keep doing that, and we'll look forward to seeing you next quarter. Thank you.

Operator

This concludes today's conference call. Thank you for your participation. You may now disconnect.

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