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AYI.N - Q3 2023 Acuity Brands Inc Earnings Call

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OVERVIEW:

Company reported net sales of $1 billion, margin of 16.3%, net sales of $941 million, Sales of $66 million, cash flow of $472 million.

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PRESENTATION

Operator

Good morning, and welcome to the Acuity Brands Fiscal 2023 Third Quarter Earnings Call. (Operator Instructions) After the speaker's presentation, the company will conduct a question-and-answer session. 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*

Thank you, Liz. Good morning, and welcome to the Acuity Brands Fiscal 2023 Third Quarter Earnings Call. As a reminder, some of our comments today may be forward-looking statements based on our management's beliefs and assumptions and information currently available to our management at this time. These beliefs are subject to known and unknown risks and uncertainties, many of which may be beyond our control, including those detailed in our periodic SEC filings. Please note that our company's actual results may differ materially from those anticipated, and we undertake no obligation to update these statements. Reconciliations of certain non-GAAP financial metrics with their corresponding GAAP measures are available in our 2023 3rd quarter earnings release, which is available on our Investor Relations website at www.investorsacuitybrands.com.

With me this morning is Neil Ashe, our Chairman, President and Chief Executive Officer, who will provide an update on our strategy and our third quarter highlights; and Karen Holcom, our Senior Vice President and Chief Financial Officer, who will walk us through our fiscal third quarter financial performance. There will be an opportunity for Q&A at the end of this call. (Operator Instructions) We are webcasting today's conference call live. 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 welcome to all of you joining us this morning. In the third quarter of fiscal 2023, we expanded adjusted operating profit margin both sequentially and year-over-year. We continue to grow adjusted diluted EPS, and we generated strong cash flow from operations despite a decline in net sales. We completed the acquisition of KE2 Therm and we continue to repurchase our shares. We are making meaningful progress in both our Lighting and Spaces businesses.

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In the Acuity Brands' Lighting and Lighting Controls business, our strategy is clear: increase product vitality, increase service levels and use technology to improve and differentiate both our products and our services. This quarter, we launched Design Select. We developed Design Select to elevate our service for the specification community by making it easy for them to choose superior solutions with dependable service. Design Select consists of 3,000 configurable products that meet important specification needs from some of our core families of lighting and lighting control brands, including Aculux, Gotham, Lithonia Lighting, nLight and SensorSwitch.

Design Select is an important addition to our service strategy. ABL Lighting and Lighting Control products are now organized into 3 clear categories: Contractor Select is 300 of the most important everyday lighting and lighting control products available in stock at retailers and electrical distributors; Design Select is 3,000 configurable products that meet the key choices of lighting specifiers with dependable service; and the remainder is made to order.

Through the combination of high product vitality and improved service levels with the specification community, distributors and contractors, we continue to differentiate ourselves and challenge the existing industry standards.

We also continued to introduce new products during the quarter. Our Luminis brand launched the in-line family of exterior luminaires for use in plazas and arenas. Each light module can rotate 355 degrees and can be individually controlled, allowing installers to position the Luminaire on site for improved flexibility to create optimal illumination solutions.

The recognition of our product vitality efforts is important to our team and our customers. And this quarter, several of our products won prestigious Red Dot Design Awards, including products from Luminis and Eureka. The Eureka Tangram-Trace was awarded a Red Dot Best of the Best distinction for its groundbreaking design. Other winners in this category included products from Apple, IBM and Sonos, and span categories from VR headsets to first responder drugs. We're proud to be in this company of innovators.

Now moving to our Intelligent Spaces Group. This was a big quarter for our spaces team both at Distech and at Atrius. First, on Distech. Our strategic priority is to expand our addressable market, which we are doing in 2 ways. The first is geographic, which continues to progress successfully. The second is by increasing what we control in a built space.

During the quarter, we announced the completion of the acquisition KE2 Therm, which allows us to expand Distech's addressable market by entering the commercial refrigeration control space. By controlling commercial refrigeration, we are able to more effectively sell the entire Distech portfolio in verticals like retail, restaurants and schools.

The timing is significant as the refrigeration industry responds to the need for ultra low global warming potential refrigerant technologies. This has led to growing demand for transcritical CO_2 solutions, which require the precision of digital controls to provide safety, efficiency and reliability while delivering cost savings to the customer.

I now want to spend a few minutes on Atrius. Our strategy with Atrius has been to build a data layer that connects the edge to the cloud and use that data to develop applications that make a difference in built spaces. Earlier this month, we showcased our products at the IBcon 2023 Conference in Las Vegas. This is the largest smart building conference for commercial real estate and facilities companies.

At IBcon, we launched Atrius DataLab, a powerful data layer that supports a portfolio of Atrius applications that is foundational to our ability to automate the environment of a built space. Atrius Data Lab captures data from a building management system and organizes it in the cloud. From there, it harmonizes the data for accessibility and usefulness and creates a digital twin. Applications are built on top of that digital twin, allowing users to analyze historic scenarios, get live updates of the current building environment and model other scenarios.

This service is important because every building is different. Our Atrius applications have been built to ensure that our partners achieve their specific energy and sustainability goals through the collection, measurement and management of data in each of their built spaces.

Atrius Sustainability and Atrius Energy are live and were built on the foundation of Atrius Building Insights. Atrius Sustainability is an automation tool that captures, categorizes and reports on carbon emissions within built spaces. Atrius Energy facilitates the reduction of energy and carbon

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usage by allowing facilities teams to benchmark their usage against Science Based Targets. Later this year, our team will be rolling out Atrius Facilities and Atrius [Resolve].

Now looking to the remainder of fiscal 2023. Our third quarter played out as expected with sales being impacted by both lead time normalization and the macro environment. Entering our fourth quarter, we believe that there will be a continuation of these trends. While our order rates and our shipment rates are returning into closer alignment with each other, we have not yet returned to normal sequential seasonality.

In ABL, we are going to focus on strategic pricing, continued productivity improvements and managing material costs. In ISG, we're going to focus on the continued growth of Distech and Atrius and the successful integration of KE2 Therm. We will continue to prioritize managing margin, generating strong cash flow and allocating capital effectively.

Now I'll turn the call over to Karen, who will update you on our third quarter performance.

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

Thank you, Neil, and good morning to everyone on the call. In the third quarter of 2023, we delivered sequential and year-over-year adjusted operating profit margin improvement despite a decline in net sales. We grew adjusted diluted earnings per share and generated strong cash flow from operations. For total AYI, we generated net sales of $1 billion, which was 6% lower than the prior year as a result of the decline in net sales in our ABL business. As Neil described, this was the result of lower volumes, consistent with lead time normalization trends and the impact of the wider macro environment.

As we made clear on our last call, our focus is on delivering margin and operating cash flow. During the quarter, both operating profit and adjusted operating profit were flat on lower sales. We expanded adjusted operating profit margin to 16.3%, which was an increase of approximately 100 basis points over the prior year and an improvement of 230 basis points sequentially, driven by the improvement in gross profit margin. During the quarter, our adjusted diluted earnings per share of $3.75 increased $0.23 or 7% over the prior year.

Moving to our segment performance review. ABL net sales were $941 million in the quarter. This decrease of 7% compared with the prior year was largely driven by declines in the independent sales network and lower OEM sales. This was partially offset by infrastructure projects in the direct sales network and continued strong performance in our retail channel.

ABL's operating profit and adjusted operating profit were both flat on lower net sales, and we delivered adjusted operating profit margin of 17%, a 120 basis point improvement over the prior year and a 200 basis point improvement sequentially as price held and material input costs improved, particularly steel and inbound freight.

The spaces segment continued to perform well with another good quarter. Sales were $66 million, an increase of 13% as both Distech and Atrius continued to grow. Spaces' operating profit was $9 million and adjusted operating profit was $13 million as we continued to invest in the business for longer-term growth.

Now moving to our cash flow performance. We generated $472 million of cash flow from operating activities for the first 9 months of fiscal 2023, an increase of $306 million over the same period in 2022, driven largely by improvements in working capital. We have improved both days of inventory and accounts receivable compared to the end of the year.

As we've discussed on prior calls, we've continued to bring inventory down by 22 inventory days from the peak in February 2022, and we've also brought inventory levels down by over $36 million sequentially from the second quarter of fiscal 2023.

Year-to-date, we invested $48 million in capital expenditures and allocated $219 million to repurchase approximately 1.3 million shares. Our capital allocation priorities remain the same. We have invested for growth in our current businesses through R&D and CapEx. We've expanded our platform through acquisitions, as evidenced by the purchase of OPTOTRONIC in our lighting business and KE2 Therm in our spaces business.

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We've maintained our dividend, and we've created permanent shareholder value with approximately $1.2 billion share repurchases since the fourth quarter of fiscal 2020 at an average price of approximately $142 per share, which was funded by organic cash flow.

To summarize our performance for the quarter. We delivered strong margin and cash flow despite sales being down year-over-year. Based on year-to-date results and our expectations for the fourth quarter, we now expect full year net sales to be between $3.9 billion and $4 billion. Our expectations for full year adjusted diluted earnings per share have not changed. Our focus continues to be on meeting the needs of our customers and delivering margin and cash flow.

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 Tim Wojs with Baird.

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

Maybe just to start out on the market. I appreciate kind of the color around kind of order rates and shipment rates and kind of how those are normalizing. I was curious if there was any way to kind of break that out by the channel or segmentation, whether it's kind of the project business or what you're seeing on the stock and flow side and then maybe some of your more direct accounts?

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

Yes. Tim, so let me start from kind of back to front. So first, on the corporate accounts and on the OEM side, that's where those are obviously going to be volatile, and those are down and those order rates are relatively low. There's lots of reasons for those, the timing of renovations at our big customers on the corporate account side; and then second, on the OEM side, there's probably some continued destocking going down in the driver market.

Then as you kind of get to our direct sales network and our project business, that's where the C&I order rate is relatively stable at this point. So -- and our direct sales is also consistent. So they're finding a level here where they're relatively consistent. And then finally, we've had continued strong performance in retail. So when you blow it all back together, I think it's a continuation of the trends we've seen from this quarter and looking out to what we can see right in front of us.

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

Okay. And I guess, like as you mentioned in your prepared remarks that you're not really quite back to normal revenue seasonality yet. I mean, is there any kind of expectation or thought when you might be back to that kind of normal seasonality?

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

Yes. We're not ready to call that yet, Tim, as we sort our way through this. I mean, we're looking at the same kind of windshield metrics that you are to try and understand. So because we haven't gone through a period that looks like this one, we don't have a perfect proxy for where that is. So we're, at this point, going to take it one quarter at a time.

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

Okay, okay. Makes sense. And then just the last one, and this is maybe more of a bigger picture question. Just with how you're bucketing sales with just under the Contractor Select, the Design Select and kind of the MTO products. I mean, I guess, could you talk about what's different with that segmentation versus before? And if you're aligning it this way, does that have more of a top line sales impact for you, just easier to order? Or is that more of a benefit to margins because maybe it eliminates a lot of, like cats and dogs on some of the products?

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

Yes. So I think the delineation -- the clarity of the delineation is powerful on a number of levels. First, as you know we've had a lot of success for Contractor Select. So building a product of 300 SKU product line that's built for stocking and resale and retail and electrical distribution provides us the ability to be very -- have very high product vitality, have very high service levels and be an important partner to the retail and electrical distribution industry, and it allows us to compete effectively with whoever wants to enter the market through that channel. So that's been a real success for us.

Design Select is then about configurable products for the specification community. And what this allows them to do is choose -- basically make good choices among the product families. So this is the next step in that process. So our expectations aren't that this creates a new line of revenue, but it is -- our expectations are that we will create a lot more efficiency for them as well as for us. And then finally, we can isolate made to order. So when we isolate made to order, then we can treat it as such, which is made to order. And we can price it accordingly, we can -- and we can service it accordingly.

So that's the import of creating those different buckets, is ultimately that we're trying to make the light and lighting control business more predictable, repeatable and scalable.

Operator

Our next question comes from Joe O'Dea with Wells Fargo.

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

Wanted to start on the margin front. Really strong gross margins during the quarter. I think just sort of if you could unpack a little bit on the price/cost dynamic. And maybe if we go back a couple of years, you were talking about a gross margin target of around 42%. It looks like you should be north of 43% this year. So how do we think about the sustainability of that? And then what you might be seeing on the price side, any sort of incoming pressure you're seeing there?

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

Joe, thanks for the question this morning. I'll start and then I'll pass it over to Neil to add on. So as we talked about on the call, at ABL, we're really focused on strategic pricing, continued productivity improvements and managing material costs. So again we've demonstrated discipline in all these areas this year, which is resulting in the strong gross margin that you see in the quarter, and that's going to continue to be our focus. And the other thing I would add is that we're having continued growth at ISG, and so that's helping us as well.

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

Yes. And I would only build on that a little bit, Karen. I think you summarized it well to say that, Joe, I think we have made an improvement from where we were when we were targeting the 42%. So clearly, we've improved the business since then. And I would just pick up on 2 things that Karen pointed out there. First, around strategic pricing, so that's where on the Contractor Select portfolio, we can compete with anyone that wants

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to enter the market through those channels, which is very effective. And we can choose which projects we want to participate in based on pricing. So we're significantly more strategic about how we're pricing.

Second is that we're really working hard, and our teams have done a nice job on the combination of productivity improvements and material cost savings. That's a combination of our product vitality efforts and the work that we're doing in our supply chain to level load. And then finally, I'd emphasize that the continued growth of ISG is growth accretive, margin accretive and returns accretive.

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

And then just a question related to outlook, both this year and next. I think this year, the earnings outlook, sounds like maintaining that but it's $1.50 range. And so any anything that you would talk to in terms of what's most likely within a narrowing of that band? And then as you think about a '24 guide in a few months, Neil, just what are sort of the most important watch items for you over the next few months to sort of inform how you'd be thinking about that outlook?

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

Yes. So let me contextualize first and then I'll dig in to answer the specifics of your question. We -- as we've said consistently, our plan is to provide annual guidance and not update that guidance through the year. We felt it important to identify for you that we weren't going to meet the lower end of our net sales guidance for the year, but we still are in the adjusted EPS range that we gave at the beginning of the year.

And to be transparent, we're proud of that. So this has been a -- our teams have done really hard work to deliver the results that we're delivering this year to maintain dollar profit margin on lower sales, to increase margins, et cetera. So we feel really good about that.

As we look forward to '24, as I said, we're going to take this one quarter at a time for right now. So we're not going to get too far ahead of ourselves on predicting '24. Our general indications are that the rest of this calendar year feels like it's going to be similar trends that we're having now, that could change. And we're confident in our ability to continue to grow the ISG business and then some of the growth initiatives that we're planning for ABL going forward.

So our priority, as we've said through this environment, is to layer in margin, which we've demonstrated that we're doing. Whether or not we have sales growth, we're trying to layer in margin. We're trying to continue to deliver free cash flow, and we've delivered a ton of it, and we're going to continue to grow the Intelligent Spaces Group.

Operator

Our next question comes from Ryan Merkel with William Blair.

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

I wanted to pick up on the orders again. Just sort of clear it, it sounds like orders are tracking sort of down mid-single digits, and you mentioned lead times and the macro. Can you just unpack those a little bit more? Is it distributor destocking? Is it tighter credit? What are some of the factors that are impacting the order rate decelerating a little bit here?

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

Yes. I will take a shot at that and, Karen, fill in any gaps that I leave in the explanation. So first, just to reiterate the bigger picture here. So looking back to last year, we had a combination of longer lead times and a price increase environment, which basically pulled forward a lot of orders. So

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we had a swelled backlog and we've been working through that backlog through this year. And through this quarter, it's starting to be back to about normal.

So which means that in any period, we will basically ship what's ordered. So over the long arc of time, obviously, we will. But in a normal quarter, we will ship generally what's ordered in that quarter and a little bit from the quarter before. So we're starting to get to kind of more normalized levels there. On the positive side, those numbers are relatively consistent, absent volatility of the corporate accounts and the OEM, which I discussed in the first question.

So that's -- we feel good about kind of where we are on that front. So as you look forward off of that, then the quarters as the next one, and this is why we're saying we're taking this one quarter at a time will be impacted by kind of normal macroeconomic trends. And I don't think -- we're looking at the same data you are, and we don't pretend to have a crystal ball.

So our focus there is that we're going to -- or continue to get every piece of business we can get. All indications are from all of our data sources that we're either holding or taking share and we'll continue to try and layer in margin and deliver free cash flow in this environment.

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

Got it. That's helpful. And then another question I had was on project releases. I was hearing that tighter credit and shortage of switch gear was delaying the releases of projects. Are you guys seeing that? And any visibility as to when maybe that gets a little bit better?

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

Yes. So I'll take switchgear and then projects. First on switch gear. The lead times, as we understand it, have not yet -- have not compressed for switch gears. So just to put that in context, they were in the kind of 50-week range, so not days, weeks range. So they have been the bottleneck on many of the already funded projects. So that's the switch gear thing.

Those will -- all those projects will continue to happen. And now that our lead times are basically normal, our expectation is that they will order their lighting for those projects on a more normal schedule. So that should play out over a while.

In terms of new projects, that's really -- from our perspective, that's the macro environment. So with higher rates, I think everyone is going to relook at their projects. And so anecdotally, we have projects that are -- we have a fair number of projects in our independent sales network that are in queue, but they're being changed, modified, kind of reevaluated, those sorts of things, which is frankly normal. It's not abnormal.

But it doesn't make it clear exactly what the market size is going to be, which is why again we're taking it quarter by quarter and we're focused on kind of layering the margins, delivering cash flow.

Operator

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

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

So the last couple of quarters, we've seen very significant 300 basis points gross margin expansion, but also pretty steep volume declines. And I know there's destocking headwinds. But is there a negative volume impact in response to the company's increased focus on margins? And Neil, I would just be interested in hearing about how you think about that trade-off and why the focus on margins is the right one for Acuity.

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

Yes. So I'll happily address that. And from our perspective, the -- we're very clear with our company on how we create value. We grow net sales, we turn profits into cash and we don't grow the balance sheet as fast. So as we look out strategically around price, volume, et cetera, our objective with the lighting, lighting control business is to be predictable, repeatable and scalable and we're delivering on that.

So in the current environment, you're right, and Karen has indicated this on other call, that we have had more price than volume over the course of kind of this year. So -- and that's a combination of kind of all of the factors we've talked about before. And that is delivering the results that we are seeing.

We also have all indications from our external sources that we're either maintaining or taking share in the process. So we're trying to guide the company to -- or steer the company to, as I said, this ability to be more predictable, repeatable and scalable in this business. So we do think these are the right choices. That is how we will create value. We'll grow net sales, we'll turn profits into cash and we won't grow the balance sheet as fast. And we're demonstrating that we can do that in a number of different market environments.

We succeeded through the challenge of the pandemic when it was -- when things fell off. We succeeded when they shot up. And now I believe we're succeeding as we try and return to some normalized marketing -- or market environment.

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

I appreciate that. And I wanted to follow up on the commentary around share gains, which is very impressive considering raising gross margin and taking share. I guess what gives you confidence that the company is taking share? Because I think investors see construction markets up 20% on the nonres side and obviously ABL down 7%. So how do we -- obviously, a big lag there. How should we think about -- or how do you guys think about the impact from the destock within that versus the potential share shifts, which are maybe more structural in nature?

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

Yes, sure. And so this is a -- this could be a soliloquy -- a long kind of PhD level soliloquy, but let me just kind of summarize it, that with the benefit of a lot of the data work that we've done, there is not a like-for-like correlation between the lighting industry and a specific same quarter external macro number that we can point to. That requires a basket to have any kind of a correlation and the correlations we've gotten are, kind of our squares of like 0.8. So we're in the good, not great range on the predictability of that. It takes multiples of those.

The second is that our research has shown that generally, we are performing ahead of the general macroeconomic cycle, both for the good and for the not as good. So we're working through that now. So the direct answer to your question is there is -- it is not a surprise to us that those numbers would diverge the way you described it.

Second thing that I would highlight there is the difference between nominal and real in the construction data. So that also, to the last question, is consistent with our performance as well. So there's -- I wish there were a more algebraic kind of tied to external market data that would predict our results, but there isn't. It's a basket, and we're not surprised by the relationship between those numbers that you described.

Operator

Our next question comes from the line of Brian Lee with Goldman Sachs.

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

I might have missed this, but -- and I hate to kind of beat a dead horse, but the lead time issue, could you elaborate a bit more maybe in quantitative terms just sort of where they are, where you want them to be, the sort of trajectory from here? And is it a purely destocking issue at the moment? Just maybe give us a frame of reference with some of the quantification, that would be helpful.

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

Yes. Brian, we covered this in some detail on the last quarter call. So I'll summarize it now, which is that kind of at the end of last fiscal year, our lead times and days were in the 50s range and now they're in the 20s range. So basically, we've reduced lead times by about 30 days. So that resulted in a buildup of backlog kind of towards the end of last fiscal year that we've been working through this year.

And correspondingly, obviously, a little bit of an order drought as projects have been -- and needs have been pulled forward. So that's the big picture view of that and why -- and also why we've identified that we're starting to come back into balance and that basically we ship what's ordered over kind of basically a 60-day period.

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

Yes, Brian, the only thing I would add is that last year, if you recall, we had several price increases as well, and that resulted in some of that pull forward that Neil described in addition to the lead time.

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

Okay. Fair enough. Yes. I appreciate that clarification. And then I guess second question I had, and thanks for bringing it up, Karen, just around the price. I know you guys have gone away from talking specifics on price. But as you alluded to, last year, price was a meaningful tailwind. Historically, price has generally been, I think, maybe a plus or minus kind of low single-digit type of number for you all.

Is that kind of where we are in terms of back to being toward a more normal? And then in relation to that, you've had a decent amount of product vitality, You introduced some new stuff and the Design Select as well. So maybe any high-level sense you can provide as to the impact on mix and price just as you're introducing a lot of these new products as well?

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

Yes. Brian, I would just go back to our posture on strategic pricing that we talked about earlier. We have really focused on this discipline over the past couple of years. We talked about it with our Contractor Select portfolio, which is really a combination of 300 everyday lighting products that we're able to compete with the right product, the right place at the right price. So that gives us the ability to compete in a certain part of the market that a while ago we weren't able to compete in.

And then if you look on the project side of the business, our strategic approach there is that we're able to pick the projects that we want and just be more disciplined about our pricing overall. So that's really what's driving the pricing that we're seeing today.

Operator

(Operator Instructions) 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*

A lot of ground covered. I want to go a little bit further back just into what you're seeing in kind of the renovation markets in general. You obviously addressed kind of what you see in corporate account level. But anything you could kind of add there on kind of the vertical markets within that? You think this is mostly kind of a function of rates squeezing out marginal projects? Or any other color there would be interesting.

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

Sure, Jeff. At ABL, the sales decreases by vertical are really what you would expect to see. We had declines in Industrial. If you recall, last year, we had a lot of warehouse and logistics projects that were taking place. And then also, we're seeing declines in health care and commercial office due to the impact of the wider macro environment. So really, nothing -- kind of nothing surprising on the vertical front.

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

And on the renovation front, Jeff, I would say that change for us is good. So we've gotten a lot of questions about kind of what happens if the -- in the commercial office space or the commercial around the broader lending environment, valuations, et cetera. And so I would just use, I think everybody saw the Wall Street Journal article about the building on Market Street in San Francisco that had a $300 million valuation in 2019 and then was sold for $60 million recently.

So while it's unpleasant experience for the capital side of that trade, the reality with that building is that it will now be reset at different rates, new tenants will move in and they will need to customize the space to what they want. And so they're going to need lighting and lighting controls. So that's kind of -- so that's anecdotally how renovation will play out for us over the next foreseeable future.

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

Yes. And I guess that could be a 2- or 3-year process though, right, as kind of work from home and everything resettles. No great visibility on that, I would think. The -- could you just address a little bit more on -- also just on the price side. You were pretty explicit about managing the algorithm, right? And you've said it a couple of times, gross margin, lagging growth in the balance sheet to kind of leverage the capital base.

But do you see an environment emerging where it, in fact, would make sense in that algorithm to just kind of overtly seed share in the name of protecting margins and cash flow? And do you see that sort of competitive pressure brewing or starting to emerge anywhere?

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

Yes, Jeff, the part of the reason we talk a lot about Contractor Select is that we have fundamentally changed our posture on product vitality. So we now have a product portfolio on a relatively consistent basis that is able to compete with all comers, and it allows us to deliver a margin at a price that's competitive in the marketplace. So that's a -- I think about the strategy around Contractor Select as really like what Kirkland is to Costco, Contractor Select is to the electrical distribution industry.

In other words, it doesn't necessarily have to be the lowest priced product out there, but it is the highest value price and is competitive -- very competitive. That's allowed us to be in a very interesting position. And so we've tested this on price and whether we drive volume with price. And the -- and we've had really good results on that. So a little bit can go a long way there, which allows us to manage that.

And to your ultimate question about which one -- which would we choose, I don't think we will unnecessarily chase share if we think it's going to impact us negatively on our value-creation algorithm. So we are very competitive. We're comfortable with our position in the marketplace from a competitive perspective because of all the vitality and productivity improvements we've demonstrated. And so now we really want to -- we want to make the Lighting and Lighting Control business as predictable and repeatable and scalable as we can for a longer period of time, which would deliver value for a lot of us.

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And then I don't want to answer this question without also highlighting the importance of the Intelligent Spaces Group and our portfolio. So as you saw this quarter, we continue to grow with Distech, we continue to grow Atrius, we continue to find -- we are finding ways where we can put capital to work to make that business better.

So then the whole company hopefully looks different going forward. The lighting business is more predictable and repeatable and scalable with an obvious value creation algorithm, and we're growing the technology business at ISG.

Operator

Thank you. 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, Liz. I'd like to thank all of you for joining us today. We appreciate the engagement and the questions. We had a solid quarter. We delivered margin and cash flow despite a decline in sales. We allocated capital effectively, and we continue to improve our underlying businesses. So thank you for your interest in Acuity Brands, and we look forward to seeing you again next quarter.

Operator

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

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