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Rockwell Automation, Inc. (ROK)

Q3 2021 Earnings Call – Prepared Remarks

Corporate Participants

Blake D. Moret, *Chairman & Chief Executive Officer, Rockwell Automation, Inc.*

Nicholas Gangestad, *Senior Vice President & Chief Financial Officer, Rockwell Automation, Inc.*

Jessica Kourakos, *Head of Investor Relations, Rockwell Automation, Inc.*

Operator

Thank you for holding and welcome to Rockwell Automation's Quarterly Conference Call. I need to remind everyone that today's call is being recorded. Later in the call, we will open up the lines for questions. If you have a question at that time, please press *1.

At this time I would like to turn the call over to Jessica Kourakos, Head of Investor Relations.
Ms. Kourakos, please go ahead.

Jessica Kourakos

Head of Investor Relations, Rockwell Automation, Inc.

Thanks, Rein. Good morning and thank you for joining us for Rockwell Automation's third quarter fiscal 2021 Earnings Release Conference Call.

With me today is Blake Moret, our Chairman and CEO, and Nick Gangestad, our CFO.

Our results were released earlier this morning, and the press release and charts have been posted to our website. Both the press release and charts include, and our call today will reference, non-GAAP measures. Both the press release and charts include reconciliations of these non-GAAP measures. A webcast of this call will be available at that website, for replay, for the next 30 days. For your convenience, a transcript of our prepared remarks will also be available on our website at the conclusion of today's call. Supplemental information related to our new business segments can be also found in the investor relations section of our corporate website.

Before we get started, I need to remind you that our comments will include statements related to the expected future results of our Company and are, therefore, forward-looking statements. Our actual results may differ materially from our projections due to a wide range of risks and uncertainties that are described in our earnings release and detailed in all our SEC filings.

So, with that I'll hand the call over to Blake.

Blake D. Moret

Chairman & Chief Executive Officer, Rockwell Automation, Inc.

Thanks, Jessica, and good morning everyone. Thank you for joining us today. Before I begin, let me first congratulate our Milwaukee Bucks for such an incredible season. Go Bucks!

Let me now take a moment to talk about a couple of key highlights in the quarter. First of all, I'm pleased to welcome Cyril Perducat as our new Chief Technology Officer. He succeeds Sujeet Chand, who is retiring later this year after a long and very impactful career at Rockwell, and I'll talk more about his legacy in November. Cyril brings a wealth of automation and digital transformation experience to the role, with great global experience and a passion for helping customers. His mindset and additional perspective will help drive even more value from the combination of our core automation, software, and managed services offerings to provide positive outcomes for customers.

We also announced the signing of a definitive agreement to acquire Plex Systems, which we expect to close in Q4 of this year. Plex is the leading cloud-native, smart manufacturing platform operating at scale, and it will be a big part of our Factory Talk Software-as-a-Service offering. We look forward to showcasing its unique capabilities and integration into a complete production system at Investor Day during our November Automation Fair, in Houston.

Now let's turn to our quarterly results on slide three. We saw another quarter of exceptional demand across our product portfolio. Total orders surpassed $2 billion, reflecting a very strong demand pipeline. Total revenue of over $1.8 billion hit a new record and grew 33%, including a 1 point contribution from recent acquisitions, including ASEM, Kalypso and Fiix.

Organic sales grew 26% versus prior year, despite significant supply chain challenges. The manufacturing supply chain continues to remain constrained due to increased levels of demand and persistent electronic component shortages. It's a dynamic situation that we are monitoring closely. Our global supply chain organization continues to navigate these challenges and is taking a variety of measures, investing in both short and long-term strategies to increase our supply chain resiliency.

I'll now comment on our top line performance by business segment. Intelligent Devices organic sales increased 29%, led by strong, broad-based demand for our automation products. From an orders perspective, this is the third consecutive quarter of record order intake in this segment. Once again, strong order growth in Motion was driven by our Independent Cart Technology offering, which saw over 100% orders growth in the quarter. Independent Cart orders growth was broad-based and included strong wins in eCommerce and warehouse automation, including Intralox, an important North American material handling OEM partner, whose machines are supporting some of the largest eCommerce applications in the world. Intralox is leveraging our Independent Cart Technology in a high bottleneck area of their process and was able to realize a 30% increase in sortation throughput.

Software & Control organic sales grew 32%, led by strong demand across the segment. Logix sales grew over 40% versus the prior year and was our strongest major product family. Orders for the Software & Control business segment grew over 55% year-over-year, showing strong momentum.

In Lifecycle Services, organic sales increased 17% versus the prior year, and increased 8% sequentially. Book-to-Bill for the segment of 1.18 is expected to drive continued sequential sales improvement in the segment through the fourth quarter. Total company backlog grew by over 50% year-over-year.

Turning to profitability, segment operating margin of 20% increased by 340 basis points versus the prior year, primarily due to higher sales.

Adjusted EPS of $2.31 grew 75% and was above our expectations. Stronger sales and favorable mix all contributed to our strong profit performance in the quarter as we continue to increase our business resiliency and make technology and people investments that set us up for a strong future.

Turning to Information Solutions and Connected Services, which represent many of Rockwell's newest digital revenue streams, we had another great quarter. Organic sales and orders grew strong double digits, with contributions across a variety of end markets. Recent orders also include a number of meaningful software and infrastructure-as-a-service wins with some of the world's most important Food & Beverage and Life Sciences manufacturers. For example, SINOVAC, one of the largest pharmaceutical manufacturers in China, recently chose our PharmaSuite MES to help bolster production of their vaccines.

We also had a great win with GE Renewable Energy on a greenfield project to develop a major power plant in Africa. Once operational, this hydro plant is expected to provide 30% of the country's energy demand, while reducing annual power generation costs by $100 million. In addition to using our core automation products, our capabilities in industrial cybersecurity helped us win even greater share of this greenfield project.

Kalypso also continues to play a very important role within our Connected Services offerings, and last week received PTC's systems integrator Partner of the Year award. This is in addition to Rockwell receiving PTC's overall Partner of the Year Award, as we continue to see good synergies across the PTC-Rockwell portfolio.

Turning to slide four. At last year's Investor Day, we talked about how we are bringing our FactoryTalk software offering to the cloud with SaaS offerings in three key areas: FactoryTalk Design Hub, FactoryTalk Operations Hub, and our FactoryTalk Maintenance Hub. The organic development of our FactoryTalk Design Hub is well underway and complements our best-in-class Studio 5000 software.

With the addition of Plex, we will have a world-class, full scale FactoryTalk Operations Hub. Plex's smart manufacturing platform includes one of the most advanced cloud-native MES offerings available as well as cloud-native quality and supply chain management solutions. Capabilities like inventory management, supply chain optimization and track and trace are more critical than ever, and we will have unmatched on-premise and cloud-native solutions. Last week, we also announced our partnership with Kezzler, a leading provider of cloud-based traceability software that will be a great complement to both our on-prem and cloud-native supply chain offerings.

The foundation of our FactoryTalk Maintenance Hub comes from last year's acquisition of Fiix, an AI-enabled maintenance management platform, with a cloud-native offering that is sold 100% on a subscription basis. Since the acquisition, we've seen accelerated growth at Fiix, including the addition of their first two customers with contributions of over $1 million of annual recurring revenue each. This quarter, Fiix revenue grew by over 40% both year-over-year and sequentially, and they've added on average, over 50 new logos per month since they've joined Rockwell. Fiix and Plex applications are highly complementary, with many opportunities for customers to further improve manufacturing productivity, product quality and asset utilization. In addition, we believe that Fiix's high velocity, go-to-market model will provide additional revenue synergies in the years ahead.

As we mentioned on the call to announce the Plex deal, we are moving fast, because manufacturers are picking up the pace of innovation; and we have the opportunity to leap ahead with new value from highly scalable, easy to use, and well-integrated information solutions that build on our rock-solid heritage, born in the world of real-time data.

Let's now turn to slide five where I'll provide a few highlights of our Q3 end-market performance. Figures are for organic sales.

We had great performance in our Discrete industry segment, with roughly 40% sales growth. Within this industry segment, Automotive sales grew at about 50%, led by an increase in capital project activity. We estimate two-thirds of the capital projects we are winning are related to EV projects taking flight. For example, we had another win at the Indian automotive supplier Wipro-PARI, where our core automation technology will be used in an EV battery pack assembly line for one of North America's largest automotive brand owners.

In Semiconductor, we grew about 35%. We believe strong secular tailwinds, increasing capital spend, and broadening share of wallet with customers are all driving our growth. We are raising our Semiconductor growth outlook once again to high teens for the year.

Another highlight within Discrete was our performance in eCommerce, with sales growing approximately 65% versus prior year. This vertical has significant secular tailwinds with pureplay ecommerce players, as well as traditional retailers, that are transforming their warehouses through automation.

Turning now to our Hybrid industry segment. These verticals also had a terrific quarter. Food & Beverage grew over 30% and had the most significant outperformance relative to our expectations, as customers prioritize investing in technologies that help them differentiate their offerings and maximize their growth. We believe we are taking share in this market and that our technical and commercial strength is reaping dividends that should carry through into fiscal 22.

Life Sciences grew over 40% in Q3 and was another great performer in the quarter. Life Sciences was our fourth largest industry in the quarter, not far behind Automotive, and we continue to believe we are taking share in this fast-growing vertical. Key wins included a highly competitive win for a large greenfield project with Butantan to fast-track their Covid-19 vaccine production in Brazil. Here our PlantPAX Control System, Factory Talk Batch, and Pharmasuite MES will enable a best-in-class paperless system that will fully integrate with batch control and other equipment on the factory floor.

Our fastest growing vertical in the Hybrid segment was Tire, which was up about 60% in the quarter. Key wins included Toyo Tire Group in Japan, where Rockwell was chosen as the automation standard for their plant in Serbia. Our core automation technology, our IoT-ready architecture, and strong MES capability were all critical factors in securing this key win. Tire has always been a strong industry vertical for Rockwell and our technologies are actively supporting our customers' increasing investments in innovation and production capacity.

Process markets were up approximately 15% and were better than expected. This was the first quarter where we saw all of our major process industry verticals return to positive growth, including Oil & Gas, which grew low single digits versus the prior year, and grew high single digits sequentially.

Turning now to slide six, and our Q3 organic regional sales performance.

North America organic sales grew by 29% versus the prior year, with strong double-digit growth across all three industry segments. EMEA sales increased 21%, driven by strength in Food & Beverage and Tire. Sales in the Asia Pacific region grew 23%, with broad-based growth led by Semiconductor, Life Sciences and Tire.

In China, we saw double digit growth driven by strength in Tire, Life Sciences and EV. We continue to expect growth in China will exceed the company average for the year, as our longer cycle businesses kick in. Latin America growth of 26% was led by Food & Beverage and Automotive.

Let's now turn to slide seven to review highlights for the full-year outlook.

Orders momentum and backlog are expected to drive strong sales growth in the balance of the year and into fiscal 2022. Our higher top line guidance is driven by improvements in our Hybrid and Process industry segments.

Our new outlook for total reported sales growth is up 12%, including 8% organic growth versus the prior year. We are seeing strong growth in both Core automation as well as Information Solutions and Connected Services. Acquisitions are contributing over a point of profitable growth. We are increasing our margin expectation to 20%.

Our new adjusted EPS target of $9.20 at the midpoint of the range represents 17% growth compared to the prior year. This also includes $0.15 from transaction fees related to our pending acquisition of Plex. I should add that we expect double-digit Annual Recurring Revenue growth in fiscal 21, with the Plex acquisition expected to add over $175 million to our ARR totals next fiscal year.

A more detailed view into our outlook by end market is found on slide eight. I won't go into the details on this slide, but as you can see, we continue to expect broad-based organic sales growth this year.

With that, let me now turn it over to Nick who will elaborate on our third quarter performance and updated financial outlook for fiscal 21. Nick?

Nicholas Gangestad

Senior Vice President & Chief Financial Officer, Rockwell Automation, Inc.

Thank you, Blake, and good morning everyone.

I'll start on slide nine, third quarter key financial information. Third quarter reported sales were up 33% over last year. Organic sales were up 26%. Acquisitions contributed one point of growth, and currency translation increased sales by 5 points.

Segment operating margin was 19.9%, an expansion of 340 basis points compared to Q3 of last year. Higher sales volume, a favorable mix, and price all contributed to our margin expansion. These factors more than offset higher incentive compensation, our planned investment spend, last year's pay reductions, and higher input costs.

Corporate and Other expense was $29 million, slightly higher than last year, mainly driven by costs related to the pending Plex acquisition. The Adjusted Effective Tax Rate for the third quarter was 14.6% compared to 14.1% last year. Third quarter Adjusted EPS was $2.31, above our expectations, primarily related to higher sales. I'll cover a year-over-year Adjusted EPS bridge for Q3 on a later slide.

Free Cash Flow was $437 million or conversion of 161% in the quarter. Strong conversion in the quarter was driven by continued management of our working capital. Year to date, Free Cash Flow conversion was 118% and Free Cash Flow dollars was up 39% versus last year.

One additional item not shown on the slide, we repurchased 225,000 shares in the quarter at a cost of $60 million dollars. For the full year, we have lowered our repurchase target from $350 million to $300 million, in anticipation of our upcoming Plex transaction. At June 30th, $613 million remained available under our repurchase authorization.

Slide ten provides the sales and margin performance overview of our three operating segments.

The Intelligent Devices segment had organic sales growth of 29% in the quarter. Segment margin was 21.9%, 500 basis points higher than last year, mainly due to higher sales. This segment did see higher input costs both year-over-year and sequentially, however these costs were largely offset by price. We once again had strong orders performance in the quarter. Intelligent Devices orders grew approximately 65% led by North America and EMEA demand.

Software & Control segment organic sales grew 32% in the quarter. Acquisitions contributed 3 points to growth. Segment margin was 25.2%, which was 270 basis points above last year. The margin benefit from higher sales was partially offset by higher investment spend. These investments relate primarily to software development and additional sales resources to drive revenue growth in FY 2022 and beyond. Software & Control orders also grew strong double digits led by Logix, which grew double digits in all regions.

Organic sales of the Lifecycle Services segment grew 17% year-over-year, led by Life Sciences, Food & Beverage, and Semiconductor. Acquisitions contributed about 1.5% to growth. Operating margin for this segment was 10.3%, an increase of 60 basis points compared to last year. This increase was primarily due to higher sales partially offset by the reinstatement of incentive compensation.

Third quarter book-to-bill performance for the Lifecycle Services segment was 1.18. The next slide, eleven, provides the Adjusted EPS walk from Q3 fiscal 2020 to Q3 fiscal 2021.

Starting on the left. Core performance had a positive impact of approximately $1.65, primarily due to higher sales and favorable mix. We did see higher input costs this quarter compared to a year ago, which we have been offsetting with targeted price increases throughout the year.

Approximately, $0.10 was related to non-recurring accelerated investments that we announced earlier this year. These investments are mostly in our Software & Control segment. Currency contributed about $0.05.

Incentive compensation, and the reversal of the temporary pay reductions, was a year-over-year headwind of approximately $0.55, of which bonus was $0.40 and temporary pay actions $0.15. As a reminder, there was no bonus expense in Q3 of fiscal 2020. Acquisitions were about $0.05 dilutive as we expected.

Moving to slide twelve, quarterly product order trends. This slide shows our average daily order trends for our products, which includes our software portfolio. The trends shown here account for about two-thirds of our overall sales. Order intake improved again this quarter. Q3 product order levels grew year on year as well as sequentially and are at an all-time high; particularly strong areas were in Logix and Motion.

Not included on this slide are orders for the Lifecycle Services segment, which were up double digits in the quarter both sequentially and year-over-year. The overall strong order performance resulted in total company backlog of over $2 billion, growing over 50% year-over-year.

This takes us to slide thirteen, updated guidance. We are increasing our organic sales growth outlook to 8%, which is a one-point increase from the previous mid-point of 7%. We expect currency translation to now contribute about 2.5 points to growth, and we still expect acquisitions to contribute about 1.5%. In total, we are forecasting reported sales to be about $7.1 billion or up 12%.

We have also updated the Adjusted EPS guidance to a new range of $9.10 to $9.30. This new range now includes about $0.15 of transaction fees related to the pending Plex acquisition. I'll review the bridge from the prior guidance mid-point of $9.15 to the new mid-point of $9.20 on the next slide.

Segment operating margin is now expected to be approximately 20%. This represents a 50-basis point increase from prior guidance and primarily reflects higher sales partially offset by additional bonus expense. We continue to expect positive price / costs for the full year.

Our Adjusted Effective Tax Rate is still expected to be about 14%, the same as prior guidance. This includes a 200-basis point annual benefit related to discrete items which we expect to realize in Q4. We believe our normalized Adjusted Effective Tax Rate is around 18%.

Given our strong generation of free cash flow through the first three quarters, we are now projecting free cash flow conversion to be above 105% of Adjusted Income.

A few additional comments on fiscal 2021 guidance. Corporate and Other Expense is expected to be about $135 million, and now includes about $20 million primarily from transaction-related fees and expenses anticipated for the pending acquisition of Plex.

Net interest expense for fiscal 2021 is now expected to be about $95 to $100 million and now reflects the expected incremental interest of about $5 million related to new debt for the pending acquisition of Plex. Finally, we're assuming average diluted shares outstanding of 117.1 million shares.

This takes us to slide fourteen. This slide bridges the mid-point of our April Adjusted EPS guidance range to the mid-point of our new guidance. Starting on the left there is a higher contribution from core operating performance, primarily due to the higher organic sales and increase in margin. The contribution from currency is now expected to be $0.05 higher compared to prior guidance.

Next, given the increase in guidance, there is about a $0.15 impact from higher bonus expense. Full-year bonus expense is now expected to be approximately $175 million. Given our projected full year performance this bonus is higher than the initial fiscal year 21 target of about approximately $115 million. For comparison, this was $0 for fiscal year 2020.

Finally, we now have about a $0.15 impact coming from the pending acquisition of Plex, which we anticipate will close in Q4. This brings the new midpoint of the guidance range to $9.20.

Finally, a few more comments on Plex, turning now to page fifteen. Plex will be reported in our Software & Control segment and be a part of our Information Solutions & Connected Services portfolio of offerings. We are forecasting that in fiscal year 22, it will generate $175 million of ARR, $160 million of revenue after the adjustment for deferred revenue, and a neutral impact to Earnings Per Share. About $0.35 of incremental EPS from operations is forecasted to fully offset the deferred revenue adjustment, integration expenses, and incremental interest expense. We expect fiscal year 2023 revenues to be above $200 million with a meaningful contribution to EPS in fiscal year 2023. We have included further details in the appendix on the financial impact of Plex in fiscal year 2021 and 2022.

With that, I'll hand it back to Blake for some additional comments.

Blake D. Moret

Chairman & Chief Executive Officer, Rockwell Automation, Inc.

Thanks, Nick.

Once again, strong order trends and record backlog underpin a robust top line outlook, and we have confidence in our team's ability to navigate the supply chain challenges. And we continue to invest in our future.

The combination of our software portfolio with our controllers, Intelligent Devices, and Lifecycle Services creates unique value for customers across Discrete, Hybrid, and Process end markets.

Our momentum would not be possible without the tremendous efforts of our employees. I'd like to thank everyone at Rockwell, and particularly the people in our Integrated Supply Chain organization, who have done a great job managing pandemic challenges and now mitigating our sourcing constraints. We're leveraging our own manufacturing expertise to help customers be more resilient, agile and sustainable.

Let me now pass the baton back to Jessica and we'll begin the Q&A session.

Q&A Session

Jessica Kourakos

Head of Investor Relations, Rockwell Automation, Inc.

Thanks everyone for joining us today. We know it's a busy day for earnings. We appreciate your interest and support. That concludes today's call.