27 – July – 2022

Rockwell Automation, Inc. (ROK)

Q3 2022 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.*

Aijana Zellner, *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 conference 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 Aijana Zellner, Head of Investor Relations. Ms. Zellner, please go ahead.

Aijana Zellner

Head of Investor Relations, Rockwell Automation, Inc.

Thanks, Rex. Good morning. Thank you for joining us for Rockwell Automation's third quarter fiscal 2022 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 on our 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.

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, Aijana, and good morning, everyone. Thank you for joining us today. I want to also take the opportunity to congratulate Aijana on her promotion since our last earnings call.

Let’s turn to our third quarter results on slide 3.

We had a strong quarter, with orders, shipments, margin, and profit all at or above our expectations. We successfully navigated supply chain disruptions in a still-volatile environment, and we saw the positive impact of pricing actions that demonstrate our strong position in the market.

Total orders grew over 17% versus prior year, with strong demand in all three business segments. Our continued orders strength reflects the value our customers place on Rockwell’s differentiated offerings and the increased need for automation solutions regardless of the current macroeconomic backdrop.

Total revenue of almost $2 billion was up 6.5% year-over-year. Organic sales came in as expected and grew over 7% versus prior year. Acquisitions contributed two and a half points of growth. Currency translation reduced sales by over 3% driven by continued strengthening of the U.S. dollar.

While we saw a gradual overall improvement in supply chain through the quarter, our sales volume and mix continue to be impacted by component shortages, as we’ve been discussing for a while now. Our topline performance, both by segment and region, was driven by specific component availability in Q3 more than the underlying demand, which remains strong.

In the Intelligent Devices business segment, organic sales were up over 2% year-over-year but below expectations. This segment was disproportionately impacted by component availability, further exacerbated by extended China Covid shutdowns.

Software & Control organic sales growth of over 13% versus prior year was above expectations. Our strong performance here reflects both an improvement in the chip supply and some early benefits from the recent resiliency investments. Sales of our View Operator Interface panels, which we redesigned to optimize our component supply, were up almost 60% year-over-year. Our software sales grew double digits versus prior year.

In Lifecycle Services, organic sales increased almost 9% versus the prior year, despite continued component shortages and a partial shutdown of our Shanghai facility earlier in the quarter. Within Lifecycle Services, Sensia had another quarter of strong growth with both orders and sales up over 20% year-over-year. Sales in our Services business also grew double digits driven by higher demand for asset management and cybersecurity. Lifecycle Services book-to-bill was 1.27 in the quarter, reflecting continued strength in our orders.

Information Solutions & Connected Services orders and sales both grew strong double digits in the quarter with particular strength in MES software and industrial cybersecurity sales. Within Information Solutions, we had a number of strategic wins this quarter thanks to our industry-leading portfolio of scalable and flexible software offerings. For instance, Eli Lilly and Company has chosen Rockwell Automation's PharmaSuite MES solution as the next generation MES platform for their Drug Products.

In addition to our on-prem software wins, we continue to gain traction with our recent cloud-native acquisitions. One of our Plex wins this quarter was with ZEVx, an Arizona-based company focused on electrification of light and medium duty fleet vehicles world-wide. Our smart manufacturing platform will this customer's aggressive growth plan with advanced supplier and inventory management, improved data visibility and reporting. We're also happy to report the sale of a Plex application that will run natively on Microsoft Azure in Europe, as well as a growing list of wins in Food & Beverage companies. These are important deal synergies that we are starting to realize.

At Fiix, we continue to see strong double-digit sales growth led by both new logo wins and expansion deals. Our competitive maintenance management wins across many verticals, including EV and Food & Beverage, reflect the platform's differentiated AI capabilities and ease of deployment.

Connected Services orders and sales were also strong in the quarter, demonstrating customers' increasing reliance on our deep domain expertise, cybersecurity services, and 24x7 remote support, especially as many companies are struggling with labor shortages and temporary budget constraints.

In the quarter, total ARR was up almost 60% and organic ARR grew 18%. Our strong operating performance and focus on price/cost execution resulted in exceptional earnings this quarter, with Adjusted EPS growing 15% versus prior year.

Let's now turn to slide 4 to review key highlights of our Q3 end-market performance.

As I mentioned earlier, while we saw a gradual overall improvement in supply chain constraints this quarter, some of our businesses and industry verticals, mainly Discrete and the hardware-intensive parts of Hybrid, were disproportionately impacted by the ongoing component supply issues.

In our Discrete industries, sales were up low single digits. Within this industry segment, Automotive sales were up 6% versus prior year. We continue to see investments in the EV transition from both traditional brand owners and EV startups, with a healthy mix of greenfield and brownfield activities.

In Q3, we had a strategic greenfield win in Asia, where a Chinese automotive company, Chery Auto, chose Rockwell's differentiated MES, IoT, and core automation offerings over their traditional European supplier to build a smart plant and increase their speed to market.

In addition to working with leading electric vehicle manufacturers, we continue to gain share in the EV battery space, with several competitive wins in the quarter, both in Asia and Europe. While most of our previous wins in this space were in battery assembly and conveyance, we are starting to expand our presence in battery cells. Rockwell's integrated Logix and Motion offering was selected by Durr Clean Technology Systems to provide an end-to-end coating process, from powder handling and slurry mixing to coating and drying.

Semiconductor sales declined 2% versus prior year and were significantly impacted by Covid-related shutdowns in China. Despite the near-term supply chain challenges impacting its own ecosystem, the industry continues to see strong demand with about 80 greenfield and 300 brownfield projects announced to date.

In eCommerce and warehouse automation, our sales were down over 15% in the quarter, mainly driven by electronic component shortages and tough prior year comps. While we are seeing a slowdown in investments from some eCommerce customers, we continue to work with traditional retailers and grocers who are investing in new automated infrastructure to gain share in the market.

Turning to our Hybrid industry segment. Sales in this segment grew mid-single digits, led by growth in Life Sciences and Food and Beverage. Food and Beverage sales were up mid-single digits versus prior year. While inflation might put some pressure on new expansion investments, we continue to expect especially strong demand in certain markets like agriculture processing, where Rockwell has high share and a differentiated technology offering.

We saw a number of capex wins in Latin America this quarter, with one of our Food and Beverage wins coming from CP Kelco, a Brazilian nature-based ingredients manufacturer, who chose Rockwell and our PlantPAx process control architecture as their automation partner for the next capacity expansion project.

Life Sciences sales grew over 15% in Q3 with strong year-over-year growth in medical devices, pharma, and biotech. This was another industry where our differentiated process controller, along with strong network infrastructure and overall project management expertise, helped us win a competitive project with Thermo Fisher in their joint venture plant in China. A combination of industry-leading MES and IoT software and multi-discipline Logix platform for hybrid applications, along with our increasing expertise in biotech and cell gene therapies, position us well in this fast-growing vertical.

Tire was up low single digits in the quarter. We continue to see increased customer demand for our software and services in this vertical. In the quarter, we had our first Plex win in Tire with Prometeon Tyre Group, a global leader in tire manufacturing, headquartered in Italy. The customer chose our Plex QMS to standardize quality management across its global operations.

Moving to Process, this industry segment grew 12% versus prior year, with Oil & Gas, Mining, and Metals all growing double digits.

We continue to grow our presence in Process by displacing the traditional DCS players across Oil & Gas, Mining, and Chemical industries. Our investments in process control technology and petrochemical expertise are paying off, as demonstrated by our recent wins in North America and Europe.

We also had a strategic multi-million dollar ESG win, where Rockwell will be helping one of the most active operators in the Permian Basin reduce its greenhouse gas emissions and bring all operated oil and gas assets to net zero by 2050.

Turning now to slide 5 and our Q3 organic regional sales performance, once again, these results were heavily impacted by our component availability. North America organic sales grew by 11% versus the prior year. Latin America sales increased by over 15%, EMEA sales were up over 3%, and Asia Pacific was down almost 6%.

Let's move to slide 6, an update to a new slide we had provided last quarter. As you can see, order cancelations remain very low and are within our historical ranges. Our strong orders and record backlog of over $5 billion continue to support strong sales in fiscal year 2022 and beyond.

As we turn to slide 7, let's review highlights for the full year outlook.

Orders are expected to stay strong for the remainder of this fiscal year. While we continue to expect strong double-digit year-over-year and sequential organic sales growth in Q4, resulting in double-digit growth for the full year, we are reducing the midpoint of our organic growth range to 11%. Our revised guidance reflects ongoing supply chain volatility in this environment, especially for business operations and suppliers located in Asia. The supply of electronic components is gradually improving but remains volatile.

Acquisitions are expected to contribute two and a half points of profitable growth, more than offsetting a two-point headwind from currency translation. We continue to expect double-digit growth in both core automation as well as Information Solutions and Connected Services. We continue to expect another year of double-digit Annual Recurring Revenue growth. Our organic investments and acquisitions help make this revenue stream become a more meaningful contributor to our overall business resilience.

Our additional investments in resiliency actions are progressing well, as we develop deeper relationships with key suppliers, complete re-design projects, and realize price to mitigate inflation.

We expect our margins to expand in Q4 on higher sales and continued price/cost execution. With only one more quarter to go, we have narrowed our Adjusted EPS guidance range with our midpoint still at $9.50. We continue to expect Free Cash Flow conversion of 85% for the full year

Nick will now add detail to our Q3 results and financial outlook for fiscal 2022. Nick?

Nicholas Gangestad

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

Thank you, Blake, and good morning, everyone.

I'll start on slide 9, Third Quarter Key Financial Information. Third quarter reported sales were up 6.5% over last year, with organic sales up 7.1% and acquisitions adding another 2.5 points to total growth.

Foreign currency translation reduced sales by 3.1%. While the US dollar has strengthened against many currencies, the strength against the Euro has had the largest impact on Rockwell in the quarter.

We saw our organic sales improve through the quarter, helped by some easing of supply chain constraints following the lifting of COVID restrictions in China.

Segment operating margin was 20.8%, an increase of 90 basis points versus last year, mostly due to higher sales and lower incentive compensation, partially offset by higher investment spend.

Last quarter, we shared our expectation that price / cost would improve significantly in Q3 and that is exactly what happened. Price in the quarter more than offset our year over year increases in input costs.

Our Adjusted EPS in the quarter was $2.66, up 15% from the prior year. I'll cover a year-over-year Adjusted EPS bridge on a later slide. The Adjusted Effective Tax Rate for the third quarter was 14.5% and in line with the prior year. This was better than our expectations due to a favorable return to provision true up.

Free Cash Flow dollar generation was $327 million in the quarter and down compared to the prior year due to higher working capital primarily in receivables. We saw a higher percentage of our sales in June than in the prior year. Our Free Cash Flow conversion exceeded 100% in the quarter despite our increases in working capital.

One additional item not shown on the slide, we repurchased 860 thousand shares in the quarter at a cost of $176 million. On June 30th, $1.3 billion remained available under our repurchase authorization.

Slide 10 provides the sales and margin performance overview of our three operating segments.

We had a good quarter with organic sales up in all three business segments, both year-over-year and sequentially. Improving sales and our strong operating execution resulted in sequential margin growth of over 500 basis points.

Intelligent Devices organic sales were up 2.7% in Q3. This segment had the largest negative impact in the quarter from component availability and extended shutdowns in China. Compared to last year, Intelligent Devices margins declined 220 basis points to 19.7%, primarily driven by higher investment spend. Year-over-year price increases were able to neutralize the impact of higher input costs. Margins in this segment improved sequentially by 510 basis points driven by positive price/cost and higher volume.

Software & Control total sales were up 19% including 13.4% organic growth versus the prior year. Strong sales were driven by improved chip supply and benefited from resiliency actions taken earlier in the year. Segment margins were up 620 basis points compared to last year and up 680 basis points sequentially, mostly due to higher sales. Price/cost was positive year over year and sequentially.

Lifecycle Services organic sales grew 8.7%, led by strong double-digit growth in Sensia. Demand continues to remain strong across all businesses. Book to Bill was 1.27 for Q3. Segment margin declined 90 bps compared to the prior year driven by supply chain constraints and higher investment spend, partially offset by higher sales and lower incentive compensation. Segment margin was up again sequentially on higher sales. With gradual improvement in the supply chain, we expect the trend of sequential margin expansion to continue in the coming quarters.

The next slide, 11, provides the Adjusted EPS walk from Q3 fiscal 2021 to Q3 fiscal 2022.

Starting on the left, Core performance was up about $0.15 including about $0.25 from higher sales. Price/cost contributed $0.05. Strong execution led to about $0.10 of productivity. We saw some favorable corporate items, about half of which were due to timing between Q3 and Q4. We also continue to invest in growth and resiliency which offset the core growth by $0.35.

In the prior year, we made about $0.10 of non-recurring accelerated investments that mostly impacted our Software & Control business. Currency negatively impacted our earnings by about $0.10. On a year-over-year basis, incentive compensation was about a $0.20 tailwind. This brings us to our total Adjusted EPS of $2.66.

Let's move on to the next slide, 12, our guidance for fiscal 2022.

We are updating our sales guidance to a new range of approximately $7.7 to $7.9 billion in fiscal 2022, up 10.5% to 12.5% for the year. We expect organic sales growth to be in a range of 10% to 12%. We expect about 2.5 points of growth coming from acquisitions and currency translation will be a headwind of about 2 points. Our sales guidance range reflects the continued volatility we see in the supply chain.

The midpoint of our guidance implies a 9% sequential increase in Q4 total sales driven by improved material flow from key suppliers including those in China, further sequential improvement from resiliency actions, and higher sequential price realization.

We continue to expect full-year segment operating margin to be about 20% and unchanged from our prior guide. We expect our margins to continue to expand in the fourth quarter. The margin expansion will come primarily from higher sequential sales and continued positive momentum on price/cost. While price cost will be negative for the full year, it is positive in the second half.

We now expect second half core conversion above 40%. We expect the full year Adjusted Effective Tax Rate to be around 16.5%. We are narrowing our Adjusted EPS guidance range to $9.30 to $9.70, with no change to our midpoint of $9.50 from prior guidance.

Finally, we continue to expect full-year fiscal 2022 Free Cash Flow conversion of about 85% of Adjusted Income.

A few additional comments on fiscal 2022 guidance. Corporate and Other expense is now projected to be around $110 million. Net interest expense for fiscal 2022 is now expected to be about $120 million. We're assuming average diluted shares outstanding of 116.7 million shares.

Finally, on capital deployment. Our capital allocation priorities for this year remain the same, including our focus on de-leveraging. As I mentioned earlier, we repurchased about $176 million worth of shares in Q3 and are now projecting our full-year share repurchases to be about $300 million.

Turning now to page 13.

While there is no change to the mid-point of our Adjusted EPS guidance, we wanted to show some of the moving pieces within this number. Starting on the left. There is a lower contribution due to the lower organic sales guidance. This is fully offset by improved productivity, favorable segment mix, and lower corporate expenses. Currency is an additional headwind of about $0.05. A more favorable tax rate adds $0.05. Which brings us to our mid-point of $9.50.

Although not on this page, we continue to expect our acquisitions, including Plex, to be about neutral this year including incremental interest expense or a year-over-year benefit of about $0.15.

With that, I'll turn it back over to Blake for some closing remarks before we start Q&A.

Blake D. Moret

Chairman & Chief Executive Officer, Rockwell Automation, Inc.

Thanks, Nick.

We had a good quarter of growth, price realization, profitability, and investment for the future. We are executing well, and I'm proud of how our teams are managing supply chain complexity to serve the needs of our customers. In volatile times, our relentless focus on helping customers creates long-term differentiation and value.

Aijana will now begin the Q&A session.

Aijana Zellner

Head of Investor Relations, Rockwell Automation, Inc.

We would like to get to as many of you as possible, so please limit yourself to one question and a quick follow up. Thank you.

Rex, let's take our first question.

Q&A Session

Aijana Zellner

Head of Investor Relations, Rockwell Automation, Inc.

OK. That concludes today's call, thank you for joining us.