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Rockwell Automation, Inc. (ROK)

Q1 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.*

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 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 Jessica Kourakos, Head of Investor Relations. Ms. Kourakos, please go ahead.

Jessica Kourakos

Head of Investor Relations, Rockwell Automation, Inc.

Thanks, Emma. Good morning everyone and thank you for joining us for Rockwell Automation's first 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. Additional information and news about our company can also be found on Rockwell's investor relations twitter feed using the handle @InvestorsROK, that's @Investors R-O-K.

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 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. Let's turn to our first quarter results on slide 3.

Total orders grew by more than 40% to over $2.5 billion, once again reflecting very strong demand across our portfolio of core automation and digital transformation solutions. Total revenue of $1.9 billion grew 19%. Organic sales grew 17% versus prior year, better than our expectations, despite significant supply chain challenges in the quarter.

The manufacturing supply chain remains constrained due to extremely high levels of demand and persistent electronic component shortages. It's a very dynamic situation, and our global supply chain organization continues to navigate these challenges. We are taking a variety of actions, including qualifying additional semiconductor technology, and investing in capacity to increase our supply chain resiliency and support our growth.

Turning now to our top line performance. Core automation sales and orders momentum was broad-based across our product lines, including Control, Visualization, Network, Motion, Power, Sensors and Safety.

In the Intelligent Devices business segment, organic sales increased 26% versus prior year, even with significant headwinds from supply chain.

Software & Control was also impacted by supply chain constraints, but organic sales growth of 8% was above our expectations. We also had very strong orders growth in the segment. Of note, industrial PC orders at ASEM, our recent acquisition, were particularly strong and almost doubled from a year ago.

In Lifecycle Services, organic sales increased 10% versus the prior year, led by double-digit growth at Sensia and our Solutions business. Demand is strongly increasing in this segment, as demonstrated by double-digit sequential orders growth and a 1.38 book-to-bill for the segment.

Information Solutions & Connected Services grew double digits in both orders and revenue. Q1 sales were particularly strong across the entire Information Solutions portfolio as well as Kalypso's digital consulting services.

Industrial cybersecurity demand was strong in the quarter and included a strategic win with one of the world's leading natural gas pipeline companies in North America. We also had a key win with one of the largest Beverage manufacturers in EMEA, demonstrating how our industrial cyber business continues to create new ways for us to win.

Our investments in the cloud are also showing very good traction. Another notable win in the quarter was with The Shyft Group, formerly known as Spartan Motors. The Shyft Group is a global leader in the commercial vehicle industry and a big beneficiary of EV and last mile delivery trends. Here, Plex's Smart Manufacturing Platform was chosen to enable best practices across their operations, reduce material costs, automate quality processes, all while supporting high-speed line deployments.

At FiiX, we had another great quarter, with their ARR growing over 40% and over 600 new Fiix customers added in just the last 12 months. In the quarter, Rockwell expanded its presence within Lucid Motors, one of the top up-and-coming luxury EV companies in the world. Lucid had already selected Rockwell's FactoryTalk software to manage production and is growing the FiiX subscription base to ensure readiness and facilitate skilled resource effectiveness. This is a great example of the synergies we are already seeing across our cloud and on-prem software portfolios, and the positive contributions they are making to our overall business.

I'd also like to highlight the continued traction we see with our PTC partnership. The capabilities and versatility of the combined solution has contributed to our significant software portfolio differentiation and has become a great way to win with customers.

In summary, I'm very happy with how these digital offerings are contributing to our recurring revenue base, including contributions from our organically developed software, PTC, and our recent acquisitions. In the quarter, total ARR grew by over 50% and organic ARR grew double digits.

Let's now turn to slide 4 where I'll provide a few highlights of our Q1 end-market performance.

Each of our industry segments showed strong, double-digit, year-over-year organic growth. And as we've said, our strong orders are reflective of underlying demand. Advance orders for longer lead-time products that are not immediately needed made up about 10% of the total.

In our Discrete industry segment, sales grew approximately 20% versus the prior year. Within this industry segment, Automotive sales grew mid-teens, led by a 50% increase in EV capital project activity around the world and strong growth in EV battery, led by our independent cart technology.

Semiconductor sales grew over 25% in the quarter, with strong double-digit growth in all regions. Significant greenfield project activity is leading to our strong growth at semiconductor-focused engineering firms and machine builders.

eCommerce was our fastest-growing vertical, with sales growing approximately 50% over the prior year. eCommerce orders included a series of multi-million dollar wins to automate new fulfillment centers throughout North America for a well-known eCommerce provider. We believe our strong differentiation in Motion, including advanced material handling technology, and support services are driving market share gains in this fast-growing vertical.

Turning now to our Hybrid industry segment. The verticals in this segment also had a terrific quarter. Food and Beverage grew over 20% in Q1, with broad growth across the regions. Once again, SKU expansion, end-of-line automation, and the need for greater manufacturing flexibility are important trends requiring greater levels of automation. We believe the steady pipeline of greenfield and brownfield project opportunities, our deep relationships with machine builders, and our strong technology differentiation are driving record demand in this key vertical.

Life Sciences sales grew over 10% in Q1, off of an extremely strong quarter last year and remains one of our fastest-growing verticals in fiscal 2022. We have significantly invested in this area of our business over the last few years and believe we are well positioned to gain more share through broader and deeper offerings and expertise.

Our fastest growing vertical in the Hybrid segment this quarter was Tire, which grew about 35% in the quarter. This is another great vertical that is investing heavily in innovation.

Turning to Process, this industry segment grew approximately 15%, led by improving trends in upstream and midstream Oil and Gas. Our Sensia joint venture had strong sales and orders in the quarter, led by strength in process automation and lift control solutions. Sensia's digitalization solutions are well suited to the energy industry's desire to improve productivity and extend the useful life of existing infrastructure, as well as the desire to use modern technology to improve safety and reduce environmental impact. As operating and capital budgets increasingly open up, we believe Sensia is well-positioned for double-digit growth in fiscal 2022.

Turning now to slide 5 and our Q1 organic regional sales performance. North America organic sales grew by 16% versus the prior year, with strong double-digit growth across all three industry segments. EMEA sales increased 15%, driven by strength in Food and Beverage and Tire and Metals. Asia Pacific was our fastest growing region in Q1, growing 25%, with broad-based growth led by Semiconductor and Food and Beverage. In China, we saw double-digit growth driven by strength in Tire, Food and Beverage, Chemical, and Mass Transit.

Let's now turn to slide 6 to review highlights for the full year outlook.

We now expect orders for the year to exceed $9 billion, which is above what we expected just a few months ago - and really taking our business to a whole new level.

We continue to expect total reported sales growth of 17.5%, including 15.5% organic growth versus the prior year. Our projections reflect a detailed review of supply chain constraints by supplier and product line over the course of the year, but, as we've said before, these constraints remain very dynamic.

We continue to expect double-digit growth in both Core Automation as well as Information Solutions and Connected Services. Acquisitions are off to a good start and expected to contribute two points of profitable top line growth. We are maintaining our margin expectation and Adjusted EPS target of $10.80 for the year, which represents about 15% growth at the midpoint of the range compared to the prior year.

I should add that we continue to expect another year of double-digit Annual Recurring Revenue growth, including our recent Plex acquisition, which adds approximately $170 million to our ARR totals in fiscal 2022.

A more detailed view into our outlook by end market is found on slide 7. I won't go into the details on this slide, but as you can see, there is no change to the outlook for our three industry segments.

With that, let me now turn it over to Nick who will elaborate on our Q1 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 8, First Quarter Key Financial Information.

First quarter reported sales were up 19% over last year. This is slightly better for the quarter than we expected and indicated in November. We saw some improvements in the timing of electronic component shipments from our suppliers that resulted in a stronger first quarter than we anticipated.

Q1 organic sales were up 17% and acquisitions contributed 2.6 points to total growth. Currency translation decreased sales by under 1 point. Segment operating margin was 19.1%, better than expected and improved sequentially from Q4. Our stronger sales performance improved our margins in the quarter. Versus last year, our margins declined 70-basis points due to higher planned spend and negative price/cost both in-line with expectations. These were both partially offset by the impact of higher sales.

Corporate and Other expense was $29 million. Our Adjusted EPS in the quarter was $2.14. Q1 of FY2021 included a non-recurring favorable legal settlement of $0.45. Excluding the prior year favorable legal settlement, Adjusted EPS grew 11% versus the prior year. I'll cover a year-over-year Adjusted EPS bridge on a later slide.

The Adjusted Effective Tax Rate for the first quarter was 15.3% and in line with the prior year. Free Cash Flow was negative by $50 million in the quarter and down compared to the prior year due to the payout of the fiscal 2021 bonus, an increase in our working capital to serve our strong demand, and higher planned tax payments. One additional item not shown on the slide, we repurchased 151 thousand shares in the quarter at a cost of $49 million. On December 31st, $503 million remained available under our repurchase authorization.

Slide 9 provides the sales and margin performance overview of our three operating segments. Total reported sales grew double digits across all three of our segments.

Intelligent Devices grew organic sales by 26%. Compared to last year, Intelligent Devices margins expanded 430 basis points to 23.7%, on higher sales despite a price/cost headwind.

Software & Control organic sales were up 8%. Segment margins for this segment declined 730 basis points compared to last year, with higher planned investment spend, and the impact of acquisition integration costs, partially offset by higher organic sales. This segment also saw negative price/cost in the quarter.

Lifecycle Services grew organic sales by 10%. Segment margin was 5.5% and declined 340 basis points driven by higher planned investment spend, unfavorable project mix, and higher input costs, partially offset by higher sales. Margin is expected to grow through the balance of the year as a result of strong sales growth and a higher margin backlog.

The next slide, 10, provides the Adjusted EPS walk from Q1 fiscal 2021 to Q1 fiscal 2022.

Starting on the left, Core performance was up about $0.55 on a 16.8% organic sales increase. Approximately $0.20 was related to temporary pay actions that were benefiting the prior year and have since been reversed. This is the last quarter that we have this in our prior year comparables as a headwind. Currency was slightly unfavorable by about $0.05. Acquisitions, had a negative impact of $0.10, mostly related to Plex. We continue to expect that Plex, including the impact of interest expense, will be breakeven in FY22 EPS and up $0.15 from FY2021. As a reminder, our prior year EPS included a non-recurring legal settlement gain of $0.45. This brings us to our total EPS of $2.14.

Let's move on to the next slide, 11, guidance for Fiscal 2022.

We are reaffirming our sales guidance of about $8.2 billion in fiscal 2022, up 17.5% at the midpoint of the range. We expect organic sales growth to be in a range of 14% to 17%, and 15.5% at the mid-point of our range. This guidance is based on our current view of electronic component availability.

By quarter, we see Q2 total sales improving sequentially low to mid-single digits with continued improvement in the second half of the year. Our first half is expected to be in line with our initial projections with our first quarter being a little stronger and our second quarter coming in a little lower due to timing of electronic component availability. We are pleased with our supply chain team's ability to navigate through this dynamic environment and keep the focus on serving our customers.

We expect full year segment operating margin to be about 21.5%. We continue to expect slightly positive price/cost for the full year. We expect the first half impact of price/cost on margins to be dilutive by approximately 200 basis points, and that the margin impact in the second half from price/cost will be accretive by over 100 basis points.

Given the first half of the year negative impact of price/cost, we expect margins in the 2nd quarter to be similar to Q1 margins, with the positive impact from higher sales being offset by higher sequential input costs. We expect the phasing of our price increases along with higher sales will significantly benefit margins in the second half of the year. Our full year view on margins and the impact of price/cost on those margins remains unchanged.

We continue to expect full year core earnings conversion of between 30% and 35%. We are on track on to grow our R&D and other growth-related investments by double digits. These investments will position us well as we drive sustained growth in 2022 and beyond.

We continue to expect the full year Adjusted Effective Tax Rate to be around 17%. We do not anticipate any material discrete items to impact tax in fiscal 22. We are also reaffirming our Adjusted EPS guidance of $10.50 - $11.10. At the midpoint of the range, this represents 15% Adjusted EPS growth.

Finally, we are projecting full-year fiscal 2022 free cash flow conversion of about 90% of Adjusted Income. This reflects a $155 million bonus payout made in quarter one for the fiscal 2021 performance, $165 million of capital expenditures and funding higher levels of working capital to support significantly higher sales growth. Our working capital is target is aligned to our historical amount of around 12% of total sales.

A few additional comments on Fiscal 2022 guidance. Corporate and Other expense remains around $125 million. Net interest expense for fiscal 2022 is expected to be about $115 million. We're assuming average diluted shares outstanding of about 117.5 million shares. Finally, on capital deployment, no change to our strategy or fiscal 2022 priorities. Our first priority is organic growth. After that, we focus capital deployment on inorganic activities. Then we focus on capital returns to shareholders, through our dividend, and then share repurchases. We continue to focus on de-levering in fiscal year 2022.

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

Blake D. Moret

Chairman & Chief Executive Officer, Rockwell Automation, Inc.

Thanks, Nick.

Strong order trends and record backlog underpin a robust top line outlook for fiscal 2022. As we said last quarter, we are making investments in our capacity, technology, and people to support our future growth.

We are investing in our operations to expand capacity by $500 million per quarter, while at the same time increasing the resiliency of our supply chains. We made significant progress in the quarter to release FactoryTalk SaaS offerings, including new PLEX Smart Manufacturing Platform capabilities, and we've expanded FiiX's applied AI capabilities.

We also released the next version of Emulate 3D to further our capabilities in creating and operating digital twins of production systems. A significant release of new Logix functionality is scheduled for next quarter. Importantly, last year's accelerated organic investments have allowed us to release new secure remote access functionality and cloud-based data management of automation design information earlier than originally anticipated.

In summary, Q1 was a great start to the year. We have been very busy capitalizing on the opportunities we see today while at the same time building for the future.

I want to take a moment to recognize the people in our organization and the tremendous work that went into these results during especially challenging times. We are making significant investments in existing and new talent and are empowering them with the technologies and resources to be successful. We continue to encourage fresh ideas from across the organization and look at ways to increase our value through the customer's eyes.

I feel confident that investments in automation and digital transformation have never been more top of mind than they are today. As a pureplay leader devoted exclusively to these areas, we think our agility, our differentiated portfolio of products and services, our significant domain expertise, and our ecosystem of best-in-class partners, make us the best positioned company to benefit from what should be a significant, multi-year growth cycle.

Let me now pass the baton back to Jessica to begin the Q&A session.

Jessica Kourakos

Head of Investor Relations, Rockwell Automation, Inc.

Thanks, Blake. Before we start the Q&A, I just want to say that 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.

Emma, let's take our first question.

Q&A Session

Jessica Kourakos

Head of Investor Relations, Rockwell Automation, Inc.

Thanks, everyone. That concludes today's call.