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Rockwell Automation, Inc. (ROK)

Q1 2024 Earnings Call – Prepared Remarks

Corporate Participants

Blake 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 & Market Strategy, 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 and Market Strategy. Ms. Zellner, please go ahead.

Aijana Zellner

Head of Investor Relations & Market Strategy, Rockwell Automation, Inc.

Thank you, Julianne. Good morning and thank you for joining us for Rockwell Automation's first quarter fiscal 2024 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 it over to Blake.

Blake Moret

Chairman & Chief Executive Officer, Rockwell Automation, Inc.

Thanks, Aijana, and good morning, everyone. Thank you for joining us today.

Let's turn to our first quarter results on slide three. This quarter we saw double-digit sequential growth in orders, with all business segments and regions up from the trough in Q4 of last year. While we are continuing to see the impact of excess inventory in the channel, the underlying demand from machine builders and end users remains strong.

Total sales were up 3.6% year-over-year. Organic sales grew 1% in the quarter, led by North America. China was the single largest drag on our shipments. Currency translation increased sales by over one point, and acquisitions contributed almost a point and a half of growth.

Our organic sales did come in below our expectations, largely due to the timing of our recovery to a more normal product book and bill process. As the source of our demand shifts from older backlog to new orders that need to be shipped as soon as they are received, we are working through some lingering shortages and line constraints. Our supply chain team is expected to complete this transition in Q2, with little impact on the full year.

In our Intelligent Devices business segment, organic sales were down 4.5% versus prior year. While product shipments in this segment experienced the biggest supply chain constraints in the quarter, we were able to offset some of that impact with strong performance from our configure-to-order businesses and from recent acquisitions.

Our Clearpath and Cubic acquisitions had a strong quarter, both on topline and bottom line, showcasing the tremendous value these offerings are bringing to our customers across new verticals and applications. Last quarter I talked about our presence in data center buildouts, and Cubic's momentum with large cloud service providers continues to fuel our growth in this end market. I'll touch on some of the important Clearpath wins later on the call.

Software & Control organic sales increased 4% year-over-year and were in line with our expectations. Logix continues to demonstrate unique value in the marketplace, and we've made some major software investments in this segment over the last few years. We are seeing the value from this innovation, demonstrated by double-digit sales growth in our cloud-native and on prem information software offerings.

Lifecycle Services organic sales grew over 8% versus prior year, better than we expected. Book-to-bill in this segment was 1.13, with strong order activity across solutions, services, and our Sensia joint venture. I'm pleased with how our Sensia team is making progress, with profitable growth in the quarter. Q1 orders and sales were up over 25% year over year. One of the strategic Sensia wins this quarter was with Mellitah, Oil & Gas joint venture, one of the largest Oil & Gas companies in Libya. Sensia's advanced measurement technology is helping this customer modernize all of their liquid metering skids and establishes Sensia as one of the key players in the region for major metering turnkey solutions.

Another highlight of the quarter was our continued growth in ARR. Total Annual Recurring Revenue was up 20% year-over-year, with strong growth across our Plex and Fiix SaaS offerings and recurring services, including our growing cybersecurity business. The impact of these contracts on our financial performance is also increasing, especially in a year with relatively low product growth. This quarter, our Plex SaaS platform was selected by EOS Energy, an energy start-up focused on grid scale storage for utility companies. EOS Energy, in partnership with Acro Automation Systems, has selected Rockwell Automation to provide Plex MES and QMS information software to compliment Acro's battery manufacturing solution built on Rockwell's control platform. Acro is currently building out the first state-of-the-art manufacturing line that will manufacture Eos Energy's next gen Z3 batteries.

Segment margin of about 17% and Adjusted EPS of $2.04 were both down versus prior year. The Adjuted EPS was below our expectations, and Nick will discuss this further in a few minutes.

Let's now turn to slide 4 to review key highlights of our Q1 industry segment performance. Before we get into the individual verticals, keep in mind that the more product-intensive industries were the most impacted by planned shipments moving to Q2 and later in the year.

Our Discrete sales were down 10% year-over-year. Within Discrete, Automotive sales were down high single-digits. While auto customers are focused on near-term profitability and temporary slowdown in EV demand, they continue to fund new EV and battery capex programs. In addition to these investments, we are seeing increased activity across our traditional ICE and plugin hybrid platforms as brand owners and tier suppliers are looking to diversify their exposure in response to consumer demand and infrastructure limitations. As you know, Rockwell has a substantial installed base with these established automotive customers, and is well positioned to capture additional market share, regardless of the application.

This quarter, our Logix platform was selected by Akasol/Borg Warner, a global battery producer and automotive tier supplier developing innovative battery manufacturing processes for their production plants in Seneca, South Carolina and Darmstadt, Germany. This customer plans to increase their production volume in Europe and North America and scale to more plants globally. Another exciting automotive win this quarter came from Clearpath Robotics, where a large brand owner will be using over a hundred of our Otto autonomous mobile robots in their U.S. sub-assembly applications.

Semiconductor sales were also down high-single-digits versus prior year. While the industry is still navigating through a myriad of challenges, including geopolitical risk, excess memory capacity and workforce shortages, we continue to see new announcements and orders for greenfield projects and legacy fab upgrades, along with continued momentum in our wafer transport solutions.

Within our eCommerce and Warehouse Automation industry, sales declined mid-teens and were in line with our expectations. Customers across many verticals continue to modernize their existing operations to match the current market's needs. In addition to a strong funnel of these warehouse transformation projects, we are starting to see renewed capex plans from our eCommerce customers for fulfilment center builds later in fiscal year 24 and in fiscal year 25.

Moving to our Hybrid industries. Within this industry segment, growth in Life Sciences and Tire were offset by declines in Food and Beverage. Food and Beverage sales were down high-single-digits versus prior year. Given the mix of products serving this customer segment, our Q1 performance in this vertical was most impacted by our internal capacity constraints mentioned earlier on the call. Similar to previous quarters, we continue to see large end users investing their digital and cyber capabilities across their global footprint.

This quarter, we had another sizeable Clearpath win at one of the largest Food and Beverage manufacturers in the world, where the customer chose our Otto AMRs to replace their existing AGV system to increase throughput and flexibility, while enhancing material movement security. It is clear our customers across many industries are focused on augmenting their existing workforce through autonomous and innovative solutions to drive further productivity, safety, and sustainability in their operations.

Life Sciences sales grew 10% in the quarter. Note that our Life Sciences revenue is more weighted to software and services versus products. In addition to our MES and cybersecurity services momentum, we are continuing to see increased investments in high-growth areas, such as Advanced Therapy Medicinal Products and GLP-1 diabetes and obesity drugs. Tire was up high-single-digits.

Moving to Process. Sales in this industry segment grew over 10% year-over-year, once again led by strong growth in Oil & Gas, Metals, and Mining. Oil & Gas sales were up over 25% this quarter. I already mentioned our performance in Sensia, and we continue to see follow-on orders from our customers' decarbonization and digitization projects worldwide.

Let's turn to slide 5 and our Q1 organic regional sales.

North America organic sales were up over 4% year-over-year. North American manufacturers are continuing to invest, and we expect this region to be our strongest-performing market this year. Latin America was down half a point. EMEA sales were down about 2%, and Asia Pacific sales declined over 7%. Similar to the last few quarters, we continue to see challenges in the Chinese manufacturing economy, with high cancellations and pushouts relative to the rest of the world. Sales in China were down high teens versus prior year.

Moving to slide 6 for our fiscal 2024 outlook.

We continue to expect our full-year orders to grow low-single-digits versus prior year, with strong sequential growth through the balance of this fiscal year. Factoring in our performance through January, our continuous analysis of distributor inventory levels, and strong pipeline of customer projects, we are reaffirming our fiscal 2024 sales guidance range with organic sales projected to grow 1% at the midpoint. Currency is also expected to increase sales by 1%, and we now expect acquisitions to contribute a point and a half of growth. ARR is still slated to grow about 15%.

Segment margin is expected to increase slightly versus prior year, with significant second half increases coming from increased product volume, spending discipline, and the growing benefit of productivity initiatives being taken in Lifecycle Services. Nick will share additional calendarization detail in his section. Adjusted EPS is slated to grow 5% year-over-year at the midpoint, again weighted to the back half of the year, and we still expect Free Cash Flow conversion of 100%.

Let me turn it over to Nick to provide more detail on our Q1 performance and financial outlook for fiscal 2024. Nick?

Nicholas Gangestad

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

Thank you, Blake, and good morning, everyone. I'll start on slide 7, first quarter key financial information.

First quarter reported sales were up 3.6% over last year. Q1 organic sales were up 1% and acquisitions contributed 140 basis points to total growth. Currency translation increased sales by 120 basis points. About 3 points of our organic growth came from price, in line with our expectations.

Segment operating margin was 17.3% compared to 20.2% a year ago. This 290-basis point decrease reflects higher investment spend, mix between products and solutions, and lower supply chain utilization. While our Q1 spend was down sequentially, we had a difficult year-over-year comparison due to an abnormally low investment spend in Q1 of last year. Key areas of year-over-year spending increases include investments in new products, digital infrastructure, and commercial resources. I'll comment later on the expected progression of our investment spend when I cover our full year outlook.

As Blake mentioned, orders inflected upward sequentially, and we expect strong sequential order growth through the remainder of the year. The expected slope of orders is consistent with what we have discussed over the last couple of quarters.

Adjusted EPS of $2.04, down 17% compared to last year, was below our expectations primarily due to lower-than-expected sales and lower segment operating margin. The devaluation of the Argentine peso was an additional $0.10 Adjusted EPS headwind in Q1. I'll cover a year-over-year Adjusted EPS bridge on a later slide.

The Adjusted Effective Tax Rate for the first quarter was 18%, slightly above the prior year rate. Free Cash Flow was negative $35 million compared to positive $42 million in the prior year. Our lower year-over-year free cash flow generation in the quarter was driven by a higher incentive compensation payout during the quarter, which was tied to our fiscal 23 performance. Working capital decreased in Q1 driven by lower accounts receivable partially offset by lower accounts payable.

One additional item not shown on the slide. We repurchased approximately 400,000 shares in the quarter at a cost of $120 million. On December 31, $800 million remained available under our repurchase authorization.

Slide 8 provides the sales and margin performance overview of our three operating segments. Blake discussed our top-line performance in the quarter, so I'll focus on our margin performance.

As I mentioned earlier, our investment spend in the year-ago quarter was lower than normal, as most of the incremental fiscal 2023 investments started in Q2 of last year. This resulted in a difficult year-over-year margin comparison in Q1 for both Intelligent Devices and Software and Control.

Intelligent Devices margin decreased to 16.2% compared to 22.4% a year ago. The decrease from the prior year was driven by lower sales volume, the timing of prior year investment spend, and the impact of acquisitions partially offset by positive price/cost. Our Clearpath and Cubic acquisitions, both part of Intelligent Devices, are performing well, and we are making commercial and technical investments here to accelerate profitable growth.

Software & Control margin of 25% decreased from 29.2% last year. The lower margin was driven by the timing of prior-year investment spend and lower supply chain utilization, partially offset by price/cost.

Lifecycle Services book-to-bill was 1.13. Lifecycle Services margin of 10.4% doubled from the year-ago margin of 5.2%. Strong margin performance was driven by higher sales, lower incentive compensation, and higher margins in Sensia. We are realizing productivity benefits from Lifecycle Services restructuring actions we took last year, and those benefits are coming in as expected.

The next slide, 9, provides the Adjusted EPS walk from Q1 fiscal 2023 to Q1 fiscal 2024.

Core performance was down $0.10, on a 1% organic sales increase, as positive price/cost was more than offset by negative product mix and lower supply chain utilization. Higher investment spend was a $0.40 EPS headwind. Incentive compensation was a $0.20 tailwind. This year-over-year improvement reflects a lower projected bonus payout this year vs. an above-target payout last year.

The impact from acquisitions was a $0.10 headwind and aligned with our expectations. The year-over-year impact from currency was a $0.05 headwind, with the $0.10 headwind from the Argentine peso revaluation more than offsetting the positive impact from other currencies. The net $0.05 currency headwind was offset by a $0.05 tailwind from interest expense. Share count and tax rate were each immaterial to the year-over-year change in EPS this quarter.

Let's now move on to the next slide, 10, guidance for fiscal 2024.

We are reaffirming our guidance for fiscal year 2024 of reported sales growth of 0.5% to 6.5% and organic sales growth in the range of negative 2% to positive 4%. As Blake mentioned earlier, we now expect acquisitions to add 150 basis points to growth, up from 100 basis in our points prior guidance, as the growing pipeline of projects from Clearpath is leading to higher expected growth. Given this improvement, Clearpath is now expected to dilute Adjusted EPS by $0.20 vs. our prior expectation of $0.25.

We now expect a full-year currency tailwind of 100 basis points, down from 150 basis points in our prior guide because projections for the Euro and Canadian dollar have weakened slightly for the year. We continue to expect price to be a positive contributor to growth for the year. We expect the full year Adjusted Effective Tax Rate to be around 17.0%. We are reaffirming our Adjusted EPS guidance range of $12.00 to $13.50.

We expect full-year fiscal 2024 free cash flow conversion of about 100% of Adjusted Income. This reflects our continued expectation that inventory days on hand will drop to approximately125 days by the end of FY24 compared to the 140 days of inventory we had at the end of FY23. We continue to expect free cash flow conversion in the first half to be well below 100%, mostly tied to the higher incentive compensation payment made in Q1 related to our fiscal year 23 performance and higher income tax payments related to the realized capital gain on the sale of our stake in PTC as well as our Tax Cuts and Jobs Act transition tax payment.

From a calendarization perspective, we expect Q2 sales dollars and segment margin to be similar to Q1 levels. We previously expected the lead times on our last constrained products would return to normal by the end of Q1, and this is now being pushed back to the middle of the year. This means that our split between first half and second half revenue will be even more weighted toward the second half.

Our plan was and continues to be for balanced spend across the four quarters of fiscal year 24, compared to our upward trajectory of spend in fiscal year 23 as confidence in supply chain recovery pace grew. Given the split of sales between first and second half, that means first half margins will be noticeably lower compared to the year prior and second half margins noticeably higher. We expect margins in Q2 to remain similar to what they were in Q1 and then increase to the mid-20's in Q3 and Q4. That expansion in margin is driven virtually all by revenue returning to levels consistent with end demand. We anticipate investment spend to be relatively flat across the four quarters of fiscal year 24. From a year-over-year perspective, Q2 and Q3 increases in investment spend will be approximately $10 million each and then a year-over-year decrease in Q4.

A few additional comments on fiscal 2024 guidance. Corporate and Other expense is expected to be around $125 million. Net Interest expense for fiscal 2024 is expected to be about $120 million. We're assuming average diluted shares outstanding of 115.1 million shares. We expect to deploy between $300 and $500 million to share repurchases during the year.

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

Blake Moret

Chairman & Chief Executive Officer, Rockwell Automation, Inc.

Thanks, Nick.

Despite geopolitical volatility, our detailed discussions with our distributors, machine builders, and end users point to fairly healthy market conditions. Our outlook for fiscal year 24 is based on an acceleration of new product orders, as distributors and machine builders reduce excessive inventory. Our operations team is working around the clock to ensure we can convert these new orders into shipments at lead-times that are as good or better than pre-pandemic lead times.

We continue to gain share across our key platforms, especially here in North America. We are seeing early orders from customer projects facilitated by economic stimulus, and automation continues to be an important way to maximize the productivity of available workers.

Our recent acquisitions are performing well on both revenue and cost, with Clearpath Robotics being a standout addition to Rockwell's portfolio. We've seen multi-million dollar wins across diverse end markets including Automotive, Food & Beverage, and even Warehousing and Logistics, and this is just the beginning.

We have a unique portfolio of high-value assets that we've built and bought, with the best partner ecosystem in the business. Our focus is now to integrate these elements as only a pure-play can, growing share, profitability, and cash flow by driving efficiency and synergy.

Aijana will now begin the Q&A session.

Aijana Zellner

Head of Investor Relations & Market Strategy, Rockwell Automation, Inc.

Thanks, Blake. We would like to get to as many of you as possible, so please limit yourself to one question and a quick follow up. Julianne, let's take our first question.

Q&A Session

Aijana Zellner

Head of Investor Relations & Market Strategy, Rockwell Automation, Inc.

Thank you, everyone, for joining us today. That concludes today's conference call.