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Rockwell Automation, Inc. (ROK)

Q4 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, Chris. Good morning and thank you for joining us for Rockwell Automation's fourth 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. 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 quarterly results on slide three. We saw another quarter of exceptional demand across all three business segments. Total orders surpassed $2.2 billion and grew 40% over the prior year, reflecting a very strong demand pipeline across our portfolio of core automation and digital transformation solutions. Total revenue of over $1.8 billion grew 15%, with additional sales that shifted into fiscal 2022 due to supply chain headwinds. Organic sales grew 13% versus prior year.

We had very strong growth in Core automation and Information Solutions & Connected Services grew double digits in both orders and revenue. This performance was led by strong demand for software and cybersecurity services.

Turning to ARR, we continue to make significant progress to drive recurring revenue. Our ARR grew organically by over 18%, and including our recent acquisition of Plex, now accounts for over 8% of total sales. Segment margin of 18% came in line with our expectations, with the execution of planned investments in Q4.

I'll now comment on our top line performance by business segment.

Intelligent Devices organic sales increased 15% versus prior year, even with significant headwinds from supply chain. From an orders perspective, this is the fourth consecutive quarter of record order intake in this segment, with orders 30% above fiscal 2019 levels. We continue to see significant strength across the automation portfolio and share gains particularly evident in Motion, led by our Independent Cart Technology.

Software & Control organic sales grew 14%, led by strong demand across the segment, including double-digit growth in Logix. Orders grew approximately 50% year-over-year, once again showing great momentum across the software, control, visualization, and network portfolios.

In Lifecycle Services, organic sales increased 7% versus the prior year, and increased 2% sequentially, even with some projects delayed as a result of component availability. Lifecycle Services book-to-bill of 1.09 was well above seasonal Q4 levels. Total company backlog of $2.9 billion grew by over 80% year-over-year. Over 40% of backlog is related to our Lifecycle Services business.

Turning to Information Solutions and Connected Services, which represent many of Rockwell's newest digital revenue streams, we had another great quarter. Recent orders included a number of meaningful software and infrastructure-as-a-service wins.

One of the more notable wins in the quarter was with Ardagh Group, one of the world's largest sustainable packaging companies. The company had placed a $1 million order for Fiix software in Q3 to reduce unplanned downtime. Ardagh, like a lot of manufacturers, is trying to respond to a sharp increase in demand. By Q4, as the relationship developed, we pulled through an additional $4 million purchase of Core automation products. Showcasing the tremendous synergy resulting from our new software capabilities and intelligent devices. With their ARR growing 45%, and over 470 new Fiix customers added in just the last 9 months, I'm very happy with the contributions Fiix has been able to make to our overall business.

We also had a great win with one of the world's largest food & beverage companies in two key application areas. The first win is in the area of predictive analytics, where our Kalypso digital consulting business will combine our Factory Talk Innovation Suite with our automation technology to provide real-time monitoring and analytics for their manufacturing environment.

The second application is in the area of sustainability, where our software and automation technology will be used to help monitor water, air, gas, electricity, and steam usage to develop real-time KPIs that further reduce their carbon footprint and drive quantifiable production outcomes.

Kalypso continues to play a very important role within Rockwell and is spearheading some of the most exciting digital transformation projects in all of manufacturing. Our customers are recognizing Rockwell's expanding capabilities to converge IT and OT and be a strong partner throughout the digital transformation journey. In fact, we announced yesterday that we are adding to Kalypso's capabilities with our acquisition of AVATA, which will strengthen and expand their supply chain solutions domain expertise.

This expertise, combined with our operations management software and that of our partners, drives great outcomes for our customers. We are very excited to be expanding our presence in the connected supply chain, since it is such a critical, high-growth area.

We also accelerated our Factory Talk SaaS offering with the acquisition of Plex in September. The integration is going well, and we look forward to showcasing the entire FactoryTalk software offering, including Plex, at our upcoming Investor Day on November 10th in Houston. We hope to see you there.

I'd also like to highlight the increasing traction we are seeing with our PTC partnership. Our salesforce is seeing the number and size of engagements growing. The capabilities and versatility of the combined solution is a great way to win with both existing customers and new ones all over the world. A number of the wins we saw this quarter were in diverse industries around the world. We're happy with this partnership and think it's a great part of our software portfolio.

Let's now turn to slide four where I'll provide a few highlights of our Q4 end-market performance.

We had great performance in our Discrete industry segment, with roughly 15% sales growth. Within this industry segment, Automotive sales grew about 15%. Led by an increase in EV capital project activity, including a strategic win at Magna, one of the top Tier 1 auto manufacturers, delivering EV content for GM and Ford. Semiconductor was strong, growing 20% off of a very good quarter last year. eCommerce performance was also exceptional, with sales growing approximately 30% versus a strong prior year.

Turning now to our Hybrid industry segment. The verticals in this segment also had a terrific quarter. Food & Beverage grew about 15%, led by strong greenfield and brownfield project opportunities in North America and EMEA as well as strong double-digit OEM demand. Life Sciences grew over 15% in Q4 and remains one of our top-growth verticals. We see continued growth in the overall Life Sciences market, and evidence that we are taking market share. Once again, our fastest growing vertical in the Hybrid segment was Tire, which was up about 35% in the quarter.

Process markets grew over 10%, with strong sequential and year-over-year growth in Oil & Gas, especially in our Sensia JV. In summary, we are clearly seeing very strong growth across Discrete and Hybrid segments, as well as improving Oil & Gas trends.

Turning now to slide five, and our Q4 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 7%, driven by strength in Food & Beverage and Tire and Metals. Sales in the Asia Pacific region grew 12%, with broad-based growth led by EVs, Semiconductor, and Mining. In China, we saw double-digit growth driven by strength in Mining, Life Sciences, Tire, and EV.

Let's now turn to slide six, to review highlights of fiscal 2021.

Record orders of $8.2 billion grew 26%. Reported sales grew 11%, even with supply chain constraints. Organic sales grew almost 7%. IS/CS revenue exceeded $500 million at year end and grew double digits organically. Adjusted EPS grew 20%, and we, once again, generated significant cash flow due to our very profitable financial framework, strong focus on productivity, and financial discipline.

At the same time, we made significant investments in our future to accelerate profitable growth. That included organic investments as well as inorganic investments. In fiscal 2021, we accelerated funding of software development projects and deployed approximately $2.5 billion toward inorganic investments. At the same time, we returned $800 million back to shareowners in the form of dividends and buybacks.

Turning to slide seven, you can see how these investments, and our strong order momentum and backlog, are helping accelerate our top line performance heading into fiscal 2022.

Our new fiscal 2022 outlook expects total reported sales growth of 17.5%, including 15.5% organic growth versus the prior year. These projections take into account our latest view of supply chain constraints. We have the people, supplier commitments, and plant capacity to support this growth, but we will no doubt need to continue to manage new challenges as they emerge in this highly dynamic environment.

We expect double-digit growth in both Core automation as well as Information Solutions and Connected Services. Acquisitions are expected to contribute two points of profitable growth. We are increasing our margin expectation to 21.5%, up 150 basis points over the prior year. Our new Adjusted EPS target of $10.80, at the mid-point of the range, represents about 15% growth compared to the prior year. I should add that we 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 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 in fiscal 2022.

With that, let me now turn it over to Nick who will elaborate on our fiscal 2021 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 nine, fourth quarter key financial information. Fourth quarter reported sales were up 15% over last year. Q4 organic sales were up 12.6% and acquisitions contributed 1 point to total growth. Currency translation increased sales by 1.5 percentage points.

Segment operating margin was 17.9%, in line with our expectations. The 230-basis point decline was primarily related to higher planned investment spend, the reversal of temporary pay actions, and the restoration of incentive compensation, partially offset by the impact of higher sales. Corporate and Other Expense was $33 million. The year-over-year increase was from deal costs associated with the Plex acquisition.

Adjusted EPS of $2.33 was better than expected and grew 21% 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 fourth quarter was -3%, much lower than expected, compared to 15% in the prior year. The lower-than-expected rate was related to the cumulative impact of several one-time discrete items recognized in the current quarter.

Free Cash Flow performance was in line with our expectations. We generated $160 million of free cash flow in the quarter. The Free Cash Flow generation includes higher levels of working capital in the current year to support our increasing revenue and build inventory in anticipation of the accelerated revenue levels in fiscal year 2022.

One additional item not shown on the slide, we repurchased 200,000 shares in the quarter at a cost of $61 million. For the full year, our share repurchases totaled $301 million, in line with our July guidance. On September 30th, $552 million remained available under our repurchase authorization.

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

Organic sales of both Intelligent Devices and Software & Control were up double digits. Lifecycle Services organic sales were up sequentially and up 7% year-over-year led by Oil and Gas, Life Sciences, and Food & Beverage. All segments saw strong double-digit growth in orders.

Compared to last year, Intelligent Devices margins were up 100 basis points, on higher sales. This segment did see higher input costs both year-over-year and sequentially; however, these costs were largely offset by price.

Segment margins for the Software & Control segment declined 330 basis points compared to last year, with higher planned investment spend, partially offset by higher organic sales. This segment benefited from positive price/cost in the quarter.

Lifecycle Services segment margin was 8.1% and declined 820 basis points driven by the reversal of temporary pay actions, the reinstatement of incentive compensation, as well as unfavorable mix, partially offset by higher sales.

The next slide, eleven, provides the Adjusted EPS walk from Q4 fiscal 2020 to Q4 fiscal 2021.

As you can see, Core performance was up about $0.70 on a 12.6% organic sales increase. 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.

The reversal of temporary pay actions and restoration of incentive compensation contributed –($0.45). Acquisitions were a $0.15 headwind due to the deal costs associated with the Plex acquisition. As previously noted, our lower Adjusted Effective Tax Rate contributed $0.40.

Slide twelve provides a walk from our Q4 mid-point in our July guidance to our actual Q4 Adjusted EPS results. We usually don't provide this information, but I wanted to show how the quarter played out relative to the mid-point of what we had guided back in July.

The unforeseen impact of the Delta variant in Southeast Asia added incremental pressure to the supply chain, but the impact of the volume miss of $0.40 was mitigated through lower incentive compensation, further productivity, and favorable mix, all of which contributed about $0.35. As noted previously, a more favorable tax rate benefited our EPS versus guidance by $0.25.

Moving to slide thirteen, product order trends.

This slide shows our average daily order trends for our products, which includes our software portfolio. As a reminder, the trends shown here account for about two-thirds of our overall sales. Order intake was broad based and improved sequentially for the fifth consecutive quarter. Q4 product order levels grew at about 40% versus the prior year and are well above pre-pandemic levels as customers are increasingly interested in investing in our Core automation and software, both of which are essential to drive the outcomes that come from digital transformation.

Slide fourteen provides key financial information for full year fiscal 2021.

Reported sales grew 10.5% including over one point coming from acquisitions. Organic sales were up 6.7% led by double-digit growth in our Hybrid & Discrete end markets and improving Process verticals.

Full year segment margin remained at about 20%, including close to $30 million of one-time accelerated investments, mostly in our Software & Control segment. R&D expense was up 14% compared to fiscal 2020, and R&D as a % of sales increased further, to 6% of sales in fiscal 2021.

Our core conversion, which excludes the impacts of acquisitions, currency, and our accelerated one-time investments, was 34%. Corporate & Other was up just over $20 million mostly related to acquisition costs associated with the Plex acquisition.

Adjusted EPS was up 20%. A detailed year-over-year Adjusted EPS walk can be found in the appendix for your reference. Free Cash Flow performance remained strong and was in line with our July expectations. Free cash flow conversion was at 103% of Adjusted Income. Finally, ROIC remained well above our target of over 20%.

For the year, we deployed about $3.3 billion of capital towards acquisitions, dividends, and share repurchases in fiscal 2021. Our capital structure and liquidity remain strong.

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

As Blake mentioned, we are expecting sales of about $8.2 billion in fiscal 2022, up 17.5% at the mid-point of the range. We expect organic sales growth to be in a range of 14% to 17%, and about 15.5% at the mid-point of our range. This outlook includes our latest assumptions on supply chain constraints.

We expect full year segment operating margin to be about 21.5%. We expect positive price/cost for the full year from the additional price increase we implemented this month.

At the mid-point, our guidance assumes full year core earnings conversion of between 30% and 35%. We believe we are in the early stages of a cycle of sustained growth and are making investments to fuel this growth in 2022 and beyond. Our fiscal 2022 segment margin and core conversion outlook includes our plan to increase R&D and other growth-related investments by double digits.

We 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 2022. This rate is under current tax law. Should tax laws change, we would provide an updated outlook with the impacts from these changes.

Our Adjusted EPS guidance is $10.50 - $11.10. This compares to fiscal 2021 Adjusted EPS of $9.43. At the mid-point of the range, this represents 15% Adjusted EPS growth. I will cover a year-over-year Adjusted EPS walk on the next page.

From a calendarization viewpoint, based on our current supply chain availability, we expect our first quarter sales to be relatively flat compared to our Q4 of fiscal 2021. Following the first quarter, we expect sequential sales to improve over the balance of the year.

We expect segment margins and the Adjusted EPS to decline sequentially in Q1 and then improve throughout the year in line with sales volume and the timing of price increases. We anticipate recent price increases to have a more substantial benefit in subsequent quarters given the timing of when customer agreements are renewed throughout the year. Also, as a reminder fiscal 2021 Q1 included a non-recurring $0.45 gain related to the settlement of a legal matter.

Finally, we expect full-year fiscal 2022 Free Cash Flow conversion of about 90% of Adjusted Income. This reflects a $155 million bonus payout for the fiscal 2021 performance, $165 million of capital expenditures and funding higher levels of working capital to support higher sales. Our working capital is targeted to be aligned with our historical amount of around 12% of sales.

A few additional comments on fiscal 2022 guidance. Corporate and Other expense is expected to be around $125 million. Net interest expense for fiscal 2022 is expected to be about $115 million. Finally, we're assuming average diluted shares outstanding of about 117.5 million shares.

The next slide, sixteen, provides the Adjusted EPS walk from fiscal 2021 to fiscal 2022 guidance at the mid-point. Moving from left to right, Core performance is expected to contribute about $2.15. This includes the benefit of higher organic sales. We anticipate price realization will exceed input cost inflation by about $0.10. Our pricing philosophy is built on the high value that we bring our customers. In light of increasing input costs, we have taken several price adjustments this year to mitigate, and we are prepared to take additional price actions as needed.

The removal of the one-time accelerated investments made in fiscal year 2021 will be about a $0.20 benefit. The one-time gain from a legal matter that was settled in the prior year is a $0.45 headwind. Plex will be a $0.15 tailwind in fiscal 2022, including the impact of incremental interest. We have included further information showing the impact of Plex in both fiscal 2021 and fiscal 2022 in our appendix. No real significant changes to what we showed in July.

We expect about a $0.05 impact coming from share dilution. The higher tax rate is expected to be about a $0.75 headwind.

Moving on to the next slide, seventeen, I'll make a few comments on our capital deployment framework.

Our long-term capital deployment priorities remain the same. 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.

In addition to our organic and inorganic investments, our capital deployment plans for fiscal 2022 include a focus on de-levering, dividends of about $520 million, and share repurchases of $100 million.

In summary, our guidance assumes a combination of order and backlog growth that drives 15.5% organic sales at the mid-point and reaches total sales of over $8 billion. We continue to offset inflationary pressure through additional price actions yielding segment margins of 21.5%. We expect Adjusted EPS growth of 15% and continued strong Free Cash Flow.

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.

As we look forward to fiscal 2022, strong order trends and record backlog underpin a robust top line outlook. We are making investments in our capacity, technology, and people to support our future growth.

Our people delivered great results this year, and I want to take a moment to recognize their tremendous work during especially challenging times. As the world recovers, investments in automation and digital transformation have never been more top of mind. Nobody is better positioned to help industrial customers be more resilient, agile, and sustainable.

As many of you will see at our upcoming Investor Day, we are taking manufacturing to a whole new level and look forward to a great year ahead.

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

Jessica Kourakos

Head of Investor Relations, Rockwell Automation, Inc.

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.

Operator, 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.