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Rockwell Automation, Inc. (ROK)

Q4 2023 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, Abby. Good morning and thank you for joining us for Rockwell Automation's fourth quarter and full year fiscal 2023 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 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 fourth quarter results on slide three. We delivered strong double-digit growth this quarter, with both sales and adjusted earnings growing by over 20% year-over-year. Our solid execution and improving supply chain helped us exceed our Q4 expectations, resulting in double-digit sales growth across all regions and business segments.

With lead times significantly improving across our product lines, we were able to deliver products to customers faster than expected this quarter, contributing to over $2.5 billion in total sales. This record shipment reflects Rockwell's continued capacity investments and demonstrates our organization's ability to scale for sustained growth.

Total sales were up 20.5% versus prior year. Organic sales grew almost 18% year-over-year. Currency translation and acquisitions each contributed about a point and a half of growth in the quarter. Consistent with prior quarters, the split of our sales by business segment, region, and industry was largely driven by the composition of our backlog.

In our Intelligent Devices business segment, organic sales increased 18% versus prior year with strong growth across all regions. Within this segment, Independent Cart Technology had another strong quarter, finishing this fiscal year with over 50% growth in sales. This offering continues to be an integral part of our advanced material handling and production logistics offering. We are excited about our latest addition to this differentiated portfolio with our acquisition of Clearpath Robotics, and I will cover some strategic highlights of this deal later on the call.

Software and Control organic sales grew 23% year-over-year. We continue to innovate in both the software and hardware portions of our architecture, with significant new offerings such as High Availability, Process I/O, FactoryTalk Optix, and FactoryTalk Data Mosaix. We are pleased with how our organic and inorganic investments in this business are delivering new customer value and continued share gains.

Lifecycle Services organic sales were up over 10% year-over-year. Book-to-bill in this segment was 0.97, and above the historical average for Q4. Within this segment, our Sensia joint venture had a strong finish to the year with over 50% year-over-year order growth in the quarter. This growth was driven by strategic wins in process automation and artificial lift control systems, positioning this business for continued double-digit growth and improved profitability in fiscal year 2024.

Information Solutions and Connected Services sales grew 10% versus prior year. One of the largest Information Solutions wins ever was with Prometeon Tyre, a global leader in tire manufacturing, headquartered in Italy. This customer was already using our cloud-native Plex quality management system and has recently selected our on-prem MES software to digitize the manufacturing processes at a number of their global sites. This win not only demonstrates the standalone differentiation of our modular offerings, but also highlights the value from integration of our entire portfolio, making it easier for customers to standardize their global operations.

Within Connected Services, we continued to grow our cybersecurity practice, with Q4 sales growing 30% year-over-year. Our industrial cybersecurity software and expertise along with differentiated partnerships on the IT security front are helping us grow our cybersecurity services into a business of well over $100 million this fiscal year, with a significant portion of this being recurring revenue.

Total Annual Recurring Revenue grew 16% year-over-year. That's a good number, and ARR is a meaningful contributor to our future growth framework. Segment margin of 22.3% was in line with our expectations. Adjusted EPS of $3.64, which is a company record for quarterly earnings, grew almost 20% year-over-year. Significantly improving lead times and our Q4 shipment overperformance contributed to rapid backlog reduction in the quarter. We are ending the year with over $4.1 billion in backlog, over 40% coverage of annual sales, which is still well above pre-pandemic levels. A return to superior customer service remains our highest priority.

Let's now turn to slide four to review key highlights of our Q4 end-market performance.

Our Discrete sales grew over 15% versus prior year. Within Discrete, Automotive sales were up 30% year-over-year, reflecting continued strength of our offerings in both Electric Vehicle and Battery. Our EV business was close to 40% of our total automotive revenue in the quarter, growing double digits both year-over-year and sequentially. One of our strategic Battery wins was with Nanotech Energy, a start-up with new and innovative energy storage technologies. Nanotech has chosen Rockwell as their exclusive automation partner to build new battery gigafactories.

Semiconductor sales grew high single digits. We continue to take share in Facilities Management Control System applications at major semiconductor companies across the globe. In addition to our existing portfolio, we continue to win and build out a strong funnel of advanced wafer transport solutions leveraging our Independent Cart Technology across customers' greenfield and brownfield projects. We are also participating in the rapid build-out of data centers to support cloud computing and Artificial Intelligence. Our control systems are used to control and optimize the environment and safety systems in these facilities, and our recent Cubic acquisition extends our reach into the power distribution portion of data centers. We've seen some strategic wins in Asia and in the U.S. in the quarter, with more to come.

In our eCommerce and Warehouse Automation vertical, sales declined mid-single digits versus prior year. After several quarters of customer delays and cancellations in the eCommerce portion of this vertical, we are starting to see new investments, especially in North America, positioning us for low-single-digit year-over-year growth in fiscal year 2024.

Turning to our Hybrid industries, strong sales in this segment were paced by good growth in Food and Beverage, our largest customer vertical. Food and Beverage sales grew low double digits versus prior year. In addition to continued cybersecurity and infrastructure modernization wins in this vertical, we had several wins in Q4 incorporating Generative AI functionality, where our digital services business is helping our CPG customers use real-time AI assistance as they develop new products, formulations, and recipes.

Life Sciences sales grew mid-single digits in the quarter. This vertical is a great example of how we are delivering expanded customer value through a combination of software, hardware, and digital services capabilities. This quarter, our PlantPax system was selected by BeiGene, a global biotechnology company developing innovative and affordable cancer medicines, for their process control and environmental monitoring solutions at a greenfield site in New Jersey.

Tire was up high teens in the quarter with multiple wins across the globe, including the large software deal at Prometeon Tyre I mentioned earlier on the call.

Moving to Process. Sales in this industry segment grew over 25% year-over-year, led by strong growth in Oil and Gas, Mining, and Metals. Oil and Gas sales were up over 30% in the quarter. This growth was driven by a combination of digital oilfield solutions including process safety and lift control in EMEA and Asia, as well as several new carbon capture wins in North America.

We continue to grow our Process industry footprint with a combination of Sensia and Rockwell oil and gas capabilities. We had a notable win this quarter at Multitex Filtration Engineers, an India headquartered global EPC company working on onshore and offshore projects. This was a competitive DCS win for Rockwell with one of the largest government-owned oil and gas explorer and producers in India, and we are excited to partner with Multitex as they increase their footprint in the U.S. and Middle East.

Turning now to slide five and our Q4 organic regional sales.

Once again, our sales by region in Q4 and for the full year fiscal year 2023 reflect the composition of our backlog rather than the underlying customer demand. Our full-year orders in the Americas outperformed the rest of the world. North America organic sales were up over 12% year-over-year.

Both Latin America and EMEA sales grew over 20% in the quarter, and Asia Pacific was up over 31%. While we saw strong sales growth in China in fiscal year 2023, we continue to see high order deferrals and cancellations in China.

Let's move to slide six for key highlights of fiscal 2023.

We had a record year of sales and earnings, with our total sales exceeding $9 billion. We achieved this milestone ahead of the timeframe we anticipated when we introduced our framework for accelerated profitable growth at Investor Day in 2019. Both reported and organic sales grew 17% this year, well above our original expectations.

Information Solutions and Connected Services were up 9% year-over-year, reaching over $870 million, demonstrating our customers' accelerated adoption of new digital offerings. This is almost three times what this figure was in 2018.

Total ARR grew 16% with strong growth in both our software-as-a-service and recurring services offerings. Our strong operating performance resulted in 140 basis points of segment margin expansion versus prior year. Adjusted EPS of $12.12 was up 28%.

We generated a record $1.2 billion of Free Cash Flow this year. The much better Free Cash Flow conversion in the quarter was primarily driven by improved working capital. This represents 86% Free Cash Flow conversion for the year, and Nick will provide more detail in his remarks.

And last, but not least, we continued to invest in key areas of growth. In the last few months we made two acquisitions, Clearpath and Verve, to further expand our value and accelerate topline growth. While we'll talk more about both investments at our upcoming Investor Day, let's turn to slide seven and take a few minutes to share why we are excited about the impact Clearpath will have on both our near and longer-term growth.

As we've shared with you earlier in the quarter, Clearpath is a leader in autonomous mobile robots, or AMRs, serving customers across many industry segments. Their differentiated portfolio of Otto brand AMRs is focused on the production logistics space, where customers traditionally have relied on manual labor to move raw materials and sub-assemblies to the right place on production lines, and also to move finished goods to shipping docks and warehouses. These workflows have been identified by many automotive companies, semiconductors fabs, and consumer packaged goods suppliers as their top opportunity for efficiency and increased safety.

Given the workforce shortage and skills gap, along with the overall move to more autonomous operations, the market for industrial mobile robots in factory-floor applications is expected to grow over 30% for the next five years, and we believe no one is better positioned to capitalize on this growth than Rockwell and Clearpath.

Together, we are the only end-to-end provider of autonomous operations in this space. We'll bring together our FactoryTalk Design capabilities to configure and simulate the production environment, including these AMRs, integrate with our cloud-native operations management software like Plex and FiiX, and optimize the production process with our Logix and embedded AI capabilities, all with one technology platform. This is an important milestone for Rockwell, and you will see more of what this can do for industrial operations at Automation Fair and Investor Day next week. We closed this acquisition in early October and expect it to contribute about a point of growth to our topline performance in fiscal year 2024.

As we move to slide eight, let's review our fiscal year 2024 outlook.

Consistent with what we shared with you on our last earnings call, our orders continued to decrease through fiscal year 2023, reaching what we believe to be a trough in our fourth quarter. Orders for the full year were $8.2 billion. We expect fiscal year 2024 orders to increase low single digits year-over-year.

Order growth is expected to be highest in the Americas. Asia orders are expected to be down year-over-year due to China. However, our relatively low exposure to China helps reduce the impact on our global results. The lead times on our products have largely returned to pre-pandemic levels, with the remainder of our SKUs getting back to normal lead times around the end of our fiscal Q1. This addresses the final 'golden screw' constraints to shipping past due backlog and clearing "committed inventory" at our distributors.

Based on our analysis of lead time reduction by product line, distributor inventory, and underlying demand at our largest machine builders and end users, we expect orders to begin to recover in Q1 and build in Q2.

Customers continue to move forward with plans for both greenfield and brownfield capacity investments, and also with resilience projects requiring increased cybersecurity and digitization. In the U.S., we've been adding commercial resources specifically focused on projects that are incented by recent stimulus authorized by legislation including Infrastructure, IRA, and the CHIPS and Science Act. This team won new business during the second half of fiscal year 2023, with a strong funnel of additional projects expected to close in fiscal year 2024.

Our fiscal year 2024 guidance assumes total reported sales of about $9.4 billion at the midpoint. Organic sales are projected to grow 1% at the midpoint. Currency is expected to increase sales by 1.5% and acquisitions are slated to contribute about a point of growth.

We are projecting ARR to have another year of double-digit growth. Segment margin is expected to increase slightly versus prior year. Nick will cover this in more detail later.

Adjusted EPS is slated to grow 5% year-over-year at the midpoint. At a high level, we expect strong conversion on slightly higher year-over-year organic sales. Good performance in reducing backlog during Q4 of fiscal year 2023 pulled forward about $100 million of revenue and $0.25 of earnings. Clearpath is expected to reduce fiscal year 2024 adjusted earnings by a similar amount.

Let me turn it over to Nick to provide more detail on our quarter four performance and financial outlook for fiscal year 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 9, fourth quarter key financial information.

Fourth quarter reported sales were up 20.5% over last year. Q4 organic sales were up 17.7% and acquisitions contributed 140 basis points to growth. Currency translation increased sales by 140 basis points. About 6 points of our organic growth came from price.

Segment operating margin was 22.3% and compared to 23.3% a year ago. The year-over-year decrease reflects the impact of higher sales volume and higher price being more than offset by higher incentive compensation, investment spend, and restructuring actions.

Adjusted EPS of $3.64 was above our expectations primarily due to higher organic sales, partially offset by higher investment spend and incentive compensation. We also took a restructuring charge in the quarter of just over $20 million, which is expected to yield more than $40 million of benefit on an annualized basis. All in, Adjusted EPS grew 20% versus 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 17%, slightly below the prior year rate. Free Cash Flow of $776 million was $417 million higher than prior year. Our strong free cash flow generation in the quarter was driven by higher income and reductions in working capital. As you know, due to supply chain volatility, we have seen working capital balances grow over the last couple of years, and we are pleased to see our actions starting to bring working capital down.

One additional item not shown on the slide, we repurchased approximately 200,000 shares in the quarter at a cost of $55 million. On September 30, $900 million remained available under our repurchase authorization.

Slide 10 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.

Given our pay-for-performance culture and strong results, all of our business segments saw higher bonus expense this year. In Q4, this represented between 200 and 300 basis points of year-over-year margin headwind for each of the segments.

Intelligent Devices margin decreased by 100 basis points year-over-year and was up 450 basis points sequentially because of higher volume. Within Intelligent Devices, we are investing in our next generation portfolio of drives and IO.

Software & Control margin of 33.5% decreased 100 basis points year-over-year. Our strong Q4 margin was driven by 25% year-over-year topline growth. This is the segment with the highest share of incremental investments as we continue to invest in next generation Logix performance and our cloud-native software portfolio.

Lifecycle Services margin of 8.4% was under the 10% exit rate we anticipated. In addition to a higher bonus, this segment was the most impacted by the restructuring charges taken in the quarter. Absent those two items, the margin for this segment came in as we planned.

Before moving to the Adjusted EPS walk, I'd like to talk about our Sensia joint venture. Challenged by the pandemic and global supply chain constraints, this joint venture underperformed our initial expectations for 2020 through 2023. Our updated outlook, which includes this lower base, resulted in a partial goodwill impairment in the fourth quarter.

Sensia's one-time items and supply-chain related inefficiencies in recent quarters are largely behind us. Sensia delivered double-digit topline growth in fiscal 2023 and has strong orders growth, as Blake mentioned. Going forward we expect profitable double-digit growth from Sensia.

The next slide, 11, provides the Adjusted EPS walk from Q4 fiscal 2022 to Q4 fiscal 2023. Core performance was up $1.05, on a 17.7% organic sales increase. Incentive compensation was a $0.45 headwind. This year-over-year increase reflects the higher bonus payout this year versus a below-target payout last year. The year-over-year impact from currency was a $0.05 headwind, offset by a $0.10 tailwind from interest expense. Share count and tax rate were each immaterial to the year-over-year change in EPS this quarter.

Slide 12 provides key financial information for the full fiscal year 2023. Reported sales grew 17% to $9.1 billion, including over one point coming from acquisitions. Currency negatively impacted sales by approximately $100 million or 1.4 points. Organic sales were up 17%.

Full-year segment margin of 21.3% increased 140 basis points over last year. The increase was due to higher sales, partially offset by higher investment spend and higher incentive compensation. We accelerated growth investments for fiscal year 2023 above our original expectations as our revenue outperformed. Adjusted EPS was up 28%. A detailed year-over-year Adjusted EPS walk can be found in the appendix for your reference.

As discussed earlier, free cash flow conversion was ahead of our expectations with free cash flow conversion of 86% in fiscal 23. Free Cash Flow increased $532 million from fiscal 2022. The increase in Free Cash Flow was driven by higher pre-tax income. Working capital peaked in Q3 at 24% of sales and came down to 20% in Q4. Return on Invested Capital was 20.9% for fiscal year 2023 and 570 basis points better than the prior year, primarily driven by higher net income.

For the year, we deployed about $850 million of capital towards dividends and share repurchases and made inorganic investments of $170 million. We also paid down debt by about $870 million. Our capital structure and liquidity remain strong. This strength is what allowed us to fund our acquisitions in the first quarter of fiscal year 2024 without any new long-term debt.

Before we turn to our fiscal 2024 guidance, we want to update you on Q4 orders and our current thinking as we look forward. In Q4 orders decreased quicker than we expected as machine builders and distributors continued to work through inventory in response to our rapidly improving lead times. As Blake said, we believe Q4 was the trough, and orders in October support that view. We expect fiscal year 2024 orders to grow low-single digits, with an order profile similar to what we discussed in Q3.

Let’s now move on to the next slide, 13, guidance for fiscal 2024.

In fiscal year 2024 we’re focused on growing earnings even in a year of low top-line growth. At the same time, we’ll continue to invest in our own resilience, in our most important innovation projects to extend our differentiation, and in customer-facing resources to capitalize on continuing strong secular demand for automation.

We expect our reported sales growth to range from 0.5% to 6.5%. We expect organic sales growth in the range of negative 2% to positive 4%. We expect acquisitions to add 100 basis points to growth in addition to a full-year currency tailwind of 150 basis points.

From a segment perspective, given our exceptionally strong backlog execution in Software & Control that resulted in 25% topline growth in fiscal year 2023, we expect this segment to see the lowest growth in fiscal year 2024. We expect positive organic sales growth in both our Intelligent Devices and Lifecycle Services segments. We expect price will be a positive contributor to growth for the year.

Segment margin will be around 21.5%, up slightly from fiscal year 2023. This includes a 60-basis point headwind coming from the acquisitions of Clearpath and Verve. Verve's impact to Adjusted EPS is relatively flat in FY24. Clearpath will reduce EPS in fiscal year 2024 by $0.25 on an unlevered basis. This impact reflects continued R&D and commercialization investments as well as integration expenses. We expect the Clearpath acquisition to become accretive to earnings in fiscal year 2026.

We expect the full year Adjusted Effective Tax Rate to be around 17.0%. Our Adjusted EPS guidance range is $12.00 to $13.50.

We expect full-year fiscal 2024 Free Cash Flow conversion of about 100% of Adjusted Income. This reflects our expectation that inventory days on hand will drop to ~125 days by the end of fiscal year 2024 compared to the ~140 days of inventory we had at the end of fiscal year 2023. Our outlook for cash tax payments is higher due to a tax payment for realized capital gains on the sale of our stake in PTC, and higher tax payments required under the tax cuts and jobs act. We expect free cash flow conversion in the first half to be well below 100%, mostly tied to the timing of our incentive compensation payout and income tax payments.

From a calendarization perspective, we expect year-over-year organic sales to grow in the low single digits in Q1 followed by sequential growth in sales volume as we progress through the year. As a result of our strong Q4 backlog performance, volumes will be down from Q4 to Q1. Given this dynamic, Q1 is projected to be our lowest margin quarter, with sequential improvement throughout the year.

For the full year, let's turn to slide 14, for our Adjusted EPS walk.

Our Core is expected to have a modest positive impact on earnings of about $0.05 from fiscal year 2023 to fiscal year 2024 Structural productivity from our Q4 actions is expected to increase earnings by $0.25 while increased growth investments will reduce earnings by $0.55.

Incentive compensation for fiscal year 2023 was above target due to strong performance, so this represents a tailwind of $0.85 for fiscal 2024. Acquisitions will be dilutive by $0.25. Our 150 basis points of sales growth from currency will add $0.25. The net of interest, tax, and shares will contribute about $0.05.

A few additional comments on fiscal 2024 guidance. Corporate and Other expense is expected to be around $120 million. Net Interest expense for fiscal 2024 is expected to be about $115 million. We're assuming average diluted shares outstanding of 115.3 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 Moret

Chairman & Chief Executive Officer, Rockwell Automation, Inc.

Thanks, Nick. As I reflect on 2023, it's clear our continued investments in talent and technology are paying off. I'm proud of how our tight-knit organization has navigated through a dynamic environment and helped us deliver a record year of sales and earnings, exceeding expectations.

Looking at the year ahead of us, we are aware of the macroeconomic backdrop and the geopolitical situation that continues to change every day. You heard us talk today about focusing and optimizing our workforce for further productivity so that we can continue investing in key areas of growth.

Our customers rely on our continued innovation and differentiation to provide energy and critical infrastructure security across the globe, to help bring new life-saving drugs to market, and to use leading technology to augment and enable their workforce.

We look forward to seeing a lot of you at our Investor Day in Boston next week, where we will be sharing our long-term business strategy and some of the most exciting developments across our key markets and applications.

Aijana will now begin the Q&A session.

Aijana Zellner

Head of Investor Relations & Market Strategy, 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. Abby 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.