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Rockwell Automation, Inc. (ROK)

Q1 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, Julianne. Good morning and thank you for joining us for Rockwell Automation's first quarter 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 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 3. I'm pleased with our team's exceptional focus and execution as we delivered another quarter of strong growth and profitability. Organic sales and earnings were both up year-over-year, and better than we expected this quarter. Rockwell's continued investments in resiliency and agility, along with a gradually improving supply chain environment, helped more than offset many of the headwinds we faced heading into Q1.

Orders and backlog were up sequentially in the quarter. Order cancellation rates were flat to prior quarter and remain in the low-single-digits through January. We are encouraged by the continued strength of our end user demand across all business segments and regions.

Total sales grew almost 7% versus prior year. Organic sales were up 10% year-over-year, better than our expectations despite a very dynamic supply chain environment. Currency translation reduced sales by 4%, and acquisitions contributed about a point of growth this quarter. Consistent with our prior assumptions, the split of sales by business segment, region, and industry, was impacted by access to specific electronic components and the composition of our backlog.

In the Intelligent Devices business segment, organic sales increased about 7% versus prior year, with growth in all regions and product lines. We had another quarter of remarkable order growth in our Independent Cart Technology business, driven by large multi-year deals across many industries, including EV, material handling, and semiconductor. I'll cover some of these strategic wins in a few minutes.

Software & Control organic sales grew almost 16% versus prior year. Better than expected growth was driven by our team's ability to quickly redesign and requalify certain Logix products to secure additional component supply, with the support from key suppliers. We also continue to see a gradual improvement in electronic component supply.

Lifecycle Services organic sales were up 10% year-over-year. Book-to-bill in this segment was a healthy 1.21 and was consistent across solutions, services, and Sensia businesses.

Information Solutions & Connected Services sales had another quarter of double-digit year-over-year growth. We are seeing a significant uptick here in large multi-site and multi-year deals, both in software and services.

One of our Information Solutions wins this quarter was with a leading potato processing company, where a combination of our Kalypso digital consulting and enterprise analytics capabilities helped the customer increase throughput and reduce energy costs across multiple production lines. We are proud to be an important digital partner to this global company as they focus on doubling their revenue over the next five years.

Our recent software acquisitions continue to land us new logos across various industries and regions. These include Plex wins in Metals, Food & Beverage, and Automotive, and numerous enterprise asset management wins with Fiix's cloud-native offering in Asia, where we are leveraging the distribution network to amplify our sales with local customers.

On the Connected Services side, we continue to build momentum with enterprise cybersecurity wins, with customers across Food & Beverage, Life Sciences and Consumer Packaged Goods prioritizing their investments in resiliency of their operations.

One of our key cyber wins this quarter was with one of the world's largest global consumer goods companies, who chose Rockwell's differentiated portfolio of hardware, software and services, along with the capabilities of our partner Claroty, to manage OT security at hundreds of their sites globally. This multi-year deal will also contribute to our double-digit growth in Annual Recurring Revenue. Q1 ARR grew 14%. Segment margin of 20% was up over 100 basis points year-over-year and was better than expected. Adjusted EPS grew 15% year-over-year.

Let's now turn to Slide 4 to review key highlights of our Q1 end-market performance. All three industry segments saw strong year-over-year growth and were above expectations, consistent with the continued gradual improvement in electronic component availability.

In our Discrete industries, sales were up low teens. Within discrete, Automotive sales were up 25% versus prior year. We continue to win new and follow-on orders with both the brand owners and the supporting EV ecosystem, including vehicle and battery OEMs and system integrators.

A good example of Rockwell's strong position in EV this quarter is our win with a leading battery supplier. Our Independent Cart Technology was selected for the battery cell assembly and formation process to support Ford's Blue Oval greenfield plants in Kentucky and Tennessee. We talked about our strategic partnership with Ford at our Investor Day last November, and we are excited about the progress we are making together.

Semiconductor sales grew over 20% versus prior year. This is another vertical where we are able to expand our offering to new applications, including Independent Cart for wafer transport and Logix-based automation for silicon carbide wafer manufacturing.

In eCommerce and Warehouse Automation, our sales were down low teens versus prior year. Some of our largest eCommerce customers are in the process of shifting their investment from greenfield to brownfield, and we expect continued investments in upgrading existing facilities, including next gen sortation systems, over the course of this fiscal year.

One of our large multi-year wins in eCommerce this quarter was with CMC, a leader in smart solutions for sustainable packaging. Rockwell's smart machine architecture, which includes our full portfolio of hardware and software, will help CMC produce its innovative on-demand packaging at scale.

Another important win in the quarter was with Phononic, a technology company focused on unique heating and cooling systems. This customer is working with our Kalypso team to create the cloud and IoT infrastructure necessary to support Phononic's disruptive design for cold chain solutions in warehouse applications.

Moving to our Hybrid industry segment. Sales in this segment grew low teens year-over-year, led by strong growth in Food and Beverage. Food and Beverage sales were up over 15% versus prior year. As I mentioned earlier, we saw a number of large cybersecurity wins in this vertical, underscoring customers' focus on resiliency and security in their operations.

Life Sciences sales grew mid-single digits in the quarter. In addition to software, we saw a high number of cybersecurity wins in this end market this quarter, with several important wins coming from Europe. Tire was also up mid-single digits in the quarter.

Let's turn to Process. This segment grew mid-single digits versus prior year, led by growth in Metals and Oil & Gas. We rarely talk about our Metals vertical, but we had an important sustainability win with Cornish Lithium, a pioneering mineral exploration and development company, who chose Rockwell's PlantPAx process control system for its demo plant to convert lithium concentrate into high-grade refined lithium used for battery production. We are excited to partner with Cornish Lithium on this energy transition journey.

Turning now to Slide 5 and our Q1 organic regional sales. Similar to last fiscal year, our performance here is a reflection of electronic component availability rather than the underlying customer demand.

North America organic sales grew 8% year-over-year. Latin America sales were up 6%. EMEA sales increased by over 13%, and Asia Pacific was up 16%.

Let's now move to slide 6, fiscal 2023 outlook. Given our Q1 performance, our record backlog, and a gradually improving supply chain, we are increasing our topline and bottom-line outlook for fiscal 2023. While we are encouraged by the improving electronic component landscape, the macroeconomic environment is still very dynamic, and we continue to take a conservative approach in our operations.

Our fiscal 2023 guidance projects total reported sales growth of 12%. Organic sales growth of 13% at the midpoint assumes continued supply chain improvement. The majority of our fiscal 2023 shipments are already in backlog.

We continue to expect acquisitions to contribute a point of profitable growth, and currency to be a headwind of about two points. Nick will touch more on this later.

ARR is still expected to grow 15%. Segment margin is expected to increase by over 100 basis points year-over-year. Adjusted EPS is expected to grow 17% versus prior year, and we continue to target 95% Free Cash Flow conversion.

Let me turn it over to Nick to provide more detail on our Q1 performance and financial outlook for fiscal 2023. 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 6.7% over last year. Q1 organic sales were up 9.9% and acquisitions contributed 80 basis points to total growth. Currency translation decreased sales by 4 points. About 7 points of our organic growth came from price.

Segment operating margin expanded to 20.2% and was significantly higher than our expectations. The majority of our margin improvement versus our expectations was driven by the higher revenue from the redesign activity and improved electronic component availability that Blake discussed earlier. The 110-basis point year-over-year increase in margin was driven by positive price/cost and higher sales volume, partially offset by higher investment spend.

Corporate and Other expense was $27 million, in-line with our expectations. Adjusted EPS of $2.46 was ahead of our expectations and grew 15% versus 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 17.1%. This was in-line with our expectations and aligned with our full year estimate of an 18% Adjusted Effective Tax Rate.

Free Cash Flow of $42 million was $91 million higher compared to last year driven by higher pre-tax income. As in recent quarters, working capital continued to grow sequentially. We expect one more quarter of working capital increases this year. We expect working capital balances to decline slightly in the second half of the year as our supply chain gradually improves.

One additional item not shown on the slide; we repurchased approximately 600,000 shares in the quarter at a cost of $156 million. On December 31st, $1.1 billion remained available under our repurchase authorization.

Slide 9 provides the sales and margin performance overview of our three operating segments. Organic sales grew double digits in Software & Control and Lifecycle Services, with Intelligent Devices growing 7% year-over-year.

As Blake mentioned earlier, orders grew sequentially in Q1 as we saw healthy demand driven by continued strong project activity with our customers. We continue to see customer ordering patterns consistent with the longer lead times we have for portions of our portfolio. We expect further normalization of ordering patterns as lead times in different products improve.

Turning to margins, Intelligent Devices margin declined by 130 basis points year-over-year due to higher resiliency spend and an unfavorable currency impact, partially offset by positive impact from higher price/cost.

Segment margin for Software & Control increased 630 basis points compared to last year, on positive price/cost, the favorable year-over-year impact of Plex, and higher sales.

Lifecycle Services margin was roughly flat year-over-year. Similar to FY2022, we expect Lifecycle Services margin to expand through the balance of the year.

The next slide, 10, provides the Adjusted EPS walk from Q1 fiscal 2022 to Q1 fiscal 2023.

Core performance was up $0.55 on a 9.9% organic sales increase. The impact of currency was a $0.15 reduction in earnings per share, which was slightly better than our expectation. The year-over-year impact was due to a stronger US dollar.

Incentive compensation was a $0.10 headwind, slightly more than our original plan, and driven by our increased growth and earnings expectations for the year. Our higher Adjusted Effective Tax Rate was a $0.05 headwind. Our reduction in outstanding shares added about $0.05.

Let’s move on to the next slide, 11, guidance for fiscal 2023.

We are increasing our reported sales guidance to about $8.7 billion in fiscal 2023, or 12% growth at the midpoint. We expect organic sales growth to be in a range of 11% to 15%, or 13% at the midpoint of our range. We expect volume to be 9 points of growth and price to be 4 points of growth. This guidance takes into account our Q1 outperformance and is based on our current view of electronic component availability and the rate at which we can deliver on our backlog.

By quarter, we expect organic growth rates in Q2 and Q3 to be the highest of the year, with each up in the mid-to-high-teens year-over-year, while Q4 revenue is expected to grow organically single digits. While we expect sales to be up sequentially in Q2, we expect margins to be similar to Q1 levels due to higher sequential spend on new product development, resiliency, and the timing of our annual merit increase.

We now expect a full-year currency headwind of 200 basis points, which is 50 basis points better than our previous guidance. This updated outlook primarily reflects the strengthening of the euro against the US dollar.

We expect full-year segment operating margin to be about 21%, up from prior guidance of about 20.5%. We continue to expect positive price/cost for the full year, with most of the favorability coming from the price actions we took in fiscal 2022. As expected, the majority of our year-over-year price/cost benefit this year is coming in the first half of the year.

Our updated guidance now assumes full year core earnings conversion of around 35%. We continue to expect the full year Adjusted Effective Tax Rate to be around 18%. We are increasing our Adjusted EPS guidance to $10.70 - $ 11.50. At the midpoint of the range, this represents 17% Adjusted EPS growth, up from the prior guidance of approximately 12% at the midpoint. We expect full-year fiscal 2023 Free Cash Flow conversion of about 95% of Adjusted Income.

A few additional comments on fiscal 2023 guidance. Corporate and Other expense is still expected to be around $120 million. Net interest expense for fiscal 2023 is now expected to be about $130 million. We're assuming average diluted shares outstanding of 115.4 million shares. We've also included on slide 12 an Adjusted EPS walk from our previous guidance to our current guidance at the midpoint, for your reference.

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. In this dynamic environment, we are positioning ourselves and our customers for a more resilient, agile, and sustainable future. Automation has never been more important in solving our customers' biggest challenges.

A large percentage of these global investments are being made in the U.S., where we have the strongest market share, the best channel, and decades-long relationships. Shoring is real for many of our most important verticals, and we see these investments along with the early benefits of the Inflation Reduction Act reflected in our continued strong order rates.

We are accelerating the pace of our innovation, including new product introductions across all key product platforms and our recent acquisitions. These were showcased at our very successful Automation Fair in Chicago, where we welcomed over 18,000 customers, partners, and employees to an amazing demonstration of the value provided by Rockwell and our friends. I was also able to meet our new Cubic team in Denmark a few weeks ago, and I am excited about the new opportunities to expand our sustainability portfolio with an increased presence in renewables, Cubic's largest customer segment.

Importantly, I'm happy with how our culture is both embraced and enriched by our recent additions, and I'm excited to see how we deliver strong growth and new customer value together in the years to come.

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. Thank you. Julianne let's take our first question.

Q&A Session

Aijana Zellner

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

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