07 – August – 2024

Rockwell Automation, Inc. (ROK)

Q3 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 third 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. Before we turn to our third quarter results, I'll make some initial comments.

As we saw in Q2, operational performance continued to be strong in our third quarter, but order growth continued to ramp at a slower than expected pace. Our accelerated actions to bring costs in line with the lower outlook on current year orders contributed to the strong margin performance in the quarter, and we are well into the more comprehensive program to expand margins introduced during our Investor Day last November.

We continue to expect savings of $100 million in the second half of this year from accelerated actions taken this fiscal year, which will create a good starting point for FY25. Based on actions taken in the last twelve months, our worldwide headcount is down 6% since Q2, and most others who will be affected have been notified. We will see incremental savings of $120M next year from these actions alone, plus a larger amount of additional savings from the more comprehensive program, as I'll discuss in a few minutes.

We've announced our new CFO, Christian Rothe, who starts in two weeks and is excited to begin. Christian brings a successful track record and will work with me and the rest of the team to combine market-beating growth and financial performance in a consistent longer-term model, based on the targets introduced last November, to create significant shareowner value.

Turning to specific results in the quarter. Q3 orders were up low single digits, both year-over-year and sequentially, with growth across all regions. However, while our distributors and machine builders are making progress on working down their excess inventory, their orders to us came in lower than expected in the quarter due to weaker end user demand. As a result, we are projecting a more gradual sequential order growth in Q4 and into fiscal year 25 than we had previously expected.

We had another quarter of strong execution with sales, margins and EPS all exceeding our expectations. Total and organic sales were down 8.4% versus prior year. Organic sales came in better than we expected, with strong backlog execution in our longer cycle businesses, including Lifecycle Services and the configured-to-order products in Intelligent Devices.

Organic sales in our Intelligent Devices segment were down by about a point versus prior year. We continue to see a solid pipeline of projects across all product lines, including good opportunities involving Clearpath's Otto mobile robots and Cubic data-center solutions.

In Software & Control, organic sales declined over 31% year-over-year, compared to 24% growth in Q3 of last year. Sales in this segment were still better than expected, driven by better Logix recovery as machine builders reduced their inventory. We also saw good growth in our software business, including both on-prem and cloud-native offerings. For example, in the quarter we had over 150 new logos for our recently launched FactoryTalk Optix portfolio. This reinforces the importance of continued investment in innovation and new product introduction as we continue to redeploy and prioritize our spend towards areas of highest growth and strategic importance. We've talked a lot about cost savings during this challenging year, but we're taking great care to preserve the investments that will enable us to continue to grow share.

Lifecycle Services had another strong quarter, with organic sales up over 11% year-over-year, driven by continued relative strength in process end markets and strong execution of our project backlog. Book-to-bill in this segment was 1.0. We did see some additional project delays, especially affecting our Solutions orders. Some manufacturing customers are taking a pause in making large capacity investments as they deal with slower consumer demand, high interest rates, and policy uncertainty around tax, tariffs, and stimulus incentives. Even so, our customers are still investing in their operational resilience, reflected by continued double-digit sales growth of our recurring managed services.

Total ARR for the company was up a strong 17% this quarter. Segment margin of 20.8% and Adjusted EPS of $2.71 were well above our expectations. We are making good progress on driving productivity across the enterprise, and we are seeing the benefits of these actions with over $40 million of savings in Q3 alone.

Turning to slide 4 to review key highlights of our Q3 industry segment performance. Last quarter we talked about some project delays and end user capex slowdown in parts of our business, namely Automotive and Food & Beverage. We saw project delays across a broader group of industries this quarter, which will impact our end market performance through the end of the fiscal year.

Sales in our Discrete industries were down high single digits versus prior year, with declines in Auto and Semi being partially offset by year-over-year growth in Warehouse Automation. Within Discrete, Automotive sales declined high teens versus prior year. Brand owners are delaying more EV programs as they continue to re-assess their product strategy in light of slower consumer adoption and policy uncertainty in the U.S.

Semiconductor sales were down high teens. We continue to see delays in new capacity builds and the associated tooling, due in part to questions about the timing and certainty of CHIPS funding disbursements. eCommerce and Warehouse Automation sales grew high teens versus prior year, led by strong double-digit growth in North America. We continue to see a broad-based recovery at our end user and machine builder customer segments.

Moving to Hybrid, sales in this industry segment were down mid-teens, driven by year-over-year declines in Food & Beverage and Life Sciences. Food & Beverage sales decreased mid-teens in the quarter. Producers in certain segments of the Food & Beverage market, like baking and snacks, are seeing inflationary headwinds as consumers shift from high-end brands to more affordable labels. We are seeing less greenfield activity, but we do continue to see high demand for software and services that optimize processes to increase efficiency. Life Sciences sales were down high teens. Similar to Food & Beverage, customers in Life Sciences are prioritizing investments in their operational resilience and infrastructure.

In the quarter, we had important wins with two leading pharmaceutical companies. The life science business of Merck KGaA, Darmstadt, Germany, which operates in the U.S. and Canada as MilliporeSigma, selected Rockwell to assess the company's current plant infrastructure and help enhance the digital connectivity and cybersecurity resilience of operational assets.

Another important Q3 win in Life Sciences was with AstraZeneca. Together with our partner Claroty, we are helping the customer identify and monitor plant assets, detect threats, and integrate internal services and systems to provide a comprehensive global cyber platform for all of their OT environments.

Process sales were mixed across the individual vertical markets. Overall, sales were about flat year-over-year, with growth in Oil & Gas and Mining offset by declines in Chemicals and Metals.

Oil & Gas sales grew low-single-digits this quarter. Within this segment, our Sensia JV sales grew double digits versus prior year with good growth in process automation and digital solutions offerings. And while we continue to win business in the energy transition space, we did see some North America project pushouts tied to customers wanting to understand potential policy changes that may occur after the U.S. elections in November.

In Mining, our sales increased high-single-digits versus prior year. Our growth in the quarter was driven by continued double-digit growth in Latin America. Here, Rockwell was chosen to integrate an end-to-end solution for Vale's new processing plant, as this customer looks to increase production capacity, reduce water consumption, and enhance cybersecurity infrastructure. This is a great example of how Rockwell brings our hardware, software, and services together to deliver differentiated value for our end users.

Let's turn to slide 5 and our Q3 organic regional sales. The Americas continue to outperform the rest of the world, with North America sales flat year-over-year in the quarter and Latin America sales up almost 19%.

EMEA sales were down 28% with continued macroeconomic challenges across Germany, Italy, and France impacting end user demand. Despite these headwinds, we continue to make progress with our European machine builders to gain share in the end user market. In the quarter, IMA Group, an Italian-based leader in designing and developing packaging machines, has sold over a dozen machines equipped with our Rockwell platform, by recognizing the technical advantage of our motion control capabilities, coupled with the time to market provided by our integrated architecture solution. Their end user, who is based in Germany, is now looking to adopt Rockwell as its preferred choice in all future commissions.

Asia Pacific sales declined 22%. In addition to continued inventory destocking and economic challenges in China, we saw incremental headwinds from EV battery project delays in Korea this quarter.

Moving to slide 6 for our fiscal 2024 outlook. While our orders are improving sequentially, they are progressing at a more gradual pace than we anticipated. We believe this is largely tied to a pause in new capacity investments as manufacturers focus on cost control and operational efficiency, waiting for a potential reduction in interest rates and broader U.S. policy changes.

Therefore, we are reducing our FY24 guidance to reflect this gradual pace of orders growth. Taking into account our order progression through early August, we now expect Q4 orders to be up low-single-digits sequentially. With that, we expect our organic sales to decline 10% for the year. We continue to expect acquisitions to contribute about a point and a half of growth, and we expect currency to be about neutral for the year. Total ARR is expected to grow about 15% and will exceed 10% of total Rockwell sales this year.

We now expect our segment margin to be slightly over 19% for the year. While this represents about a 200-basis point decrease versus last year, it also shows the improving resilience of our business model. Adjusted EPS is slated to decline 21% versus prior year. We expect Free Cash Flow conversion of 60%. Nick will cover this in more detail in his section.

Before I turn the call over to Nick, I'd like to spend a few moments on slide 7 to discuss the progress we are making in setting the foundation for long-term productivity and margin expansion.

We already talked about the accelerated actions we are taking in the second half of this fiscal year to drive efficiency and scale across our entire company, and we remain committed to delivering $100 million of savings this year and $120 million of incremental savings in fiscal year 25, mainly targeted at reducing our SG&A spend.

We will continue to optimize our general and administrative spend through a targeted approach, although the majority of additional productivity and margin expansion will be realized as a result of reductions in our cost of sales. As you can see from this chart, we expect to save another $130 million in fiscal year 25 through additional margin expansion and productivity projects, bringing our total fiscal year 25 year-over-year savings to roughly $250 million.

You can see the broad list of actions and programs that are under way to realize these targets. These productivity projects include savings in the areas of product cost, indirect material, purchased services, logistics, manufacturing workflow, make or buy decisions, portfolio optimization through SKU reduction, and price.

We look forward to our new CFO, Christian Rothe's additional perspective as we maximize the effectiveness of this program in fiscal year 25 and preserve it as a foundational part of our operating model going forward, regardless of the top-line growth in any particular year.

Let me now turn it over to Nick to provide more detail on our Q3 performance and financial outlook for fiscal 24. 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, Third Quarter Key Financial Information. Third quarter reported and organic sales were down 8.4% compared to last year. Acquisitions contributed 60 basis points to total growth. Currency translation decreased sales by 60 basis points. About 350 basis points of organic growth came from price this quarter.

Segment operating margin was 20.8% compared to 21.1% a year ago. Margin performance in the quarter reflects lower sales volume and unfavorable mix, largely offset by positive price/cost, lower incentive compensation, and the benefits from cost reduction actions we announced on our last earnings call.

Adjusted EPS of $2.71 was higher than expectations driven by better revenue, mix, and savings from our cost actions. I'll cover a year-over-year Adjusted EPS bridge on a later slide.

The Adjusted Effective Tax Rate for the third quarter was 13.3%, benefitting from discrete tax items, and below the prior year rate. Free Cash Flow was $238 million compared to $240 million in the prior year. Our lower year-over-year free cash flow generation in the quarter was driven by lower pre-tax income but was mostly offset by lower working capital, which improved for the second consecutive quarter but at a slower rate than anticipated.

One additional item not shown on the slide, we repurchased approximately 600,000 shares in the quarter at a cost of $160 million. On June 30, $500 million remained available under our repurchase authorization.

Slide 9 provides the sales and margin performance overview of our three operating segments.

Intelligent Devices margin increased to 20.2% compared to 16.8% a year ago. The increase from the prior year was driven by positive price/cost, lower incentive compensation, and our cost reduction actions, partially offset by lower sales volume.

Software & Control margin of 23.6% decreased from 34.8% last year. The lower margin was driven by lower sales volume partially offset by positive price/cost, lower incentive compensation, and our cost reduction actions. As Blake mentioned earlier, Software & Control margin exceeded our expectations this quarter with better performance in Logix sales.

Lifecycle Services margin of 19.3% more than doubled from the year-ago margin of 9.3%. The margin performance was driven by lower incentive compensation, higher sales, continued strong project execution and ongoing savings from the prior year structural actions. Lifecycle Services book-to-bill was 1.0.

The next slide, 10, provides the Adjusted EPS walk from Q3 fiscal 2023 to Q3 fiscal 2024.

Core performance was down $0.80, on an 8.4% organic sales decline. The EPS decline was driven by lower volume and unfavorable mix and was partially offset by positive price/cost. Cost reduction actions contributed $0.30 to the year-over-year increase. Incentive compensation was a $0.40 tailwind. This year-over-year increase reflects no projected bonus payout this year versus an above-target payout last year. The dilution impact from acquisitions was $0.10 and currency was a $0.15 headwind. Share count, interest expense, and tax were a combined $0.05 tailwind.

Let's now move on to the next slide, 11, guidance for fiscal 2024.

We are lowering our guidance for fiscal year 24. We now expect reported sales to decline by about 8.5% and organic sales to decline about 10%. As Blake mentioned earlier, we continue to expect acquisitions to add 150 basis points to growth. And now expect currency to be neutral for the year on continued strength in the US dollar. We continue to expect price to be a positive contributor for the year. We now expect the full year Adjusted Effective Tax Rate to be around 16%. We are lowering our Adjusted EPS guidance to $9.60, down 21% year-over-year.

With lower sales, our improvements in inventory days will be delayed and we now expect to end fiscal year 24 with 160 days of inventory. As a result, we expect full-year Free Cash Flow conversion of about 60% of Adjusted Income. Our Free Cash Flow conversion for the year also reflects several non-recurring headwinds including our second half restructuring actions, the timing of our cash bonus payout, and tax payments for both the TCJA transition tax and on our prior year PTC gain.

From a topline perspective, we expect flat sequential sales in Q4 in each of our business segments. Sequentially, we expect margins in Q4 to be about 100 basis points lower than in Q3. By segment, we expect our Q4 margin in Intelligent Devices to decline about 100 basis points and Lifecycle Services margin to decline about 200 basis points sequentially. In both segments we expect the decline to be driven by a less favorable mix. We expect margin in Software & Control to be similar to Q3.

A few additional comments on fiscal 2024 guidance. Corporate and Other expense is still expected to be around $130 million. We're assuming average diluted shares outstanding of 114.5 million shares. We still expect to deploy between $600 and $800 million to share repurchases during the year. Net Interest Expense for fiscal 2024 is now expected to be about $140 million.

Before I pass it on to Blake, I'd like to talk about how actions we're taking this year are going to benefit our results in fiscal 2025 and beyond. As you heard earlier, we expect our productivity and margin expansion actions to provide about $250 million in year-over-year benefit next year. These are expected to offset compensation headwinds next year, which includes merit increases and the reinstatement of incentive compensation.

The $250 million in benefits is split about equally between improvements in gross margin and the reductions in SG&A. We expect R&D spending next year to remain similar as a percentage of sales as we continue to invest in areas of highest growth.

With my upcoming retirement I'd like to thank Blake for this opportunity and to thank all of you for your engagement over the last several years. Thank you.

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. This will be Nick's last earnings call with us. I'd like to thank him again for his commitment to Rockwell's mission over the last few years. He is working closely with Christian for a smooth transition, and we wish Nick and his family the very best in retirement.

Christian will join me in leading the fourth quarter earnings call and Investor Day in November.

As always, Investor Day takes place during our annual Automation Fair. Last year over 8,500 customers, distributors, partners, and investors joined us in Boston.

Registration opens tomorrow for the 2024 event in Anaheim, California, which takes place during the week of November 18. This year the fair offers an expanded four days of show floor access, showcasing major new hardware, software, and services offerings.

Rockwell's technology portfolio, domain expertise, and unmatched ecosystem uniquely position us to help customers in our home market of North America and around the world, and we look forward to seeing you in Anaheim in just over three months.

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.