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Rockwell Automation, Inc. (ROK)

Q4 2024 Earnings Call – Prepared Remarks

Corporate Participants

Blake Moret, *Chairman & Chief Executive Officer, Rockwell Automation, Inc.*

Christian Rothe, *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 fourth quarter fiscal 2024 earnings release conference call.

With me today is Blake Moret, our Chairman and CEO, and Christian Rothe, 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. I'll make a couple of comments before we turn to our fourth quarter results.

With the U.S. federal election day now behind us, we're optimistic that the country will turn its focus to a smooth transition to newly elected leaders. We're pleased that policymakers recognize the essential role that U.S. manufacturing plays at the core of our economy. Rockwell is the clear leader in providing technology that helps U.S. manufacturers be more competitive, so we welcome policies that will benefit our most important market by spurring innovation, streamlining project approvals, and levelling the playing field.

Orders continued to be soft in Q4, but we had solid execution on several fronts. Customer service levels and conversion of new orders to shipments are back to pre-pandemic levels across all businesses. We are growing profitable software and digital services lines of business, which helped to partially mitigate the impact of excess product inventory in our channel. Annual Recurring Revenue grew double digits in the year and is now 10% of our total revenue. For comparison, ARR was about 4% of our revenue in 2018.

We've seen modest market share gains over the past few years, based on U.S. market share reports, product-specific studies, and comparison to the automation businesses of our closest competitors. Our best results in fiscal year '24 were in North America, our home market, and China is now less than 5% of our revenue.

We are broadening our cost-savings activities, and Christian Rothe, our new CFO, has jumped into the effort with enthusiasm. He brings valuable new perspectives on additional opportunities. At the end of fiscal year '24, we were able to accelerate our savings to realize about $110 million of cost reductions in the second half of the year, $10 million above the target we first discussed in May. As of the end of October of 2024, our global headcount is down over 12% since Q2 of fiscal '24.

In the last call we talked about multiple additional cost-out opportunities, including activities to reduce the price paid for purchased components and services, as well as actions to increase the efficiency of our manufacturing plants. Despite the headwind of lower volume, we are still confident in our ability to save $250 million in FY25 from the combination of all our productivity actions. We continue to see positive impact from pricing actions.

These have been difficult times, but I'm impressed by the resilience and sense of urgency of our teams as we position ourselves to deliver market-beating growth and profitability. Later on this call, Christian will cover our pricing, productivity, and margin expansion actions for next year.

Let's now turn to our Q4 results on slide 3. Our Q4 orders were down low-single-digits sequentially, compared to our expectations for low-single-digit improvement. Similar to last quarter, the rate of reduction of lingering excess inventory at our distributors and machine builders was gated by slower end user demand. Of note, we did see sequential orders growth in North America, with Asia contributing the largest sequential decline. Going forward, we expect our Q1 orders to be flat sequentially, and we expect our Q1 sales to be down high-single-digits from last quarter, primarily due to typical seasonality in our configure-to-order and solutions businesses and slower orders in Q4 of fiscal '24. I'll talk more about our fiscal '25 outlook later on the call.

Despite weaker-than-expected orders, our Q4 organic sales came in largely in line with expectations. As I mentioned earlier, we quickly converted incoming product orders to shipments, and Lifecycle Services capped off a year of improved performance with good execution in the quarter. Q4 sales for the company declined 21% versus prior year, compared to 18% growth in Q4 of last year. The decline is due to the difficult year-over-year comparison, lingering channel destocking effects in our product businesses, and slower end user demand. Organic sales in our Intelligent Devices segment declined 20% year-over-year. Products were down, with configure-to-order offerings and acquisitions growing year-over-year.

I'm pleased with how our recent acquisitions are expanding our market. In particular, we saw good growth in our CUBIC orders for data center power needs, where we continue to gain traction with leading hyperscalers and IT infrastructure providers. This quarter we secured a strategic win at NTT, a leading data center co-location provider. Rockwell is helping this customer achieve significant footprint savings by leveraging CUBIC's modular, compact, and switchgear-agnostic custom design capabilities.

In Software & Control, organic sales were down over 30% year-over-year. Within this segment, Logix shipments were weaker due to slower end demand in product-centric end markets. Despite the continuing volatility in product shipments, our PLC market share is slightly up, helped by our geographic mix and continued innovation. We recently introduced Logix SIS, our new Process Safety controller, building on Rockwell's established leadership in safety applications across discrete, hybrid, and process applications, and we're already helping key OEM's design significant upcoming Rockwell product releases into their new machine designs.

Other launches extend the differentiation of our software offering. Last quarter we launched our Vision AI solution to help customers improve their quality and yield. In general, software was our best-performing area this year, with good revenue growth across Fiix, Plex, and other FactoryTalk offerings. The newest FactoryTalk Design Studio release features a co-pilot which boosts automation system design productivity and is integrated in this cloud-native application, which is an industry first. You'll see many of these products at our Automation Fair in a few weeks.

Lifecycle Services organic sales grew about 2% versus prior year. Book-to-bill in this segment was 0.9 and slightly below our historical average for Q4. We saw a couple of customers delay projects in our Sensia business this quarter. We continue to have a healthy pipeline of projects, which include both traditional and energy transition applications, and reflect a general shift toward autonomous operations to improve safety and operational performance. Energy end markets overall were over 15% of our total business in fiscal '24. On the services side, we continue to increase customer penetration through managed services, with a growing number of contracts generating recurring revenue.

Total ARR for the company grew 16% in the quarter with double-digit growth across our software and services offerings. Segment margin was over 20% and Adjusted EPS was $2.47.

Turning to slide 4 to review key highlights of our Q4 industry segment performance. Similar to our overall topline results in the quarter, our performance by industry reflects difficult year-over-year comparisons with Q4 of last year being a record quarter of shipments. Sales in our Discrete industries were impacted by continued declines in Auto and Semi, partially offset by growth in eCommerce and Warehouse Automation.

In Automotive, we saw another quarter of EV project delays as brand owners and tier suppliers wait for more policy certainty and an overall improvement in consumer spending. Despite this pause in EV, there is still activity, and we continue to win business across traditional ICE and hybrid programs. Rockwell was selected by Ford Motor Company as the automation partner for their Louisville, Kentucky facility. Rockwell will be supplying a full portfolio of Logix controllers, Drives, HMI, and Industrial Components for the Body and Final assembly shops. There is also additional content for their next generation truck programs.

Moving to Semiconductor, while the industry is dealing with oversupply and uncertainty around future stimulus support, we secured an important win with a global leader in semiconductor manufacturing to automate their R&D facilities here in the U.S. We also continue to gain traction with our production logistics offering for material transport.

eCommerce and Warehouse Automation sales increased 25% versus prior year. In addition to continued investments in warehouse upgrades by both eCommerce and traditional retail players, we see the benefits of data center investment, particularly in our CUBIC business.

Turning to our Hybrid industries, sales in this segment were impacted by double-digit year-over-year declines in Food & Beverage and Life Sciences. In Food and Beverage, we continue to see muted capacity investments as end users are delaying projects and focusing on driving operational improvements across their existing facilities. With that said, we are working with leading food and beverage producers on their next greenfield plans.

In the quarter, we had an important win with Kikkoman, the largest soy sauce manufacturer in the world. In partnership with the engineering firm CRB, we are delivering Rockwell's portfolio of Plex MES software and scalable plant-wide control, helping Kikkoman build their factory of the future here in Jefferson, Wisconsin.

Within our Life Sciences vertical, we are seeing the investment in GLP1 drugs as key pharma companies and their contract manufacturers aggressively add manufacturing capacity to support soaring consumer demand. Sales growth in our Process industries was impacted by difficult comps, with over 25% growth in Q4 of last year for this industry segment.

Within Oil & Gas, similar to last quarter, we saw project pushouts in North America due to election uncertainty and potential policy changes, given the impact they may have on funding of greenhouse gas related projects. Sensia did grow double digits in the quarter and continued to deliver improved profitability.

In Mining, customers are investing in the sustainability and safety of their operations. This quarter, Rockwell was chosen by Seriti New Denmark in South Africa to upgrade their Environmental Monitoring System from a competitive software offering, to ensure effective monitoring of environmental conditions and respond to potential hazards.

Let's turn to slide 5 and our Q4 organic regional sales. In general, sales were down sharply year-over-year due to tough comparisons and the lingering impact of destocking. Orders were up sharply year-over-year due to the easy comparison with Q4 of fiscal year '23. Sequentially, orders were down low single digits and shipments were flattish. The Americas, our home market, continue to be our best-performing region. As I mentioned, orders were up sequentially in North America.

While we are happy with our strong presence in the Americas, we continue to expand our share of wallet with European machine builders as they serve their end users around the world. In the quarter, we won an important project with GEA in India. GEA is one of the world's largest systems suppliers for the food, beverage, and pharmaceutical sectors. The GEA portfolio includes machinery and plants, as well as advanced process technology, components, and comprehensive services. The end user will implement state–of–the–art technologies to ensure efficient water usage and replenishment.

Let's move to slide 6 for key highlights of fiscal 2024. We finished the year with a 9% year-over-year decline in reported sales. Sales from our Clearpath and Verve acquisitions contributed about a point of growth as we expand our customer value in the production logistics and cybersecurity spaces.

Total ARR grew 16% with strong performance across our recurring software and services portfolio and is now over 10% of our total business. The 200 basis point decrease in our segment margin on a high-single-digit year-over-year sales decline would have been worse without our more diverse business mix and the significant cost reduction actions we took earlier this year to align our cost structure with the current business environment. These actions also position us for expanded margins as markets recover. 60% Free Cash Flow conversion was in line with our prior forecast.

Let's now move to slide 7 to review our fiscal 2025 outlook. Given the uncertainty in the macroeconomic environment and continued project delays across a number of our end markets, we are projecting sales growth in the range of positive 2% to negative 4%. After a sequential decline in Q1 shipments, primarily due to typical seasonality, we expect gradual sequential improvement in our topline growth through the balance of fiscal year '25. Christian will cover the calendarization of our guidance in more detail later on this call.

We expect our Annual Recurring Revenue to grow about 10%. Segment margin is projected to be down slightly versus prior year, and Adjusted EPS is expected to be $9.20 at the midpoint. We expect Free Cash Flow conversion to return to 100% in fiscal year '25.

I'll now turn it over to Christian to provide more detail on our Q4 and full-year performance and financial outlook for fiscal '25. Christian?

Christian Rothe

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

Thank you, Blake. Good morning, everyone. I'm excited to be here this morning and look forward to working with you all over the coming quarters and years.

I'll start on slide 8, Fourth Quarter Key Financial Information. Fourth quarter reported sales were down 21% versus prior year. The positive impact of acquisitions and the negative impact of currency roughly offset each other in the quarter. About 2 points of our organic growth came from price. Segment operating margin was 20.1% compared to 22.3% a year ago. The year-over-year decrease reflects lower sales volume and unfavorable mix, partially offset by our cost reduction actions and no incentive compensation.

Adjusted EPS of $2.47 was above our expectations primarily due to price and one-time items. Those one-time items included a $22 million benefit from an adjustment to an earnout accrual tied to achievement of the seller's revenue targets on our Clearpath acquisition.

The Adjusted Effective Tax Rate for the fourth quarter was 14.9%, below the prior year rate of 17% and about 4 points below our expectations for the quarter. I'll cover a year-over-year Adjusted EPS bridge on a later slide.

Free Cash Flow of $367 million was $409 million lower than prior year, primarily due to lower pre-tax income. One additional item not shown on the slide: we repurchased approximately 450,000 shares in the quarter at a cost of $118 million. On September 30, we had $1.3 billion remaining under our repurchase authorizations.

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

Intelligent Devices margin of 20.6% decreased by 70 basis points year-over-year due to lower sales volume and unfavorable mix. If you exclude the benefit from the Clearpath earnout adjustment I mentioned earlier, segment margin in Intelligent Devices was 18.3%. Operationally, this was about a point below our expectations as better than expected price/cost was more than offset by lower volume and other costs, including the impact of currency. Purely focusing on decremental conversion, after adjusting for the earnout, the segment had decrementals in the mid-thirties year-over-year in the fourth quarter, which reflects strong execution on cost-out programs against a 20% organic sales decline.

Software & Control margin of 22.3% decreased about 1,100 basis points year-over-year due to lower sales volume, which was partially offset by cost reduction actions and no incentive compensation. Margins in this segment were below our expectations mainly due to lower shipments of Logix controllers. Revenue from the software portion of Software & Control held up nicely year-over-year. The 39% sales decline in Software & Control was driven by the hardware portion of the business

against the historically high shipments in Q4 of the prior year. The typically high decrementals for Software & Control were mitigated somewhat by our cost-out actions.
Lifecycle Services margin of 17.4% increased 890 basis points year-over-year and was slightly above our expectations. The higher year-over-year segment margin in Lifecycle was driven by no incentive compensation, strong project execution, and Sensia margin improvement. As Blake said, this business performed well throughout fiscal '24 and the incrementals reflect that.

The next slide, 10, provides the Adjusted EPS walk from Q4 fiscal 2023 to Q4 fiscal 2024. Core performance was down $2.40, on a 21% organic sales decrease with unfavorable segment and product mix driving an outsized flow-through. As Blake mentioned, cost reduction actions provided a $70 million benefit in the quarter, exceeding our expectations, and were a $0.50 tailwind. Incentive compensation was a $0.55 tailwind. This year-over-year delta reflects no bonus payout this year versus an above-target payout last year. The Clearpath earnout benefit was $0.20. The year-over-year impact from currency and acquisitions were a $0.05 headwind each, whereas tax was a $0.05 tailwind. Shares, interest, and other items taken together were a tailwind of $0.03.

I want to pause here to briefly discuss the sequential performance for Rockwell from Q3 to Q4. Although it's not in the slide, I think it is informative to discuss the progression, particularly when we later discuss the fiscal '25 guide.

Negative mix was the largest contributor to our decrementals sequentially. While reported company-wide sales were down $15 million, declines in products in both Intelligent Devices and Software & Control, including Logix, were more than double that amount. On the other hand, we saw growth in Lifecycle Services and our configure-to-order products, which have a less favorable margin profile. Further, as mentioned in our Q3 call, the Lifecyle Services segment had some high margin projects ship in Q3 that did not recur in Q4. This negative impact of both volume and mix drove high sequential decremental margins. Sequential currency and pension headwinds were offset by the earnout adjustment.

Moving on, slide 11 provides key financial information for the full fiscal year 2024. Reported sales declined 9% to $8.3 billion, including one point of growth coming from acquisitions. Currency was neutral. Organic sales were down 10%. Full-year segment margin of 19.3% decreased 200 basis points from last year. The decrease was due to lower sales and, again, an unfavorable mix that skewed heavily toward products, partially offset by no incentive compensation as well as the benefits from cost reduction actions and one-time items, including the earnout adjustment. Adjusted EPS was down 20%. A detailed year-over-year Adjusted EPS walk can be found in the appendix for your reference.

Free Cash Flow conversion was in-line with the updated expectations we shared last quarter at about 60% in fiscal 2024. Free Cash Flow decreased $575 million from fiscal '23. The decrease in Free Cash Flow was driven by lower pre-tax income. Inventory and receivables were a source of cash in the fourth quarter as we reduced our balances, in line with end demand. Return on Invested Capital was 15.2% for fiscal year 2024 and 570 basis points lower than the prior year, primarily driven by lower income.

For the year, we deployed about $1.2 billion of capital towards dividends and share repurchases and made inorganic investments of $750 million at the beginning of the fiscal year for Clearpath and Verve. Our capital structure and liquidity remain strong.

Let's now move on to the next slide, 12, to discuss guidance for fiscal 2025.

We expect reported sales in a range from negative 4% to positive 2%, or slightly below $8.2 billion at the midpoint, with no impact from currency or acquisitions. At the midpoint of our sales guidance, which is negative 1%, we expect both Intelligent Devices and Software & Control to be down low-single digits and Lifecycle Services to be up low-single digits year-over-year. We expect price to contribute about a point of growth for the year and price/cost to be favorable. Segment margin is expected to be just under 19% at the midpoint, down about 40 basis points from fiscal year '24.

As Blake mentioned, we continue to expect $250 million in year-over-year benefit from our productivity and margin expansion projects in fiscal year '25. We look forward to covering more on our productivity and operational excellence journey with you at our upcoming Investor Day in Anaheim.

We expect the full year Adjusted Effective Tax Rate to be around 17%. This is about two percentage points higher than fiscal ‘24, which benefited from some discrete events that will not recur. Our Adjusted EPS guidance range is $8.60 to $9.80, with $9.20 at the midpoint. We expect full-year fiscal 2025 Free Cash Flow conversion of about 100% of Adjusted Income.
Blake mentioned earlier that we expect first quarter sales to be down high single digits sequentially. From a margin standpoint, we expect our Q1 margins to be in the low-to-mid teens. Although we don’t give quarterly guidance, we thought it would be helpful to give some additional color on how we expect the first quarter to shape up.

Intelligent Devices sales are expected to be down low-teens sequentially, reflecting soft product demand and a seasonal low in configure-to-order products. Against this tough volume backdrop, Intelligent Devices will have compensation headwinds and the non-recurrence of the earnout adjustment. As a result, we expect Intelligent Devices segment margins to be in the low teens. Software & Control margin is expected to be in the low 20s, on flat sequential sales growth. Lifecycle Services typically has a seasonal low in the first quarter, and sales are expected to be down low-single digits sequentially. We expect compensation headwinds and the volume impact to drive segment margins in Lifecycle to the low teens.

As Blake mentioned, we expect a gradual sequential improvement in our sales through the rest of the year. We also expect a corresponding increase in our segment margins.

Let’s turn to slide 13 for our Adjusted EPS walk for the full year.

Our Core is expected to be negative $0.20 for the year with a more normalized conversion on the one percent sales decline at the mid-point of our guide. Importantly, included in our Core is R&D spending, the lifeblood of our future growth, which we continue to target at about 6% of sales. Non-R&D investments planned for fiscal ‘25 are expected to be a $0.25 headwind. These investments are structural in nature to position us for future growth. They include expansion of our CUBIC footprint to continue to capture the ongoing data center tailwind, especially in the US; a new Rockwell facility in India; and IT investments that will provide differentiated performance both inside and outside of Rockwell’s walls.

Continuing on through the waterfall, our productivity actions are expected to increase EPS by $1.85, reflecting the targeted $250 million cost-out savings. Nearly offsetting those savings are compensation and inflation headwinds next year, which are expected to decrease EPS by $1.40 at the midpoint of guide.

Adjustments to the Clearpath earnout in Q2 and Q4 of fiscal '24 result in a $0.25 headwind in fiscal '25. We expect tax to be a $0.20 headwind. Shares, interest expense, and other items taken together are expected to be a $0.06 headwind.

To break down the guide another way: our Adjusted EPS in fiscal '24 included about $0.25 of benefit from earn-out adjustments that added about 35 basis points to our segment margins for the year. Our guide of fiscal '25 segment margins of just under 19% reflects, essentially, flat segment margins on this adjusted basis year-over-year. The headwinds of a 1% sales decline at the midpoint of our guide, as well as compensation and investment headwinds, are expected to be offset at the segment level by our cost-out programs.

A few additional comments on fiscal 2025 guidance for your models. Corporate and Other expense is expected to be around $130 million. Net interest expense for fiscal 2025 is expected to be about $145 million. We're assuming average diluted shares outstanding of 113.1 million shares, and we are targeting $300 million of 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, Christian.

Despite project delays tied to policy uncertainty and the U.S. election, we won new capacity projects in the U.S. across a variety of verticals in the quarter and throughout the year. We saw a sequential ramp in these wins throughout the year, with Q4 being the best quarter. Projects came from a diverse set of end markets, including Renewable Energy, Tire, Oil & Gas, EV and Semiconductor. The funnel of these mega projects is robust, and we expect an increase in these orders during fiscal year '25.

Fiscal year '25 will be a particularly strong year for New Product Introductions including both hardware and software. We look forward to showcasing this innovation for customers during Automation Fair in two weeks, and for you at our Investor Day during the show.

Acquisitions made a year ago are expected to contribute about a point of organic growth in fiscal year '25. We do not anticipate major new acquisitions in the year. We have an unmatched portfolio that combines traditional sources of value with new ways to win. As we've said, we're now concentrating on integrating what we've built and bought to drive simplification for our customers, expanded margins for investors, and focus for our employees.

Our people remain the heart of our success, and I thank them for their dedication and resilience. My leadership team and I look forward to working shoulder-to-shoulder with our employees and partners around the world during the coming year, as we tune our operations, add new innovation to our portfolio, and win at customers.

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 for joining us today. That concludes today's conference call.