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Rockwell Automation, Inc. (ROK)

Q4 2022 Earnings Call – Prepared Remarks

## Corporate Participants

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

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

Aijana Zellner, *Head of Investor Relations, Rockwell Automation, Inc.*

## Operator

Thank you for holding and welcome to Rockwell Automation's Quarterly Conference Call. I need to remind everyone that today's 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. Ms. Zellner, please go ahead.

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## Aijana Zellner

*Head of Investor Relations, Rockwell Automation, Inc.*

Thank you, Julianne. Good morning and thank you for joining us for Rockwell Automation's fourth quarter fiscal 2022 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.

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## Blake D. 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 had a great finish to the fiscal year and delivered very strong operating performance. I'm proud of how our teams navigated this challenging year, with continued supply chain volatility, significant inflation, and currency headwinds. Our Q4 results were in-line with our expectations, with organic sales and earnings both growing double digits year-over-year and sequentially.

Orders came in as expected in the quarter. Our record backlog along with very low order cancellation rates reflect the continued solid underlying demand from our customers across many industries and regions.

Total revenue of over \$2.1 billion was up 17.6% year-over-year. Organic sales grew 20.5% versus prior year, in line with our expectations. Acquisitions contributed almost two points of growth this quarter. Currency translation reduced sales by about 5% driven by continued strengthening of the U.S. dollar.

As expected, we continue to see a gradual stabilization of global supply chain. Similar to last quarter, the split of Q4 shipments by business segment and region was driven by access to specific electronic components.

In the Intelligent Devices business segment, organic sales grew over 16% versus prior year, with growth in all regions. While growth in this segment for the quarter was once again disproportionately impacted by component availability, we were able to mitigate these supply issues with the benefits from our resiliency actions. We see continued market need for our Intelligent Devices, from PowerFlex drives, to our Motion technology, to our best-in-class safety solutions. Our Independent Cart Technology business had a record year with both orders and sales growing over 35% year-over-year.

Software & Control organic sales growth of over 32% versus prior year was above expectations. Strong double-digit growth in View and Logix was driven by an improving component supply and our redesign investments.

Lifecycle Services organic sales were up 16% year-over-year. Book-to-Bill in this segment was 1.02, very good for our fourth quarter.

Information Solutions & Connected Services had another quarter of double-digit growth in both orders and sales. Here are a couple of wins in IS/CS to highlight the continued value of our recent acquisitions and new releases in these areas.

One of our Plex wins this quarter was with Futaba North America, a member of the Toyota business network. Futaba has selected Plex smart manufacturing platform for its ERP, MES, Quality Management, and Production Monitoring. Our state-of-the-art solution provides real-time inventory management, complex planning, and full visibility into this customer's manufacturing operations.

Another example of how our newer offerings are adding new value to our traditional customers is our win with Kraft Heinz this quarter. Our Plex platform along with Kalypso's digital design and implementation services are helping Kraft meet its productivity, yield, and quality goals.

We also continue to broaden our customer base with our Fiix cloud-native maintenance management system. In the quarter, Fiix was chosen by Barrett Steel, the UK's largest independent steel stockholder, to help reduce their unplanned downtime with a solution that could be easily scaled across 28 sites.

Connected Services sales were also strong in the quarter, with double-digit growth in digital projects and Cybersecurity services.

In the quarter, ARR grew 14%, bringing our ARR to over 8% of total revenue. Segment margin of over 23% was up 540 basis points year-over-year, reflecting another quarter of strong execution. Adjusted EPS grew 30% year-over-year.

Earlier this week we completed the acquisition of the Danish company CUBIC, a worldwide leader in modular systems for the electrical panels. This acquisition will help expand the global reach for our Intelligent Devices, and will bring new customers and partners, including a broader market access in renewable energy and data centers.

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

All three industry segments grew double digits this quarter, driven by continued gradual improvement in the availability of electronic components.

In our Discrete industries, sales were up almost 20%. Within Discrete, Automotive sales were up 25% versus prior year. We had numerous wins this quarter with our customers continuing to invest in their global operations, whether it's starting up a new factory, securing their network infrastructure, or upgrading existing facilities with cloud-native software.

One of our key EV wins this quarter was with Hyundai Motors for their U.S. greenfield mega site in Bryan County, Georgia. Hyundai Motors has selected Rockwell as their controls partner for press, body, paint, and general assembly.

Semiconductor sales grew 30% year-over-year with several global wins this quarter. In addition to securing a sizeable turnkey project in Asia with our proven Facilities Monitoring System, we had an important win here in the U.S. to provide flexible wafer transfers as part of this customer's Automated

Material Handling system. Our Independent Cart Technology is being leveraged at scale to support this customer's labor productivity and capacity goals.

In eCommerce and Warehouse Automation, our sales were up high-single digits in the quarter. Even with a slowdown in new eCommerce fulfillment center investment, retailers continue to adopt our solutions for greater warehouse efficiency and throughput.

Moving to our Hybrid industry segment. Sales in this segment grew over 20%, led by growth in Food and Beverage, Life Sciences, and Eco-Industrial. Food and Beverage sales were up 20% versus prior year. Similar to last quarter, we continue to see a good pipeline of greenfield and brownfield projects at our key customers. In the quarter, we won several multi-site deals with some of the largest Food and Beverage companies, with a healthy mix of Intelligent Devices, Software, and Digital Consulting and Implementation Services.

Life Sciences sales grew over 35% in the quarter with continued customer investments in Software, Cybersecurity, and Modular Process Control.

Tire was up 20% versus prior year, led by growth at our end user customers. This is another vertical where we are seeing an increase in greenfield projects in all regions.

Turning to Process, this industry segment grew mid-teens versus prior year, with growth in Metals, Chemicals, and Oil and Gas. One of the wins in Chemicals this quarter was with Bora LyondellBasell PetroChemical, the joint venture between LyondellBassell and Bora Enterprise Group. The customer chose our advanced analytics solution to help improve product quality and increase production capacity at their new polymer production plant in China.

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

North America organic sales grew by 20% versus the prior year, Latin America sales were also up 20%, EMEA sales grew over 24%, and Asia Pacific was up almost 18%.

Let's move to slide six, an update to our orders and backlog performance this fiscal year. Order cancellations continue to stay within our historical low-single-digit range. Our orders of over \$10 billion and record backlog of over \$5 billion this year set the stage for another year of strong sales growth in fiscal year 2023.

As we turn to slide seven, let's review highlights of fiscal 2022.

We had another year of record orders, with total orders of over \$10 billion growing 20% versus prior year. Reported and organic sales grew 11%, an impressive performance in light of all the challenges of

the year. Information Solutions and Connected Services continue to meaningfully contribute to our growth with over \$800 million in sales growing double digits. ARR is also growing double digits, and now accounts for more than 8% of our total revenue.

Adjusted EPS was up 1% versus prior year. Excluding last year's one-time items, Adjusted EPS was up 11%. Free Cash Flow conversion of 61% was driven by higher working capital. Nick will cover this in more detail later. The investments we've made this year have strengthened the resiliency of our business model and position us for sustained growth in fiscal year 2023 and beyond.

Let's now move to slide eight, fiscal 2023 outlook.

With the size of our record backlog, our outlook for fiscal 2023 is predicated on the availability of components. Given continued supply chain volatility, we think a conservative approach is appropriate.

Our fiscal 2023 guidance projects total reported sales growth of 9.5%. Organic sales growth of 11% at the midpoint assumes continued supply chain stabilization, with four points of growth coming from price, and seven points coming from volume. We expect acquisitions to contribute a point of profitable growth, and currency to be a headwind of about two and a half points.

ARR is expected to have another year of double-digit growth. We are projecting segment margin to expand by 60 basis points year-over-year. Adjusted EPS is expected to grow 12% versus prior year, and we target generation of over \$1.1 billion of Free Cash Flow next year, with a return to a more normalized conversion of 95%.

Let me turn it over to Nick to provide more detail on our Q4 performance and financial outlook for fiscal 2023.

Nick?

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## **Nicholas Gangestad**

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

Thank you, Blake, and good morning, everyone. I'll start on slide nine, fourth quarter key financial information.

Fourth quarter reported sales were up 17.6% over last year. Q4 organic sales were up 20.5% and acquisitions contributed 1.9 points to total growth. Currency translation decreased sales by 4.8 points. Segment operating margin expanded to 23.3% and was in-line with our expectations. The 540-basis

point increase was driven by higher sales and positive price/cost, partially offset by the negative impact from currency.

Corporate and Other expense was \$35 million and in-line with prior year. Adjusted EPS of \$3.04 was in line with our guidance and grew 30% versus the prior year. I'll cover a year-over-year Adjusted EPS bridge on a later slide.

The Adjusted Effective Tax Rate for the fourth quarter was 17.8%. The year-over-year increase was related to the cumulative impact of several one-time discrete items recognized in the prior year. Free Cash Flow was \$359 million and was up \$200 million over the prior year driven by higher pre-tax income.

Working capital on a currency neutral basis grew 10% sequentially versus our plans for a 10% decline. Our planned inventory reductions did not materialize in the quarter due to the continued build of raw material and work-in-process waiting on critical components. The actions we put in place to right-size inventory are taking longer to implement in the current supply chain environment. Our inventory days on hand at the end of the current year were close to 130 days versus a pre-pandemic average of 90 to 100 days.

One additional item not shown on the slide. We repurchased approximately 300,000 shares in the quarter at a cost of \$76 million. For the full year, our share repurchases totaled \$301 million, in-line with our July guidance. On September 30th, \$1.3 billion remained available under our repurchase authorization.

Slide 10 provides the sales and margin performance overview of our three operating segments.

Total and organic sales grew double digits across all three segments, with Software & Control growing over 30% year-over-year. Backlog for all three segments grew sequentially and was up over 75% year-over-year. Segment margins for the Intelligent Devices segment expanded to 22.3%, on higher sales and positive price/cost, partially offset by the negative impact from currency.

Compared to last year, Software & Control margins were up over 10 percentage points, driven by higher sales and positive price/cost, partially offset by negative currency impacts. Lifecycle Services segment margin was 10.7% and increased 260 basis points versus prior year benefiting from higher sales. Book to bill in the quarter was 1.02.

The next slide, 11, provides the Adjusted EPS walk from Q4 fiscal 2021 to Q4 fiscal 2022.



Core performance was up \$1.15 on a 20.5% organic sales increase. Approximately \$0.10 were related to non-recurring accelerated investments that were made in the prior year. These investments were mostly in our Software & Control segment. The impact of currency was a \$0.25 reduction in EPS, which was about \$0.10 worse than our expectations, reflecting the continued strengthening of the US dollar throughout the quarter. Incentive compensation was a \$0.10 benefit. As previously noted, our higher Adjusted Effective Tax Rate was a \$0.60 headwind due to prior year comps. Acquisitions including the impact of interest, added up \$0.15, primarily related to the prior year Plex deal fees. Our reduction in outstanding shares added about a nickel.

Slide 12 provides a walk from our Q4 mid-point in our July guidance to our actual Q4 Adjusted EPS results. Other than currency, sales and profits in the quarter played out in-line with our guidance. Currency impact on sales was about \$25 million worse than we expected and a dime worse on EPS. The impact from currency on EPS was offset by slightly lower incentive compensation and a more favorable Adjusted Tax Rate. Strong organic sales growth and good execution delivered over 23% operating margin in the quarter.

Slide 13 provides key financial information for the full year fiscal 2022.

Reported sales grew 10.9% to \$7.8 billion, including over two points coming from acquisitions. Currency negatively impacted sales by approximately \$200 million or 2.7 points. Organic sales were up over 11%, with growth balanced across all regions and business segments.

Full-year segment margin remained at about 20%. The benefit from higher volumes and lower incentive compensation was fully offset by higher wages and labor inefficiencies in our projects and in our plants caused by supply chain constraints. Margins were also negatively impacted by negative price/cost, primarily in the first half of the year. We increased our growth investments by double digits this year with a big focus on key product launches, new digital capabilities, increased salesforce investments, and plant capacity expansion.

Corporate & Other was down \$16 million mostly related to acquisition costs associated with the Plex acquisition in the prior year. Adjusted EPS was up 1%. A detailed year-over-year Adjusted EPS walk can be found in the appendix for your reference. Excluding the impact of the tax rate and the prior year one-time items, which included a favorable legal settlement and one-time accelerated investments, our Adjusted EPS was up 11%.

As discussed earlier, Free Cash Flow performance was below our expectations with Free Cash Flow conversion of 61%. The \$460 million decrease in Free Cash Flow was driven by a 50% increase in working capital on a currency neutral basis as well as the payment of the fiscal year 2021 bonus in

fiscal year 2022. There was no bonus payment made in fiscal year 2021. Working capital as a percent of sales was 16%, compared to 12% a year earlier.

Return on Invested Capital was 15.2% for fiscal year 2022 and 16 points worse than the prior year, primarily related to higher invested capital and lower pre-tax GAAP income driven by our mark to market adjustments made on our PTC investment in both years.

For the year, we deployed about \$900 million of capital towards dividends, share repurchases, and inorganic investments in fiscal 2022. We also paid down debt by about \$150 million. Our capital structure and liquidity remain strong.

Before I cover fiscal year 2023 guidance, let's turn to page 14.

In fiscal year 2022, our backlog grew by over 75% year-over-year including strong double-digit growth in each segment. Pre-pandemic we had about one month or less of the following year's revenue in the backlog for Software & Control and Intelligent Devices. Our backlog now represents over 50% of our fiscal year 2023 sales guide for both of these segments. This unprecedented backlog coverage adds to our confidence in our revenue outlook. Our backlog also includes the benefits of price increases that were implemented throughout fiscal year 2022.

Let's move on to the next slide, 15, guidance for fiscal year 2023.

We are expecting sales of about \$8.5 billion in fiscal 2023, up 9.5% at the midpoint of the range. We expect organic sales growth to be in a range of 9% to 13%, and 11% at the mid-point of our range. This outlook includes our current backlog levels, our latest assumptions on supply chain stabilization, as well as continued price growth momentum. We expect full-year segment operating margin to be about 20.5%. At the midpoint, our guidance assumes full year core earnings conversion of between 30% and 35%. I'll cover a few more details on this on the next slide.

We expect the full year Adjusted Effective Tax Rate will be around 18%. We do not anticipate any material discrete items to impact our tax rate in fiscal 2023.

Our Adjusted EPS guidance is \$10.20 - \$11.00. This compares to fiscal 2022 Adjusted EPS of \$9.49. At the midpoint of the range, this represents 12% Adjusted EPS growth. I will cover a year-over-year Adjusted EPS walk on a later slide.

We expect full-year fiscal 2023 Free Cash Flow conversion of about 95% of Adjusted Income. This reflects \$190 million of capital expenditures. We are planning for a reduction in our working capital days with a focus on inventory days on hand. Our working capital is targeted to be about 15% of sales,

still above our historical amount of around 12% as the return to pre-pandemic supplier lead times is slow. Finally, our projections include additional income tax payments of around \$100 million related to the change in US tax law that no longer allow for the immediate expensing of R&D.

A few additional comments on fiscal 2023 guidance. Corporate and Other expense is expected to be around \$120 million. Net interest expense for fiscal 2023 is expected to be around \$120 million. Finally, we're assuming average diluted shares outstanding of 115.1 million shares.

Let's turn to slide 16.

Given the continued supply chain volatility and many moving pieces, we wanted to provide a slide that lays out the tailwinds and headwinds that are included in our fiscal year 2023 guidance.

From a topline perspective, our 11% organic sales growth is supported by our higher backlog. This includes about 7% from higher volumes due to general supply chain stabilization, low cancellation rates, and resiliency benefits coming from our redesign efforts done in fiscal 2022 and continuing in fiscal 2023. About 4% is coming from price growth mostly tied to price actions that went into effect in fiscal 2022. We also have factored in about 1% inorganic growth for our recently completed acquisition of CUBIC.

While the supply chain shows some signs of stabilization in Q4, there continues to be volatility along with a dynamic macroeconomic environment including the unfavorable impact of currency. All of these factors have informed our sales guidance and range.

On Adjusted EPS, we expect margin expansion from increased volume and positive price growth. The net favorable impact of price/cost on margins is about 100 basis points. We also will benefit from a higher discount rate favorably impacting our pension expense and will see about a \$0.15 benefit from share repurchases.

We continue to make investments in attracting and retaining key talent as well as restoring our bonus payout back to 100%. Combined these two items are around a 150-basis point headwind to our margins. While we do expect a positive price/cost for the year, we are also factoring in continued inflation, primarily in electronic components. We expect our margins to be negatively impacted by unfavorable mix and currency. Combined these two items will be a negative impact of around 150 basis points. We are expecting an Adjusted Effective Tax Rate of 18% or about a \$0.20 headwind.

The next slide, 17, provides the Adjusted EPS walk from fiscal 2022 to fiscal 2023 guidance at the midpoint for your reference and which I spoke to on the previous slide.

From a calendarization viewpoint, we expect our second and third quarters to have the highest sales growth rates for the year with each up mid-to-high teens year-over-year. We expect Q1 and Q4 to be in the single-digit growth range. Following the first quarter, we expect sequential sales to improve over the balance of the year.

We expect segment margins and Adjusted EPS to decline year-over-year in Q1. We see segment margins in the mid-teens for Q1 which is factored into our full year view of 20.5%. In Q1, we are projecting a year-over-year margin decrease from increases in spend, unfavorable mix, and currency, partially offset by positive price/cost.

We are seeing improving margins sequentially following Q1 driven by higher volumes and continued positive price/cost.

Moving on to the next slide, 18, I'll make a few comments on our Capital Deployment Framework.

Our long-term capital deployment priorities remain the same. Our first priority is organic growth. After that, we focus capital deployment on inorganic activities. Then we focus on capital returns to shareowners, through our dividend, and then share repurchases.

In addition to our organic and inorganic investments, our capital deployment plans for fiscal 2023 include a focus on de-levering, dividends of about \$540 million, and share repurchases of between \$200 and \$300 million.

With that, I'll turn it back over to Blake for some closing remarks before we start Q&A.

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**Blake D. Moret**

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

Thanks, Nick.

As we look to 2023, we are confident in our ability to execute our strategy. Our record backlog, underlying customer demand, and a more resilient operating model set the stage for a year of double-digit sales and earnings growth

As you heard today, we are continuing to invest for our future, including investing in attracting and retaining key talent. I would like to thank our people for their relentless commitment to solving the immediate needs of our customers while focusing on continued innovation and investment for the

future. We are excited to share some of these innovations with you at our Investor Day in Chicago during Automation Fair later this month.

We will be introducing an industry-first, cloud-native programming application for Logix, a new operator interface package, new I/O for process industries, on-machine motor control, and a host of other differentiated offerings that make this time a historic moment in Rockwell's journey.

Aijana will now begin the Q&A session.

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**Aijana Zellner**

*Head of Investor Relations, 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. Thank you.

Julianne let's take our first question.

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**Q&A Session**

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**Aijana Zellner**

*Head of Investor Relations, Rockwell Automation, Inc.*

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