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Rockwell Automation, Inc. (ROK)

Q2 2025 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. Mrs. 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 second quarter fiscal 2025 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.

Before we turn to our second quarter results on slide 3, I'll make a couple of initial comments.
The quarter and our full-year outlook reflect increased resiliency and flexibility in our business across our global operations, even as we and our customers continue to operate in an environment of heightened uncertainty.

We talked about some of our actions to mitigate the impacts of announced tariffs on our last earnings call. I'm proud of how our team is executing these plans while maintaining world-class delivery and customer support. In addition to effective pricing actions, we are seeing good progress with some of our production location moves and efforts to secure alternative sourcing. Christian and I will cover these in more detail later on the call.

Importantly, all these actions to add resiliency to our business model are further enhancing Rockwell's position, both from a profitability and competitive differentiation standpoint – regardless of what happens in the broader policy environment. We made significant investments in our operational resilience during the supply chain crisis, and they have been instrumental in helping us navigate through the current situation, by giving us additional flexibility in our supply chain and manufacturing footprint.

Turning to our second quarter results on slide 3. Q2 marked another quarter of solid sequential improvement in customer demand across many parts of our business. We had a healthy intake of orders in the quarter with our total company book-to-bill in line with our historical norm of about 1.0. Going forward, we will share additional information on total company order performance only when our overall book-to-bill is outside of the normal range. We will still disclose book-to-bill in Lifecycle Services each quarter, since lead times are longer for that business segment.

While there might have been some isolated customer prebuys ahead of tariff-related price increases in Q2, the overall value of these purchases did not have a meaningful impact on our topline. From a cost standpoint, the impact of tariffs on our Q2 results was also minimal.

Our sales came in better than expected this quarter with organic sales up high-single-digits sequentially. Reported sales were down 6%, and our organic sales were down 4% versus prior year due to the difficult year-over-year comparisons we mentioned on our last earnings call. Unfavorable currency reduced sales by about 2 points. Even with customers continuing to adopt a cautious approach to their capex investments in this uncertain environment, we saw a number of strategic projects across a variety of industries and geographies in the quarter.

In our Intelligent Devices segment, our organic sales declined 6% year-over-year but were above our expectations with double-digit sequential growth across all key product lines. Our strong growth over the prior quarter was led by our power control business, where our industry-leading motor control center lead times continue to secure important new customers and help Rockwell gain domestic share. One example of these competitive wins in the quarter was with Cape Electrical Supply Integration, a leading packaged power provider focused on new power generation for the data center market. Our differentiated MCC solutions are helping them secure numerous greenfield wins here in the U.S., our home market. Another strategic MCC win in Q2 was at Fecient Solutions Provider. This customer, an Asian panel builder, selected our Cubic modular power distribution systems for their flexibility and smaller footprint, a perfect application for an end-user greenfield plant in the Food and Beverage space.

Our recent Clearpath acquisition continues to broaden our customer reach. OTTO brand mobile robots continue to add new logos, with a recent win at Westfalia Technologies, a leading U.S. provider of automated warehouse solutions. Westfalia has a significant presence in Food and Beverage end users across North America. Rockwell's AMRs were chosen to reduce the use of manual forklift trucks, resulting in faster throughput and reduced finished goods damage, as well as a safer operating environment for the customer's workforce.

Software and Control organic sales were up 2% year-over-year and also exceeded our expectations in the quarter. While our high-single-digit sales growth over prior quarter was driven by another quarter of recovery in Logix, we saw sequential improvement in sales across both hardware and software businesses in this segment. We are pleased to see sharply increased adoption of the FactoryTalk Design Studio, which features a Gen AI copilot to accelerate the time to design and commission automation projects. One of our software wins in Q2 was with Bracco Imaging, a global leader in diagnostic imaging. The customer is using our PharmaSuite MES software to accelerate its revenue growth by improving quality control and increasing speed to market.

Lifecycle Services organic sales decreased 6% year-over-year and were a bit lower than expected. Book-to-Bill in this segment was a solid 1.07 and was above 1.0 across all our solutions, services, and Sensia businesses, but the current trade and policy uncertainty has impacted some large capex projects across our customer base. We saw some project delays in Automotive and Energy, and some deferrals of more discretionary spend in digital services. These customers are seeking additional certainty about the impact tariffs will have on their cost base, and whether the volatility will impact their demand. Despite these delays, our total ARR for the company grew 8% in the quarter. Double-digit growth by Plex and Fiix software businesses led our ARR performance.

Rockwell segment margin of 20.4% and Adjusted EPS of $2.45 were both above our expectations and were, in large part, driven by continued execution of our cost reduction and margin expansion actions. Our team's focus on productivity yielded another quarter of outperformance versus our target, and as we continue to look for further opportunities to expand our margins, we believe we'll exceed our full-year target of $250 million in year-over-year structural productivity. Christian will provide some additional calendarization detail in his section.

Let's move to slide 4 to review key highlights of our Q2 industry performance. Sales in our Discrete industries were up low single-digits year-over-year with growth in eCommerce and Warehouse Automation and Semiconductor more than offsetting the decline in Automotive. Consistent with our expectations, our Q2 Automotive sales continued to be challenged by the ongoing tariff and policy uncertainty. This is one of the verticals where we saw an increase in project deferrals in the quarter.

Our sales in eCommerce and Warehouse Automation grew over 45% versus prior year and were significantly above our expectations. We continue to see strong performance across our key customers in North America and EMEA. Our data center business is also continuing to gain momentum, including a significant data center project with one of Asia's largest telecom providers, delivered through our strategic collaboration with a leading full-stack data center solutions provider in the region. Given the outperformance in the first half and a solid pipeline of projects, we now expect eCommerce and Warehouse Automation to grow 45% in FY25.

Turning to Hybrid. Sales in this industry segment were flat year-over-year, with Food and Beverage, Home and Personal Care, and Life Sciences all exceeding our expectations in the quarter. Within Food and Bev and HPC, we continue to see an improvement in our machine builder performance, especially in our North American and European markets. Similar to last quarter, the majority of customer spend in these verticals is driven by productivity and efficiency projects aimed at improving their profitability and sustainability. A good example of these customer wins in Q2 was our work with a US-based restaurant chain with plans to leverage automation to improve speed and consistency of its operations while reducing its labor intensity. Rockwell's Independent Cart Technology was selected for its flexibility and agility to help increase throughput and improve cost savings.

Our Life Sciences business also exceeded our expectations for the quarter, building on our strong presence with leading GLP-1 producers and the broader life sciences ecosystem. I already mentioned our Bracco software win in the med device segment earlier on the call. Another strategic win in this vertical was with National Resilience, an innovative contract drug manufacturer specializing in bringing accessible and affordable biologic medicines to the market. This customer is investing in our OTTO AMRs within their automated storage and retrieval system warehouse as part of their initiative to expand their lights-out warehouse and automated material movements.

Moving to Process. While we were expecting to see year-over-year softness due to very difficult comparisons in our Energy business, our performance in the quarter here came in worse than expected. Within Energy, our customers continued to exercise capital discipline by choosing targeted productivity projects which help improve cost structure and boost profitability. Energy and Process broadly were another area where we saw an increase in project delays during the quarter. Despite this pause in larger capital investments, we continue to secure competitive wins in the process control space. This quarter, DPA Ingenieria, a Chilean system integrator specializing in

Mining and Energy industries, selected our Logix PlantPax solution to help a leading global lithium mining company advance their ambitious expansion plans.

Moving to slide 5 and our Q2 organic regional sales. North America was our best-performing region this quarter, and we expect it to be our strongest market for the full year fiscal year '25. We continue to believe Rockwell is a net beneficiary of policies that drive U.S. manufacturing, and we are investing in our own operations to improve our resiliency and agility. For instance, we've recently decided to expand production of our OTTO autonomous mobile robots to the U.S. We'll be producing in both Kitchener, Ontario and at our Milwaukee headquarters.

Let's now turn to slide 6 to review our fiscal 2025 outlook. As I said earlier, the impact of enacted tariffs on our Q2 results was minimal with increased cost offset by price and supply chain moves. We continue to take necessary steps to offset the impact of April 2nd tariffs through a combination of supply chain actions and pricing. We will share the actual tariff impact by quarter as we progress through the year, and Christian will provide additional detail in a few moments.

We are taking a balanced approach to the outlook for the rest of the year. Our execution has been strong, and demand continues to be solid, including in April. However, second half uncertainty still remains. I group that uncertainty in three primary areas, the magnitude of pricing we'll implement to offset any new tariffs, the impact of any advance product purchases in our flow business, and the timing of capex investments by our customers, especially in our Lifecycle Services and Configure-to-Order businesses. In terms of our fiscal '25 topline, we still expect our organic sales growth to be in the positive 2% to negative 4% range. Our reported sales midpoint now assumes a half a point of negative contribution from currency translation. Christian will provide more detail on FX and the calendarization of our second half shortly. I will add that we expect to return to year-over-year sales growth in Q3.

Annual Recurring Revenue is slated to grow about 10% this year. Taking into account our margin outperformance-to-date and continued strong execution, we are increasing our full-year segment margin target to 20%, and we now expect our Adjusted EPS to be about $9.70 at the midpoint. Importantly, we are able to expand our margins year-over-year despite higher compensation costs. Continuing benefits from the SG&A actions we took in the second half of fiscal '24, along with the team's focus on additional structural COGS productivity in fiscal '25, enable the investment in our people and new technology even as we expand margins. We continue to follow a prudent approach to hiring, prioritizing roles that drive new product introduction and revenue growth. We continue to expect Free Cash Flow conversion of 100% in fiscal year '25.

I'll now turn it over to Christian to give more detail on our Q2 and financial outlook for fiscal '25. Christian?

Christian Rothe

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

Thank you, Blake, and good morning, everyone. I'll start on slide 7, Second Quarter Key Financial Information. Second quarter reported sales were down 6% versus prior year. Currency had a negative impact of 2 points in the quarter, and organic sales declined 4%.

Segment operating margin of 20.4%, compared to 19% a year ago, was above our expectations and reflective of our strong execution across the company. About 3 points of our organic growth came from price and price/cost was favorable. Benefits from cost reduction and margin expansion actions and positive price/cost more than offset higher compensation and lower sales volume.

Adjusted EPS of $2.45 was above our expectations primarily due to the beat on segment operating margin. This was another robust performance in execution and cost control, through both structural and temporary costs. The Adjusted Effective Tax Rate for the second quarter was 17.7%, above the prior year rate of 14.8%, primarily due to lower discrete tax benefits partially offset by favorable geographic mix of pre-tax income. We remain on-track to achieve a 17% ETR for fiscal 2025.

Free Cash Flow of $171 million was $102 million higher than the prior year. Free Cash Flow conversion was 61% in the second quarter, with accounts receivable being a use of cash during the quarter due to higher shipments and the timing of those shipments. As a reminder, Q2 is typically a lower cash conversion quarter due to TCJA catch-up payments.

Not shown on the slide, Return on Invested Capital was 14.2% for the 12 months ended March 31 and 380 basis points lower than the prior year, primarily driven by lower pre-tax net income, partially offset by a lower effective tax rate.

Slide 8 provides the sales and margin performance overview of our three operating segments. As Blake mentioned, sales in Intelligent Devices and Software and Control exceeded expectations. Intelligent Devices margin of 17.7% increased by 120 basis points year-over-year. Despite the high-single-digit volume decline and higher compensation compared to last year, our cost reduction and margin expansion actions allowed us to keep segment operating earnings flat and drove margins higher. Price/cost and mix were also favorable to margin.

Software and Control margin of 30.1% was up 440 basis points versus prior year even though sales were flat year-over-year. Higher margin was driven by cost reduction and margin expansion actions and positive price/cost, partially offset by higher compensation. To underscore that, sales in Software and Control were essentially flat year-over-year, but segment operating earnings grew by about $25 million and took margins back over 30%. Really strong performance.

Lifecycle Services margin of 14.5% fell 210 basis points year-over-year, driven by higher compensation and lower sales volume. Decremental margin in Lifecycle Services was about 40%. Even though higher compensation and lower sales volumes were headwinds, segment margin here was in line with our expectations due to our cost reduction and margin expansion actions and strong project execution.

I want to take a moment to point out the sequential improvements we saw in each of our segments. Intelligent Devices had incrementals that were in the forties from Q1 to Q2, reflecting the flow through on higher volume and solid price realization. Software and Control had nearly 100% flow-through on their sequential volume increase, aided by price and margin expansion activities. Lifecycle Services was able to grow segment operating earnings slightly despite a slight decrease in sales volume. This was due to strong project execution. Overall, for Rockwell, the incremental margin on the sequential sales growth was about 70%. This is reflective of strong execution by our teams around the world. I want to thank them for their outstanding efforts.

The next slide, 9, provides the Adjusted EPS walk from Q2 fiscal 2024 to Q2 fiscal 2025. Year-over-year, Core performance was up slightly on a 4% organic sales decrease. Sales declines were driven by Intelligent Devices and Lifecycle Services, but strong cost discipline in these segments softened the volume decline impact, and in Software and Control we saw margin expansion on continued improvement in Logix sales. Pricing was strong and we continue to fund new product development with company R&D at 6% of total revenue. Software and Control R&D as a percentage of segment sales was in the low-teens.

We saw excellent execution and better timing on our cost reduction and margin expansion actions, which were above our expectations, resulting in a $0.65 tailwind. We've realized about $155 million of savings in the first half. You'll see a $0.60 impact from compensation. This year-over-year delta reflects merit increases that came into effect at the beginning of the fiscal year as well as higher incentive comp versus prior year. This number is higher than we had expected in the quarter, reflecting a higher incentive accrual on the strong performance in Q2 and the increase to our expected EPS performance for the full-year. Also, remember that in Q2 last year we had an incentive compensation accrual reversal. Coming into this year we expected a year-over-year compensation increase to be approximately $160 million. We now expect that to be about $185 million for the full year. That translates to about $0.25 for each of the remaining two quarters.

All other items resulted in a $0.15 net headwind. This was essentially all currency, as a slight tax headwind was offset by other, smaller items. Taking a step back and looking at this slide, we were able to completely offset the headwinds of volume and compensation through strong execution on margin expansion and cost reduction activities as well as price realization.

Moving on to slide 10, to discuss our updated guidance for the full year. While our first half performance exceeded our expectations, we are leaving our organic sales outlook range unchanged. Frankly, we are allowing for uncertainty, less predictability in the demand environment, and project timing.

Regarding currency, the weakening of the dollar since our last earnings call has changed our full-year expectations for currency headwind to be about half a percentage point, down from prior guidance of 1.5 percentage points. We have already realized all of that currency headwind in the first half and FX turns to a modest tailwind for the second half of the year. Based on our strong execution in the first half of the year and a slight currency tailwind, we are increasing our segment operating margin guidance to about 20%, up from 19%.

At the midpoint of our reported sales guidance, from a segment sales and margin standpoint, we are expecting Intelligent Devices margin to be slightly down year-over-year on a mid-single-digit sales decline, Software and Control margins to be up year-over-year on a sales increase of mid-single-digits, and we expect Lifecycle Services margin to be down year-over-year on a low-single-digit sales decline.

We are updating our Adjusted EPS guidance to a range of $9.20 to $10.20, or $9.70 at the midpoint. The EPS guidance increase reflects our performance in Q2 as well as the currency change from a headwind to a tailwind. Under normal circumstances, we would have narrowed ranges for both sales and EPS, but it seemed prudent to keep a wider range due to ongoing uncertainty.

Let's talk about calendarization. Our expectation is for reported sales to grow low-single-digits sequentially from Q2 to Q3. In Q4 we expect higher sequential sales due to a combination of our normal seasonality and our backlog. On a year-over-year basis, the more favorable FX outlook is expected to result in a $0.20 tailwind to EPS, which is split evenly in Q3 and Q4. Remember, this is compared to the prior year. The sequential benefit of FX is minimal. As we mentioned during Q1, we continued to take additional temporary cost measures in Q2 to offset the FX impact. We like how the temporary controls are flowing through the P&L, and the organization is executing well. In this period of uncertainty, we feel better keeping those costs in check.

Segment operating margins were strong in Q2 and expanded nicely from Q1. As we look forward to the rest of the year, we are expecting very slight margin expansion from the Q2 level, think basis points and not percentage points. As a result, on the low-single-digit sequential sales growth from Q2 to Q3, incrementals would be in the low thirties.

A few additional comments on Fiscal 2025 guidance for your models. Corporate and Other Expense is now expected to be about $150 million. Net interest expense for fiscal 2025 is now expected to be about $145 million. We're assuming average diluted shares outstanding of about 113 million shares.

Our share buybacks in Q2 were approximately 450,000 shares in the quarter at a cost of $129 million. Our opportunistic overlay on our buyback program kicked in over the last month and we recently exceeded $300 million in buybacks year-to-date. That was originally our buyback target for the full year, but we view recent market pricing as an attractive opportunity to buy more Rockwell.

Moving away from the slides, I'd like to expand on a few topics. First, you'll see we are no longer providing the dollar value of our orders. We began giving this information during the supply chain crisis, as the ratio of orders to shipments diverged from the historical range of around 1 and we felt it was prudent to give that detail to investors. That situation has passed, and we are back to a normal Book-to-Bill of around 1 so we are dropping the additional orders data point.

Second, similar to last quarter, we have analyzed our orders and shipments to see if there were any indications of pre-buys. New demand on distributors was roughly equivalent to the demand those distributors placed on Rockwell. Distributor inventory levels are stable to slightly down compared to last quarter. And our surveys and channel checks with our OEM partners do not point to prebuys. So, we aren't seeing specific examples. In addition, we have put measures in place to limit distributor and machine builder stocking orders to appropriate levels. While our diligence didn't find specific evidence, and we have controls in place, we're factoring in the possibility of limited prebuys.

Third, focusing on the cost reduction and margin expansion activities that gave us a benefit of approximately $0.65 of EPS in the second quarter. This is faster than we had projected and reflects great performance by the Rockwell organization, particularly the Integrated Supply Chain team. We expanded gross margin by 130 basis points in the second quarter, compared to the prior year, against a 4% organic headwind. While a lot of our outperformance on the cost reduction and margin expansion program in the first half was timing, we do expect the full-year benefit of the program to exceed the $250 million we have been targeting.

Looking at some cost reduction wins. In direct sourcing we've saved about $18 million in the first half of the year and are expecting to continue to yield benefits in the second half, from supplier negotiations and transitioning to new suppliers. Savings are coming from areas like cables and wires, fewer broker buys, electronic components, and drives. On the manufacturing side, we've seen about $20 million of savings in the first half of the year. This is coming from labor efficiency, and other areas like process optimization and reduced scrap.

Last quarter, we talked about rationalizing 21,000 SKUs. That number through two quarters is approximately 36,000. These were heavily low-to-no volume SKUs. There are another 4,000 to 5,000 SKUs that we evaluated and decided to take other action, meaning we didn't rationalize them, but we're taking pricing or other action. This work is ongoing and is truly a part-by-part analysis that is focused on optimization and simplification. This is particularly important as we move production and supply chains in response to tariffs.

Let's wrap things up by talking about tariffs. Assuming current tariff rates and scope that are in place today remain, we estimate our tariff cost exposure to be about $125 million for the second half of fiscal 2025. We continue to manage tariffs through several actions, the fastest of which is pricing. We have enacted changes to our prices as part of our recovery program. This program will flex up or down as tariffs are enacted, modified, postponed or rescinded. We are also working on moving some production. Resiliency actions we took during the supply chain crisis means we have some flexibility to move production of key product lines as a response.

In summary, we are positioned to fully offset our fiscal 2025 tariff cost through a combination of pricing and supply chain actions. The objective of tariff-based price changes is the recovery of the incremental cost, and not sales growth. But, to the extent pricing is used, our full-year organic sales performance could be improved due to tariff-based price realization. Again, our full-year EPS target would stay intact because our intention is to offset tariff costs and have zero impact on second half EPS.

As Blake mentioned, the impact of tariffs in Q2 was completely neutralized. Going forward, in an effort to give visibility to underlying operational performance, our intention is to disclose tariff impact on both sales and earnings in each quarter.

In conclusion, we had a solid Q2. Looking forward, it remains a dynamic and unpredictable environment, but operationally focusing on the items we can control, the Rockwell team has shown its ability to profitably navigate uncertainty. We have a plan, and we have runway. This team is focused to finish the second half of the year strong.

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. We're pleased to report another quarter that reflects our focus on consistent execution. Investments in resilience are yielding results, including process changes to achieve faster price realization, capacity increases to create redundant manufacturing lines for high-value products in multiple countries, new lines of business that increase Annual Recurring Revenue, and our comprehensive program to increase operating margins. These changes can only be successfully executed with the coordinated efforts of our employees and partners around the world.

Transformation is hard in the best of times, and I'm especially proud of our team's ability to position us so well in a very challenging environment. Our value proposition is stronger than ever before, as demonstrated by customers in the U.S. and around the world who are getting Rockwell involved earlier in their own transformation plans, because nobody is better positioned than Rockwell to provide this value.

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.