Trimble transforms the way the world works by delivering solutions that enable our customers to thrive. Core technologies in positioning, modeling, connectivity and data analytics connect the digital and physical worlds to improve productivity, quality, safety, transparency and sustainability. From purpose-built products to enterprise lifecycle solutions, Trimble is transforming industries such as agriculture, construction, geospatial and transportation.

Second Quarter 2022 Earnings Conference Call Prepared Remarks

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Trimble Corporate Participants

Rob Painter – President and CEO
David Barnes – Senior Vice President and CFO

Transforming the Way the World Works

Presentation

Rob Painter, CEO

Welcome everyone. Before I get started, our presentation is available on our website; and we ask that you refer to the safe harbor at the back. I will lead the call today as David is at home on the back end of a COVID quarantine. Jim Todd, our head of FP&A, is in the room with me, and the three of us will handle the Q&A. My commentary on revenue and ARR growth today will reflect organic performance, thereby excluding our acquisitions and divestitures, and foreign currency movements.

Let's begin on page 2 with our key messages. Our team delivered a record second quarter, exceeding our own expectations. My congratulations to our team and our global partners. Annualized recurring revenue grew 15 percent, and we now stand at $1.51 billion of ARR. Total revenue was up 6 percent, also ahead of expectations, as was gross margin of 59.7 percent, a record level for Trimble. This flowed through to exceeding our expectations on EPS.

The Trimble operating system balances strategy, people and execution. We have been busy the last few months, demonstrating progression and proof points on many fronts. On strategy, we are seeing solid progress with our Trimble Construction One™ offering, which is a bundled offering of our construction software solutions, currently targeted towards contractors. We chose to start with this segment of Trimble customers, as we have the value proposition and momentum on our side. From this new baseline we will expand to other personas in construction such as architects & designers and owners, and we will roll out the offering on a more global basis. We will then extend this approach across our other applicable businesses. Our indicators are telling us that with Trimble Construction One our win rates are going up, our sales cycles are becoming shorter, and our average deal size is increasing. We also see progress in cross-selling efforts, with more than 20 percent of our construction software bookings coming from cross-sell in the second quarter, which is increasing our share of wallet and penetration into our installed base. From a capital allocation perspective, we divested 5 businesses in the quarter, where the revenue profile was greater than 90 percent hardware that was not core to driving connected value in our industry clouds. This included product lines such as sewn goods, safety vests, weighing scales and rotating lasers. In the quarter, we made the decision to exit the Russia market, and we repurchased $200 million of our shares. Our priority remains investing back into our business and pursuing acquisitions. Our acquisition pipeline is relatively full at the moment, and we have the firepower to act.

On people, we were recently named a top company for leadership and global culture in a survey by Comparably. We also appointed Ron Bisio to oversee our Transportation and Logistics business. Ron is a 23-year Trimble veteran and has led the growth and transformation of our Survey business over the last few years. Ron is an excellent leader, and his mandate is to execute our strategy. Faster. James Langley will redirect his focus to his biggest area of strength, which is his understanding of the needs of customers and the overall market.

On execution, we continue to simplify our portfolio, through actions such as reducing the number of part numbers and product offerings. We are building resilience for future products by designing more of our new hardware offerings to have dual sourcing capabilities on key components. With respect to our digital transformation, I am pleased with the cadence of delivery on the process and systems front, which we need in order to increase the velocity and scalability of our Trimble Construction One and cross-selling efforts. Our current tech stack is deployed in France and Benelux as a test market. Our most recent release gives our customers the ability to buy and add multiple products on a single contract and gives our sellers the ability to sell across the breadth of our portfolio from a single go-to-market team. This release gives us visibility across the entire customer and prospect base, driving a true customer 360 view in one system, and providing us accurate metrics and KPIs from a single source of truth. From here we will continue to refine and add additional functionality, and extend to other geographies, including North America, which will happen in the first half of next year.

Changing gears, I have met with a few dozen customers, well more than a thousand Trimble employees, and many investors over the last few weeks, including a three week visit throughout Europe. Our team believes in our Connect & Scale journey, and I am grateful that they are willing to challenge us to execute better and faster. Our customers are validating our direction—they are asking for help to unlock more digital insights and to integrate data and workflows across multiple products to drive even more value. They have efficiency and sustainability at the top of their agendas, along with access to qualified labor and inflationary pressures to manage in the near term. They are also asking us to be easier to do business with, as they want to more broadly access our technology. On the investor front, the topic has been almost singular; that is, the macroeconomic environment and recessionary clouds. Broadly speaking, market indicators and demand remain strong on an absolute basis. On a relative basis, it seems that our end markets are catching their breath and coming off a bit of a high point—inflation is a top concern. In Engineering and Construction, we watch signals such as construction backlog, the Architectural Billing Index, Dodge Momentum Index as well as signals from our own systems. In Agriculture, we look at equipment sales, commodity prices, inventory levels and farm income. In Transportation, we look towards freight demand, capacity utilization, freight rates and fuel prices. These indicators remain net favorable on an absolute basis. Overall, Trimble is much more secular than cyclical in nature—after all, productivity and efficiency are needed more than ever in challenging markets.

To help investors appreciate the resilience of Trimble, **let's turn to page 3** and let the facts speak to the quality of the Trimble business model. Over the last 10 years, we have moved our business from 20 percent to 55 percent software, services and recurring revenue. That represents over $2 billion today in these differentiated revenue streams that uniquely enable us to connect the physical and digital worlds. Over the same time period, we have moved from $361 million of ARR to $1.51 billion of ARR, a 15 percent CAGR. We believe this is the most resilient of our revenue streams and it continues to grow at a healthy double-digit level. Finally, we have expanded EBITDA margins from 19.9 percent to 25.6 percent over this time frame, and we are doing this with an increasingly asset light business model that operates with negative working capital. The overall point here is simple. If we enter a recession, we have never been better positioned to navigate. Our mindset in this environment, therefore, is to continue to execute our strategy. We are playing the long game. And we will also be prudent with managing our expenses. Our headcount since the beginning of the year has gone up by approximately 2 percent organically, and we will remain vigilant to allocate our capital and manage our operating expenses in line with our most compelling opportunity sets.

Turning now to the quarter and our numbers on page 4, I'll start by making the point that normal seasonality and year-over-year quarterly comparisons are a bit incomplete, as the pandemic and supply chain shortages have altered historical patterns, as have our recent divestitures and adverse movements in Fx. Second quarter revenue was $941 million, up 6 percent organically. Revenue in the quarter was aided by strong performance through our supply chain, as we were able to reduce hardware backlog and improve lead times across most of our hardware offerings. Gross margin expanded by 150 basis points to 59.7%, driven by a favorable mix shift toward software offerings, and the net impact of pricing and cost. The year-on-year rate of product cost inflation eased modestly in the quarter and came in better than our expectations, as supply chain initiatives implemented over the last several quarters have allowed us to reduce our reliance on both expedited transportation and the expensive broker market for scarce parts. We are seeing meaningful improvement overall in the reliability of our supply chain, but significant issues remain, and we don't expect a fully normalized supply chain environment until well into 2023. We face a number of critical part shortages that reduced our ability to meet customer demand in the second quarter, and those issues will continue to modestly constrain our revenue for the remainder of 2022.

EBITDA and Operating Margins for the quarter were 24.2 percent and 22.4 percent, respectively. Operating costs grew versus year ago levels driven both by the gradual normalization of travel expenses and by the planned investments we are making against our strategic growth initiatives. Net income and EPS were both lower than prior year levels, yet ahead of our expectations. Over the last twelve months we have generated $470 million of free cash flow, and through the first half of 2022 we generated just over $173 million of free cash flow, both of which are below our long-term goal of generating cash flow in excess of our non-GAAP net income. The main two factors impacting second quarter cash flow are the buildup of inventory, driven by supply chain disruptions, and tax payments related to the elimination of upfront tax expensing of R&D costs in the US. We expect both of these items to normalize over time. Meanwhile, we are operating with negative working capital.

Turning to page 5, the highlight metric is the 15 percent growth in ARR, which reflects strength in bookings, high net retention and the continued conversion of our perpetual software offerings. Hardware revenue grew at a rate of 3 percent versus a very strong second quarter of a year ago, while perpetual software revenues were down modestly driven in part by our ongoing model conversions.

Geographically, North America revenue was up 8 percent, Europe was up 1 percent. The loss of business in Russia and Ukraine reduced Europe revenue growth by 5 percentage points. Asia Pacific was up 5 percent, and Rest of World was up 22 percent.

Looking at the highlighted metrics on page 6, we have covered many of these already. I'll comment on our backlog, which stands at $1.6 billion, of which approximately $240 million is hardware. Hardware backlog came down by approximately $110 million in the quarter, about half from divestitures and half from improving supply chain execution. Before the COVID-induced supply chain disruption our hardware backlog was typically around $100 million, so we are still a good distance from normal backlog dynamics. We have also returned cash to shareholders through our share repurchase program, with $445 million of share repurchases on a trailing twelve-month basis. We ended the quarter with net debt just slightly over 1X EBITDA, leaving us with a capital structure which provides both resilience and ample dry powder to invest against our strategy.

Turning now to segment trends on page 7, we had a very strong quarter in Buildings and Infrastructure with 13 percent organic revenue growth and over 20 percent organic ARR growth. We had strong bookings and net retention across our software offerings in this sector. Our civil construction business, which has a meaningful hardware component, benefited both from both strong demand and improving supply chain execution. In our Geospatial segment, we came into the quarter with an expectation of lower year-on-year organic revenue growth due to the comparison with unprecedented strength in the second quarter of last year. Organic revenue was down 5 percent, reflecting both tough comps and some acute component shortages. Demand for our survey offerings remains strong, and the combination of growing bookings and supply chain challenges resulted in backlog remaining at an elevated level through the quarter. Resources and Utilities organic revenue grew by 15 percent in the second quarter, reflecting a significantly improved supply chain situation for most of our Agriculture products. Transportation organic revenue was down 5 percent year on year and was below our expectations, driven primarily by lower hardware sales to North American customers. While the financial results for Transportation remain below our expectations, there were a number of positive developments in the quarter that position our business for improved trends in 2023 and beyond. ARR grew in the quarter at a mid-single digit rate, representing sequential improvement in the rate of growth. Our churn of mobility customers was lower in the second quarter than in any quarter since late 2018. The performance of our ELD software is now very strong and customer satisfaction has improved significantly. We have announced our new mobility product to the market and are actively engaging with both existing customers and new logos.

I'll now turn to our outlook for 2022 on page 8. We are raising our guidance on ARR growth to 16 percent for the year, as our conviction on the underlying drivers of growth has increased. For the metrics of total revenue and EPS, three factors lead us to project a more cautious outlook for the full year: FX, supply chain, and demand. This weights approximately ½ Fx and ½ supply chain & demand. The appreciation in the US dollar over the last 90 days has obviously been significant. Fortunately, our cost base is quite global and creates a natural hedge, leaving us with only a modest residual exposure to foreign exchange on operating margins. While supply chains are demonstrably better and we hold our previous conviction on gross margin improvement in the second half of the year, it only takes one component to prevent a product from shipping, and we are facing some critical component shortages that we believe will impact our Geospatial and Resources and Utilities segments. On the demand front, we are seeing modestly lower than expected ordering across the Transportation and Agriculture sectors. Farmer sentiment has moderated in the face of high input cost inflation.

Incorporating these factors, we expect revenue in the range of $3.76 billion to $3.82 billion, which reflects an outlook for full-year organic total revenue growth of 9 to 11 percent. Overall revenue growth and organic revenue growth are expected to improve sequentially from the second quarter through the third and fourth quarters, reflecting increased pricing and increasing software and recurring growth. Note that the impact of our divestitures on our revenue will be approximately 5 percent in both the third and fourth quarters. If foreign exchange rates remain where they are now, we expect a negative impact on revenue of approximately 4 percent in the third quarter and 3 percent in the fourth quarter.

Gross margins are expected to sustain the improvement we saw in the second quarter into the second half of the year, driven primarily by pricing, but also by moderating supply chain costs. Our outlook for full year operating margins remains at 23-23.5 percent. The high point for both gross margin and operating margin for the year is expected to be in the fourth quarter. Our revised full year EPS range is $2.70 to $2.80.

We expect the ratio of free cash flow to non-GAAP net income to come in around 0.7 times for the year, impacted by the aforementioned R&D expensing change under the US tax code and inventory dynamics. It is likely these factors will reverse, and we would expect to deliver free cash flow well above non-GAAP net income in 2023.

In conclusion, the financial story for the second quarter was revenue, ARR and gross margin outperformance. For the year, the punchline is seeing through currency movements, divestitures and some choppiness in the macroenvironment to highlight that we are raising our view on ARR growth to 16 percent and guiding organic revenue growth between 9-11 percent. In the second half of the year, we expect to build on our second quarter momentum with sequential improvements in organic growth and gross margin through both the third and fourth quarters. Strategically speaking, the resilience of our business is stronger than ever. Our markets are inflecting with the adoption of digital technologies—this is our moment to Connect and Scale and we remain committed to this journey.

Operator let’s open the line to questions.