EDITED TRANSCRIPT
SCHN.PA - Full Year 2023 Schneider Electric SE Earnings Call

EVENT DATE/TIME: FEBRUARY 15, 2024 / 7:30AM GMT
CORPORATE PARTICIPANTS
Amit Bhalla Schneider Electric S.E. - Senior VP & Head of IR
Hilary Barbara Maxson Schneider Electric S.E. - CFO
Peter W. Herweck Schneider Electric S.E. - CEO

CONFERENCE CALL PARTICIPANTS
Alasdair Leslie Societe Generale Cross Asset Research - Equity Analyst
Andre Kukhnin UBS Investment Bank, Research Division - Analyst
Andrew James Wilson JPMorgan Chase & Co, Research Division - Analyst
Daniela C. R. de Carvalho e Costa Goldman Sachs Group, Inc., Research Division - MD and Head of the European Capital Goods Equity Research Team
Gael de-Bray Deutsche Bank AG, Research Division - Head of European Capital Goods Research
James Moore Redburn (Europe) Limited, Research Division - Partner of Capital Goods Research
Jonathan R. Mounsey BNP Paribas Exane, Research Division - Analyst of Capital Goods
Martin Wilkie Citigroup Inc., Research Division - MD
Max R. Yates Morgan Stanley, Research Division - Equity Analyst
Philip John Buller Joh. Berenberg, Gossler & Co. KG, Research Division - Research Analyst
William Mackie Kepler Cheuvreux, Research Division - Head of Capital Goods Research

PRESENTATION
Operator
Welcome to Schneider Electric's 2023 Full Year Results with Peter Herweck, CEO; Hilary Maxson, Chief Financial Officer; and Amit Bhalla, Head of Investor Relations. Thank you for standing by. (Operator Instructions)

I will now hand you over to Amit Bhalla.

Amit Bhalla - Schneider Electric S.E. - Senior VP & Head of IR
Good morning, everyone. Thank you for being with us. We join you today from Paris with CEO, Peter Herweck; and CFO, Hilary Maxson.

The press release and presentation are already on our website. We'll make sure to keep some time for question and answers at the end.

I have to remind you about the disclaimer that you will see both in the presentation and the press release, as usual.

But without further ado, for the business highlights, over to Peter.

Peter W. Herweck - Schneider Electric S.E. - CEO
Well, thanks very much, Amit. Very happy to be with you today on the back of a very strong execution that has delivered record performance for Schneider in 2023 and I think we're well positioned to the next frontier. It's also 364 days until we announce the change in governance, and I can assure you it's been a smooth ride as you can see in the results.
Now let me start off with the record revenue that we have, EUR 36 billion in fiscal ’23, a growth of 13%, delivering an adjusted EBITA margin of 17.9%, growth of 180 bps. Now that results in an adjusted EBITA up 25% on an organic basis, exceeding our targets.

When you look at the end markets, you can basically see that we’re much stronger, of course, in data center and networks where we’re the #1. We’ll talk about it. The infrastructure has gained in weight as well. While, of course, as we’ve talked before in the buildings and industrial market, there is a little bit of -- some weakness in pockets and we’ll talk about this in more detail.

Now a very solid print of Energy Management with 14% growth in the year, EUR 28 billion of revenue. And the Industrial Automation, a little bit of a mixed picture. We talked about the weakness of the discrete market and OEM market, you see that in the result, but still 7% and the longer-cycle Process Automation market and Software very strong. We’ll get into the details.

Now -- but let me start off with the key metrics that are really at record level and the net income and free cash flow also at record levels. The first time ever, we’re crossing EUR 4 billion in net income, up 15%. Free cash flow, EUR 4.6 billion, up 36%, and that has been a solid work in respect to working capital in 2023. And that will continue to be our focus as we go into the next year and will drive, as we said at the Capital Markets Day, we want to maintain the cash flow around 100% cash conversion rate over the cycle.

We’ve proposed and we will propose to the shareholders at the AGM a dividend of EUR 3.50, which is an 11% increase on -- for the group.

Now I think we’re very well positioned with respect to the megatrends that we’ve talked about at the Capital Market Day that deliver unprecedented opportunities for us. And let me give a couple of highlights.

Of course, we’re starting off with the digitization and AI, which is so important for the market. And with the deliveries that we have with the most complete and best electrical and cooling infrastructure that is out there supported by digital solutions, you can see we’re ready and we’re delivering to it at the edge, and of course, also hyperscalers and colos, and we’ve talked about this for quite some time.

Climate change. January was the first time in history that temperature went up by 1.5 degrees. So it’s urgent need to drive it. And of course, our Sustainability business, where we’ve also closed the acquisition of EcoAct, that has come in there as a solid business with very strong performance, as you can see here.

Now the energy transitions, of course, give quite some tailwind for Schneider in respect helping save in electrifying. As a reminder, 2020, 20% of the energy mix is electricity. 2030 is going to be 30%. So you can see it’s a tailwind that we have as a company, and 2050 is going to be 50%.

Now the evolution of wealth, and you’ve seen in the file roughly 40% of our revenue is new economies where we’re on the back of very strong growth in India and the Middle East and some other countries. And of course, as we’ve said during the year, China was also a contributor to our achievement and growth in 2023.

Now if you look at the new equilibrium, we do see quite a bit of reshoring because of supply chain, because of trade, because of other political environments that are out there and it is helping us in a little bit of a bifurcated way. If we’re looking at industry, power distribution is very strong. The automation is a little bit weaker. And of course, there’s a lot of digitization in that field, very strong for us.

But let’s go into a couple more numbers because numbers speak louder than words. And those are the priorities that I’ve mentioned, my priorities, and with it, the priorities of the company. If we start off with the growth culture, we’ve invested into organic growth and as I said we also would like to see a return to it. And you can see 130 bps improvement on the ROCE, bringing us to 13.5% ROCE, well on track on our journey to 15%.

Now on the sustainability side, and we have some more details. We’re well on track to reach our target -- approach our target of 10% in 2025 and we’ll go into some of those KPIs as we speak. Now we’re #1 positioned by the Global Corporate Sustainability Assessment with a score of 88 out of 100. Very nice.
We've also said that we want to invest more into R&D to drive organic growth. And it's very nice to see that these efforts are paying off with round about 40% of the new orders that we have that are linked to products that were designed and developed in the last 3 years with a big drive of our connected product in the EcoStruxure layer 1 with a growth of roughly 20% there.

Now our digital position, very nice to see on the Software side that we’ve crossed the EUR 3 billion revenue for the group, a growth of 18% in 2023. Very proud to say that the transition of AVEVA to subscription is going very well and accelerating with an ARR growth of 19% at the end of fiscal ’23.

On the AI side, which is not only important for our data center business, but also for our own productivity for products and for our clients, we’ve increased our AI hub to 350 people and accelerating the use cases in the company and with our clients.

Now all of this is also leading to a net satisfaction score of our clients to 53.6%, an all-time high for the group.

Now we're also aligning of course, our engagements according to the megatrends to drive growth and drive thought leadership with the C level of our customers. So you've seen us at COP, [at the web] where we do talk about energy demand side, how to deploy AI, respectively, and how to do AI in a responsible way from a carbon-free energy perspective.

Now climate change continues to be, as I said, so important and we'll drive this in our factories as well. We're very proud that our Hyderabad factory is the third Sustainability Lighthouse factory that has been named after Le Vaudreuil and Lexington in Kentucky.

Now focusing on the new equilibrium and the evolution of wealth. India has become so important for the group where we've established our hub with, meanwhile, a lot of R&D, a lot of manufacturing, and of course, a lot of growth in the country.

Talking about a couple of clients. At the end of the day, that's where the rubber hits the road and I'm not going to go through all of those examples. I want to point out to the first one, is AirTrunk with whom we've built a data center in their Sydney 2 campus. Quite a nice project. And it's a little bit outside where you would expect some of this business is hitting us. Quite a great project that we've done.

Other tendencies that we see. When we look at the Vancouver Airport, where we've engaged into a 5-year partnership with an option to increase by another 5 years, we help them on their zero carbon journey until 2030.

So you can see that the contractual engagements that we have with those clients is increasing from a length perspective and moving to more recurring revenue.

I said we're going to be talking about the SSI in a little bit more detail on the climate side. We've helped our customers to save and avoid 110 million tonnes of CO2 emissions in '23 alone. So that's been quite an accomplishment. On the resource side, we're aiming for 100% of our primary and secondary packaging to be free from single-use plastic and we're on a very good way to get to the target of 100%, 63% achievement in 2023.

And also on the quality side, very proud to have been given access to now 60 -- 46.5 million people since 2009. And again, in '23, we added 1.5 million to it in South Africa and South Asia -- in Africa and South Asia, excuse me. And that's good to drive the Sustainability Index where we want to reach 10 in 2025.

Now we’ve positioned the company to be an impact company. Our people want to create impact with the clients, with the society and also in respect to technology and innovation. I'm not going to walk you through all the awards we’ve gotten. Maybe 2 or 3 to point out the -- from Fortune 2023, the world’s most admired companies for 6 consecutive years, Bloomberg Gender-Equality Index for the 6 consecutive years. BCG has named us as one of the world’s most innovative company, which makes us proud. So quite a few things in that regard. And then, of course, also the world’s top companies for women by Forbes, also an award in 2023.

So I think we're on a very good way in respect to transforming the company to an industrial tech, and with that, drive digitization, electrification and sustainability.
And you see it also in the number, Hilary.

**Hilary Barbara Maxson - Schneider Electric S.E. - CFO**

Indeed. Thanks, Peter, and happy to be here with you all today. I'll start with some key financial highlights for the full year. And as Peter said, we finished with record revenues of EUR 36 billion, up 13% organic; record adjusted EBITA of EUR 6.4 billion, up 180 basis points organic; and record net income of EUR 4 billion. We also drove record free cashflows of EUR 4.6 billion with a cash conversion ratio of above 100%. And all of this translates into strong progression on our return on capital employed now at 13.5%.

Turning to some details on full year revenues. Price contributed to slightly more than half of our 13% organic progression with volume and products impacted by the weaker markets in discrete. Sales were relatively stronger in Energy Management, up 14.4% organic for the year with Industrial Automation up 6.7%.

The negative scope impacts are from our exit from Russia and our portfolio divestment program. FX translation also adversely impacted our revenues by around EUR 1.4 billion, mainly due to the weakening of the U.S. dollar and Chinese yuan against the euro.

And as you can see in the footnotes to this slide, based on current rates, which are fairly volatile in a few places, we would expect FX impacts of around minus EUR 400 million to minus EUR 500 million to revenues in 2024 and minus around 30 basis point impact on adjusted EBITA.

Looking at our revenues in the context of our Digital Flywheel. Our digital and digital-enabling revenues grew faster than the overall group at plus 17%, landing our Digital Flywheel at 56% of group revenues. This is a step up of 3 points versus 2022, driven by strong growth in connectable products and in Software and Digital Services despite the transition to subscription at AVEVA.

And software and total services, the parts of our Flywheel we would consider the most sticky and recurring now stands at 19% of our overall group revenues. And we progressed our recurring revenues in our agnostic software businesses by 5 points to 70%, primarily driven by the accelerated transition to subscription at AVEVA.

We report our backlog on an annual basis. And you can see here that backlog has progressed from an average of around 4 months of sales historically to around 6 months in 2022. And if you recall, that was due to the supply chain constraints. And now in 2023, we have a backlog of more than 6 months driven by an increase in demand for Systems.

Our Products backlog is primarily back to normal in terms of months, aside from in North America. And of course, this increase in backlog gives us higher visibility for 2024 and beyond.

Turning now to our fourth quarter revenues. We were up 9% organic to EUR 9.5 billion with about half of that due to volume from a strong step-up in system sales. North America and Rest of World are strong contributors with impacts in Asia Pacific and Western Europe due to the as-anticipated decrease in discrete automation.

In scope, you can see the impacts from our portfolio disposal program and we no longer have impacts in Q4 from Russia. And in FX, there's a particularly strong noncash negative impact in Q4 due to the significant devaluation of the Argentine peso, which took place in December.

Turning to our diverse mix of business models. In Q4, Products grew at plus 2% with positive volumes with the softness in discrete more than offset by continued growth across most Energy Management end markets and continued stabilization in consumer-linked segments.

Our Systems business, where we sell directly to the end user into key segments like data center, infrastructure and Process & Hybrid, continued with particularly high demand translating into sales of plus 17%.

Software and Services was once again up a strong 17% for the quarter, this time driven by Software and Digital Services with AVEVA driving particularly strong ARR of plus 19%, driven by continued strong growth in SaaS and new contracts.
Specifically on Energy Management, we were up 11% organic for the quarter. North America was up 10% organic and against a high base of comparison with double-digit growth in the U.S. and high single-digit growth in Mexico, both driven by continued demand across end markets particularly data center and infrastructure. And due to that demand, we’re continuing to stabilize and invest in our supply chain in North America, particularly for residential offerings and in our Systems business.

Western Europe was up 11% organic, with strong growth across all of the major economies and across end markets with particularly strong growth in Systems supported by demand in data centers and infrastructure and with growth in distributed IT. And residential was stable against a low base.

Asia Pacific was up 10% with China up high single digit, where growth was supported by demand across most end markets, particularly transportation, new power and electronics and with some stabilization of residential building. The rest of Asia Pacific was up double digit with particularly strong growth in India and double-digit growth in Australia.

Rest of World was up 11%, including some strong pricing actions in economies with significant devaluations. Middle East and Africa and South America were both up double digit, even excluding those pricing impacts due to strong demand across end markets, particularly infrastructure and a return to growth in buildings in South America.

Turning to Industrial Automation. Sales were up 1% with a differential in performance across business models. Strong software sales and continued growth in Process Automation was partly offset by the expected weakness in the discrete markets we discussed in the Q3 2023.

North America was flat with U.S. down low single digit and Mexico up double digit. Process markets were up across the region, driven by growth in Mexico with discrete automation down in the U.S. as lead times and inventories across the OEM value chain continued to normalize.

Western Europe was down 3% for the quarter after double-digit growth in the Q4 of last year with very strong growth in Software and double-digit growth in Process Automation, offset by weakness in the OEM market, again, as demand begins to normalize there.

Asia Pacific was down 2% for the quarter, where similar to Europe, we see very strong growth in Software and growth in Process Automation, offset by weakness in discrete automation. China was down mid-single digit while the rest of Asia Pacific was up low single digit as strength in India across categories and strength in Software offset weakness in discrete automation across the rest of Asia.

Rest of World was up 15%, including some strong pricing actions to offset currency devaluations and with good resilience in discrete automation markets and strong growth in AVEVA.

Turning now to our full year P&L. We finished the year with record adjusted EBITA of EUR 6.4 billion, an organic growth of 24.5%. This was driven by our top line growth as well as an expansion in our adjusted EBITA margin of plus 180 basis points organic to finish the year at 17.9%, supported by strong progression in our gross margin.

At our Capital Markets Day, we outlined the growth opportunities we see in front of us over the next 4 years and we are investing accordingly. We stepped up our R&D-to-sales ratio, including our capitalized R&D, to 5.6%. And in addition to investments, we did have some nonrecurring items in our support function costs impacting our SFC-to-sales ratio, and I'll give a bit more detail on that in a moment.

Our adjusted EBITA margin in Energy Management was up 220 basis points, supported by strong demand and strong pricing whereas adjusted EBITA margin in Industrial Automation was down 110 basis points, impacted by lower volumes and negative mix impacts from the decline in discrete automation.

Getting into a bit more detail, starting with gross margin. We finished the year with gross margin of 41.8% or plus 200 basis points organic, supported by pricing actions primarily taken in 2022 to counter the inflation that adversely impacted our gross margin last year.
We also returned to positive productivity, although we're not yet back to the levels we had prior to the supply chain crisis. And we would expect productivity to continue to normalize in 2024, although as mentioned, we still have a few supply constraints due to continued high demand.

Mix was positive despite our higher growth in the Systems business, driven by strong pricing in that business model. In terms of our OpEx or as we call it our support function costs, we did continue to drive structural savings this year, helping to offset in part a higher inflationary year than in the past. And we continued to make investments in our strategic priorities of innovation, support to our commercial footprint and our digital transformation including investments in AI. We also had some significant nonrecurring items year-over-year, including a differential in bonus accruals and some technical accounting adjustments, outside of which we did realize some positive leverage on our cost as we would normally target.

Turning now to net income. Including scope and FX, our adjusted EBITA is up 7%. Below the line, our other income and expense was positively impacted by gains related to our portfolio disposal program. Restructuring costs were EUR 147 million for the year, EUR 80 million lower than last year and trending towards our target of around EUR 100 million per year for normal years.

In financial costs, we had a step-up in our cost of financial debt tied to the AVEVA acquisition and we were additionally adversely impacted by around EUR 100 million due to hyperinflationary accounting and other FX impacts.

Our effective tax rate was 23.8% towards the lower end of our range, and we anticipate our ETR will remain within the range of 22% to 24% for 2024.

And this all results in a net income of EUR 4 billion, up 15%. Our adjusted net income, which excludes OIE and restructuring, was up 2% and adjusted EPS is at EUR 7.26 per share.

These operating results translated into our cash flow from operations up 3% to EUR 5.5 billion. Despite an as anticipated step-up in CapEx to support growth, we realized a very strong cash conversion ratio of 115%, driven by improvements in working capital due to a normalization of supply chain constraints and a focus on ensuring the right cash profile for our Systems business. And we'd expect to continue with free cash flow conversion of around 100% over the cycle.

Our strong free cash flow supported a step-down in our net debt and an improvement in our debt ratios. You can see here that we're back to similar levels in our net debt-to-EBITDA ratio as we had prior to the acquisition of the AVEVA minority interest.

As part of our Capital Markets Day, we adjusted our return on capital employed or ROCE ambition to 15%-plus. Driven by our strong results from operations in 2023, we had a very nice step-up in our ROCE, finishing the year at 13.5%, a 130 basis point improvement. And this is a good representation of the power of our underlying portfolio to drive returns to investors.

Another component of our return to investors is our progressive dividend. And I'm pleased to announce, Peter mentioned it earlier, we've proposed a dividend of EUR 3.50 per share for full year 2023, a double-digit increase in our 14th year in a row of progressive dividends.

With that, I'll turn back to Peter to give an idea on the expected trends for 2024.

Peter W. Herweck - Schneider Electric S.E. - CEO

Thank you very much, Hilary, and let's talk about what we're seeing for the year that has just started. Now the expected trends in 2024, there is a strong and dynamic market demand to continue on the back of the structural megatrends that we've talked about. We also see strong demand for system offers, notably driven by the trends in data center, grid infrastructure investment and increased investment across process industries served by both businesses.

There is a continued focus on subscription transition in our Software business and growth in Services. And we see a gradual demand recovery for product offers weighted towards H2 and this is linked with a recovery in consumer-linked segments and discrete automation.
All 4 regions to contribute to growth, it will be led by the U.S., India and the Middle East.

Now how does that translate into our 2024 targets for the group that we’re setting as followed. The 2024 adjusted EBITA growth of between 8% and 12% organic. The target would be achieved through a combination of organic growth and margin improvement, currently expected to be a revenue growth of 6% to 8% organic and the adjusted EBITA margin up plus 40 to plus 60 bps organic. This implies an adjusted EBITA margin of around 18% to 18.2%, including scope based on transactions completed to date and FX based on current estimation.

Now if we recap also our medium targets that we’ve set last November at the Capital Markets Day called the Next Frontier in respect to financial targets and across-the-cycle ambitions, you can see that we’re well on track to achieve those in the first year as we start the journey to the Next Frontier to be a Company of 25 and have organic growth from ’23 to ’27 of 7% to 10% and the respective margin appreciation.

With that, I’ll hand over to Amit to host the Q&A session that we’re looking forward to.

---

**Questions and Answers**

**Operator**

(Operator Instructions) The first question comes from Andrew Wilson of JPMorgan.

---

**Andrew James Wilson - JPMorgan Chase & Co, Research Division - Analyst**

I just wanted to, I guess, dive into the discrete automation commentary a little bit more. I guess it’s probably a comment around China if I sort of take that in most regions it’s actually been relatively resilient for you. But just give us, I guess, a bit more color on where you think you are in terms of some of the destocking, where you think underlying demand is and whether we’re kind of confident in whether we think we’ve seen the trough and when we might start to see a bit more of a tangible recovery.

---

**Peter W. Herweck - Schneider Electric S.E. - CEO**

Well, thank you very much for the question. Again, maybe on the discrete automation, we’ve -- in general, I think I’ve talked about this for 2 quarters. It is there. It’s there in China. We have a pretty good visibility on stock levels at our distributors and at our OEMs and we can say this is normalizing.

The underlying trend, we’re expecting a recovery in H2 while we already see with some clients some positive momentum. But it’s too early to call the cycle being over. And it’s been cyclical since I’m in the business, so not a total surprise. We should see that come back in H2.

---

**Operator**

The next question, sir, is from Phil Buller of Berenberg.
Philip John Buller - Joh. Berenberg, Gossler & Co. KG, Research Division - Research Analyst

Question is on data centers. There's quite a lot of excitement out there in the financial markets. And it looks like from your Slide 4 that it's now 21% of orders, which is 2 points higher than what we shared at Capital Markets Day.

So I guess I'm wondering what is actually happening in absolute terms on the orders side for data centers and perhaps in terms of the negotiation pipeline? And how should we think about that translating into sales? In the press release, I think it's referenced as being strong double-digit growth, but perhaps you can frame that a little bit, please. Is it 20%, 30%, 40%? Really just trying to get a handle on the moving parts of data centers, please.

Peter W. Herweck - Schneider Electric S.E. - CEO

Well, thanks very much, Phil, for the question. Let's maybe start breaking this down a little bit. When we're talking about data centers, the 21% on orders that you've well recognized, the plus 2% since 2022, of course, gives a strong demand. We're usually talking about data centers, we're talking about the telecom space and then also our single-phase UPS products that go into the more general market.

From that perspective, we've seen -- if I start there, we've seen a recovery in that market coming back, the data centers, hyperscalers and colos, very good demand, very good visibility and a very good backlog that we've talked about. So we expect this to continue for quite some time.

Now maybe we can put a little bit more color on some of the numbers, Hilary, that we've buried in the press release.

Hilary Barbara Maxson - Schneider Electric S.E. - CFO

So indeed, we don't give specific growth numbers on each of the segments, but I think we've talked for quite some time about data center being double digit in our actual sales results. So that's been translating into sales now for quite some time. And I think you can put the math together probably between the backlog that you see and what we're talking about here. No doubt, this is probably our fastest-growing segment and a big opportunity for us.

At the Capital Markets Day, we'd mentioned that we expect over this 4 years that the growth rate for data center and network would be 10%-plus.

Operator

The next question is from Andre Kukhnin of UBS.

Andre Kukhnin - UBS Investment Bank, Research Division - Analyst

My question is on pricing. I wondered if you could talk about just what you expect for 2024, what your intentions are, maybe splitting it across the categories in terms of Products, Systems and Services.

And if I may just clarify, Hilary, the EUR 315 million in support function cost, is that a one-off? And is it adjusted out from your adjusted EBIT or not?

Peter W. Herweck - Schneider Electric S.E. - CEO

So maybe I'll start it off, Andre, thanks for the question. In respect to the mix, we've said that we see Products come back and there are some good signs in some of the categories that we have. Some of the categories have been very good. We've outlined the consumer-linked, so that's more on the residential side. I talked about the single-phase UPSes already. And then, of course, there are products in the industrial world.
Systems is growing very nicely and the solid, solid backlog that we have with good visibility into 2024, and also as you have seen, in the release in -- partially also into 2025.

Now Services & Software, we expect to continue to see solid growth as we go forward.

Now on the support function cost in more detail, Hilary?

Hilary Barbara Maxson - Schneider Electric S.E. - CFO

Yes, sure. So I'd encourage on the support function cost that if you take a look at the slide, we give some detail around those costs. I think it's sort of around EUR 300 million-plus. Those are nonrecurring in nature, so we've called them out but they are included in our adjusted numbers. We don't take them out for purposes of adjustment. We just particularly had some items this year that we called out in that bridge and you can see it there and impacting our SFC-to-sales ratio.

Operator

The next question is from Alasdair Leslie of Societe Generale.

Alasdair Leslie - Societe Generale Cross Asset Research - Equity Analyst

So just wondering if you could unpack the organic margin guidance a little bit. Maybe comment on the puts and takes around pricing, productivity, mix and wage inflation, how you see each of those elements driving, I suppose, or weighing on margins.

And linked to that, on FX, I mean, sort of close to a 100 basis point hit the margins in 2023. It's quite a significant headwind, another 30 basis points expected in 2024. I mean if you go back over the years, FX has kind of been a consistent headwind even if there's some other charge with the organic line.

So are you kind of planning any changes either in pricing policy or operational structure maybe to mitigate those types of moves in the future?

Peter W. Herweck - Schneider Electric S.E. - CEO

Quite a few questions baked in one question. Let me start off and then hand over to Hilary. In respect to pricing, we've seen extraordinary year in '22, and there was quite some carryover in 2023. In '24, we expect this to normalize to historic levels, but possibilities for us to drive that forward.

In respect to activity, if you recall in the last year and the year before, with the supply chain, we were worried about being able to deliver. And from that perspective, productivity was maybe a priority 2. Now it's -- that will change and has changed in the last month and into 2024. Of course, we said earlier that we're seeing extraordinary demand in some geographies. And there, we continue to have delivery capability and deliver reliability as our #1 KPIs. But in total, one should expect some productivity that comes into 2024.

Now on FX and some other stuff, Hilary, that's your expertise, clearly.

Hilary Barbara Maxson - Schneider Electric S.E. - CFO

Sure. Indeed. Maybe to give a little context from a number standpoint. So in terms of gross margin, like Peter said, we would expect price to be more -- in more normal levels. At the Capital Markets Day, we talked about driving around 35 basis points of gross margin improvement due to pricing over long time periods. So by normal in 2024, maybe we're talking about 1, maybe up to 2 points in terms of pricing on the top line impacting the gross margin as well.
Productivity, Peter covered. We would expect it to continue to normalize, but not back to its full potential quite yet.

In terms of mix, I did say in the Capital Markets Day that due to the Systems business and that increase in System business over time, we'd expect it to be negative to mixed, and we would expect that to be the case in 2024 while we're still focusing on the transition at AVEVA to subscription so that gives you a sense, hopefully, of the gross margin line.

Labor inflation, we don't expect it to be fully back to normal in 2024, but not at the levels that we saw in 2023. So some retraction, but not quite back at the levels that we saw before 2023.

In terms of FX, indeed, it's a key focus for us across, particularly the areas where we're impacted. We have good market shares in the emerging markets, in particular. And so we have a keen focus on this in terms of pricing, but also some other potential actions in order to address some of the more, I would consider, extraordinary impacts that we've seen from FX over the past year and into 2024.

Amit Bhalla - Schneider Electric S.E. - Senior VP & Head of IR
All right. Thanks, Alasdair. Next question, please?

Operator
The next question is from James Moore of Redburn Atlantic.

James Moore - Redburn (Europe) Limited, Research Division - Partner of Capital Goods Research
And my question is on the 6% to 8% organic sales growth guidance for the 2024 year. And it's really in 2 parts. Firstly, why is it below the 7% to 10% midterm 4-year target when you've got far higher visibility upfront? Are you saying that you expect the next 3 years to be higher or the midterm target is too high?

And secondly, as data center is the fastest engine behind the 6% to 8% this year, if you won't say what the data number is because obviously it's going to be above 10% (inaudible) and the difference is huge, but could you say what the book-to-bill last year for data center was and how much of the EUR 19.2 billion backlog was the global data center?

Peter W. Herweck - Schneider Electric S.E. - CEO
Thanks, James. For the question on the 6.8% (sic) [6% to 8%] guidance, which we think is very balanced as we go into 2024 and supports what we've said at the Capital Markets Day in respect to 7% to 10%, given the environment on the -- on some of the Products side.

Now in respect to data center and backlog and what's the book-to-bill ratio, we don't go into those details. But you can see from our disclosure that we've built up well over EUR 2 billion of backlog in 2023. And you should expect that a majority or a lot of this is coming from infrastructure and from data centers. And you see it in the percentages of the end market coverage that we've laid out.

So 19% to 21% for data center on the infrastructure, if I recall correctly, and please correct me, Hilary, I think it was also a point up in that respect. So that gives you a good color of where we are with what we believe is a balanced outlook or guidance in respect to growth for '24.

Amit Bhalla - Schneider Electric S.E. - Senior VP & Head of IR
All right. Thanks, James. And that growth of backlog for the EUR 2.7 billion, so well above EUR 2 billion.
Operator

The next question is from Jonathan Mounsey of BNP Paribas.

Jonathan R. Mounsey - BNP Paribas Exane, Research Division - Analyst of Capital Goods

Back to the price, actually. I don’t know maybe I didn’t hear it, but what was the price contribution in Q4? And then I think, Hilary, you just said that price is likely to be 1 to 2 in 2024. Is it fair to assume that there’s quite a bit of bias for that towards H1, especially when we see how much price was needed in Rest of the World, what’s that, hyperinflation in certain economies. So can I sort of imagine maybe this is sort of 3% in H1 but perhaps only 1% in H2, is that a fair assumption?.

Peter W. Herweck - Schneider Electric S.E. - CEO

Please go ahead.

Hilary Barbara Maxson - Schneider Electric S.E. - CFO

So in the Q4 -- starting with the Q4 question, around half of the 9% growth we saw in the Q4 was due to price.

In terms of pricing in 2024, yes, you did hear correctly that we would expect to be in the range of 1 to 2 points. Of course, that might change depending on differentials in FX or differentials in inflation than we have in the scenarios that we’ve put out today.

In terms of a bias between the H1 and the H2, I’d mentioned that we don’t -- that a lot of our 2023 price was due to carryover. So we don’t enter into 2024 with a lot of carryover from price. Agile pricing for FX, we do consistently. So this one I wouldn’t -- I wouldn’t call out anything in particular between the H1 and the H2 for 2024. Again, we said that pricing should be sort of a normal year with, again, agile pricing in the hyperinflation economies.

Operator

The next question is from Gael de-Bray of Deutsche Bank.

Gael de-Bray - Deutsche Bank AG, Research Division - Head of European Capital Goods Research

My question would be around the construct of the guidance. Did you assume any significant order decline this year and any substantial backlog consumption, for the backlog maybe to come back closer to the normalized level of performance?

And if I may, can you perhaps say how much of this $3 billion supply framework agreement with Compass Datacenter was included in the backlog at the end of December?

Peter W. Herweck - Schneider Electric S.E. - CEO

So as we said, the backlog gives us good visibility into 2024. And so that’s part of how we made up the guidance plus some pricing, as we’ve discussed in the earlier questions, Gael.

And then, of course, when you look at the products with a mixed picture, some already pretty good and some we expect to come up in H2, and all of those results into the 6% to 8%. I don’t know, I think I missed one or the other point of your question buried in there. Hilary?
Hilary Barbara Maxson - Schneider Electric S.E. - CFO

Yes. Maybe I'll just add. As usual, we create the guidance based on a bunch of different scenarios on what we think is going to happen in terms of macroeconomics. We don't have any concerns about the backlog. We don't see any uptick in terms of cancellations or anything like that. So we are going into 2024 with a few points of opportunity from a backlog standpoint.

In the Q4 and in 2023, I think you can do the math yourself. We don't give the book-to-bill, but you can see that we again drove record backlogs. Backlog consumption in 2024, we certainly expect to consume backlog to the points that I've just made. However, like we said in the expected trends, we expect to be still in a strong demand market, particularly for Systems. But also we've called out, in particular, a recovery in the consumer-linked and the discrete markets in the second half. But as you can see in the Q4, the rest of our markets, so the vast majority of Energy Management, remains well positioned.

How much of the Compass Datacenter, of the $3 billion, would be included in the backlog? It's not entirely included yet, if that's the question.

Operator

The next question, sir, is from Max Yates from Morgan Stanley.

Max R. Yates - Morgan Stanley, Research Division - Equity Analyst

Could we just talk a little bit more about the Industrial Automation margin because it's stepped down obviously quite significantly versus the first half of the year, and I imagine sort of some of those kind of dynamics around kind of price costs were there in the first half.

So I mean when we're talking about a kind of 300, 400 basis point sort of step-down, could you just help us understand maybe kind of how much of that was cost? Maybe size some of those investments? And what -- if you could just sort of lay it out a bit, what was kind of the real change versus the first half of the year? Maybe some clarity on discrete versus Process growth rates within that division might give context as well.

Peter W. Herweck - Schneider Electric S.E. - CEO

Yes. Let me start off with the different growth that we've seen and then also how some of that translates into margin and margin differential in H1 and H2.

The -- as we've said over the last 2 quarters, the discrete automation, and in particular, the OEM space for us has had declines as we anticipated. We do see in some geographies stabilization, so it's too early to call it a recovery. But we've seen some of those in the past, so I wouldn't be too worried about that.

Now Process Automation has had a good trend and you can see it in some of the pure players that are out there where we are lining up very well to those.

Now on the Software side, that is also consolidated into IA. Of course, we have the transition to subscription that has varying impacts over the quarter, but did contribute to revenue growth in the last year. And we also think that the transition should probably '25, '26, we should be through with what we've said before.

Now on the quarterly or half yearly phasing of the margin, Hilary, maybe you can support here a little bit with some insights.
Hilary Barbara Maxson - Schneider Electric S.E. - CFO

Yes, sure. So there’s -- and I think we gave the breakdown anyways of growth between the businesses -- the different business models that we have there. So like Peter said, good growth in Process Automation, actually good growth in Software you can see this year as well with the impacts from discrete.

Now of course, we don't manage quarter-by-quarter, and I've mentioned that a few times before in terms of cost. So most -- much of what you see from the impacts between the H1 and the H2 is the impact from the lower volumes in discrete. I wouldn't call out anything in pricing. I think it's really volumes here of discrete where we continue with Industrial Automation, like with Energy Management, to make some investments for the future. We've talked about things in electronics and things that we're doing in platforming in Industrial Automation.

So much of what you see in the second half is tied to the differential between volumes and costs. And secondly, we have a big mix impact between discrete and Process Automation. And of course, for 2024, we'll be watching carefully. But again, we wouldn't make an adjustment from a cost structure standpoint simply because of what we would consider to be sort of normal cyclicality in the Discrete Automation space.

Operator

The next question is from Martin Wilkie of Citi.

Martin Wilkie - Citigroup Inc., Research Division - MD

It's Martin from Citi. The question I had was on the profitability and margin in the Systems business. So I understand that System is mix negative relative to Products. But just as we think about that Systems profitability over time and given how big that backlog is, has that structurally become more profitable given the demand in data center, media voltage, these kind of areas, so that gap structurally narrow against Products? Just to understand how that relative growth rate should impact the margin over the next few years.

Peter W. Herweck - Schneider Electric S.E. - CEO

Yes. Thank you very much, Martin, for the question. Excellent question. We've talked about this at the Capital Markets Day, in fact, that our Systems business has had a solid margin improvement and that has come out of price. It has come out of also moving from a more engineered-to-order to a more configured-to-order. And in particular, when we're talking with clients where we have multiyear engagements, these are usually very much industrialized systems where we see a much better margin. You shouldn't expect that the margin will reach where the Products are, but we do see good progression.

Operator

The next question is from Daniela Costa of Goldman Sachs.

Daniela C. R. de Carvalho e Costa - Goldman Sachs Group, Inc., Research Division - MD and Head of the European Capital Goods Equity Research Team

I'll keep it quick. Just given the strong free cash flow and the balance sheet, can you comment a little bit in terms of sort of your thinking regarding triggering further inorganic growth and how you're thinking about the portfolio from that angle at the moment?
Peter W. Herweck - Schneider Electric S.E. - CEO

I think we're attached to our capital allocation that we've said at the Capital Markets Day, and we'll follow that one. I think from a portfolio perspective, we are ideally positioned to the megatrends.

And of course, in respect to M&A, we will remain opportunistic in the fields that we have talked about at the Capital Markets Day, where we are active right now.

Operator

The next question is from William Mackie of Kepler Cheuvreux.

William Mackie - Kepler Cheuvreux, Research Division - Head of Capital Goods Research

My question relates to the supply-demand imbalances or rather the capacity tightness that you're seeing across various geographies or end markets and specifically your investment intentions or CapEx plans for the year ahead. So the question is basically where do you see the most tightness across the manufacturing system? And where are you allocating or focusing the most change in investment for CapEx?

Peter W. Herweck - Schneider Electric S.E. - CEO

Yes. Thank you very much for the question, William. As we've said in the presentation and with multiple questions already, we're focusing on productivity in many geographies. That means we've pivoted away from here supply constraints.

Now in the United States, that's -- or in North America, that's a different story. We also said that there is unprecedented demand where we want to serve this demand and also have on-time delivery KPIs that are to the expectation of what we have in all other geographies.

Now from an investment perspective, we've lined out at the Capital Markets Day what the investment priorities are. There is, of course, the U.S., there is India. And then in the other geographies, I think it's around the normal investments that we have planned.

Amit Bhalla - Schneider Electric S.E. - Senior VP & Head of IR

All right. Thank you, Will. I think just mindful of everyone's time, I just want to spend a minute on the slide that you probably see on the screen. We're going to be on road shows pretty soon. So look forward to seeing many of our investors. Also on a couple of conferences that are lined up. So look forward to that.

If you need to reach out to the team, you can reach out to us by e-mail or by contacting Lorna and our team.

Thank you very much for your time and attention and your shareholding, and we look forward to seeing you soon.

Peter W. Herweck - Schneider Electric S.E. - CEO

Thank you very much.