

19-Feb-2021

Deere & Co. (DE)

Q1 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to Deere & Company's First Quarter Earnings Conference Call. Your lines have been placed on listen-only until the question-and-answer session of today's conference.

I would now like to turn the call over to Mr. Josh Jepsen, Director of Investor Relations. Thank you. You may begin.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

Thank you. Good morning. Also on the call today are Ryan Campbell, our Chief Financial Officer, and Brent Norwood, Manager, Investor Communications.

Today we'll take a closer look at Deere's first quarter earnings then spend some time talking about our markets and our current outlook for fiscal 2021. After that, we'll respond to your questions. Please note that slides are available to complement the call this morning and it can be accessed on our website at johndeere.com/earnings.

First a reminder. This call is being broadcast live on the internet and recorded for future transmission and use by Deere & Company. Any other use, recording or transmission of any portion of this copyright broadcast without the express written consent of Deere is strictly prohibited. Participants in the call including the Q&A session agree that their likeness and remarks and all media may be stored and used as part of the earnings call.

This call includes forward-looking comments concerning the company's plans and projections for the future that are subject to important risks and uncertainties. Additional information concerning factors that could cause actual results to differ materially is contained in the company's most recent Form 8-K and periodic reports filed with the Securities and Exchange Commission.

This call may include financial measures that are not in conformance with accounting principles generally accepted in the United States of America or GAAP. Additionally, information concerning these measures including reconciliations to comparable GAAP measures are included in the release and posted on our website at johndeere.com/earnings under Quarterly Earnings and Events.

I'll now turn the call over to Brent.

Brent Norwood

Manager-Investor Relations, Deere & Co.

John Deere demonstrated strong execution in the first quarter resulting in a 17% margin for the Equipment Operations. Ag fundamentals improved significantly throughout the first quarter and the improved sentiment is reflected in the most recent status of our order books and early order programs. Meanwhile, markets for our Construction and Forestry division also improved in the first quarter leading to improved levels of profitability and a heightened outlook for the rest of the year.

Slide 3 shows the results for the first quarter. Net sales and revenue were up 19% to \$9.1 billion while net sales for the Equipment Operations were up 23% to just over \$8 billion. Net income attributable to Deere & Company was \$1.224 billion or \$3.87 per diluted share.

During the first quarter of 2021, the company recorded impairments totaling \$50 million pre-tax to certain long-lived assets. These impairments were more than offset by a favorable indirect tax ruling in Brazil of \$58 million pre-tax. In comparison to last year, the quarter also benefited from minimal employee separation costs, which represented \$127 million pre-tax in the first quarter of 2020.

Before transitioning to a review of our business divisions, I'd like to highlight a few changes to our segment reporting as shown on slide 4. As you probably already noticed in our press release, the company implemented a new segment reporting structure beginning in fiscal year 2021 to align with the recent implementation of the new strategy and operating model which was announced last summer.

As a result, the company's Agriculture and Turf operation was bifurcated into two new segments. The Production and Precision Agriculture segment is responsible for developing and delivering global equipment and technology solutions for production-scale growers of large grains, small grains, cotton and sugar. Main products include large and certain midsize tractors, combines, cotton pickers, sugar cane harvesters, seeding and application equipment.

The Small Agriculture and Turf segment is responsible for developing and delivering market-driven products to support mid-sized and small growers as well as turf customers. The operations are principally organized to support production systems for dairy and livestock, high-value crops and turf and utility operators. Primary products include certain mid-sized and small tractors as well as hay and forage equipment, riding and commercial lawn equipment, golf course equipment and utility vehicles. There were no reporting changes for the Construction and Forestry and Financial Services segments. As a result, the company will now report across these four segments.

Now let's turn to a review of our Production and Precision Ag business starting on slide 5. Net sales of \$3.069 billion were up 22% compared to the first quarter last year. Primarily due to higher shipment volumes and price realization partially offset by the unfavorable effect of currency translation. Price realization in the quarter was positive by nearly 8 points while currency translation was negative by 1 point.

Operating profit was \$643 million resulting in a 21% operating margin for the division compared to an 8.7% margin for the same period last year. The year-over-year increase was driven by positive price realization, higher shipment volumes and sales mix and a \$53 million favorable indirect tax ruling in Brazil. These items were partially offset by unfavorable effects of foreign currency exchange. Excluding the impact of one-time items such as the favorable tax ruling, first quarter margins were around 19.5%.

Also, when comparing to last year, keep in mind that the results in the prior period included employee separation costs of \$42 million. With respect to price realization, the above average results for the quarter were primarily driven by a few different factors. While North American list prices were up slightly above average, the primary drivers of price came from significant midyear price adjustments made in 2020 for select foreign markets to offset unfavorable currency movements.

Additionally, certain US and Canada products also had midyear adjustments in 2020 as a result of product launches such as the new 8R in May of last year. Lastly, the current low inventory levels across the industry have led to lower overall incentive spending thus boosting net price realization. We do anticipate net price realization to moderate closer to normal levels towards the second half of the year.

Shifting focus to Small Ag and Turf on slide 6. Net sales were up 27% totaling \$2.515 billion in the first quarter. The increase was driven primarily by higher shipment volumes, price realization and the favorable effects of

currency translation. Price realization in the quarter was positive by nearly 6 points while currency translation was positive by 2 points.

For the quarter, operating profit was \$469 million resulting in an 18.6% operating margin for the division compared to a 7.9% margin for the same period last year. The year-over-year increase was due to higher shipment volumes, positive sales mix and price realization while results for the prior period were affected by voluntary employee separation expenses of about \$36 million.

Slide 7 shows our industry outlooks for Ag and Turf markets globally. In the US and Canada, we expect industry sales of large ag equipment to be up between 15% and 20% for the year reflecting improved fundamentals in the ag sector. Our outlook is guided in part by the results of our early order programs and tractor order book. Our crop care early order program which ended in October finished with unit orders up double digits compared to the prior year. In addition, we completed our combine early order program in January with results also up double digits and outpacing the results of our crop care program.

Furthermore, our large tractor order book now extends into the fourth quarter and has an increased production schedule relative to last year. Meanwhile, we expect industry sales of Small Ag and Turf equipment in the US and Canada to be up about 5%. Deere's forecasted production will be higher than the industry reflecting our plans to increase inventory levels in small ag which ended the year at historic lows.

Moving on to Europe. The industry outlook is forecast to be up about 5% as higher commodity prices strengthen business conditions in the arable segment offsetting some weakness in dairy and livestock. Importantly, our tractor order book in Mannheim now extends into the fourth quarter providing good visibility through much of fiscal year 2021. Furthermore, we've seen continued progress executing our regional strategy focused on large and precision ag.

In South America, we expect an industry sales increase of about 10%. The confluence of higher commodity prices, strong production and a favorable currency environment have boosted profitability of farmers, driving equipment demand for the year. Despite limited government financing programs, private debt is more widely available this year supporting continued strength in equipment demand. Industry sales in Asia are forecast to be down slightly though key markets for Deere are performing slightly better.

Moving on to our segment forecast on slide 8. For Production and Precision Ag, net sales are forecast to be between \$15.5 billion and \$16.5 billion in fiscal year 2021. The forecast includes a currency tailwind of about 1 point and expectations of just under 6 points of positive price realization for the full year. For the segment's operating margin, our full-year forecast is ranged between 19.5% and 20.5% with solid performance across the various geographical regions.

Slide 9 shows our forecast for the Small Ag and Turf segment. Net sales in fiscal year 2021 are forecast to be between \$10.5 billion and \$11.5 billion. The guidance includes expectations for 2 points of positive price realization and a favorable currency impact of about 3 points. The segment's operating margin is forecast to range between 14.5% and 15.5%.

Now, let's focus on Construction and Forestry on slide 10. For the quarter, net sales of \$2.467 billion were up 21% primarily due to higher shipment volumes, price realization and the favorable effects of currency translation. Additionally, Wirtgen ended its practice of reporting on a one-month lag resulting in four months of [ph] Wirt (00:10:54) connectivity in the quarter. The quarter's results were boosted by 3 points of positive price realization and a currency tailwind of about 1 point.

Operating profit moved higher year-over-year to \$268 million due to higher shipment volumes and sales mix and price realization. The increase in profit was partially offset by higher production costs and impairments of long-lived assets related to an asphalt plant factory in Germany. Also keep in mind that last year's results included voluntary employee separation costs of about \$24 million.

Let's turn to our 2021 Construction and Forestry industry outlook on slide 11. North American construction equipment industry sales are now forecast to be up about 5% while sales of compact construction equipment are expected to be up about 10%. End markets for earth-moving and compact equipment have benefited primarily from the strength in the housing market as well as a modest recovery from trough conditions in the oil and gas sector.

Furthermore, current demand levels reflect the benefit from the industry's collective response managing inventory levels tightly during the early days of the pandemic. In forestry, we now expect the industry to be up between 5% to 10% as a recovery in lumber demand particularly in North America is leading to increased production throughout the year.

Moving to the C&F segment outlook on slide 12. Deere's Construction and Forestry 2021 net sales are now forecast to be between \$10.5 billion and \$11 billion. Our net sales guidance for the year include expectations of 2 points of positive price realization and a currency tailwind of about 2 points. We expect the segment's operating margin to be ranged between 10.5% and 11.5% for the year benefiting from price, volume and non-reoccurring expenses from 2020.

Let's move now to our Financial Services operations on slide 13. Worldwide Financial Services net income attributable to Deere & Company in the first quarter was \$204 million benefiting from favorable financing spreads, lower losses on operating leases and a lower provision for credit losses. For fiscal year 2021, the net income forecast is now \$730 million. The provision for credit loss forecast for 2021 is 23 basis points when compared to the average portfolio managed.

Slide 14 outlines our guidance for net income, our effective tax rate and operating cash flow. For fiscal year 2021, our full-year outlook for net income is now forecast to be between \$4.6 billion to \$5 billion. The guidance incorporates an effective tax rate projected to be between 24% to 26%. Lastly, cash flow from the Equipment Operations is expected to be in a range of \$4.6 billion to \$5 billion and contemplates a \$700 million voluntary contribution to our OPEB plan.

I will now turn the call over to Ryan Campbell for closing comments. Ryan?

Ryan D. Campbell

Chief Financial Officer & Senior Vice President, Deere & Co.

Before we respond to your questions, I'd like to offer a few thoughts on our fiscal year 2021 outlook as well as address some of the key themes covered in our latest sustainability report published earlier this month.

With respect to our outlook, we've seen underlying fundamentals continue to improve since the last quarter. Higher commodity prices and improved market access have boosted sentiment in ag markets and are reflected in the results of our early order programs and order books. In addition, we've seen further strength in demand for compact utility tractors and turf equipment as consumers continue to focus on home and landscape projects. Furthermore, those businesses are also benefiting from our channel partners' desire to boost inventory levels from historic lows.

Meanwhile, our C&F business has benefited from a very strong housing market, a modest recovery in the oil and gas sector and the industry's proactive inventory management. While we are encouraged by some of the end market tailwinds, it is also important to point out some key risks. Dynamics in our supply base remain tight globally. While trends for COVID rates are improving, many areas are still impacted by high levels of absenteeism and are facing growing constraints for some electronic components. To date, we've been largely successful keeping our production rates on schedule. However, we acknowledge the situation is very fluid and will remain so for the foreseeable future.

Furthermore, prices for key raw materials such as steel have risen significantly over the last quarter, while freight and logistics costs have also experienced upward pressure. Our current forecast contemplates the impact of rising input costs and includes an additional \$500 million related to material and freight. Despite these challenges, we are encouraged by the strength in our end markets as well as the execution our employees have delivered so far this year.

Our first quarter results demonstrated the highest net income and Equipment Operations margins in the history of the company. While we are still in the early phases of executing our new operating model, we are encouraged by the progress made so far. Importantly, we are seeing the benefits of our new agile structure, allowing us to make decisions quickly and operate more efficiently.

I'd like to close with some perspective on our recent efforts driving sustainability. Our vision is that John Deere customers will lead their industry by becoming the world's most profitable and sustainable businesses. We believe we are uniquely positioned to deliver this for our customers. Our continued technology advancements allow our customers to make every seed, every drop and every hour count. This makes their operations more sustainable and have less impact on the environment while also saving them time and money.

Earlier this month, we released our 2020 sustainability report. In it, we highlighted how our precision technologies are already making our customers more sustainable and productive. Using technologies like AutoTrac, Section Control, ExactApply, ExactEmerge, TruSet and Combine Advisor; our corn and soybean customers use less fuel, save time, apply less herbicides and fertilizers and emit less greenhouse gases throughout their production cycles.

A John Deere customer farming 6,500 acres in the Midwest can lower their greenhouse gas emissions on an annual basis by the equivalent of nearly 1 million passenger vehicle miles driven just by incorporating these technologies into their operations. At the same time, these six technologies are improving the economics of our customers' businesses. Less inputs translates into lower costs.

In addition to reducing inputs, our approach also translates into higher yields. Taken together, this suite of technologies available today can conservatively deliver savings of \$40 per acre to our customers. These outcomes, scaled across our platform of global engaged acres, provides an opportunity unlike any other for us to impact the sustainability and productivity of our customers' operations.

On the earth-moving and road-building side of the business, we are also making progress in delivering our customers the tools to operate in a more sustainable manner. For example, our grade-control technology delivers significant time and material savings through automating control of the edge of the bulldozer. This ultimately translates into cost savings for our customers through reduced labor costs, reduced fuel usage and reduced asphalt costs. These same reductions translate into lower greenhouse gases emitted and less natural resources utilized on each job.

Our road-building business is leading the industry in both efficiency and sustainability in repaving technology with its cold recycler. Cold recycling reuses the existing materials of a roadway significantly minimizing the cost and environmental impact of repaving. While the traditional process of repaving involves milling up the old pavement, hauling the old materials away and hauling new materials to the worksite; the Wirtgen cold recycler enables the old asphalt from the existing roadway to be mixed with additives onsite to be reused. This technology can increase the life of the roadway while utilizing 90% less material and reducing greenhouse gas emissions by the equivalent of 12 million passenger miles driven per job.

These are just a few examples of technologies that are already making an impact on sustainability. And what we're most excited about is that despite the multi-decade investment we've already made, we are still just getting started on this journey. As we look to our future technology roadmap, we will enable our customers to do more with even less as well as adapt to the dynamic nature of weather patterns, consumer trends and the global regulatory environment.

In addition to our industry-leading equipment and technology stack, we have one of the most collaborative data platforms in the industry. And we're exploring ways that data can help our customers participate in new markets and programs that reward our customers for incorporating sustainable practices into their operations.

Our tools will allow customers to demonstrate the impact of their sustainable outcomes, enabling them to tap into new markets for revenue and financing. The key will be giving growers the ability to seamlessly document the appropriate data and provide them with the digital tools to confidently evaluate agronomic and business trade-offs.

As we look ahead, our biggest opportunity lies in delivering solutions that make our customers more productive and sustainable. But we also remain committed to running our own operations in a sustainable and socially responsible manner. In that regard, we continue making progress toward our 2022 sustainability goals.

We have steadily reduced the greenhouse gas emissions from our own facilities. And we have leveraged important partnerships to convert a significant portion of our electricity footprint to renewable sources. We are improving our water practices around the world, exploring new and innovative ways for recycling waste at our facilities. And through our new strategic focus on our aftermarket business, we'll continue to grow and expand our portfolio of remanufactured products.

And we can only deliver on this opportunity if we have a diverse and highly engaged workforce. Employee safety is and always has been of the highest importance to us. And throughout 2020, we took action to ensure that our employees were protected and had the proper tools to do their jobs effectively and safely. We also launched new strategic initiatives that are focused on leading and lagging indicators that are designed to enable continuous measurement of safety performance and drive continuous improvement.

We know that diverse teams working together result in better ideas and better solution. Therefore, we are committed to improving diversity at our company. To do this, we are partnering with key universities and professional organizations in order to recruit diverse talent. And we are providing employees the opportunity to connect with others that have common experiences through our employee resource groups. Moving forward, we will continue to attract, retain and develop employees with diverse backgrounds and experiences as it will be critical to delivering sustainable outcomes for all of our stakeholders.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

Now we're ready to begin the Q&A portion of the call. The operator will instruct you on the polling procedures. In consideration of others and our hope to allow more of you to participate, please limit yourself to one question. If you have additional questions, we'll ask that you rejoin the queue. Carolyn.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Our first question or comment comes from Brett Linzey from Vertical Research Partners. Your line is open.

Brett Logan Linzey

Analyst, Vertical Research Partners LLC

Q

Hey. Good morning, everybody. Was hoping you might be able to put a finer point on the better margin expectations for the Production and Precision Ag business. And any way you can bucket that between what's related to the larger mix of large ag versus precision ag pull-through and then cost and productivity? Any way to unbundle that?

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Thanks, Brett. I would say when you think about what we've seen from Production and Precision Ag, when you think about mix; it's as titled. That's essentially large ag and you're seeing the continued integration of precision ag in that. So I think that's one of the things that as we separated these and we think about how we're segmenting is we're seeing a much probably cleaner view of pure what is precision ag and production ag, so the integration of machinery and technology.

I think as it relates to the performance; certainly, we saw volume pick up. Price, as Brent noted, was a significant driver in the quarter. And that was on a number of different variables. But we saw the benefits of above average – just normal price increases. Pretty significant adjustments we've made over the last year in overseas markets as it related to currency and some new products that came in middle of the year. So you're seeing that impact. And then, as noted, the benefit of low inventory and strong demand driving lower incentive spending.

So as I think about it, I think those would be the biggest drivers particularly in the quarter. As it relates to things like R&D, timing-wise we're probably skewed a little bit to the later part of the year. That's just timing on programs. And probably worth noting when you think about that performance ex the Brazil tax item, Production and Precision Ag did about 19.5%. And we'll continue to see as a percent of sales higher R&D in that segment compared to the rest of the business. So thanks, Brett. We'll go ahead and go to our next question.

Operator: Thank you. Our next or comment comes from Jamie Cook from Credit Suisse. Your line is open.

Jamie Cook

Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. Good morning and congrats on a nice quarter. Back on the Production and Precision Ag business. Is there any way you can help us understand – obviously, the 6% price is a pretty meaningful price increase for this

segment. I'm just trying to understand how you're approaching pricing with precision ag this cycle relative to different prior cycles, how much more that should be benefiting the margins for this segment over time. And I guess just as a follow-up, your order books look pretty good across large ag. I'm just wondering how much more opportunity there is to take up production assuming markets continue to be favorable. Thanks.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Thanks, Jamie. As it relates to the order book side, we've made adjustments clearly compared to a quarter ago. We've seen sales move up as a result of that and we've done things. We've added production. We've added some shifts in some of our large facilities, places like Waterloo, for example, and in some of our facilities in South America as well. So we have made those adjustments.

The real challenge and Ryan mentioned this is on the supply side, there are components and parts that continue to be tight from a supply point of view. So we're managing those really tightly. The supply management group is working really hard with suppliers day to day. Some components are week to week in terms of what we're seeing from an availability point of view. So those are tight. So to the extent we continue to see demand, we'll try to work to react to that, to the upside but acknowledge it's a tight environment as it relates to some key components.

Relative to price and I think what we're seeing on the price side; certainly, we're seeing strong price this year of about 6 points for the year for Production and Precision Ag. I think what is happening there when you think about not just price but what's happening with price and mix is we're continuing to see average selling prices of our large ag machinery growing. And that's through the continued integration of technology and solutions into that business. So that pattern and trend has continued. And as we continue to be able to deliver those outcomes – and we talked a little bit about it from both a sustainability and an economic point of view – that is driving real value to customers. And we're seeing that as it relates to adoption and continuing to see the trends across most of our large ag machinery in terms of adoption of the latest tools.

Ryan D. Campbell

Chief Financial Officer & Senior Vice President, Deere & Co.

A

Hey, Jamie. It's Ryan. I think what you're seeing there and what we've talked about is as we built this precision infrastructure with the equipment, guidance, telematics, the John Deere Operations Center; now we're stacking on applications that have more of a software content on them that are focused specifically on the jobs our customers are doing. And as that continues to adopt and our customers continue to adopt that, you get a higher software mix in our margin profile. So that's another factor to Josh's point on average selling prices going up. That's true, but also those selling prices include a richer mix of software.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Thank you. We'll go ahead and go to our next question.

Operator: Thank you. Our next question or comment comes from Jerry Revich from Goldman Sachs. Your line is open.

Jerry Revich

Analyst, Goldman Sachs & Co. LLC

Q

Yes, hi. Good morning, everyone.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Hi, Jerry.

Jerry Revich

Analyst, Goldman Sachs & Co. LLC

(

On that mix comment, Ryan, that you just mentioned; I think in the past you folks have spoken about delivering a 3-point tailwind to essentially the average selling price from rising features. And it looks like – based on the adoption rates for precision ag technologies that you folks have shared, it feels like that's accelerating closer to maybe 5% this year. I'm wondering if you could just comment on that specifically. And then can you touch on, as we think about cycle-over-cycle margin performance for Production and Precision Ag, how much of a tailwind are you folks thinking about in your long-term margin targets from the rising adoption rates of software and precision ag that you outlined?

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Jerry, I'll start there. As it relates to kind of the incremental benefit we see; I think that couple of points, 2, 3 points of range is still very fair in terms of what we've been experiencing. The opportunities as we go forward to continue to see that or to see that move, I think, are there as you think about increasing and seeing more sensing and acting in the field. So you think about things like See & Spray that we've talked a lot about.

But we see opportunities to go beyond that, beyond herbicides into things like fungicides, pesticides, other fertilizers and into our jobs, other machine forms, plantings, for example. And as we've talked about in the past; as we continue down the automation journey, we're getting closer and closer to full autonomy. So I say all those things to point out as we do those things, those create more opportunity to drive revenue as well as a more recurring base of revenue that we can add value job to job, [ph] path to path (00:30:28).

As it relates to kind of where we're at cycle-wise and what does this mean for Production and Precision Ag margins; today what we'd say is we're just above, call it, 105% of mid-cycle for Production and Precision Ag and middle of the range margins, around 20%. So context-wise, if we compare that back to 2013; that's when we were at, from a large ag perspective, well above peak with roughly 16% margins at that time. So we're doing higher margins on lower sales and I think feel really good about the opportunity. The things I mentioned earlier in terms of what drives opportunities for us, those continue to be strong tailwinds with lots of runway.

Thanks, Jerry. We'll go ahead and go to our next question.

Operator: Thank you. Our next question or comment comes from Ann Duignan from JPMorgan. Your line is open.

Ann Duignan

Analyst, JPMorgan Securities

Q

Yeah, hi. Good morning. Maybe still on the large ag sector. How do you plan on managing the cycle this time versus the last cycle? Last cycle we saw farmers start to roll equipment annually. We saw multiple unit discount programs and eventually dealers ended up with excess used equipment. So new sales increases are great. But how are you going to manage the cycle differently this time around or is there anything you can do so we don't end up the same as we did at the bottom of the last cycle?

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Thanks, Ann. I think when we think about the cycle, we're certainly coming into this where we're seeing demand inflect here over, call it, the last three, four months; coming into a position of very low new inventories, very low used inventories. So that dynamic has certainly helped in terms of the starting point and the tightness we're seeing in overall inventory levels. I think the lessons learned from the past cycle certainly play into that. How do we make sure we're not pulling additional customers in, pulling ahead demand potentially that would have occurred later on?

And I think as we look at 2021 right now with demand that we're seeing; our order books, large tractors, for example, are into the fourth quarter. And with the early order programs, they account for nearly the entire full-year production. So I think we've got really good visibility. But I think that it's a good indicator of the replacement demand that we've been expecting and have thought we would see over the last couple of years coming to fruition here. But I think we're definitely working very closely with the dealers in terms of how do we manage the cycle but acknowledge right now we're early days in terms of seeing some of this demand pick up.

Ryan D. Campbell

Chief Financial Officer & Senior Vice President, Deere & Co.

A

Hey, Ann. It's Ryan. Maybe I'd add to that. I think it's the total industry including ourselves having the discipline to make sure that those new customers, we're providing new product for them. But also those customers that historically have purchased used and used makes more sense to them, to really be disciplined to continue to provide them with high-quality used equipment. So we maintain that trade cycle and trade ladder throughout this upturn that we have.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Yeah. I think one other piece that helps us there – and we're very early – is in performance upgrades and the ability to upgrade existing machine fleets, which provide the ability to take a used machine – it could be a generation or two old – and outfit that with updated equipment, which in some cases may alleviate some of the pressure on new because you can get a significant amount of productivity at a little bit less of a total investment cost for the customer. So thanks, Ann. We'll go ahead and go to our next question.

Operator: Thank you. Our next question or comment is from Steve Volkmann from Jefferies and Company. Your line is open.

Stephen Edward Volkmann

Analyst, Jefferies LLC

Q

Hi. Good morning, everybody. Appreciate the breakout of the small and the production ag equipment. I'm curious though what your view is going forward relative to any difference in incremental margins we should be thinking about in those two segments. I assume the large stuff is bigger, but just anything you want to kind of give us on that would be great.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Thanks, Steve. Yeah, as it relates to incremental margins, historically we've talked about in the past Ag and Turf being 30% to 35% kind of depending on how our mix sell. I think what we'd say now is the Production and

Precision Ag side pushes at the high end of that range and Small Ag and Turf probably towards the lower end of that range. I think generally that's probably a good rule. I think this year, particularly Small Ag and Turf, we're seeing a pretty strong benefit of what was – as you look at small tractors in particular – a really significant underproduction last year of retail. And we intend to build a little bit of inventory this year. So you're seeing a little bit of swing there. So that swing from underproducing to overproducing definitely benefits the margin profile as well.

Thanks, Steve. We'll go ahead and jump to our next question.

Operator: Thank you. Our next question or comment is from Tim Thein from Citigroup. Your line is open.

Tim W. Thein

Analyst, Citigroup Global Markets, Inc.

Q

Thank you. Good morning, Josh and Ryan. The question is on the dividend and how you're thinking about your view of mid-cycle earnings for the company. Obviously, we're moving into a much higher margin level as you clearly laid out. And just tying back to your point earlier about large ag being, call it, right around your view of normalized level. So just kind of tying that all together [ph] added, call it, (00:36:46) three-ish dollar annualized dividend run rate, how you're thinking about that relative to your kind of 25% to 35% payout target. Thank you.

Ryan D. Campbell

Chief Financial Officer & Senior Vice President, Deere & Co.

A

Hey, Tim. It's Ryan. And as we've said and you pointed out, we keep our dividend in the 25% to 35% mid-cycle earnings ratio. And with the structural improvements that we have, we're probably below that range with the current dividend. And so it's something that we're certainly thinking about. And with the overall liquidity situation at the company, that's something we're going to take a look at for sure this year.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Thanks, Tim. Go ahead and go to our next question.

Operator: All right. Thank you. Our next question comes from Ross Gilardi from Bank of America. Your line is open.

Ross Gilardi

Analyst, Bank of America Merrill Lynch

Q

Thanks. Good morning, guys.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Hi, Ross.

Ryan D. Campbell

Chief Financial Officer & Senior Vice President, Deere & Co.

A

Hey, Ross.

Ross Gilardi

*Analyst, Bank of America
Merrill Lynch*

You explained that you think you're at 105% of mid-cycle for large ag. Can you remind us where you expect to be relative to this cycle for your other segments through the end of this year based on your guidance? And when should we expect you guys to recast your mid-cycle margin targets? And just along with that, how does the 20% at mid-cycle that you're seeing for large ag in fiscal 2021 compare to your initial estimate when you put out the 15% target to begin with?

Joshua Jepsen

Director-Investor Relations, Deere & Co.

Ross, yeah. When we think about percent to mid-cycle, so actually the Production and Precision Ag and Small Ag and Turf are pretty much in the same range, kind of right between, call it, 105% and 110% of mid-cycle. The C&F business is right around mid-cycle as well, like nearly dead on. There's a little bit of mix impact in there where compact construction equipment is much higher. And we're obviously coming kind of off of the bottom after 2020 from a construction equipment perspective.

So there's some variation amongst the segments there in C&F, but overall about mid-cycle. I think when you think about kind of our mid-cycle margins; certainly, we've talked a lot about the 15%, continuing to focus on executing. And I'd say in 2021, a very strong first quarter. And I'd say there's lots of focus on delivering the guide that we have this year and the performance that we feel confident in. But I think post that, I think, is when we'll start to think about what's next for the company.

Ross Gilardi

Analyst, Bank of America Merrill Lynch

And, Josh, just on that, can you address at all how the 20% at mid-cycle for the large ag compares to your initial estimate?

Joshua Jepsen

Director-Investor Relations, Deere & Co.

Yeah, I think what we're seeing from that business and what we've seen in the first quarter kind of ex items is about 19.5%. I think it feels like strong performance for us. I think we're seeing some benefits of things like strong pricing and obviously the volume rebounding and operational leverage coming through is solid and I think aligned with where we would hope it would be knowing that we feel like we've got opportunity as we go forward. That business sees the majority of the headwind on material and freight that Ryan mentioned that weighs on the full year there as well.

Ross Gilardi

Analyst, Bank of America Merrill Lynch

Thank you.

Ryan D. Campbell

Chief Financial Officer & Senior Vice President, Deere & Co.

Hey, Ross. It's Ryan. I think it's fair to say we're probably a little bit ahead of where we thought we would be. But we're heads down and focused on delivering this from a sustainable perspective. And then in 2022, we'll take a step back and reflect on what's appropriate going forward.

Ross Gilardi

Analyst, Bank of America Merrill Lynch

Thanks, guys.

Q

Joshua Jepsen

Director-Investor Relations, Deere & Co.

Thanks, Ross. We'll go ahead and go to our next question.

A

Operator: Thank you. Our next question comes from Rob Wertheimer from Melius Research. Your line is open.

Rob Wertheimer

Analyst, Melius Research LLC

Thank you and good morning. So the new segments, I think, help clarify a lot and align pretty well with what you're aimed at. And for me at least, small ag was particularly impressive. I wonder – since we just talk less about it versus all the things we talk about on large ag, can you just talk about what the workflows are that have been driving the margins we saw in the quarter? And then maybe just reiterate what gets worse from here for the rest of the year given the outlook. Thanks.

Q

Joshua Jepsen

Director-Investor Relations, Deere & Co.

Yeah, Rob. When you think about Small Ag and Turf – and you're right, it tends to be a little bit less of a story. What we've seen here is really solid performance. And I think a starting point is some of the actions we've taken from executing the new strategy, I think we're seeing the benefits in Small Ag and Turf. A number of the exits or closures that we did in fiscal 2020 are benefiting us there. And those were mostly in the Small Ag and Turf part of the business. So that focus is definitely helping.

A

I think we're seeing really strong execution. Again, the benefit of moving from underproducing to slightly overproducing our small tractors helps. The pricing point of view is solid as well. When you think about small tractors and turf, those are going to be pushing much higher than, call it, that kind of between 105% and 110% at mid-cycle. So there's benefit there as well. Also embedded in that is a large portion of Small Ag and Turf is in Europe, which has tended to be a more stable market. So we see a little bit less volatility there and we've seen some strength in that market, which have been beneficial as well.

Ryan D. Campbell

Chief Financial Officer & Senior Vice President, Deere & Co.

Rob, I think taking the two businesses apart, I think, Josh alluded to; we focused on the Small Ag and Turf side with some of our fix and exit strategies and then focusing on markets where our value proposition makes sense given the industry and market dynamics. I think when you do those things and think about capitalizing – the business is a little bit different, focus in the R&D portfolio a little bit differently – the results show that you can have a great business in the small side. And both of them are equally important for us to drive our strategy going forward.

A

Joshua Jepsen

Director-Investor Relations, Deere & Co.

Yeah. And I'm sorry, Rob, I forgot about your other portion of your question, kind of what are the headwinds in the remainder of the year. And not dissimilar, I'd say all of our businesses have material and freight headwinds. The

A

\$500 million of material and freight costs that Ryan mentioned is all really kind of 2Q through 4Q. And so there's a portion of that that is impacting Small Ag and Turf. Price, we don't expect to be as strong as we move through the year. 2% for the full year compared to a strong first quarter there. And then the other maybe two things I'd mentioned. R&D there similarly is a little bit back-end weighted. So you see that, based on timing of programs, impact the rest of the year. And there are some inefficiencies related to overheads with the combination of COVID and supply challenges that we've got embedded in the forecast as well.

Thanks, Rob. We'll go ahead and go to our next question.

Operator: Thank you. Our next question comes from Steven Fisher from UBS. Your line is open.

Steven Fisher

Analyst, UBS Securities LLC

Q

Thanks. Good morning, guys. So the supply chain challenges, while going through an upturn now, kind of remind me of what you experienced in 2017 and 2018. And it was a bit of a struggle back then. But it seems like you're better prepared to handle it this time. Is that a fair assessment or is it maybe just it's a stronger up-cycle now than it was back then and that enables you to kind of cover the \$500 million of increases that you're seeing? And just kind of gauging your confidence that we've kind of gotten the supply chain challenges under control to really capture the benefit of the strong upside here as this cycle plays out.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Steve, when we look at the supply base, I think that our team has learned a significant amount as we went through what you described in that 2017-2018 timeframe as we went through tariffs with China and the first round of COVID and we saw some of those impacts. So I think the team has done a really good job and gotten much probably deeper in terms of understanding supplier by supplier what are constraints, what are capacities and what are the challenges. So that's certainly helped.

I think up to this point that we've been able to mitigate disruptions. But in some cases, I think there is – we are week-to-week in terms of how things are operating and there are challenges. So I think we're continuing to work closely there, trying to execute on the forecast and meet customer demand. And we've got ranges in the forecast for that reason, knowing there are certainly challenges that we're facing and we'll continue to face through the remainder of the year.

Ryan D. Campbell

Chief Financial Officer & Senior Vice President, Deere & Co.

A

Yeah. It's Ryan. We're also seeing the benefit. And we went through the activity to look at kind of each position in the company and how those positions worked over the last year. And I think we're seeing the benefit from a more focused and agile organization that we put in place last year and finished effectively with that towards the end of last year.

Steven Fisher

Analyst, UBS Securities LLC

Q

Thank you.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Thanks, Steve. We'll go ahead and go to our next question.

Operator: Our next question or comment comes from Kristen Owen from Oppenheimer. Your line is open.

Kristen Owen

Analyst, Oppenheimer & Co., Inc.

Q

Hi, good morning. Thank you for taking my question. I wanted to point back to slide 15 here on the deck. The \$40 an acre in economic value to the customer that you've outlined, that's pretty significant when you think about the impact to net farm income across your connected acres. Where do you feel like your customers are at this stage in terms of understanding that potential value? And when you think about the backdrop of this improved commodity prices and land values, how do you see adoption cycles moving forward?

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Yeah. Thanks, Kristen. It's a great point. I think as we look across those different technologies, there's a varying range of adoption individually where at the highest end you'd think about something like guidance which would be very, very highly adopted. And then maybe on the lower end, something like ExactEmerge which is in the low 40s percent. So varying degrees in terms of how deeply engaged our farmers are across all of those jobs.

But we think that's increasingly where we see the opportunity to drive that value. And particularly, when you start to think about additional opportunities, and Ryan mentioned this a little bit, as you start to think about the combination of carbon markets or differentiating crops because of the practices that are utilized and then our position of, one, executing the jobs but, two, having the operation center that documents those and can provide that information very, very seamlessly. We think that creates a pretty significant opportunity for our customers. So when you think about not only the technologies that we have in place today, those that are coming and then what feels like just a burgeoning opportunity for some additional revenue; I think well positions our customers and we feel like we're in a really good spot to be able to unlock and enable that.

Thanks, Kristen. We'll go ahead and go to our next question.

Operator: Thank you. Our next question is from Chad Dillard from Bernstein. Your line is open.

Chad Dillard

Analyst, AB Bernstein

Q

Hi. Good morning, guys. So I was wondering if you could give us a sense for how far along Latin America and Europe are in adopting precision ag maybe like relative to the US. So if the US is 100%, where those two regions lie. Or if it's easier, talk about it from like an engaged acre perspective that you guys talked about 230 million engaged acres globally. How does that break down from a regional perspective and kind of like what's like the total addressable market in terms of engaged acres that you could get to?

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

So when you think about what kind of regional performance; certainly, furthest along in North America. But kind of as we just alluded to and Kristen alluded to in the previous question, there's still a long way to go in North America

when you think about actually stacking all of those different technologies on the farm and what that can deliver. So that's just a bit of a caveat to say there's still a big opportunity in North America. And I think where we're seeing it grow, the adoption grow in places like South America; Brazil in particular, we've seen pretty significant growth in engaged acres last year. I think we were up something like 60% in Latin America. So continuing to grow there. And I think when you think about some of the challenges faced there, double crops as well as the opportunity to get more efficient there. That will continue to grow.

And we're seeing our dealers embrace that as well. When you think about – they've got now over 40 digital operation centers that are supporting their customer fleets. As we unlock the challenge of connectivity, that's a huge opportunity for us. And we've done a couple of things over the last couple of years. Most recently had an agreement with [ph] Quattro (00:50:35) to provide access, better connectivity and bandwidth. We think that unlocks even more potential for the use of those tools. Europe has historically been a lot of guidance. And I think we're starting to see some of that turn and shift towards more connectivity. Engaged acres grew there last year significantly like triple digits. And as you think about the potential impact of regulatory environments coming into Europe first but probably other parts of the world, the appetite for precision agriculture and some of our tools when you think about spraying and others will be particularly important as we go forward there. So continuing to grow, feel really good about the position we're in and think there's a tremendous amount of opportunity.

Thanks, Chad. We'll go ahead and go to our next question.

Operator: Thank you. Our next question comes from David Raso from Evercore ISI. Your line is open.

David Raso

Analyst, Evercore Group LLC

Q

Hi, good morning. Given the supply chain constraints amid the strong farm equipment demand, I'm curious, are you already taking tractor orders beyond fiscal 2021? And are you willing to open up your early order programs for your other products earlier this year than normal? And the other question is – we don't have the baseline for the new segments within Ag and Turf. Of the revenue increase that you put into A&T; I thought it was impressive that on those incremental sales, the incremental margin's 44%. So it's pretty impressive. But of that revenue increase – just so we have a sense of the mix, what changed – how much of the increase was the Production and Precision Ag versus how much was Small Ag and Turf? Thank you.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Yeah. So first on the order side, I think we haven't opened anything up into fiscal 2022 at this point. So we're pushing out into the end of the fiscal year for large tractors in particular. And we haven't adjusted anything at this point as far as timing of the early order programs. But you bring up a really good point in that by the time we closed our crop care early order programs, we were just beginning to see the inflection.

So if you think about kind of the low double-digit increases we saw in planters and sprayers, that was mostly well ahead of kind of the inflection we saw here in the fall. So I think obviously a lot to play out, but that bodes well there. But we haven't adjusted timing at this point. As it relates to the sales increase from a former A&T and into the Production and Precision Ag and Small Ag and Turf, really the percentage increases are pretty similar. So if we look at those businesses year-over-year, they're both up, call it, roughly 20%. So pretty balanced between the two in terms of the increase we saw compared to a quarter ago.

Thank you, David. We'll go ahead and go to our next question.

Operator: Our next question or comment comes from Larry De Maria from William Blair. Your line is open.

Lawrence T. De Maria

Analyst, William Blair & Co. LLC

Q

Hi. Thanks and good morning, everybody. If we could go just back to slide 15; obviously, what you were saying is a green-on-green solution can deliver a \$40 return. And we know there's a lot of mixed fleets out there still. So there's growth. But can you give us what's the annual cost, what's the ROI? And how does that \$40 return stack up when you're thinking and when you're competing with seed and fertilizer companies? In other words, green-on-green solution delivers \$40, what's the ROI and how does that compare to seed and fertilizer companies?

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Yeah. You mean when you think from a payback or an ROI perspective, we think about these tools and solutions and we've traditionally been in a year to two-year payback period. And I think across those, that'd be fair. Some of those are going to be much shorter that we've seen, in months compared to years of payback. So I think as you look at those technologies that we've got there, I think it would be very fair to say well under two years would be a reasonable payback period for what we're seeing there. So I think that's where we're at. And I think what's exciting about it is there's opportunity as we start to think about kind of what's coming next to grow that from both the economic value but also delivering increased sustainability outcomes as well.

Thanks, Larry. We'll go ahead and jump to our next one.

Operator: Thank you. Our next question comes from Nicole DeBlase from Deutsche Bank. Your line is open.

Nicole DeBlase

Analyst, Deutsche Bank Securities, Inc.

Q

Yeah, thanks. Good morning, guys.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Hey, Nicole.

Nicole DeBlase

Analyst, Deutsche Bank Securities, Inc.

Q

Can we just focus a little bit on South America? I thought the comments that you gave around North America order book as well as Europe and how far it extends was helpful. But there was just a bit less around what you're hearing from South America farmers and maybe how far the order book extends there.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Yeah. So Latin America and in South America, Brazil in particular, really strong. A lot of things coming together there that are driving really strong farm profitability in terms of production, FX, how it's moved. Those have all been very positive. So we saw this inflect in our fourth quarter. We've got orders – we're ordered out through May into June, so strong activity there. And we're coming out of a period with – 2020 where we ended with kind of

historically low inventory. So we're pushing there to try to not only meet demand but if we can, we'll try to build a little bit of inventory because we finished quite low. So I think, overall, South American demand, Brazil in particular, really strong. Customers feeling good. Dealers very much engaged. And I think as we step back and not just think about South America but I think the performance that we've seen this year first quarter and as we look at our forecast, we're benefiting from just really strong profitability from a global perspective of our business as well. So that's helpful.

Thanks, Nicole. We'll go ahead and go to our next question.

Operator: Our next question or comment comes from Courtney Yakavonis from Morgan Stanley. Your line is open.

Courtney Yakavonis

Analyst, Morgan Stanley & Co. LLC

Q

Hi. Good morning, guys. If we can just talk a little bit about C&F. I guess maybe just first a clarification. I know you had the extra month of working in the quarter. Are we going to see any difference in the fourth quarter of this year or is it [indiscernible] (00:57:15) to the full year? And did that have any impact on the margins, the increase in the margin guidance?

And then I guess my actual question is just in the context that C&F is at mid-cycle, can you help kind of walk us through what's going to get you to the 15% margin in that segment? Because I think you've historically talked about that 15% margin target being for both segments. And I think you've historically talked about the work and synergies being back half weighted. So just trying to understand if that's flowing through sooner or if that's still going to be a 2022 story. Thanks.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Thanks, Courtney. I think when you think about the work in the extra month, it didn't really impact margins. It was pretty much the extra month was kind of in line with where they're running for the quarter. So no significant change there, didn't necessarily impact their overall guidance or the division's total guidance. And when you think about our road-building business, we feel really good about what we're seeing there. Overall, we expect that to be up about 20% in this fiscal year. About half of that is the extra month, so say underlying business up about 10%. And when we look at the core road-building business, we feel like the margins that they're delivering are where we'd expect them to be as we talked about feeling like that business is a mid-teens business. We're executing along those lines and feel really good about how that's progressing.

I think when you step back, overall C&F; certainly, we think there's an opportunity as Wirtgen continues to perform that that will pull up margins. Technology opportunity for us as well in Construction and Forestry, we're very early on and think how do we integrate that. And we think that will drive performance there as well. We highlighted just an example on grade control and what that can do from a customer, economic and sustainable impacts as well. So those are the types of things we're looking at, obstacle detection. There's a few things that we feel like we can nearly copy-paste into that division to drive performance and continuing to be very focused on operations and executing very, very tightly in what is a volatile, somewhat cyclical business.

With that, I think we've got time for one more question.

Operator: Thank you. Our final question comes from Adam Uhlman from Cleveland Research. Your line is open.

Adam Uhlman

Analyst, Cleveland Research Co. LLC

Q

Hey, guys. Thanks for squeezing me in. And congrats on the strong quarter. I wanted to go back to the material costs discussion that we're having before. Would you be willing to break down the \$500 million by segment? And then maybe perhaps a cadence. I think you actually said that it was going to start to hit in the second quarter. Is that equally weighted throughout the rest of the year or should we be thinking about this as more of a fourth quarter impact? And then do you think you need to implement any more price increases to offset what's happening with materials and freight costs? Thanks.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Thanks, Adam. Let me tell you on the \$500 million, we haven't gotten to bright lines there. But of the \$500 million, the majority or well more than half of that is PPA, Production and Precision Ag, where we see that. On the low end, it's Small Ag and Turf where we have the smallest portion of that, but impacting those businesses.

As it relates to price, historically, we've not taken price solely based on commodities. We try to do that and be disciplined in our approach to price and pricing for value and those sorts of things. So at this point, we haven't contemplated that. If we step back and look overall, the price we're getting is more than offsetting the material but does certainly have a drag on incrementals as we go through the remainder of the year. And timing-wise, I'd say it's pretty balanced over the course of the remaining three quarters.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

So with that, I think we'll wrap up. We appreciate everyone's time and look forward to catching up with everyone. Thank you.

Operator: Thank you. That concludes today's conference call. Thank you for your participation. You may disconnect at this time.

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