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Deere & Co. (DE)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Deere & Company Fourth 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.

Good morning. Also on the call today are Ryan Campbell, our Chief Financial Officer; Cory Reed, President of Production and Precision Ag; and Brent Norwood, Manager of Investor Communications. Today, we'll take a closer look at Deere's fourth quarter earnings, then spend some time talking about our markets and our current outlook for fiscal 2022. After that, we'll respond to your questions.

Please note, slides are available to complement the call this morning. They can be accessed on our website at johndeere.com/earnings. First a reminder, this call is 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 copyrighted broadcast without the expressed written consent of Deere is strictly prohibited.

Participants in the call, including the Q&A session, agree to their likeness and remarks in all medium 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. Additional information concerning these measures, including reconciliations to comparable GAAP measures, is included in the release and posted on our website at johndeere.com/earnings under Quarterly Earnings & Events.

I'll now turn the call over to Brent Norwood.

Brent Norwood

Investor Relations, Deere & Co.

John Deere finished the year with solid execution in the fourth quarter, resulting in a 13.6% margin for the Equipment Operations. Ag fundamentals remain strong through the course of the year, and our order books indicate another year of robust demand into 2022. Meanwhile, the Construction & Forestry markets also continue to benefit from strong demand and lean inventories leading to the division's strongest financial results in over 15 years.

Now, let's take a closer look at our year-end results for 2021 beginning on slide 3. For the full year, net sales and revenues were up 24% to $44 billion, while net sales for Equipment Operations increased 27% to $39.7 billion. Net income attributable to Deere & Company was $5.96 billion or $18.99 per diluted share.

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Slide 4 shows the results for the fourth quarter. Net sales and revenue were up 16% to $11.3 billion, while net sales for the Equipment Operations were up 19% to nearly $10.3 billion. Net income attributable to Deere & Company was $1.283 billion or $4.12 per diluted share.

At this time, I'd like to welcome Corey Reed, President of Production and Precision Ag, to the call to discuss the segments' results and provide an update on the global Ag environment. Corey?

Cory J. Reed

President-Worldwide Agriculture & Turf Division, Production and Precision Ag, and Americas and Australia, Deere & Co.

Thanks, Brent. Before I cover our fourth quarter results, I'd like to recognize all of John Deere's 77,000 employees for their tremendous hard work and dedication throughout a year filled with unpredictability. I'd also like to recognize the ongoing efforts and unparalleled capabilities of the John Deere dealer network. It's not only an integral part of our value proposition in the market, but also often called upon in the toughest of times to keep our customers up and running.

Let's start with fourth quarter results for Production and Precision Ag, starting on slide 5. Net sales of $4.66 billion were up 23% compared to the fourth quarter last year, primarily due to higher shipment volumes and price realization. Price realization in the quarter was positive by about 7 points, and currency translation was also positive by roughly 1 point.

Operating profit was $777 million, resulting in a 16.7% operating margin for the segment compared to 15.2% margin for the same period last year. The year-over-year increase was driven by positive price realization, higher shipment volumes and mix, partially offset by higher production costs. Also, it's worth noting that last year's results were negatively impacted by employee separation expenses resulting from restructuring activities.

Shifting focus to Small Ag & Turf on slide 6, net sales were up 17%, totaling $2.8 billion in the fourth quarter. The increase was primarily driven by higher shipment volumes and price realization. Price realization in the quarter was positive by just over 4 points. While currency translation was minimal, for the quarter operating profit was $346 million, resulting in a 12.3% operating margin. The higher shipment volumes, sales mix and price realization were partially offset by higher production costs, R&D and SA&G. When comparing to the fourth quarter of 2020, keep in mind the prior period included $77 million in separation costs and impairments.

Slide 7 shows our industry outlook for Ag & Turf markets globally. In the US and Canada, we expect industry sales of Large Ag equipment to be up approximately 15%, reflecting another year of strong demand. In fiscal year 2021, customer demand driven by the combination of strong fundamentals and advanced fleet age and low inventory, outpaced the industry's ability to supply. With all of these dynamics still present in 2022, we expect demand to exceed the industry's ability to produce for a second consecutive year, as supply-based delays continue to constrain shipments.

Order books for the upcoming year are mostly full except for a few cases where we've paused orders to manage supply challenges and allow us to reevaluate inflationary pressure later in the year. Currently, orders are complete for the year's production of crop care products, while our combine production slots are over 90% full with the Early Order Program still ongoing. Meanwhile, large tractor orders are sourced well into the third quarter. We expect the remainder of the book to fill out shortly.

We're encouraged that take rates for our mainstay precision technologies like Combine Advisor, ExactApply and ExactEmerge continue to track higher year-over-year. More recent product introductions such as ExactRate

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planters and the X9 Combine saw significant increases when compared to last year, while our premium and automation software activation take rates are over 85% for our H Series and 9R Series tractors.

Additionally, we saw significant increases in customer engagement with our digital tools in 2021. engaged acres now stand at over 315 million acres, due in part to a sharp increase in Europe, where the number of engaged acres has doubled over the past year. Likewise, use of our digital features such as Expert Alerts and Service Advisor Remote has increased by about 30% compared to last year. In the Small Ag & Turf segment, we expect industry sales in the US and Canada to remain flat for the year, as supply challenges continue to limit industry production. Following two years of very robust demand, field inventory levels are at multiyear lows and are unlikely to begin recovering until sometime in 2023.

Moving on to Europe. The industry is forecast to be up roughly 5%, as higher commodity prices strengthen business conditions in the arable segment and dairy prices remain resilient, even as margins show some pressure from rising input costs. We expect the industry will continue to face supply-based constraints, resulting in demand outstripping production for the year. At this time, our order book expands into the third quarter for Mannheim tractors.

In South America, we expect industry sales of tractors and combines to increase about 5%. Farmer sentiment and profitability remain steady at all-time highs, as our customers benefit from robust commodity prices, record production and a favorable currency environment. Our order books reflect this strong sentiment and currently extends into the second quarter, which is as far as we've allowed it to grow.

Despite limited government-sponsored financing programs, private financing is supporting continued strength in equipment demand, while strong farmer balance sheets enable many customers to purchase using cash. Industry sales in Asia are forecast to be flat, as India, the world's largest tractor market by units, holds steady in 2022.

Moving on to our segment forecast beginning on slide 8. For Production and Precision Ag net sales are forecast to be up between 20% and 25% in fiscal year 2022. Forecast includes expectations of about 9 points of positive price realization for the full year. For the segment's operating margin, our full year forecast is between 20% and 21%, reflecting consistently solid financial performance across the various geographical regions.

Slide 9 shows our forecast for the Small Ag & Turf segment. We expect net sales in fiscal year 2022 to be up 15% to 20%. This guidance includes nearly 7 points of positive price realization and roughly 1 point of currency headwind. The segment's operating margin is forecasted to range between 16% and 17%.

With that, I'll turn it back over to Brent Norwood.

Brent Norwood

Investor Relations, Deere & Co.

Thanks, Cory. Now, let's focus on Construction & Forestry on slide 10. For the quarter, net sales of $2.8 billion were up 14%, primarily due to higher shipment volumes and 6 points of positive price realization. Operating profit moved higher year-over-year to $270 million, resulting in a 9.6% operating margin due to positive price realization and higher shipment volumes, partially offset by higher production costs, SA&G and R&D. The quarter also benefited from the lack of one-time expenses included in the prior period.

Let's turn to our 2022 Construction & Forestry industry outlook on slide 11. Both earth-moving and compact construction equipment industry sales in North America are expected to be up between 5% and 10%. End markets for earth-moving and compact equipment are expected to remain strong in our fiscal year 2022 forecast,

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benefiting from continued strength in the housing market, increased activity in the oil and gas sector as well as strong CapEx programs from the independent rental companies.

Demand for earth-moving and compact construction equipment is expected to exceed our production for the year, resulting in continued low inventory levels, especially for compact construction equipment. In Forestry, we now expect the industry to be up about 10% to 15%, as lumber production looks to remain at elevated levels throughout the year even though lumber prices have come down from peaks in mid-summer.

Moving to the C&F segment outlook on slide 12. Deere's Construction & Forestry 2022 net sales are forecasted to be up between 10% to 15%. Our net sales guidance for the year includes about 8 points of positive price realization. We expect the segment's operating margin to be between 13.5% and 14.5% for the year, benefiting from price, volume and lack of one-time items from the prior year.

Now, let's move now to our Financial Services operation on slide 13. Worldwide Financial Services net income attributable to Deere & Company in the fourth quarter was $227 million, benefiting from income earned on higher average portfolio and favorable financing spreads, as well as improvements on the operating lease portfolio, partially offset by a higher provision for credit losses. Results for the prior period were also affected by employee separation costs. For fiscal year 2022, the net income forecast is $870 million, as the segment is expected to continue to benefit from a higher average portfolio.

Slide 14 outlines our guidance for net income, our effective tax rate, and operating cash flow. For fiscal year 2022, our full year outlook for net income is forecasted to be between $6.5 billion and $7 billion. The full year forecast is inclusive of the impact from higher raw material prices and logistics costs, which we estimate will add an additional $2 billion in expenses relative to 2021. At this time, we expect two-thirds of that increase to manifest itself in the first half of the year as the comparisons get easier in the back half of fiscal year 2022. At this time, our forecasted price realization is expected to outpace both material cost and freight for the entire year though we will likely be price cost negative in the first quarter.

Moving on to tax. Our guidance incorporates an effective tax rate projected to be between 25% and 27%. Lastly, cash flow from the equipment operations is expected to be in the range of $6 billion to $6.5 billion and includes a $1 billion voluntary contribution to our pension and OPEB plans.

Before we open up the line for Q&A, we'd like to first address a few of the likely questions around the current market dynamics, our financial results and the details around our new labor agreement, as well as provide some thoughts on capital allocation for the next year. To cover the range of topics, I'll engage today's call participants to provide some additional color, and then we'll open up the line for additional questions.

First, I'd like to start with the current demand environment for Large Ag equipment. Cory, can you provide some additional color on demand for Large Ag products and which new technologies are resonating with customers?

Cory J. Reed

President-Worldwide Agriculture & Turf Division, Production and Precision Ag, and Americas and Australia, Deere & Co.

Yeah. Thanks, Brent. We're really encouraged by both the velocity of our order books and the take rates for some of our latest technology. Demand has been strong since the beginning of 2021 and, overall, that doesn't look like it's going to let up in 2022. I touched on this earlier. Our order books are either full or near full for most of our North American Large Ag product lines.

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Starting with our combine EOP, our EOP for 2022 production will finish in January, where we'll grow the levels of [ph] X (00:15:01) Series production and we've already sold out of our planned production for X9 Combines. This is the first year in a multiyear ramp up of production for X9, and will ship 1,000-plus units of X9 into North America alone. We'll further solidify our market leadership in the power class 9 plus combine categories, while also establishing a clear new global benchmark in both productivity and efficiency.

We're also seeing strong demand for some of our newer products, products like ExactRate planter applied fertilizer systems and AutoPath. ExactRate represents an important first step in the precision application of fertilizer. Future iterations of this product will be critical in helping us improve nitrogen use efficiency for our customers. In just its second year, we're seeing take rates of that product close to 20% which is really encouraging.

Similarly, in the first full season, we've seen tremendous feedback from the launch of John Deere AutoPath. AutoPath leverages John Deere's onboard technology like our Gen 4 Displays, SF 6000 Receivers, including the SF3 correction signal and embedded software linked to the John Deere Operation Center throughout a customer's entire production cycle. That technology leverages data from planting to know exactly where the row unit travel to plant seeds and then creates a guidance line for each subsequent path, making in-season fertilizer applications, manual cultivation for weeding or crop protection passes easier and more accurate. At harvest, it makes it easier to find your guess row and makes that easy for harvest to be even more efficient.

In 2021, we saw take rates of the automation package activation or subscription which includes AutoPath double, leading to more customers enabled with John Deere's highest-value Precision Ag software. In 2022 and beyond, we'll continue to add value to AutoPath through new features and new technologies as a part of our Precision Ag software package strategies. And AutoPath will be foundational for even more automated farming in the future, making every step of our customer's production system even better.

Lastly, See & Spray. See & Spray Ultimate is going to hit the market this year on a limited basis, and we're excited to get it into more customers' hands. We view See & Spray as just the first step in a long series of sense and act, and that journey we're encouraged by to see early demand for both See & Spray itself and multiple products related to plant-level management in the future.

Brent Norwood

Investor Relations, Deere & Co.

Let's talk a little bit deeper on the fluctuations in North American Large Ag market share for fiscal year 2021, and then let's provide some expectations for this next year in fiscal year 2022. Can you first walk us through the progression of market share that we saw in 2021, Cory?

Cory J. Reed

President-Worldwide Agriculture & Turf Division, Production and Precision Ag, and Americas and Australia, Deere & Co.

Sure. Yeah, 2021 was a unique year. Demand inflected sharply from October of 2020 to January 2021 timeframe. And as a result, we experienced pressure on market share early in the year due to our asset-light model. If you recall, we talked about this dynamic in our fourth quarter earnings call last year and noted that we expected to recover that share quickly and that's exactly what happened. In fact, we gained 2 points of market share in North America for our Large Ag products by year-end. And you can see an example of that in the last three quarters of retail sales data for the 100-plus horsepower tractor categories.

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Brent Norwood

Investor Relations, Deere & Co.

So, how might market share play out this next year, given that our most recent labor agreement didn't ratify until November 17?

Cory J. Reed

President-Worldwide Agriculture & Turf Division, Production and Precision Ag, and Americas and Australia, Deere & Co.

Yeah, that's a great question. And while it's too early to forecast with a lot of precision, we see the potential for 2022 to play out very similarly. We're very likely to see similar pressure in the first quarter, as we recover from record low inventories, but also expect a production ramp that helps us maintain and even grow our position

as we execute throughout the year.

Brent Norwood

Investor Relations, Deere & Co.

Let's pivot to some of the details on our latest labor agreement. One of the most frequent questions out there is on the incremental cost of the new contract relative to the previous one. So, how should investors think about the impact to our cost structure?

Cory J. Reed

President-Worldwide Agriculture & Turf Division, Production and Precision Ag, and Americas and Australia, Deere & Co.

First, it's important to know we're really glad to have our UAW employees back in our factories and proud of the groundbreaking contract that we put in place. With respect to its impact on our cost structure, there are a few moving parts to the agreement. Some components directly impact wages and benefits immediately, while many others like of the retirement benefits will have a longer tail that largely accrue outside of the contract period.

Over the six-year contract, the incremental cost will be between $250 million and $300 million pre-tax per year, with 80% of that impacting operating margins.

Brent Norwood

Investor Relations, Deere & Co.

So, we experienced a gap between the last contract and the current one resulting in a few weeks of lost production. How does that impact the quarterly cadence of our financial results?

Cory J. Reed

President-Worldwide Agriculture & Turf Division, Production and Precision Ag, and Americas and Australia, Deere & Co.

There are a number of unique items impacting the first quarter. First, we would – if you think about first quarter 2022 we expect the top line for the Equip Ops to be pretty similar to the first quarter of 2021, missing a few weeks plus of production will neutralize some of the benefits that Corey

mentioned in terms of ramping up to higher line rates in December and January.

With respect to margins, there are a few things to consider. First quarter, we'll have our toughest price-cost comp for the year. We expect that to be negative in the first quarter, but positive for the full year. We also expect to experience poor overhead absorption due to the lower volumes as mentioned, and there are a few other one-time

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items that'll provide some additional drag, including ratification bonus and some favorable tax credits that we saw in the first quarter of 2021 that don't repeat in 2022.

All-in, we expect first quarter margins to be mid- to high-single digits for the Equipment Operations, with those businesses that have been most affected by the delayed ratification to be below that average. Looking beyond the first quarter, though we do expect margins for the rest of the year to be more favorable and incrementals more in line with historical averages, and maybe stepping back and just thinking about the full year impact on margins, we'd say it'll be about 1 point lower as a result of combination of work stoppage and some of the supply disruption.

Brent Norwood

Investor Relations, Deere & Co.

Switching topics. Let's conclude with some discussion around capital allocation. Ryan, how would you characterize our capital allocation strategy in fiscal year 2021? And what might we expect this coming year?

Ryan D. Campbell

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

Yeah. Thanks, Brent. With respect to 2021, our strong liquidity position and our cash flow generation really allowed us to execute against all of our cash priorities. We continue to focus on maintaining our solid A credit rating, but beyond that we invested in our strategic growth priorities both organically and inorganically.

In addition, we returned over $3.5 billion in capital to shareholders through dividends and share repurchases. Our two dividend increases are evidence of the confidence we have and the structural improvements we've made and the earnings power of our business. Overall, our actions in 2021 serve as a good blueprint for how to think about 2022, as we expect to again execute against all of our priorities.

Brent Norwood

Investor Relations, Deere & Co.

It sounds like we'll continue to see discipline with respect to returning capital. But can you elaborate any further on investing back into our businesses?

Ryan D. Campbell

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

Sure, Brent. The Smart Industrial strategy that we put in place during 2020 is the foundation for us to focus our resources on the areas that are most differentiated from a customer value perspective. It's through that lens that we are positioned to increase the level of investment back into our business, both organically and inorganically through M&A. As you can see in our guidance, the R&D investment is up 17% in 2022.

The focus of the increase is on further developing our tech stack, which accelerates our capabilities related to sense and act, autonomy, digital solutions, connectivity and electrification. We're planning to demonstrate many of our new technologies at our Investor Tech Day in mid-2022, so stay tuned for that exciting event. Finally, as it relates to M&A, expect us to continue to be active, aligned with the themes that we've discussed over the last year.

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Brent Norwood
Investor Relations, Deere & Co.

Lastly, is there anything else that you'd like to highlight for investors to expect in 2022?

Ryan D. Campbell
Chief Financial Officer & Senior Vice President, Deere & Co.

Now, 2022 is shaping up to be a very important year for us. We've put in place the new strategy and are well-positioned to accomplish our goals. On that note, we do have a set of goals both related to business and sustainability that will sunset this year. Accordingly, we'll be rolling out our next suite of goals that will highlight the opportunity we have and what we think we can accomplish over the rest of the decade.

Importantly, we are uniquely positioned and that there is direct alignment between our creation of customer value, improving our own earnings and delivering more sustainable outcomes for the environment. So Brent, expect us to see – expect to see a comprehensive suite of goals that really brings all of those elements together.

Brent Norwood
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 procedure. In consideration of others and our hope to allow more of you to participate in the call, please limit yourself to one question. If you have additional questions, we ask that you rejoin the queue. Tasha?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Bob Wertheimer with Melius Research. Your line is open.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Hi. Good morning, everybody, and thanks for all the color. My question is on See & Spray Ultimate. I wonder in whatever way you could, if you could expand on what limited launch means, how the technology is progressing. I don't know if you can talk about the pipeline for fertilizer versus herbicide and/or the geographic scope of the launch. Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, I'll start there. And Cory, please add in. We haven't put out exact numbers, but we'll have that out again in customers' hands with production units; and again through multiple products, soybeans, cotton, corn. So, continuing to evolve there. And I think we feel really, really good about both how we're performing and the customer response as we get it into their hands.

Cory J. Reed
President-Worldwide Agriculture & Turf Division, Production and Precision Ag, and Americas and Australia, Deere & Co.

A

Yeah. I would say, our See & Spray journey started with ExactApply and the ability to use individual nozzle control. We've gone through and put the select product into the market this year in full supply, so that's the green-

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on-brown solution. We're now taking many units into a commercial application with select customers in 2022 of See & Spray Ultimate. That's to both prove out our business model and show the value and then we'll ramp from there. So, it's a really exciting journey. We're seeing a lot of demand for it and we're excited about it going forward.

Joshua Jepsen
Director-Investor Relations, Deere & Co.
A

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

Rob Wertheimer
Analyst, Melius Research LLC
Q

Thank you.

Operator: Jerry Revich with Goldman Sachs, your line is open.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC
Q

Yes. Hi. Good morning and Happy Thanksgiving, everyone. I'm wondering if you folks can talk about what you're seeing in the installed base of equipment. I know you track used equipment inventories closely based on industry data that we see. It looks like that's cut in half from 2015 levels, but maybe you can comment on where it stands for your equipment specifically. And what does that tell you about what the potential for new equipment demand to outstrip supply beyond 2022?

Joshua Jepsen
Director-Investor Relations, Deere & Co.
A

So I think when you look at used, I mean we're at tremendously low levels of used inventory, particularly in Large Ag. Levels we haven't been at for well over a decade, we've seen that pulled down. And what that's driving is, increasing used prices which has been really positive for our farmers that are trading in product. So, impacting their trade differentials making those differentials as they trade up more – make that differential less, excuse me.

So I think that's a big piece. I think it's also important as we think about just overall the replacement cycle and recovery that we're seeing there. The lower those inventory levels are, I think that extends some of that cycle. Cory, anything you'd add?

Cory J. Reed
President-Worldwide Agriculture & Turf Division, Production and Precision Ag, and Americas and Australia, Deere & Co.
A

No. Josh said it. We're well below the bands that we'd normally see and the lowest we've been in 10 years. You have a combination of factors going on. Obviously, you have solid financial income on the part of farmers, albeit with some headwinds and inputs. You have an aging fleet. You have new technologies. You have the opportunity to trade their equipment at the highest values they've ever traded, and it's driving tremendous demand.

So right now the limitation is, used is creating significant demand going forward. It's really figuring out the supply side and making sure that we can deliver every product into the market. But used right now is at all-time low.

Joshua Jepsen
Director-Investor Relations, Deere & Co.
A

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

Operator: Jamie Cook with Credit Suisse. Your line is open.

Jamie Cook
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. Good morning. I guess, question, the R&D up 17%. That's a big jump. I'm just wondering if given where we're going with technology, should R&D structural be up in sort of the high-teens range going forward? And then just sort of on the M&A front, can you just talk about the pipeline there and what that implies for – is it just focused on technology, Precision Ag tech solutions? Thanks.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

The R&D may be – looking at the increase in 2022, some of that is compared to 2021 where we were down a bit and some of that was really the effects of pulling together the organization, creating the Chief Technology Officer org, which did allow us to pull and centralize components of the tech stack. So we saw some elimination of redundancies.

So that's really the jumping off point then for this increase in 2022, which is focused on the areas that Ryan mentioned in terms of where we really feel like we can accelerate and differentiate, sense and act, autonomy, electrification, connectivity. So, those are the areas where we see the biggest opportunities to deliver value for customers and are spending there accordingly.

Relative to M&A?

Ryan D. Campbell
Chief Financial Officer & Senior Vice President, Deere & Co.

A

Yeah. This is Ryan. So as it relates to M&A, as we've talked over the last year, we've got these thematic trends with respect to the sense and act platform that we're building, autonomy, digital solutions, connectivity and also electrification. An example of digital solutions, we acquired Harvest Profit and that's right along with our expectations of delivering value and overall management of a customer's P&L and making it super seamless and easy for them to use.

With respect to autonomy which we see accelerating, Bear Flag is an example of a transaction like that. And so, we've got a relatively full pipeline over the next several months. You'll see us continue to be active and source deals and close deals that allow us to accelerate our journey along those thematic trends. So, stay tuned; more to come. And you'll see us be active in this area over the next several years.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

And maybe one thing, Jamie – sorry, I missed part of your question it was just the level. This does represent a bit of a step-up compared to where we were. We think broadly this level is reasonable for where we operate. Again...

Jamie Cook
Analyst, Credit Suisse Securities (USA) LLC

Q

[indiscernible] (00:31:17)

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Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

[ph] ... where we'd reserve the right (00:31:17) in the future as we see new technologies or new opportunities to invest, to create value, but I think that's a fair view of where we are today.

Jamie Cook
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Thanks.

Operator: Stephen Volkmann with Jefferies, your line is open.

Stephen Volkmann
Analyst, Jefferies LLC

Q

Hi. Good morning, everybody. I'm wondering if we could go back to inventory but touch on the new side. Does your plan for 2022 anticipate rebuilding any new inventories or does that sort of get pushed out into 2023?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Morning, Steve. It really does imply very little to no inventory build. Given what we're seeing broadly a demand above the industry's ability to produce, we would expect most everything we ship gets retailed but no replenishment of those inventories. As a result of that, whether it's Large Ag equipment, Small Ag and into Construction, it probably takes multiple years to rebuild some of the field inventory levels coming off of historic lows.

For example, if we look at small tractors or compact construction equipment, they're in the teens inventory-to-sales as we ended the year. And the targets there are probably closer to 40-plus percent inventory-to-sales, so there's a lot of room to go there. And even Large Ag, which traditionally comes down where we're at levels we've really not seen before, row crop tractors 10% inventory-to-sales, combines low single digits, so very, very low. And I think as we consider how this continued replacement drives forward, we do see that as positive in that we see the need to recover inventory over a few years, not just one.

Thanks, Steve.

Stephen Volkmann
Analyst, Jefferies LLC

Q

Thank you.

Operator: Chad Dillard with Bernstein, your line is open.

Chad Dillard
Analyst, Sanford C. Bernstein & Co. LLC

Q

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Hi. Good morning, guys. So my question is how much room is there to impose higher equipment prices on farmers? I'm just trying to get sense of whether there's any fatigue in the near term, given what we're seeing on the fertilizer price side. And could you actually pass some of the costs on from the labor cost increases?

Cory J. Reed
President-Worldwide Agriculture & Turf Division, Production and Precision Ag, and Americas and Australia, Deere & Co.

A

Yeah, thanks for the question. I think, certainly, farmers have seen some headwinds relative to their overall input cost. I think the first part is for us to focus on being able to deliver technologies that help them improve their profitability. So, a lot of our pricing comes from our ability to deliver technologies in the machines that make them or give them the ability to create more yield or manage their cost differently. So, that's a big part of it.

Now, obviously in the last 18 months with a lot of the commodity increases, there's also been the opportunity to recover for some of those commodities, and that's allowed us to do that. But by and large, I would tell you that our pricing model is based upon delivering value for them and being able to make sure that each time they can go to the field, we can make them more profitable by using the equipment that we put out there. And each of the examples [indiscernible] (00:34:45) See & Spray or X9 or AutoPath, that's what they do is allow them to either create more yield or manage their cost and be more efficient in the field, and that's the focus.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

The other thing we've seen too that's impacted price has been very strong overseas pricing. So as we've reacted to both FX movements as well as inflationary environments, we've taken more price. So really throughout 2021 and into 2022, we're seeing, if we look at Production and Precision Ag, low double-digit pricing in the overseas market that has driven that.

So as we think – looking forward, we continue to see that occurring. The one piece that we don't see as much repeating [ph] or a (00:35:31) tailwind is on lower discounts. As we pulled down discounts throughout the back half of 2020 and through 2021, there's not much left there. So, that is another thing to consider when we think about price.

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

Operator: Tim Thein with Citigroup, your line is open.

Tim W. Thein
Analyst, Citigroup Global Markets, Inc.

Q

Thanks. Good morning. Josh, maybe dig into the Production and Precision Ag margin guidance of, call it, under 100 basis points of improvement on 20-plus percent sales growth, with $1.5 billion or so of positive price. Just if you walk us through obviously that, I would assume as you talked about for the full – for the total company call it 100 basis points from the work stoppages, I assume a disproportionate amount of that is impacting that segment. Again, maybe you can correct me on that. But maybe just walk us through how you get to headwinds and tailwinds as we think about margin for that segment. Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Sure, and you're right. There's an outsized proportion of that impact is in Production and Precision Ag, most largely affected. If we think about the puts and takes, particularly in the first quarter, as you mentioned, you've got

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some amount of lower production impacting that, which drives lower overhead absorption. Material and freight cost, higher. And we'd expect to be price-cost negative in 1Q, in Production and Precision Ag. And then there, again, you have the larger portion of some one-time items like ratification bonus.

And you may recall, last year in the fourth quarter – excuse me, last year in the first quarter, we had about a $50 million benefit from taxes overseas related. So, that goes I guess into the first quarter. So that pulls down the absolute margin pretty significantly. Stepping forward from that and then thinking about the full year which you mentioned, about 100 bps higher from an absolute margin point of view, we return to the incrementals that would run historically where we expect to see them. So, around 35% incremental rest of the year through 4Q for PPA.

Tim W. Thein
Analyst, Citigroup Global Markets, Inc.

Q

Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

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

Operator: Kristen Owen with Oppenheimer, your line is open.

Kristen Owen
Analyst, Oppenheimer & Co., Inc.

Q

Great. Thank you. Cory, you talked about the incremental functionality that you're looking at rolling out for AutoPath over the coming years. And can you just speak to how you're thinking about sort of current customer's ability to participate in that incremental functionality? The question is really one about business model and what types of model, be it subscription, service, et cetera, that you're exploring for that solution. Thank you.

Cory J. Reed
President-Worldwide Agriculture & Turf Division, Production and Precision Ag, and Americas and Australia, Deere & Co.

A

Sure. And you'll see more on this from us in the coming quarters, as we roll out some objectives for how we're thinking about this. One of the things we're talking about and making sure is that, just like we did with guidance solutions in the past where we started years ahead, putting base functionality into machines that would allow us to both put the functionality for, in this case, AutoPath or further automation features into every machine, we'll start working through a series of making sure that the base functionality of the vehicle will allow us to either ship the vehicle with the functionality or upgrade it in the future.

And we're looking at new ways and new business models to make that easier for customers to adopt. So that journey, we're on that path right now. We're rolling out ways that we're doing that with our Precision Ag hardware. You'll see us do it more with our subscriptions and software going forward. So we're out cooperating and working with customers and how we can make that work on their operations today and how they like to consume it. And you'll see that revenue stream continue to grow from us in the future.

Ryan D. Campbell
Chief Financial Officer & Senior Vice President, Deere & Co.

A

Yeah. And Kristen, it's Ryan. As we talk about and roll out our next generation of goals, you'll see us think through an evolution of our business model over the next decade with respect to what Cory talked about and the value

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we're delivering every time our customers go across the field and how can we think through a business model that's more of an ongoing basis. So, more to come on that and you'll see us have some relatively specific targets and goals on what we think we can deliver from that evolution.

Kristen Owen
Analyst, Oppenheimer & Co., Inc.

Q

Thank you.

Operator: Adam Uhlman with Cleveland Research, your line is open.

Adam Uhlman
Analyst, Cleveland Research Co. LLC

Q

Hey, everybody. Happy Thanksgiving. I guess, one of the – turning back to the supply chain issues that you'd mentioned, could you share some more insights on what exactly you're seeing and more so maybe what you've included in the forecast? I'm curious how much visibility you have into supply chain getting better. What could be tough still with chips that maybe should start to improve? And maybe what could be held back by capacity limitations at your suppliers that maybe won't free up for another year or so?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Good morning, Adam. If you go back a quarter ago in the third quarter, we expected the supply challenges to be more impactful in 4Q, and that's what we saw. We did see it deteriorate. It was a more challenging environment in the fourth quarter. Between the supply challenges and some of the work stoppage, that probably impacted the fourth quarter by, you call it, a half point of margin or so for the equipment operations. So, it was more challenging.

And as we think about the 2022 plan that we went in, assuming that similar level of disruption and activity in supply chain. So, we have embedded a significant amount of improvement there. We expect to continue to be challenged and choppy. One of the things we did do during the last couple months is we continued to bring parts in, parts and components into – to our facilities. So we were able to continue that. We didn't slow that down. So that's positive, as we ramp up, as Cory mentioned, start to ramp up production coming back. That's important.

But we think that continues to be a challenge, and it's broad-based. So chips you mentioned, very tight. We expect that continues through 2022. Other things, there's material challenges, there's labor availability in the supply base and this extends across many geographies, so logistics become a challenge as well. So we're continuing to work through those. Supply management team is working really closely with our suppliers. We're giving them more visibility than we ever have before to try to work through this and we try to plan accordingly.

Cory J. Reed
President-Worldwide Agriculture & Turf Division, Production and Precision Ag, and Americas and Australia, Deere & Co.

A

Yeah. I would echo that. This is Cory. If we look at 2021, we knew we were going to have some challenges coming forward. And what we said was, we have to execute and make sure that we can manage that better than anyone in the industry. And I think what you saw us do through the back half of the year was manage it well. We're positioned well as we kickoff and have the workforce back. And there are going to be a whole lot of pop-ups that come; electronic components, labor, logistics, but we have to manage through them. And that's what our folks have been up to the task on at this point and we're confident they can be up to that task going forward.

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Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, we have seen reasonable disparities. I think Europe for us has probably operated a little more smoothly than say the Americas and Asia. So, there are some deltas and differences there that have impacted our businesses differently. But, yeah, continue executing and we'll update as we go through the year. Thanks, Adam.

Operator: Ross Gilardi with Bank of America, your line is open.

Ross Gilardi
Analyst, Bank of America Merrill Lynch

Q

Yeah. Good morning, guys. Can you just address your ability to deliver in time for planting season which isn't that far away in the aftermath of the strike and given all of the supply chain constraints? And then, just also there seems to be a lot of investor chatter that soaring input costs for the farmer are going to lead to a big slowdown in equipment demand for a premature end of the cycle. I mean, it seems like the opposite might be true if lower fertilizer application rates lead to greater demand for Precision Ag as well as lower yield. And I'm just wondering if you can address that too. Thanks.

Cory J. Reed
President-Worldwide Agriculture & Turf Division, Production and Precision Ag, and Americas and Australia, Deere & Co.

A

Yeah. Thanks, Ross. This is Cory. You're right. I mean, one of the things we're focused on is, even as we're in the middle of the interruption was making sure that we could deliver products on time seasonally for our customers. Planting is the top end of that. We continued and made sure we could surge components into our planting lines as people were coming back. We've got a production plan that's commensurate with what our Early Order Program is. We do have some risks. We've gone out and talked to our customers about where we are and our dealers about where we are with that.

But we feel really confident in our ability to deliver even more planters into the market this year. And where we have the opportunity if customers want to accept planters later in the season, we'll do that as well. So from that standpoint, we operate with transparency, talk to our dealers and customers and then put a good production plan together that allows us to meet market demand. That demand hasn't slowed, in fact it's continued. And much like all of our other Large Ag products, planters were one of those things that even post the optimum planting window people are taking product.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

And then, Ross, your question related to input costs and how does that impact the cycle. Maybe stepping back more broadly and I'll address that in part of this, but where are we at right now and how are we seeing this play out? We feel like there is continued runway of replacement recovery out here to continuing to be had. And that's for a few reasons. One, underlying farmer fundamentals continue to be very strong, whether it's cash receipts, income. What we're seeing land values, for example, those are positive.

We see demand for replacement, the age of the fleet, you've heard us talk about this a lot. 2021, we got older. And even as we look to 2022, we'd expect the fleet overall in North America to age out. And then you have this dynamic that we've seen in 2021 and repeated in 2022, where demand's above the industry's ability to deliver further in our mind stretches or elongates a little bit of that recovery cycle. And as mentioned earlier, inventory levels for both new and used are quite low.

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So, again when you think about comparing back, when you compare back to 2012 and 2013 and some of the dynamics, one of the big differences is we are at significantly lower levels of inventory, which makes some of the replacement demand push out a bit further. And then lastly, as it relates to input costs, as input costs rise, the impact that our precision tools can have in terms of leveraging technology to drive more accuracy, more precision, with inputs, whether that's seed, fertilizer, chemical and make that value proposition even more attractive.

And Cory talked a bit about this in his prepared remarks, but the take rates that we're seeing on technology took a significant step up. We're ExactApply on sprayers, 55% which is up quite a bit. ExactEmerge on planters, 55%. And then we're seeing that really across these technologies, a pretty significant step function change in terms of the use of the technology that drives, again back to better yields and lower cost through increased precision. So, we'll continue to execute there, but we feel like there are legs to this recovery that we're in and really began about one year-ago right now.

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

Operator: Mig Dobre with Baird. Your line is open.

Micrea Dobre
Analyst, Robert W. Baird & Co., Inc.

Q

Yes. Thanks for taking the question. Just looking to maybe get a little more color on the commentary of raw material headwinds, the $2 billion that you called out. So, kind of two questions to that. First, where are you in terms of the assumptions that you made relative to current spot prices for things like steel? Like what's kind of baked into this number? And then, given the higher-than-normal visibility that you have in terms of where the Early Order Program seem to be shaping up, I'm kind of curious as to what you're doing in terms of either forward buying materials or the various components that you know you're going to need. Thanks.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

The material freight cost, so Brent mentioned this, we expect $2 billion of headwinds compared to 2021. And that's split roughly 80% material and about 20% freight. And the freight is driven by essentially all different modes, whether it's air, ocean, truck, all those things are impactful there. On the materials side, it's things like the raw that you mentioned, steel, for example. Traditionally, we buy roughly a quarter ahead. We have seen – from a pure spot price, you've seen steel moderate some from where it was peaking probably a quarter or so ago. So we haven't adjusted significantly.

We do work with supply base to ensure that we've got availability. So given the demand we have and the customer desire to get products, we will try to balance that in terms of having product and making sure we've got the availability of raws. So, I mean from a price perspective, we haven't got into the detail of where we're at or where we're locking in, but definitely we do expect to see more of that come through the first half of the year and our comps get a little bit easier in the back half. So of that $2 billion, we expect about two-thirds to come through in the first half of 2022.

And maybe lastly, similar splits in terms of the businesses, about half of that is Production and Precision Ag; about 30% is Small Ag & Turf; and roughly 20% C&F. And a lot of that just varies based on the products and the makeup overall of their material.

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With that, we'll go ahead and jump to our next question.

Operator: Joel Tiss with BMO, your line is open.

Joel Tiss
Analyst, BMO Capital Markets Corp.

Q

Hey, guys. Just switching gears a little bit. Can you talk a little bit about the focus of future restructuring and any guidelines that you can give us about you think 50 basis points a year of margin improvement or 100 basis points, or just sort of some of the targeted areas and what it's going to mean?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Good morning, Joel.

Joel Tiss
Analyst, BMO Capital Markets Corp.

Q

Good morning.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Going through the Smart Industrial operating model and the shift in changes we made in 2020, we feel like we're seeing the benefits of that play out in 2021, as we refocused the organization and then really started to put the capital allocation model to work in terms of how do we guide and invest in parts of the business where we feel like we can differentiate and create the most value.

So I think as we've worked through that, I think you see now maybe some of that impact as you see R&D increasing this next year, and that's in the areas that we focused on. So we made adjustments to how we're organized and to how we're allocating resources. We worked through some things like divestitures in 2020. So I think that's the continued model.

Ryan D. Campbell
Chief Financial Officer & Senior Vice President, Deere & Co.

A

Hey, it's Ryan. I think you'll see us pivot, particularly as we announce our next set of goals, to focus on the growth opportunities that we have. There'll be financial components of the goals that come out, but there'll also be kind of additional infrastructure-related investments that we can make with our technology stack that will really unlock the next generation of customer value. So, that's where we're focused.

We spent the last couple years doing some restructuring activities, having a more dynamic capital allocation process. But now as we move forward, it's going to be more about growth and taking advantage of the unique opportunities that we have to create customer value, both profitability and sustainability wise.

Joel Tiss
Analyst, BMO Capital Markets Corp.

Q

Yeah. Great. Thank you.

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Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

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

Operator: Stanley Elliott with Stifel, your line is open.

Stanley S. Elliott
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Hey, good morning, everyone. Thank you all for taking the question. Could you talk a little bit about the – with the news on the infrastructure bill the other week, when would you expect to see that through the portfolio? And then also maybe any sort of nuances between the road construction business versus the legacy core.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Morning, Stanley. On infrastructure, the interesting thing there is, as we start to see that, we think jobs probably really start to move more towards the end of 2022. But given this dynamic of demand above the industry's ability to produce due to supply, probably not as much impact as one might expect or hope in 2022. So, we'll continue to watch that.

We think that type of program is very, very positive for the industry. Tends to have a long run of impact but probably start to see more of that in 2023. When we step back and look at that, there's a significant amount of the funding, that is roads, bridges, waterways, broadband, all of which really are very attractive and applicable to our earth-moving and road building businesses. So, I think that's particularly positive.

If you look at our industry outlooks, we're – and again, this is muted somewhat by just the supply constraints, but up 5% to 10% North America for both construction and compact construction. Globally, we'd say road building's probably in that same vein, up 5% to 10%. So we'll keep our eyes out there. Dealers are obviously working very closely with customers. I think we'll watch the independent rental companies. We've seen some of their CapEx start to move upward in 2021 and into 2022, and that's probably a good leading indicator of some of the work on infrastructure coming.

Stanley S. Elliott
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thanks, everyone. Happy Thanksgiving.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Thanks, Stanley. Take care.

Operator: Courtney Yakavonis with Morgan Stanley, your line is open.

Courtney Yakavonis
Analyst, Morgan Stanley & Co. LLC

Q

Hi. Good morning, guys. Thanks for the question. Can you just pair for us a little bit the gap between your Small Ag industry guidance and your sales guidance? Obviously, pricing was a part of it, but I don't think you said that

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you're really expecting inventory levels [indiscernible] (00:55:05) mix or just help us understand the difference between those two.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

The Small Ag & Turf North America, we expect to be up – or excuse me, expect to be flat. Our overall sales for that business unit are up 15% to 20%. So a big part of its price, so about 7 points of price embedded in there. That is also a more global operation. So that has some impact when we think about where and how we operate around the world. So there's a piece there. So there's a little bit of market share. It would be fair to assume some gains there.

And then on the very little margins, maybe on some segments of tractors, we expect to build a little bit of inventory, but are relatively muted. So I think those are the components that are driving the difference between those outlooks.

Courtney Yakavonis
Analyst, Morgan Stanley & Co. LLC

Q

And maybe just as a follow up, can you also just comment on the margins being down year-over-year in that segment? Is that – anything that's disproportionately weighing on the Small Ag segment?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah. Good question. Price-cost for Small Ag and Turf is positive for 2022, but it's the most challenged. So we're price-cost positive, but that's where we're seeing a bigger impact there as it relates to margin, in particularly incremental margins are more challenged in that regard. And I would say, that's the part of the business where we are seeing constraints on the supply side that are impacting some parts of that business maybe a little bit more than others.

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

Operator: Larry De Maria with William Blair, your line is open.

Lawrence De Maria
Analyst, William Blair & Co. LLC

Q

Hey, thanks. Good morning. I'm slightly off topic here, but now that the labor negotiations strike are concluded, congratulations, we have potential OSHA rules on the horizon around mandatory vaccines. I'm just curious if there's anything in the contract that talks to that, what Deere's policy is. And just trying to understand the expectation around further issues in production both here and potentially even in Mannheim. Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Sure. Thanks, Larry. Yeah. I mean, I would say, the focus here over the last couple months has really been around the negotiations and the contract and getting our employees back in our facilities and operating. We'll continue to work through all the important guidelines and everything that needs to be put in place.

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I'd say if we go back to the early days of the pandemic, we were taking measures ahead of guidelines, ahead of CDC requirements and as well as in other parts of the world to take care of our workforce, to keep them safe. We shifted to multi-shift operations in order to create distance. We put a number of those things in place early on. So I think we feel pretty good about the track record we have of taking care and keeping our employees safe and our work environment safe, and we'll continue to do that.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

With that, we'll go ahead and wrap up the call. I appreciate everyone's time. Hope everyone has a good Thanksgiving and we'll talk soon. Take care.

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

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