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Deere & Co. (DE)

Q1 2022 Earnings Call

CORPORATE PARTICIPANTS

Joshua Jepsen

Director-Investor Relations, Deere & Co.

Brent Norwood

Manager, Investor Communications, Deere & Co.

John C. May

Chairman & Chief Executive Officer, Deere & Co.

Ryan D. Campbell

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

Jill Kutzbach Sanchez

Manager, Sustainability and Investor Relations, Deere & Co.

OTHER PARTICIPANTS

Jerry Revich

Analyst, Goldman Sachs & Co. LLC

Courtney Yakavonis

Analyst, Morgan Stanley & Co. LLC

Steven Fisher

Analyst, UBS Securities LLC

Jamie Cook

Analyst, Credit Suisse Securities (USA) LLC

Rob Wertheimer

Analyst, Melius Research LLC

David Raso

Analyst, Evercore ISI

Kristen Owen

Analyst, Oppenheimer & Co., Inc.

Ross Gilardi

Analyst, Bank of America Merrill Lynch

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Deere & Company First Quarter Earnings Conference Call. Your lines have been placed on a listen-only mode 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.

Thanks, Robin. Hello. Good morning. Also on the call today are John May, Chairman and Chief Executive Officer; Ryan Campbell, CFO; Jill Sanchez, Manager of Sustainability and Investor Relations; 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 2022. After that, we'll respond to your questions. Please note that 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 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 copyrighted 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. 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

Manager, Investor Communications, Deere & Co.

John Deere completed the first quarter with sound execution despite managing through a very dynamic period. Financial results for the quarter included an 11% margin for the equipment operations. Strong ag fundamentals carried over from fiscal year 2021 and have remained solid through the beginning of fiscal year 2022, with our order books largely full through the balance of the year. Meanwhile, construction and forestry markets also continued to benefit from strong demand and price realization, contributing to the division's solid performance in the quarter.

Slide 3 shows the results for the first quarter. Net sales and revenues were up 5% to \$9.569 billion, while net sales for the equipment operations were up 6% to \$8.531 billion. Net income attributable to Deere & Company was \$903 million or \$2.92 per diluted share.

Now, let's turn to a review of our Production and Precision Ag business, starting on slide 4. Net sales of \$3.356 billion were up 9% compared to the first quarter last year, primarily due to price realization and higher shipment volumes. Price realization in the quarter was positive by about 8 points, and currency translation was negative by roughly 2 points. Operating profit was \$296 million, resulting in a 9% operating margin for the segment compared to a 21% margin for the same period last year.

The year-over-year decrease was due to higher production costs and an unfavorable sales mix. The higher production costs were largely the result of higher material and freight costs as well as lower overhead absorption at the factories affected by the delayed ratification of our labor agreement. These items were partially offset by the improved price realization and higher shipment volumes. The most recent quarter was negatively affected by the UAW contract ratification bonus, while the prior period benefited from a favorable indirect tax ruling in Brazil.

Shifting focus to small ag and turf on slide 5, net sales were up 5% totaling \$2.631 billion in the first quarter as price realization more than offset lower shipment volumes. Price realization in the quarter was positive by just over 6 points, while currency translation was negative by about 1 point. For the quarter, operating profit was down year-over-year at \$371 million, resulting in a 14.1% operating margin. The decreased profit was primarily due to higher production costs and a combination of lower sales and an unfavorable sales mix. These items were partially offset by price realization.

Slide 6 shows our industry outlook for ag and turf markets globally. In the US and Canada, we expect industry sales of large ag equipment to be up approximately 20%, reflecting another strong year of demand. In fiscal year 2021, customer demand outpaced the industry's ability to supply driven by the combination of strong

fundamentals, advanced fleet age, and low field inventory. With all of these dynamics still present in fiscal year 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 allow us to reevaluate inflationary pressures later in the year. In the small ag and turf segment, we expect industry sales in the US and Canada to remain largely flat for the year as supply challenges continue to limit the industry's ability to produce. Following two years of robust demand, field inventory levels are at multiyear lows and unlikely to begin recovery until sometime in 2023.

Moving on to Europe, the industry is forecasted to be up roughly 5% as higher commodity prices strengthen business conditions in the arable segment and dairy prices remain resilient even as we're starting to see modest pressure on margins 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 extends through the duration of fiscal year 2022.

In South America, we expect industry sales of tractors and combines to increase between 5% to 10%. Farmer sentiment and profitability remain 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 May, which is as far as we've allowed it to grow. Industry sales in Asia are forecasted to be flat as India, the world's largest tractor market by units, moderates from record volumes achieved in 2021.

Moving on to our segment forecasts beginning on slide 7. For Production and Precision Ag, net sales are now forecasted to be up between 25% to 30% in fiscal year 2022. The forecast assumes about 10 points of positive price realization for the full year and roughly 2 points of currency headwind. For the segment's operating margin, our full year forecast is now between 21% and 22%, reflecting consistently solid financial performance across all geographic regions.

Slide 8 shows our forecast for the small ag and turf segment. We now expect net sales in fiscal year 2022 to be up about 15%. This guidance includes 8 points of positive price realization and 2 points of currency headwind. The segment's operating margin is forecasted between 15.5% and 16.5%. The decreased sales guidance relative to our previous forecasts reflects supply challenges particularly with limitations around small engines, while higher material and freight costs are pressuring margins.

Now, let's focus on construction and forestry on slide 9. For the quarter, net sales of \$2.544 billion were up 3% primarily due to price realization and higher shipment volumes. Last year, Wirtgen's one-month reporting lag was eliminated resulting in four months of Wirtgen activity in the first quarter of 2021, which increased net sales by \$270 million.

Operating profit moved slightly higher year-over-year to \$272 million, resulting in an 11% operating margin due to price realization, partially offset by higher production costs and lower sales and unfavorable sales mix. The higher production costs were largely a result of higher material and freight costs as well as poor overhead absorption at the factories affected by the delayed ratification of our labor agreement. Additionally, the current period was impacted by the ratification bonus, while last year's results included impairments of long-lived assets.

Let's turn to our 2022 construction and forestry industry outlook on slide 10. Industry sales of earth-moving equipment in North America are expected to be up between 5% to 10%, while the compact construction market is now forecasted to be flat to up 5%. End markets for earth-moving and compact equipment are expected to remain

strong in our fiscal year 2022 forecast, 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. The decrease in our compact construction equipment outlook is entirely due to supply constraints affecting those product lines.

Overall, demand for earth-moving and compact construction equipment is expected to exceed our production for the year, resulting in continued low inventory levels. Demand related to infrastructure has yet to materialize and will likely begin in fiscal year 2023. Global roadbuilding markets are expected to be up between 5% to 10%, with growth in the North American market offsetting some weakness in China. In forestry, we expect the industry to be up 10% to 15% as lumber production looks to remain at elevated levels throughout the year, with lumber prices rising again after coming down from peaks last summer.

Moving to the C&F segment outlook on slide 11, Deere's construction and forestry 2022 net sales are forecasted to be up between 10% to 15%. Our net sales guidance for the year includes 8.5 points of positive price realization and 2 points of negative currency impact. We are maintaining our outlook for the segment's operating margin at between 13.5% and 14.5%. The year is benefiting from increases in price and volume and a lack of one-time items from the prior year.

Let's move now to our financial services operations on slide 12. Worldwide financial services net income attributable to Deere & Company in the first quarter was \$231 million, benefiting from income earned on higher average portfolio balances and improved performance of our operating lease residual values. For fiscal year 2022, we maintain our net income outlook at \$870 million as the segment is expected to continue to benefit from a higher average portfolio balance.

Slide 13 outlines our guidance for net income, our effective tax rate, and operating cash flow. For fiscal year 2022, we are raising our outlook for net income to be between \$6.7 billion and \$7.1 billion. The full year forecast is inclusive of the impact of higher raw material prices and logistics costs. At this time, our forecasted price realization is expected to outpace both material and freight costs for the entire year, though we were price-cost negative in the first quarter and expect the second quarter to include our highest material and freight inflationary costs when compared to last year. As we progress through the second half of the year, we expect those material and freight comparisons to improve.

Moving on to tax, our guidance incorporates an effective tax rate projected to be between 25% and 27%. Lastly, cash flow from equipment operations is now expected to be in the range of \$6.2 billion to \$6.6 billion and includes a \$1 billion voluntary contribution to our OPEB plan, which occurred in the first quarter.

At this time, I'll turn things over to John May, our Chairman and CEO, for some comments on the company's new Leap Ambitions. John?

John C. May

Chairman & Chief Executive Officer, Deere & Co.

Yeah, thanks, Brent. First, I just want to convey how incredibly excited I am to announce our new Leap Ambitions. We are uniquely positioned to deliver both economic and sustainable outcomes for our customers, employees, and our broader stakeholders. These goals demonstrate the enormous opportunity in front of us, and I firmly believe that our greatest potential still lies ahead.

Before launching into the framework of our new Leap Ambitions, I first want to revisit the journey we've taken to get to this point. Almost two years ago, we launched our Smart Industrial strategy. Through that process, we

really accomplished four things. We reorganized the company around the way our customers do business, which we call Production Systems. We focused our capital allocation on differentiated, value-creating solutions. We also centralized our technology development under CTO, our Chief Technology Officer, and created a group dedicated entirely to Lifecycle Solutions.

Our financial and operating results over the last two years demonstrate the tangible impact of our operating model. By organizing our company to mirror our customers' production systems, we gained incredible insights on how to best unlock increased value for them. The new structure also allowed us to further empower our team, giving us agility to respond more quickly to the ever-changing market conditions we faced over the last two years. In addition, we overhauled our capital allocation framework, enabling us to exit business that were unprofitable or didn't fit our strategy. We then redeployed that capital to the parts of our business that are the most differentiated and aligned to our strategy.

And now with the centralization of our Tech Stack, we've been able to drive leverage across our businesses and make significant investments in technology, strengthening our capabilities in digital, automation, autonomy, and electrification. I am incredibly proud of what our employees have accomplished throughout one of the most dynamic periods in the company's history. Amazingly, we executed all these changes during a global pandemic, a ramp in customer demand, and significant supplier and labor challenges.

These challenges introduced a high level of uncertainty, but our team really powered through it to strengthen our foundation for the future. Quite frankly, introducing this amount of change during such a dynamic period, it felt risky at times, but I've come through it convinced more today than ever that it was absolutely necessary to position our company for the opportunity ahead of us and energize our team to achieve new levels of performance.

In just a short period of time, we've made significant progress on our financial goals that we set back at my first Analyst Day in 2020, and are delivering value-creating technologies to our customers at a rapid pace, such as the recent unveiling of our autonomous 8R and automated tillage tool that we launched at CES. I'm also convinced that to realize our full potential, we must set even higher goals. The actions we took over the last two years were the foundational steps required for us to define our next steps of ambitions. The reorganization of the company and a structurally-improved financial position were critical steps that position us to make the investments required to identify and achieve these new goals.

So, with that context, I am excited to share our new goals, our Leap Ambitions, which will help us achieve our company's purpose of both delivering economic and sustainable value for our customers over the next decade. Our Leap Ambition framework has three simple components: first, we size the incremental market opportunity; then, we identify the key actions required; and lastly, we define the desired outcomes we hope to achieve. The journey to develop our Leap Ambitions started with sizing the new value-creating opportunities ahead of us. Through the work of our production systems teams, we've developed deep insights into the jobs our customers do, enabling us to deliver better quantified areas where our technology and solutions can unlock economic headroom for our customers.

So, across our three businesses, we see over \$150 billion in incremental addressable market for Deere. That figure represents the new opportunity for all the stakeholders across the applicable acres, job sites, in which our products and solutions operate. This is entirely ahead of us, and represents a tremendous opportunity for top line and margin growth over the remainder of the decade. This growth will provide a continued path for Deere to share in that value creation, rewarding employees, dealers, and shareholders for the investments being made.

After identifying the size of the opportunity, we then define the key executional drivers by segment required to unlock that value. We did this to offer more insight into some of the key growth investments we are making. Progressing our capabilities in digitalization, autonomy, automation, and electrification are key to creating both value for our customers and revenue growth for Deere. So, our future investment profile will reflect this focus. Additionally, we identified executional drivers applicable to all three segments such as connected machines and business model transformation, which are each critical enablers of the ambitions.

Lastly, our Leap Ambitions include measurable financial and sustainable outcomes. Due to the structural improvements we have made over the last two years, we've made clear progress on our 15% margin goal and have now set our sights even higher. By 2030, we see a path to 20% margins at the equipment operations level. That goal includes the impact of the increase in growth of investments required to deliver the next generation of advanced technologies to our customers.

It's also important to note that we aligned our environmental goals with our financial goals because for us, the two are intertwined. Executing our business plan will help us, and importantly, our customers in achieving both financial and sustainable outcomes without having to choose one over the other, something you will see clearly in our Sustainability Report, which we just published today as well.

Our latest sustainability goals include improvements upon our existing suite of eco efficiency goals. While the bar to include a Scope 3 reduction target, we raised that bar for our Scope 3 target reduction, as well as enhanced customer outcomes through reduced use of costly inputs with high carbon footprints. Overall, I'm incredibly proud of the progress we've made and of the Leap Ambitions, which are possible because of our Smart Industrial strategy and demonstrate the tremendous growth opportunity that lies ahead.

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

Brent Norwood

Manager, Investor Communications, Deere & Co.

Thanks, John. Before we open up the line for Q&A, we'll first address a few of the likely questions around the quarter as well as some of the details of our new Leap Ambitions. 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 environment across our businesses. John, can you provide some additional color around our execution in the quarter?

John C. May

Chairman & Chief Executive Officer, Deere & Co.

Yeah, Brent, first, I really want to start with thanking our employees for overcoming a lot of adversity in the quarter. As you can see from the results, our factories were able to ramp-up production rather quickly throughout the quarter. In fact, the AEM data, which is shown on slide 20 (sic) [21], shows that we outpaced the industry for the quarter in all but one of the categories. That is an amazing feat when you consider that many of our factories were down for five weeks because of work disruption.

The credit for this impressive performance goes first to factory employees who did an outstanding job post-ratification of our labor agreement, and next, to our dealers, who have managed through delays due to both supply chain challenges and work stoppages at our factories. They have done an incredible work rescheduling

deliveries and making the necessary accommodations ahead of planting season to ensure our customers' needs are taken care of.

It's worth noting that our supply base will likely remain challenged throughout fiscal year 2022. Issues continue to arise, and our guidance contemplates successful resolution of these issues without significant disruptions. Components with heavy labor content remain in tight supply, and of course, semiconductor availability will continue to be limited throughout the year. Our supply management teams are working tirelessly on mitigation actions such as multi-sourcing, additional investments in supplier tooling, and even in some cases, helping our suppliers with supplemental John Deere labor.

While the operating environment has been challenging, our supply partners are working with us to solve these challenges. I am proud of our collective efforts to get products into our customers' hands as soon as possible in this challenging environment.

Brent Norwood

Manager, Investor Communications, Deere & Co.

What can you tell us about the demand environment? Are supply-based challenges cooling demand at all?

John C. May

Chairman & Chief Executive Officer, Deere & Co.

Not at all, Brent. As you noted, our order books across all of our businesses are mostly full for the year, except in a few cases where we paused orders to allow for more dynamic pricing. Our guidance does reflect order restrictions where our supply base has constrained our ability to produce. In fact, fiscal year 2022 will be the second year in a row in which the industry demand has outstripped supply. That's why we are already getting interest in our model year 2023 products. While we haven't opened up model year 2023 yet, we'll likely get started on that in the second quarter of the year.

Brent Norwood

Manager, Investor Communications, Deere & Co.

Thanks, John. That's helpful color commentary on the quarter. Let's pivot to the company's new Leap Ambitions. First, help us understand the timing of these goals. Why now two years into the Smart Industrial strategy?

John C. May

Chairman & Chief Executive Officer, Deere & Co.

As I noted earlier, the first two years of the Smart Industrial operating model were about repositioning the organization. There were a lot of structural shifts needed before we could set goals that truly reflect our potential. We've done a lot of work with our org design, also with our capital allocation process, and standing up our CTO organization, and that has put us in a position where we can achieve these ambitions. We also had a suite of legacy goals that were sunseting in fiscal year 2022, so the timing worked out well in that respect. I'd also like to point out that the new goals contain both four- and eight-year horizons, highlighting that longer lead times will be required to achieve some of our goals.

Brent Norwood

Manager, Investor Communications, Deere & Co.

There's certainly a lot more goals than we've disclosed in the past. Can you talk through the framework for our goals and explain why this suite of goals, ambitions, is more comprehensive than years' past?

John C. May

Chairman & Chief Executive Officer, Deere & Co.

Yeah, I'd be happy to, Brent. You're right. In the past, we publicly highlighted our financial goals. Usually, it would be a margin goal or a SVA-type of goal, and then we had some eco efficiency goals, which were publicized less and not explicitly connected to our strategy. When we updated our strategy in 2020, it was clear that sustainability was going to be an integral part of our strategy and that the future goals would need to be better conveyed and with a lot more prominence.

While there are a lot of different goals, the framework is relatively simple. It starts with identifying the new opportunities to create value. We call that incremental addressable market. Then, we identified the key executional drivers required to unlock that incremental market. Last, we defined the outcomes we expect to generate both in terms of financial and sustainable outcomes for Deere and our customers.

Where Deere's position is truly unique is that a singular strategy will deliver better financial returns for Deere and its stakeholders. It will also deliver aligned positive sustainable outcomes. The alignment between the two is a key motivator for our team.

Brent Norwood

Manager, Investor Communications, Deere & Co.

Let's jump into some of the specifics. While we've touched on the concept at a high level, what do you mean by incremental addressable market? And can you give an example?

Joshua Jepsen

Director-Investor Relations, Deere & Co.

Sure. This is Josh. I can take that one. Through the work of the production systems teams, we attempt to quantify the total value of a new or prospective solution that we'll deliver. If we use ag as an example, we multiply that value by the addressable acres to arrive at the incremental addressable market figure. The total value represents the entirety of the economic headroom unlock that will then be shared by Deere, our customers, and other industry stakeholders.

So our figure here is forward-looking; does not include solutions that are already in the market today, things like ExactEmerge or ExactApply. See & Spray Ultimate is an easy example to follow. Simply put, See & Spray vastly reduces the amount of herbicide required to grow a crop. The incremental addressable market would calculate the herbicide savings per acre multiplied by the addressable acres. That's the value of the solution that gets shared between Deere, customers, and other stakeholders.

Brent Norwood

Manager, Investor Communications, Deere & Co.

So the Ambitions include several executional drivers such as goals around digital engagement, electrification and business model transformation. John, can you talk about the rationale to include these type of goals?

John C. May

Chairman & Chief Executive Officer, Deere & Co.

Sure, Brent. We've always had internal goals around key executional items that help us deliver our business results. By making these public, we can help investors and stakeholders better understand our top priorities and give a better insight to the things we need to execute to unlock the immense opportunity ahead.

Ryan D. Campbell

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

Yeah, Brent, this is Ryan. I'd like to add on to that, by noting some of the key themes in our executional drivers. They should be familiar to those that have been following us, but they are worth additional commentary.

The segment-specific goals largely center around digitization, automation, autonomy, and electrification. The inclusion of these themes in our Leap Ambitions indicates the focus of our capital allocation plans.

As it relates to autonomy, you might ask why we don't have a specific call-out in our Production and Precision Ag segment. With our acquisition of Bear Flag Robotics and our CES announcement of our fully autonomous 8R, we are aggressively working to deliver on these products and expand our offerings. In this segment, we've been working on autonomy for the last few years and felt we did not need a separate, specific executional call-out at this point.

Expect to see an increasing portion of our capital allocation weighted to these themes through R&D, CapEx and M&A. The structural improvements that we have made over the last few years were critical for us to be able to accelerate our investments in these key growth areas, while also generating higher operating returns. These investments are key drivers for our ability to unlock the significant opportunity in front of us.

Brent Norwood

Manager, Investor Communications, Deere & Co.

Thanks, Ryan. Let's pivot to some of the outcomes included in our Leap Ambitions, starting with our sustainability goals. First, I'd like to ask Jill to update us on the status of our existing sustainability goals that will sunset in 2022.

Jill Kutzbach Sanchez

Manager, Sustainability and Investor Relations, Deere & Co.

Sure, Brent. Thanks. So, we're definitely still committed to seeing our existing goals sweep through to the end of 2022. We feel good about achieving success there with our progress on Scope 1 & 2 greenhouse gas emissions being a real standout. We just published our 2021 Sustainability Report today, and you can see our progress on these goals to-date in that report.

Also, as you look at the Leap Ambitions, you'll notice that we will continue to focus on the key areas that were covered by our 2022 goals but we're raising the bar for ourselves in those areas as we look to the future.

Brent Norwood

Manager, Investor Communications, Deere & Co.

What about some of the new goals we're stacking on top of our existing ones? Which one of those new goals stands out for you, Jill?

Jill Kutzbach Sanchez

Manager, Sustainability and Investor Relations, Deere & Co.

Yeah, we have added a few more key areas that we'll be focusing on going forward. One of the most significant to highlight is the inclusion of Scope 3 targets. There, we have committed to working with the science-based targets initiative to align on a pathway for us to achieve a 30% reduction in our Scope 3 greenhouse gas emission, which includes a focus on our products as well as our supply chain by 2030.

To accomplish this, we are actively exploring and innovating alternative power solutions that will address the emissions of the products we produce.

And as you look at the full picture of the Leap Ambitions, you'll see that this goal is directly linked to some of the executional drivers we have around electrification and demonstrating the viability of low and no carbon power solutions by 2026.

Brent Norwood

Manager, Investor Communications, Deere & Co.

And what about goals pertaining to customer outcomes? What can you tell us about those?

Jill Kutzbach Sanchez

Manager, Sustainability and Investor Relations, Deere & Co.

Sure. In a lot of respects, the underlying themes around our ag customer outcome goals are not new at all for us. As we've demonstrated in last year's Sustainability Report as well as the report we just published today, our strategy has already been delivering solutions that unlock better economic and sustainable outcomes for our customers.

In the past, we focused a lot on the economic piece as we've worked on product development and going to market with our product solutions. Going forward, we will for sure continue to focus on the economic piece, but you can expect to see us balancing that with the sustainability element as well.

As an organization, this means we'll be working throughout the development process to demonstrate and measure the impact that our technologies and solutions have, not only on profitability and productivity, but also on the carbon footprint and environmental impact of our customers' operations.

You know, as precision technologies continue to reduce the inputs used per unit of output, the environmental impact of generating that output improves, and this is increasingly of interest in our customer base for a variety of reasons.

First, our customers are seeing that the customers they serve are increasingly interested in traceability. Second, new markets are emerging such as carbon trading markets that present completely new revenue opportunities for our customers. And third, jurisdictions around the world are implementing new regulations that impact how our customers can execute their jobs.

So, through our precision tools and digital operations center, we feel confident we can address all of these by making our customers more profitable while also positioning them to continue serving their customers' dynamic needs, enabling them to access these new markets, and easing their regulatory burdens.

Brent Norwood

Manager, Investor Communications, Deere & Co.

Thanks, Jill. Let's change focus for a bit to the goals pertaining to business model transformation and financial outcomes. Starting with the goal to reach 10% recurring revenue by 2030, Ryan, can you comment on the reason for its inclusion and give some expectations for what that journey may look like over the next few years?

Ryan D. Campbell

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

Yeah, Brent, the goal reflects that the nature of our solutions is changing. Many of our future solutions will have a higher component of software and machine learning content. They will also evolve and improve over time. We'll have the ability to support these products well after the point-of-sale through over-the-air updates that add new capabilities or productivity enhancements.

As a result, we'll adapt our business model to reflect the continual value creation and improving nature of the solution sets. More total solutions will feature renewable license component to them versus pricing almost exclusively at the point-of-sale. While it will take some time to build the base of recurring revenue, we see the potential for a future less dependent on the number of units of new equipment sales which should help decrease the amplitude of our business cycle.

And just as important, there's a significant customer benefit to this shift as future solutions may require a smaller upfront capital outlay versus the value created and also more closely match the payments to delivery of value. We think this will push adoption faster and deeper into the installed base, and different business models can also make some technologies more accessible to a broader set of producers.

Brent Norwood

Manager, Investor Communications, Deere & Co.

So our Leap Ambitions show that we are revising our Equipment Operations through cycle margin goal from 15% up to 20%. How did you arrive at the 20% goal?

Ryan D. Campbell

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

Yeah, keep in mind that the 20% is a through-cycle target compared to the 15% we have today. The 20% through-cycle target balances the investments that we will make to capitalize on this unique opportunity but also delivers continued margin improvement. It also balances the business model evolution to more recurring revenue which will have some short-term margin trade-offs that ultimately should lead to increased margins and reduce variability in our performance over the long-term.

Brent Norwood

Manager, Investor Communications, Deere & Co.

Can you go into a little more detail on the journey to achieve that 20% target?

Ryan D. Campbell

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

Yeah, sure, Brent. Although we're not providing a growth rate or longer-term revenue target, we clearly expect growth to be the key driver in our ability to generate higher returns.

Let me focus on one aspect of that growth, precision technologies. Previously, we've discussed the ways in which we monetize precision features, including through our base equipment, adding options for newer technologies

that allow customers to do jobs better, and finally, through subscriptions. When we develop solutions and monetize them in this way, we have grown the revenue and increased the margin in our business. This is shown by the performance in the Production and Precision Ag segment over the last few years.

The journey for the PPA segment to-date has been largely through monetizing solutions by adding them to base and by increasing take rates on additional features, to a much lesser extent, on subscriptions. With the new strategy, the PPA business is now poised to grow the recurring revenue aspect of their business which we believe can add higher margin potential over time.

The small ag & turf and construction & forestry portions of our business are in the earlier stages of leveraging precision technologies to drive performance. Similar to the journey that PPA has been on, there's potential of margin expansion through increasing the base utilization of our precision offers as well as developing additional value-enhancing features and options for customers.

As we progress in the execution of our strategy, there will also be more opportunities for building recurring revenue in these areas. We are confident in executing our margin target as we have been on the precision journey in parts of our business for some time and can see the results in our performance. In those areas, we are ready to begin the next phase. In other parts of the business, we can improve the unit revenue and margin performance through precision features, while we put the building blocks in place to unlock the next levels of value.

For sure, there are other areas that will contribute to our margin improvement targets, but growth and more specifically growth in precision technology, is expected to be the primary driver. It's also worth noting that we have made significant progress on structural margin improvement over the last few years, and our new ambitions give us good line of sight towards structurally achieving 20% on a through-cycle basis.

To the extent we accomplish this ahead of 2030, we will update our goal accordingly.

Brent Norwood

Manager, Investor Communications, Deere & Co.

Thanks, Ryan. That's really helpful. Let's switch gears here a little bit. We made a big announcement at CES regarding autonomy. How have customers responded, and where does this rank on priorities over the coming years?

John C. May

Chairman & Chief Executive Officer, Deere & Co.

Yeah, Brent, let me start with this and give you my thoughts, and then I'd love to hear from Ryan as well.

We've been working on autonomy for the last few years and always knew, always knew it would offer significant customer value. Even so, the response we got from our dealers and our customers was even greater than we imagined. The need for autonomy is here today. The demand for the solution is real. We already have customers paying for autonomy this spring, but we are still rolling it out on a limited basis. That said, we are very, very excited by how we see this scaling over the next few years.

While we will scale to many more acres for the tillage solution, we are also working on scaling to additional jobs like planting and additional machine forms. More than any other technology, autonomy will scale deeper and faster, and we are really excited by that.

What's also important to note, and I have some pride in this because of my relationship with Blue River, it's important to note that the leverage we are getting from our Blue River Technology acquisition, they were able to utilize the same machine learning platform that they've built for See & Spray to deliver our first autonomy solution. Augmenting Blue River's capabilities with the outstanding talent and technology from Bear Flags Robotic (sic) [Bear Flag Robotics] will really ensure John Deere continues to win in autonomy.

Ryan D. Campbell

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

Yeah, John, this is Ryan. Just one thing to add to that. As we work to achieve our goal of 10% recurring revenue, autonomy will play a significant role. Along with further development of our Sense and Act platform, delivering these new technologies will be key in building our base of recurring revenue streams in addition to driving overall top line growth.

Brent Norwood

Manager, Investor Communications, Deere & Co.

That's really helpful. We have one last question. We are making big growth investments and setting lofty ambitions. Can you talk about the investment we're making in our people to ensure that we execute this strategy?

John C. May

Chairman & Chief Executive Officer, Deere & Co.

Yeah, it's a great question, Brent. People are our number-one asset and we would not have enjoyed the success we had last year without their hard work. Our goal, it will not change. We want to have the best talent, the best teams, and we want to provide the best place to work. Our people are the foundation of our strategy. They are the ones driving the deep customer understanding within each production system. They are the ones developing the technology for the new tech stack and deploying that across the enterprise. They are coming up with the new ways to support our customers that we have never been able to do in the past.

We would not have achieved the success that we have had up to this point without our world-class employees, and we will not achieve our success going forward without them. We've got the best employees in the industry hands-down.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

We're now ready to begin the Q&A portion of the call. Operation will...

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question is from Jerry Revich, Goldman Sachs. Your line is open.

Jerry Revich

Analyst, Goldman Sachs & Co. LLC

Q

Yes. Hi. Good morning, everyone. I'm wondering if you could talk about the top line contribution that you're expecting by 2030 out of the \$150 billion TAM. So you've outlined what looks like about a \$5-plus billion tailwind from subscription. Can you just talk about from a high-level standpoint any other contributions and what proportion of the TAM do you expect Deere's value capture to be over time? Thanks.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

[audio gap] (45:22-45:33) that's the industry, sorry, if you couldn't hear me, Jerry. The industry or the value that we can create, \$150 billion, is at the highest level. If you think about how does that work its way down to Deere, I think there's a couple steps. It's what is our market share and then what is the share of value between customer and the company.

So those would be the components to work that down from \$150 billion to what would impact our top line, and as John and Ryan mentioned, as we execute and work to unlock the value through the goals that we've laid out today, we think there's a significant amount of opportunity, not just between here and 2030, but 2030 and beyond.

John C. May

Chairman & Chief Executive Officer, Deere & Co.

A

Maybe just to add, Josh, you had some great points there. This is John. A couple things for you to think through. If you look at the Smart Industrial journey and where we've been and how we've executed over the last two years, our focus have been on, first of all, deeply understanding our customers' production systems, and once we do that, we know where we have the greatest opportunity to provide product, technology, and solutions that unlocks value for the customer. That may come in the form of lower input costs or it may come in the form of – or higher yields or even both. The benefit back to Deere is more revenue, more margin on a per unit basis.

This next set of Leap Ambitions really allows us to do a couple of things. One, we've gone deeper, deeper into these production systems and we have identified even greater opportunities to create value for our customers. At the same time, we've unlocked new technologies that we didn't have access to over the last two years. That would be digitalization, automation, autonomy, and electrification. You're going to see us invest heavily in those new technologies and continue to provide that value to the customer and build out that new revenue base for us and more profitability for our customers.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

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

Operator: Our next question is from 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. If we could just go back to some of the comments you had on the 10% recurring revenue path, can you just remind us, I think you're less than 1% recurring revenue today, but do you have any guidepost? I know you put out some other 2026 goals, but should this be a very linear ramp, or are there certain product launches where we should be expecting a pretty significant jump over the years?

And then I think you had mentioned some short-term margin trade-offs as a result of this new business model. Can you just comment specifically on what those short-term trade-offs you were talking about were?

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Thanks, Courtney. You're right, today, the recurring revenue that we have is relatively small, primarily focused around guidance, subscriptions in terms of correction signals, so it is a small portion today, and we will begin building that with – as we get out this year with See & Spray Ultimate and in the autonomous solution that John mentioned, so that'll start the foundation. We would not expect that it's linear. It'll take time to build that base and to see that grow, so that's the way that we would frame that out, the way we're thinking about that today.

As it relates to trade-offs, the question there is really as you make some shift to moving from monetizing at point-of-sale to on a more recurring basis, we do expect to see some of that revenue really then move out of the upfront sales equipment and then incurred or received as we deliver that value on a more regular basis, whether that's per-year or by usage, et cetera.

Courtney Yakavonis

Analyst, Morgan Stanley & Co. LLC

Q

Thank you. That's helpful.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Thanks. We'll go to our next question.

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

Steven Fisher

Analyst, UBS Securities LLC

Q

Thanks. Good morning. A lot to clarify in the very exciting Leap Ambitions, but maybe just to focus for a minute on the near-term was obviously a really nice beat given the significant number of challenges that you had in the quarter, but the raise was a little bit less than the beat of consensus, and I know it was consensus, not your numbers, but wondering if you could just share your general thoughts on the rest of the year.

To what extent are things getting more predictable and where they might be getting more predictable, and where less predictable and kind of where you feel you need to bake in a little bit more caution in the outlook. Long question, but if you can provide some color. Thanks.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Yeah, I'll start. This is Josh, Steve. The full year definitely, if you look at the rest of year, we raised guidance and what we see there is, I think, two things. One, continued unpredictability and challenges in the supply chain. That was evident in the first quarter. We think that continues throughout the year.

The hard part about that is it's unpredictable and difficult to forecast, which also is driving higher freight cost, premium freight in particular, as we need to accelerate things to get them into the factories to keep production moving. So those I would say are impacts that are weighing on the business as we go forward.

I think importantly as we look at the rest of year forecast, our incrementals are strong. I think, from an Equipment Operations perspective in total, the incrementals are in the 25% to 30% range; specifically on Production and Precision Ag, around 35% incremental rest of year. So although we do expect some disruption and the choppiness that we discussed through the supply chain, we feel good about the ability to execute as we manage through the year.

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

Operator: Thank you. Our next question is Jamie Cook, Credit Suisse. Your line is open.

Jamie Cook

Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. Good morning. Yeah, so a lot to uncover here. I guess just following up on the short-term headwinds, can you help me understand where are these going in the short to medium-term, is there a ramp that then starts to fade? I'm just trying to think about how that impacts the 20% sort of margin target. And is there – the 20% margin target, is there a difference across the three segments, or if you could help me understand that, that would be helpful.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Yeah, just to clarify, did you say R&D? Was that your first question?

Jamie Cook

Analyst, Credit Suisse Securities (USA) LLC

Q

Yeah, R&D. Yeah, the first part is R&D. Is there a ramp in the beginning, you know what I mean, and then that fades? I'm just trying to understand how that impacts the 20% margin target.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Sure. This year, we've seen a step-up in R&D and that's intentional and focused on the themes that Ryan and John had mentioned today. That focus will continue. As we discussed, we will be making investments to unlock this value as well as thinking about the journey on our emissions, so I think those things I would expect to continue. We'll be making those investments around the themes and around the value that we can create for our customers.

On the 20%, that's Equipment Operations in total, so we haven't broken out the moving pieces there in terms of the different business segments. I wouldn't expect they're all the same, and as we go forward and execute, I think that will be, we'll see where each business lies as we are continuing to unlock value.

Jamie Cook

Analyst, Credit Suisse Securities (USA) LLC

Thank you.

Q

Ryan D. Campbell

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

Hey, Jamie. It's Ryan. They're not all the same, but I think it's fair to say all of them will improve to hit that enterprise target of 20% through-cycle.

A

Jamie Cook

Analyst, Credit Suisse Securities (USA) LLC

Okay. That's very helpful. Thank you.

Q

Joshua Jepsen

Director-Investor Relations, Deere & Co.

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

A

Operator: Thank you. Our next question is from Rob Wertheimer of Melius Research.

Rob Wertheimer

Analyst, Melius Research LLC

Hi. Good morning, everybody. My question is on See & Spray Ultimate. You seem pretty comfortable with the stage of technology development there, perhaps I'm inferring that from some of the machine learning sort of resource shifting you've done over to autonomy.

Q

Can you tell us how far you've gotten and what you can talk about input cost reduction, percentage of fields that it works on, and what the disengages or has issues, speed at which it operates, really anything to give us context on how well-developed or solved, if it is solved, that technology is, and versus your goals. Thank you.

John C. May

Chairman & Chief Executive Officer, Deere & Co.

Hey, Rob. It's John. I'll start, and great question. It's actually very interesting because we had our staff meeting yesterday, and at the end of our staff meeting, Jamie played a video for us of the first full production See & Spray Ultimate unit coming off the assembly line, and on its way to customer hands, and then went into much more detail than I'm sure you're interested in where every camera automatically calibrated and machines started up and the systems were fully-functional.

A

So we are really, really excited about what we're going to learn in the field this year. And to your point, to quantify some of that savings, I still think it's going to be a high number. It's going to be, I think, around 80% herbicide reduction, and I plan personally to get out in the field with those sprayers and interact with our customers to see how they're performing. But just like autonomy, lots and lots of excitement from our customers and our dealers to get those products in the hands of their customers and to test, not only the product but the business model.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

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

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

David Raso

Analyst, Evercore ISI

Q

Hi. Thank you for the time. In this thought-process through 2030, how are you viewing the traditional economic cycles within this timeframe, or are you simply taking a cycle like it is right now, what the incremental business, from the incremental addressable market how that would impact your margins?

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Yeah, morning, David. This is Josh. I'll start there. I'd say first and foremost, we're looking at what is the value that we can create and the great thing about this is, this is value that is meaningful and impactful for our customers regardless of where we are in the cycle.

And when you talk about either reducing their inputs, improving their profitability, and improving yield, so I think I would say the value creation here is somewhat agnostic of where are we in the cycle, and I think that's the beauty of what we can do, in addition to the sustainable outcomes that will be beneficial. And Jill referred to this, but we believe we'll create additional revenue opportunity for the customers as it comes to the potential for carbon or other markets as well as commodity differentiation.

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

Operator: Next question is from Kristen Owen, Oppenheimer. Your line is open.

Kristen Owen

Analyst, Oppenheimer & Co., Inc.

Q

Hi. Good morning. Thank you for taking the question. I wanted to follow-up on the recurring revenue base, and just some of the comments around the lower point-of-sales revenue in this long-term target. I was wondering if you can clarify how you think about total customer value over the lifetime of that equipment relative to the current model, and how you see that progressing? Thank you.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Sure. The point being that we're making there is today we monetize very heavy at point-of-sale and the opportunity to make that more accessible and see the technologies carrying that type of model be more heavily adopted, more quickly adopted across more jobs, more acres at that different price-point and really tied closer to the value that's created through the technology is a significant opportunity for our customers and for us to be able to move forward.

Thanks, Kristen. We'll go ahead and take one more question.

Operator: Thank you. Our last question is from Ross Gilardi with Bank of America. Your line is open.

Ross Gilardi

Analyst, Bank of America Merrill Lynch

Q

Thanks for squeezing me in. Yeah, I just had a question on pricing, just as it relates to this inflationary environment we're in. I mean, prior to the last couple of years, your business has historically been able to get 200 to 300 basis points of pricing a year through the ups and downs of the cycle, and clearly, it's been a lot higher than that recently, and this year [ph] you're getting it back (59:00), you are aiming for 1,000 basis points of pricing in Large Ag.

And if we're in a sustained inflationary environment, I mean is there any reason why your annual pricing gains can't remain well above that sort of historical 200 to 300 basis points particularly if you step-up investment in all these new technologies that are driving so much product differentiation. Thanks.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Thanks, Ross. Maybe one thing to clarify. When we think about new value of features or tools solutions, that's not embedded in that price realization. That is really intended to be more from an inflationary perspective. So separate, we will see the value and the benefit of the solutions and tools that we're delivering from a technology point of view.

Looking at the inflationary environment, we are monitoring this and trying to understand what is happening both from an input perspective for our products and solutions and being cognizant of how do we price, and we've priced more dynamically the last couple years as a result of that. So I would say we'll continue to monitor and adjust our pricing accordingly with inflationary pressures staying high. Will we be above our historical averages in that 2 points to 3 points? Potentially. I think that's fair, but we'll continue to be thoughtful there.

I think one important thing to remember or consider as it relates to price is the increases we're seeing in used prices of equipment, so where we've seen strong increases on new, in many cases, we've seen more than double that increase on the used side. So trade differentials have actually been pretty attractive from a customer perspective. So low levels of inventory have driven used prices to be strong.

Ryan D. Campbell

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

A

Hey, Ross. It's Ryan. Maybe just real quick. The other thing, our equipment and solutions can help growers address the other inflationary parts of their P&L which are trending higher right now, and so we think there's a benefit for upgrading technology because it can allow them to operate much more efficiently from an input perspective, and the inflation on those is significantly higher than what we're putting through on the equipment right now.

Ross Gilardi

Analyst, Bank of America Merrill Lynch

Q

Thank you.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

Well, with that, we'll wrap-up the call. We thank everyone for their time, and we'll talk soon. Take care.

Operator: Thank you. This does conclude the call. You may disconnect your lines, and thank you for your participation.

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