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Deere & Co. (DE)

Q3 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to Deere & Company's Third 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. Brent Norwood, Director of Investor Relations. Thank you. You may begin.

Brent Norwood

Director, Investor Relations, Deere & Co.

Hello. Also on the call today are Cory Reed, President of Worldwide Production & Precision Ag; Raj Kalathur, Chief Financial Officer and President of John Deere Financial; Josh Jepsen, Deputy Financial Officer; and Rachel Bach, Manager of Investor Communications.

Today, we'll take a closer look at Deere's third quarter earnings, then spend some time talking about our markets and our current outlook for fiscal year 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 also may include financial measures that are not in conformance with accounting principles generally accepted in the United States of America, 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 will now turn the call over to Rachel Bach.

Rachel Bach

Manager of Investor Communications, Deere & Co.

Thanks, Brent. Good morning. John Deere achieved higher production rates in the third quarter resulting in a 25% increase in net sales, despite ongoing supply challenges. Financial results for the quarter included an 18% margin for the equipment operations, ag fundamentals remain solid with our order books beginning to fill for model year 2023 products reflecting continued healthy demand as we look ahead. The construction and forestry markets also continued to benefit from demand contributing to the division's strong performance in the quarter. Similarly, order books are now extending into 2023 providing visibility into the new year.

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Slide 3 shows the results for the second quarter. Net sales and revenues were up 22% to $14.1 billion, while net sales for the equipment operations were up 25% to $13 billion. Net income attributable to Deere & Company was $1.884 billion or $6.16 per diluted share.

Looking at results by segment, beginning with our production and precision ag business on slide 4, net sales of $6.096 billion were up 43% compared to the third quarter last year largely due to higher production and shipment volumes. Price realization in the quarter was positive by about 15 points, whereas currency translation was negative by about 4 points.

Operating profit was $1.293 billion, resulting in a 21% operating margin for the segment. The year-over-year increase in operating profit was primarily due to price realization and higher shipment volumes, partially offset by higher production costs and higher SA&G and R&D spend. The production costs were mostly elevated material and freight. Overhead spend was also higher for the period as persistent supply challenges continued to cause production inefficiencies.

Despite these challenges, factories were able to achieve higher rates of production and made progress on reducing the number of partially completed machines in inventory. Our factories are focused on finishing and shipping the remaining machines in the fourth quarter, which will help our progress toward restoring productivity and efficiencies going into next year. The increased SA&G and R&D spend reflects our continued development of our technology stack and our progress on our leap ambitions, both of which will unlock additional value for our customers.

Next, small ag and turf on slide 5, net sales were up 16%, totaling $3.635 billion in the third quarter due to higher shipment volumes and price realization more than offsetting negative currency translation. Price realization in the quarter was positive by 10 points, while currency translation was negative by over 4 points. For the quarter, operating profit was down year-over-year at $552 million, resulting in a 15% operating margin. The decreased profit was primarily due to higher production costs, specifically material, offset by price realization.

Turning now to the industry outlook on slide 6, we expect US and Canada industry sales of large ag equipment to be up around 15%. While the industry continues to be constrained by supply, demand remains robust and our guidance assumes a heavier back-end loaded year for industry retail. Relative to the industry, we've had our strongest results in high-horsepower row crop tractors and we plan to end the year approaching our highest market share on record. Our order books for the remainder of the current fiscal year are full, and we see signs of robust demand into 2023 with some order books already full through the first half of next year.

Small ag and turf industry demand continues to be estimated generally flat this year. While we see steadiness from our hay and forage segment, consumer products such as compact utility tractors and turf equipment, are down due to supply constraints, low turf inventory, and moderating demand.

Moving on to Europe, the industry is forecast to be roughly flat despite solid demand. While supply constraints and operating challenges are affecting the industry, we expect to finish the year with higher shipments and market share gains. In South America, we expect industry sales of tractors and combines to increase by about 10% to 15%. Despite the low trend crop yields due to inclement weather, customers are very profitable this year, benefiting from high commodity prices. Industry sales in Asia are still forecasted to be down moderately as India, the world's largest tractor market by units, has moderated from record volumes achieved in 2021.

Moving on to our segment forecast on slide 7, production and precision ag net sales continue to be forecasted up between 25% and 30% in fiscal year 2022. The forecast assumes nearly 14 points of positive price realization for

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the full year, which will allow us to be price-cost positive for the fiscal year. This is partially offset by roughly 2 points of currency headwind. For the segment's operating margin, our full year forecast is between 20% and 21%. The forecast reflects higher costs for material and freight inflation as well as the elevated overheads associated with the supply constraints that have introduced a number of factory inefficiencies this year.

Slide 8 shows our forecast for the small ag and turf segment. We now expect fiscal year 2022 net sales to be up in the range of 10% to 15%. This guidance includes over 9 points of positive price realization, partially offset by 3 points of unfavorable currency impact. The segment's operating margin is now forecasted between 14% and 15%. The margin guidance reflects higher material costs and lower expectations for volume, as small engine availability has been especially challenging. Price-cost remains neutral for the year.

Changing to construction and forestry on slide 9, for the quarter, net sales of $3.269 billion were up 8% due to price realization. Operating profit increased year-over-year to $514 million, resulting in a 16% operating margin. Favorable price realization offset higher production costs during the quarter. The production costs were mainly a result of elevated material and freight as well as higher overhead spend.

Now, let's take a look at our 2022 construction and forestry industry outlook on slide 10. Industry sales of earth-moving equipment in North America are expected to be up approximately 10%, while the compact construction market is forecasted to be flat to down 5%. Though demand remains strong for compact construction products, the downward revision reflects extremely low levels of inventory and supply challenges constraining shipments.

End markets for earth-moving are expected to remain strong as oil and gas activities remain steady, US infrastructure spend begins to ramp, and CapEx programs from the independent rental companies drive re-fleeting efforts. Housing starts have moderated, though still remain elevated versus historical levels. Additionally, record low levels of new and used equipment will dampen any slowdown.

In forestry, we now expect the industry to be flat to down 5% primarily due to supply constraining the ability to meet demand. Global roadbuilding markets are expected to be flat to up 5%. Roadbuilding demand remains strongest in the Americas, while China and Russia markets are down significantly.

The C&F segment is on slide 11. Deere's construction and forestry 2022 net sales are forecasted to be up around 10%. Our net sales guidance for the year includes about 10 points of positive price realization and 3 points of negative currency impact. The segment's operating margin outlook remains at a range of 15.5% to 16.5%.

Shifting over to our financial services operations on slide 12, worldwide financial services net income attributable to Deere & Company in the third quarter was $209 million. This is a slight decrease compared to the third quarter last year due to unfavorable discrete income tax adjustments, a higher provision for credit losses, and lower gains on operating lease residual values. These are partially offset by income earned on a higher average portfolio.

For fiscal year 2022, we maintain our net income outlook at $870 million, slightly lower than fiscal year 2021 due to a higher provision for credit losses, less favorable financing spreads, and higher SA&G. The higher provisions for credit losses are primarily related to Russia. The segment is expected to continue to benefit from income earned on higher average portfolio balance. Overall, financial services continues to deliver steady results. Credit loss provisions, lease return rates, and past dues are all in good shape, reflecting the solid balance sheet for our customers.

Slide 13 outlines our guidance for net income, our effective tax rate, and operating cash flow. For fiscal year 2022, we adjusted our outlook for net income to be between $7 billion and $7.2 billion. The full year forecast is inclusive

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of the impact of higher raw material prices, higher logistics costs, and production inefficiencies caused by supply disruptions. Our forecasted price realization is expected to outpace both material and freight costs for the entire year.

Moving on to tax, our guidance incorporates an effective tax rate projected to be between 21% and 23%. Lastly, cash flow from the equipment operations is now expected to be in the range of $5.3 billion to $5.5 billion. The decrease reflects the adjusted income forecast and increases in working capital required through the end of the fiscal year as we expect to maintain higher production levels heading into the first quarter of 2023.

At this time, let's discuss a few topics for the quarter in more detail. First, I would like to take a closer look at production and precision ag third quarter results, an impressive jump in net sales both compared to the third quarter last year as well as compared to the second quarter this year. Net sales were up 43% year-over-year and up 19% sequentially, which is not our typical seasonality.

Cory, can you talk through some of the factors that enabled us to achieve that?

Cory J. Reed

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

Yeah, thanks, Rachel. There's really several contributing factors this quarter. First is higher production rates. If you look back at the first half of this year, we had a work stoppage in the first quarter and had to ramp up at several of our largest US factories. We also had two new product introductions, the 9R forward drive tractor and the X9 combine. During the third quarter, we ramped up and we achieved our highest production line rates yet this year across several large ag factories.

Second, as we started to ramp up through the second quarter, we continued to experience supply challenges resulting in higher partially completed machines in inventory. We've procured the needed parts and made good progress in both finishing and shipping machines, reducing the number of partially completed machines in inventory. And we did see overall inventories build slightly again in the third quarter, but that was mostly attributable to higher levels of raw inventory as we expect to maintain higher production rates both through the fourth quarter and into Q1 of 2023, which is different from our typical production wind-down in the fourth quarter.

It's important to note we're focused on not adding more partially completed machines to inventory. We're making progress completing that inventory and getting it delivered to our dealers and customers. We've also been able to increase our parts inventory which is helping us as we go into the fall to support our customers in their operations.

Rachel Bach

Manager of Investor Communications, Deere & Co.

Going back to the higher production rates and even the partially completed inventory, we're seeing some modest improvement in the supply base, but overall it's still very fragile and deliveries are still choppy.

Cory J. Reed

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

Yeah, that's right. We continue to prioritize getting equipment out to our customers. While past due deliveries from suppliers have declined a bit, they're still at elevated levels. Missing parts and late part deliveries result in rework to complete partially built machines and contribute to production inefficiencies and higher overhead costs. We're able to achieve the higher line rates despite the continued difficulties and constraints within the supply chain. We're proactively working with our supply base to obtain allocations and improve on-time deliveries of parts,

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looking for opportunities to dual-source or providing resources to address constraints. Again, all so we can get equipment out to our dealers and customers.

Joshua Jepsen

Deputy Financial Officer, Deere & Co.

Hey, this is Josh. Maybe one thing to add. As Cory mentioned, we've been focused on producing at higher levels in order to get products to customers which has resulted in higher costs related to supply availability, inflationary pressures, overhead inefficiencies. So, maybe for example, we've incurred expedited freight and experienced production inefficiencies. Expedited freight comes at a premium, and anytime we have to touch machines or move them in our factories more than once, it comes at a cost. In that respect, 2022 has been a challenge given the ramp in demand juxtaposed with the lost production in the first quarter in a challenging supply environment.

So we've really been chasing production all year as a result. Importantly, we're seeing the benefit of getting those products into the hands of our customers reflected in market share and retail statistics. So we feel like we're broadly outperforming the industry. As we look forward, we'll build at higher levels of production in Q4 and into 1Q 2023, which will help with our inefficiencies while also taking actions on costs that we've incurred over the last two years.

Rachel Bach

Manager of Investor Communications, Deere & Co.

Yeah, all good points, Josh. You've both now mentioned higher production rates achieved during the third quarter are expected to carry forward. It's too early to guide for fiscal year 2023, but let's spend a little more time there.

Cory, can you share some insights from our customers' perspective to provide some context as we look ahead?

Cory J. Reed

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

Sure. Overall ag fundamentals remain really strong. Corn and soy prices have declined from a few months ago, but so have inputs like fertilizer and others. Also, when you look at global stocks to use, it's tight and it's expected to decline again, continuing to support elevated crop prices. It may also take a couple seasons to recover those grain stocks to normal levels.

So while profitability may come in a bit from record 2022 levels, our customers will still be profitable and the environment is supportive of replacement demand, especially when you consider that farmers haven't been able to replenish their fleets as much as they wanted to this year. The age of the fleet remains above average. Additionally, dealer inventories remain at historic lows since the industry shorted demand the last couple years due to supply constraints. These factors should help extend the duration of the replacement cycle.

Rachel Bach

Manager of Investor Communications, Deere & Co.

And how has that been factoring into our crop care early order book that opened in June, so sprayers and planters?

Cory J. Reed

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

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As you may recall from last year, we basically filled the full year production in the first phase of the EOP. We didn't do a second or third phase like we've done in the past. Then with the work stoppage and supply challenges, we've delivered a portion of those orders after their seasonal use this year. So this year's program is structured differently with two phases, both of which are on allocation. These phases are only intended to source orders for pre-seasonal use deliveries. We'll run yet another phase later for post-seasonal shipments. So year-over-year, EOP results won't be comparable due to the different structures we're running this year versus last.

Rachel Bach

Manager of Investor Communications, Deere & Co.

And how about tractors?

Cory J. Reed

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

We're also sold ahead on tractors well into the second quarter next year, and our new and used inventories for all large tractors are sitting at multiyear lows. With products like the 9R tractor going through both the work stoppage and new product transition, the momentum for all large tractors coming out of the third quarter on production rates will carry forward through the fourth quarter and well into next year. Demand is strong and still outstripping supply in 2023. Bottom line, we fully expect to produce more large ag equipment next year than we did this year.

Brent Norwood

Director, Investor Relations, Deere & Co.

Yeah, and let me add that these expectations around higher production rates are reflected in our revised cash flow outlook for this year, which we lowered a little bit due to increased working capital. We don't plan to see our normal seasonal reduction in inventory, and to help offset some of the supply challenges and maintain the higher production rates through the fourth quarter and into the next year, we're carrying a little bit more raw inventory heading out of 2022.

Rachel Bach

Manager of Investor Communications, Deere & Co.

Thanks, Brent. That is important to note. The inventory increases are not replacing partially completed inventory, but increasing raw inventory as we prepare for that continued higher production rate. This is different than what we've seen seasonally in the past. So, Cory, before we move on, what are we seeing on take rates in the model year 2023 early order programs?

Cory J. Reed

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

Yeah, it's good across the board. Customers are seeing the value in technology and the advanced solutions that we're offering. We saw increases in take rates for ExactEmerge on our planters to nearly 60%, and ExactApply for sprayers jumped over 10 points to 65% take rate. Tech products like our premium activations for tractors and sprayers are nearing 100% adoption by our customers.

Rachel Bach

Manager of Investor Communications, Deere & Co.

Great. Thank you. Now, I'd like to spend some time on the industry outlook. US and Canada large ag is projected to be up about 15% on a unit basis. It's been a common theme across the industry. AEM retail data is choppy

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month-to-month and by product. It impacted by when the products are able to get shipped so less reflective of demand right now.

Our model year 2023 order books reflect that too. Demand has remained resilient as ag fundamentals remain positive. We've been able to ship more product in the third quarter and are forecasting to outpace the industry for full year indicating some market share gains in the US and Canada large ag space.

Cory, what about Europe?

Cory J. Reed

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

Yeah, Europe is another region where demand continues to outpace what the industry can supply. The industry has seen a lot of production challenges in Europe due to supply chain issues, geopolitical events, and other disruptions as well, so same story of partially completed machines waiting for parts or, even in some cases, completed machines just waiting on an outbound truck. For us, though, despite all that, Europe has remained a bright spot. The team has executed really well. We've been outperforming the industry, so we're on track to grow high-horsepower tractor, combine, and SPF-8 share there as well.

Rachel Bach

Manager of Investor Communications, Deere & Co.

And what about South America?

Cory J. Reed

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

We've seen strong profitability for our customers and strong market demand which has outpaced industry production in 2022 particularly in Brazil, where we're releasing production monthly to maintain tight controls between inflation and pricing, and we're seeing our calendars fill up within hours of releasing them. We fully expect the strong demand cycle in Brazil will continue in 2023.

On top of that, our precision ag engagement in the region also continues to accelerate. South America is experiencing the fastest growth in engaged acres of anywhere in the world and technologies such as ExactEmerge are accelerating across the region. Historically, we've had an objective to put South American profitability on par with Region 4. We're now meeting and exceeding that goal.

Rachel Bach

Manager of Investor Communications, Deere & Co.

Great. Thanks, Cory. I think that's helpful insight to how our net sales guides reconcile to the industry guides. Our net sales guide includes not only higher price, but also stronger volumes and higher take rates of precision ag solutions.

Brent, what about small ag and turf? The industry is expected to be flat compared to our net sales guide of up 10% to 15%.

Brent Norwood

Director, Investor Relations, Deere & Co.

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Yeah, I think we really need to parse it out a little bit. If we look at the parts of our business that are linked to the ag economy like mid-sized tractors versus consumer products like compact utility tractors, there's different stories going on there. First, with mid-sized tractors linked more to hay and forage markets, livestock, and dairy margins, they've all remained pretty steady. High protein and dairy prices have helped offset some of the higher feed and input costs that we're seeing, so we do see continued demand for our products like the 6 Series tractors, and this is a positive contributor in terms of our mix for small ag and turf.

On the other hand, consumer products are beginning to soften as they are more closely linked to the general economy. So equipment inventory – so while equipment inventories remain well below normal levels, they're starting to see a rise a little bit for small tractors. So we're monitoring these inventory levels closely but re-stocking the channel should moderate slowing in the retail demand that we're seeing especially in turf, which hasn't seen much of any increase in inventories just yet.

Rachel Bach

Manager of Investor Communications, Deere & Co.

Thanks. I touched on C&F industry outlooks earlier. Josh, anything to add for C&F?

Joshua Jepsen

Deputy Financial Officer, Deere & Co.

Sure. In North America, while we're seeing indicators of housing moderate a bit, earth-moving and roadbuilding are held by steady oil and gas and the US infrastructure beginning to ramp up. In fact, in North America, it's really been a bright spot for roadbuilding. China and Russia are down for roadbuilding, and we're beginning to see some softening in Europe, but North America is offsetting much of that. And that mix is contributing to some really good margins for roadbuilding which are the best we've seen since the acquisition.

Rachel Bach

Manager of Investor Communications, Deere & Co.

Thanks, Josh. Raj, before we transition to the Q&A portion, any summary comments?

Rajesh Kalathur

Chief Financial Officer and President, John Deere Financial, Deere & Co.

Sure, Rachel. A few things. First, I want to acknowledge the extraordinary efforts by our production and operations employees to ramp up factory output while finishing and shipping a portion of the partially completed inventory while continuing to manage through supply challenges. The dedication to getting products to our customers is just phenomenal. Yes, through the third quarter, we continued to see elevated costs and production inefficiencies, but we also demonstrated higher line rates and those rates will continue through the fourth quarter and into next fiscal year to meet customer demand.

Next, I want to highlight the $1.2 billion worth of shares we repurchased during the third quarter. It's a testament to our use of cash philosophy. We will continue to be proactive with buybacks and opportunistic with volatility in the market. As we look ahead, we plan to continue the momentum we built during the third quarter into the fourth quarter and beyond, of course, which continue to be dependent on supply chain performance.

As Josh mentioned, we are taking steps to reduce the impact of a persistently volatile supply chain, allowing us to focus on improving production inefficiencies and managing material costs as we pivot to 2023. Demand remains strong in multiple end markets and we continue to see strong demand for our technologies and precision

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solutions. Finally, through our smart industrial strategy and execution of our leap ambitions, we will continue to unlock more value for our customers, leaving our best years still to come.

Brent Norwood

Director, Investor Relations, Deere & Co.

Now we are 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.

Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Tim Thein with Citigroup. You may ask your question.

Tim W. Thein

Analyst, Citigroup Global Markets, Inc.

Q

Thank you. Good morning. Hey, Raj, good to hear your voice. There's good discussion in terms of the line rates and build plans in the near term for large ag. Can we maybe just think about or talk a bit about what pricing may look like obviously coming from a high base this year, but given what's already been announced in the spring EOP and then some of the model year tractor increases that you've announced, maybe just share some high-level thoughts around the pricing for PPA. I know a lot goes into that equation, but maybe just some framework to help us think about the pricing opportunity for 2023. Thank you.

Brent Norwood

Director, Investor Relations, Deere & Co.

A

Yes, regarding pricing for 2023, it's still a little bit early. We don't have a formal price realization guide out there. We do have some earlier programs and some rolling order books that are extending well into next year, so we do have some list prices out there. For large ag, we're seeing list price increases in the high-single digits to low-double digits depending a bit on the product line. Moving to construction and forestry, we're looking at more kind of mid- to high-single digits in terms of list price increases year-over-year. As I noted, it's still early and those aren't to be confused with price realization forecasts for 2023, but at least that's how our order books are shaping out at this point.

Thanks, Tim.

Operator: Thank you. Our next question comes from Tami Zakaria with JPMorgan. You may ask your question.

Tami Zakaria

Analyst, JPMorgan Securities LLC

Q

Hi. Good morning. Thank you for taking my question. So looking at the production and precision ag segment, it seems like you're expecting sequential sales growth, call it, in the mid-single-digit range sequentially in the fourth quarter, but the operating profit seems to be growing around 30% sequentially to get to your full year guide. So

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can you help us understand what would be driving this high incremental margin of about 50% in the segment in the fourth quarter?

Brent Norwood
Director, Investor Relations, Deere & Co.
A

Yeah, sure. Thanks, Tami, for the question. With respect to our fourth quarter implied guide, I think there's a lot of moving parts in there. We will see some of our best cost compares in the year come in the fourth quarter, I would think. Up until this point, the cost comparisons relative to last year have been more difficult. We'll start to see that abate a little bit as we anniversary some of the inflation that we began to see come in in the third and fourth quarter last year.

Incrementally, price is going to get a little bit better in the fourth quarter. That's going to help as well. And we will see a slight increase in line rates even from the third quarter. So between price, volume, and anniversarying some of the cost inflation that we saw last year, that does point to higher margin profile for us in the fourth quarter.

Tami Zakaria
Analyst, JPMorgan Securities LLC
Q

Great. Thank you.

Brent Norwood
Director, Investor Relations, Deere & Co.
A

Thanks, Tami.

Operator: Thank you. Our next question comes from Kristen Owen with Oppenheimer. Your line is open. You may ask your question.

Kristen Owen
Analyst, Oppenheimer & Co., Inc.
Q

Great. Thank you for taking the question. If we think about some of the longer term contracts that you've talked about on the supply side, clearly today that's oriented around getting priority on components, but I'm just wondering how we should think about the margin impact of those contracts on a go-forward basis. If we were to start to see supply chains normalize, how would that influence your long-term margin outlook? Thank you.

Brent Norwood
Director, Investor Relations, Deere & Co.
A

Regarding this supply chain, there's really a myriad of things that we are working on proactively to manage the supply base. Kristen, you named one of many levers that we're pulling. For some, certain critical components, we have signed some long-term contracts. I would say for other parts of the supply base, we're working on other strategies as well. Dual sourcing also a very viable strategy for us in the short and midterm. For some of our suppliers, we're investing in additional machinery capacity.

So it's really a multi-pronged approach for us in requiring a lot of day-to-day management and we do foresee that day-to-day management of the supply chain continuing really for the foreseeable future, and so – but with respect to the long-term contracts, as you noted, we're very mindful of the prices that we're committing to and the volumes that we're underwriting, and like I said, we've really limited that to the parts of supply base that are critical and where most necessary.

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Joshua Jepsen
Deputy Financial Officer, Deere & Co.
A

Hey, Kristen, it's Josh. Maybe one thing to add. Those types of things are also contemplated as we think about how we're pricing for the upcoming year, so those are definitely part of the equation.

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

Yeah, Kristen. It's Cory. The only thing I would add is if you think about the third quarter what we've been doing is we've been getting the supply base to prove out that it can perform at the line rates we have, in addition put additional material that allows us to clean up some of that unfinished inventory. As we look at our production schedules going forward, that gives us higher confidence that we're going to be able to run those line levels consistently and into the first quarter. That gives us a tremendous amount of confidence in how we think about all the additional costs that go into securing, expediting all the things that happen that result – rework that results in drag on margin.

Kristen Owen
Analyst, Oppenheimer & Co., Inc.
Q

That's helpful. Thank you very much.

Brent Norwood
Director, Investor Relations, Deere & Co.
A

Thanks, Kristen.

Operator: Thank you. Our next question comes from Jamie Cook with Credit Suisse. Your line is open. You may ask your question.

Jamie Cook
Analyst, Credit Suisse Securities (USA) LLC
Q

Hi. Good morning. Understanding inventory was – oh, and welcome back, Raj, to the earnings call. But understanding inventories were higher more so because of raw, can you help us understand how much of the billion of unfinished product we got out the door from second quarter, so what's in Q3 versus Q4? And then your commentary on production into 2021, the first quarter being strong. It's interesting. Wondering if we should assume obviously production at high levels all year like from the first quarter run rate basis, and whether you expect to fill or replenish channel inventory in 2023. Thanks.

Brent Norwood
Director, Investor Relations, Deere & Co.
A

Yeah, I'll start on the inventory question. The increase in inventory that we saw sequentially from the second quarter was really more raw as we noted, a little less WIP and more parts inventory as well, and I think that reflects our strategy to continue with kind of high line rates coming out of the fourth quarter. So it's really a sign of a positive outlook for next year. With respect to the level of – or the number of partially completed machines that we had coming out of the second quarter, we made great progress on reducing the number of machines. Roughly about a third we were able to work through over the third quarter which will leave us with some inventory left for next quarter.

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Importantly, the number of machines that we still have held as partially completed inventory for the most part, we're looking at machines that only need one or two parts before they're ready to ship and retail to customer, so for the machines that needed more significant rework, those were some of the machines that we worked our way through in the third quarter which gives us a little more confidence as we look at fourth quarter line rates in our revenue guide.

Joshua Jepsen
Deputy Financial Officer, Deere & Co.

A

Yeah, I would say, and Brent hit it. I mean, if you look, we were averaging, those machines that were coming off, first of all we're taking them down – taking that inventory that's unfinished down. We also were averaging in many cases 10 to 12 run withouts, so parts – significant parts that would have to be reworked were now down in low-single digits and many of them just one part that's waiting or just one set of tires that's waiting.

So, significant progress both in the number but also the amount of rework remaining on machines to ship. The other thing you ask about the first. You think about we actually were shut down at the front-end based on what happened with our strike and ultimately, this year, we just keep producing right through. We finished our 2022 builds and go right into 2023.

Brent Norwood
Director, Investor Relations, Deere & Co.

A

Thanks, Jamie.

Operator: Thank you. Our next question comes from Dillon Cumming with Morgan Stanley. You may ask your question.

Dillon G. Cumming
Analyst, Morgan Stanley & Co. LLC

Q

Great. Good morning. Thanks for the question. Really great to hear the uptake commentary from Cory with regards to the ExactApply and ExactEmerge uptake. Just curious if you can comment on See & Spray integration, whether or not you've been able to commercialize that more fully in the EOP rollout this year, and if you have, what level of kind of volume outlook is for next year as well.

Brent Norwood
Director, Investor Relations, Deere & Co.

A

With respect to See & Spray, this was our first year to commercialize it. We did so on a limited basis. 2023 will be our final year of limited production there. We want to make sure that we get it right, that we really calibrate on the right spec level and make sure that we're tooled up in the factory to go full production in 2024.

I think we've actually learned quite a bit over the course of this limited production season. We've really learned what it takes to ensure that our customers are getting the outcomes that they expect when they use the tool. We've learned a lot about the acceptance of the per acre business model, and we'll be a little bit smarter as we head into next year and a little more dialed in with respect to the pricing and structure of our 2023 offering.

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

A

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No, I think Brent hit it well. I'll just add. The big part of this was getting the product in the hands and really seeing customer value being driven by how they use the product. We can deliver all the technology. We have to see how they're going to use it to help improve the outcomes, to be able to do more acres, do it with less material, improve their profitability, and all of that's proving out, so we're sitting well as we go into the next limited production year and then we'll open up and start delivering even more going forward.

Dillon G. Cumming
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you.

Operator: Thank you. Our next question comes from Seth Weber with Wells Fargo Securities. You may ask your question.

Seth Weber
Analyst, Wells Fargo Securities LLC

Q

Hey, good morning, everybody. I wanted to ask about Europe. I guess I was a little surprised that it sounds like you're still seeing Europe to be kind of hanging in flattish. I think you said demand was actually still pretty good there on the ag side. Just given what's going on with the drought and just geopolitical stuff, can you just give us some additional color on what you're seeing maybe by some of the countries across Europe or just what you think is sustaining Europe farmer sentiment at this point? Thanks.

Brent Norwood
Director, Investor Relations, Deere & Co.

A

Yeah, Seth, thanks for the question. Regarding Europe, some of the flat retail data that you're seeing year-to-date is really a reflection of inability for the industry to get supply out there. I know there's been a lot of discrete issues with a lot of industry players this year in terms of production capabilities. We are seeing the overall market as remaining strong and steady. There is definitely differing weather patterns depending on what part of Europe we're talking about. The Central Europe is faring a little bit better than Western Europe a little bit, but overall elevated wheat prices are largely offsetting some of the surging input prices that they've seen. Arable margins, the outlook remains supportive for the rest of the year.

As we pivot into the dairy and livestock sector there, fiscal year 2022 margins were really better than expected from elevated dairy prices, maybe a little bit of risk there on dairy margins going into next year, but overall we've seen that market remain pretty steady. And again, the flat outlook for the year is really a reflection of production capabilities more so than any demand concerns that we have at this point.

Seth Weber
Analyst, Wells Fargo Securities LLC

Q

Okay.

Joshua Jepsen
Deputy Financial Officer, Deere & Co.

A

Yeah, this is Josh, Seth. I think one thing to continue to highlight there is we shifted our strategy a few years ago. We're much more focused on where we can differentiate through technology in production and precision ag in particular and in the markets where that really speaks to driving value to customers. And so we're seeing a continuation, really a third year of market share gains on high-horsepower tractors. This year we're seeing good

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movement in terms of share on combines, so the work that the team is doing from a strategic point of view as well as a lot of really good work with the dealer channel and focusing there is driving a lot of positive results for us. Thanks.

Seth Weber
Analyst, Wells Fargo Securities LLC

Q

Thanks, guys.

Operator: Thank you. Our next question comes from Rob Wertheimer with Melius Research. You may ask your question. Your line is open.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Yeah, hi. I had a short-term and a long-term question on R&D. The cadence of R&D ticked up in the quarter in the back half of the year. I'm wondering what happened to shift your view on what needed to be spent. And then in general, I think you've gotten pretty good efficiency in R&D over the past couple of years. I'm wondering if the uptick in spending is an indication of the end of the road on that or new programs or if you just have general comments. Thank you.

Brent Norwood
Director, Investor Relations, Deere & Co.

A

Hey, Rob. Thanks for the question. Regarding R&D for the year, we saw it tick up a little bit in the guidance and that really reflects just our ability to accelerate some projects faster than we had originally anticipated. So I think that's a positive note. I think longer term, the neighborhood that we're traveling in right now on R&D spend is about right, plus or minus 10% on maybe any given year, but the big step-function change that we've seen this year, I think, really puts us in the right spot to execute on our leap ambitions and other targets for production and precision ag and the other divisions as well.

Joshua Jepsen
Deputy Financial Officer, Deere & Co.

A

Hey, Rob, it's Josh. Brent summed it up well. I think the continued focus in these areas where we feel like we can really differentiate and accelerate development of solutions that are going to unlock value and also be leverageable across our different businesses, so whether that's digitization, electrification, automation and autonomy, those are the areas where we're seeing the biggest opportunities and where as we can and as we particularly bring on new talent, whether it's the acquisition or other, we're accelerating development in those spaces.

Brent Norwood
Director, Investor Relations, Deere & Co.

A

Thanks, Rob.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Thank you.

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Operator: Thank you. Our next question comes from Jerry Revich with Goldman Sachs. Your line is open. You may ask your question.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Yes, hi. Good morning, everyone. I'm wondering if we can just talk about the guidance revision. So, nice to see pricing accelerating, and with the production costs, we've got margins coming down. So as we look at the impact of the inefficiencies, Josh, that you spoke about, it looks like based on the revision to guidance, there's about an $800 million incremental cost headwind versus three months ago. Is that all the inefficiencies of waiting for parts and moving machines around, or how much of that is other incremental inflation as we think about what that picture looks like when things normalize? Thanks.

Brent Norwood
Director, Investor Relations, Deere & Co.

A

Hey, Jerry. I think there's a lot of moving parts to the guidance in the back half of the quarter. Really what we saw in terms of the lowered guidance primarily related to increased material cost, freight and then excess overhead, which is coming from those supply disruptions that Josh noted about earlier, I mean there's really a myriad of issues that affects that.

Line rates may differ day-to-day, makes it hard to optimize the workforce. We are doing more rework on partially completed machines, and that creates a lot of increased overhead. So those are really the primary factors that drove the guidance change for us in the back half of the year. We're already starting to think about what the cost structure will look like as we exit the year and start making plans and build rates and schedules for the next year.

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

A

Hey, Jerry. This is Cory. Maybe I'll just use an example for you to give you an idea of how it's impacted us. If you took two of our largest units, Harvester Works and Waterloo, and you looked at the average over three years from 2018 to 2020 of what they spend in premium freight alone, so this is expedited freight and air freight, they [ph] just spent (00:43:40) combined about $25 million. We're probably going to spend almost $200 million this year.

Now, we made a conscious decision that we wanted to drive customers to get their products as close to on-time as we could, so we went to extraordinary efforts. That extraordinary number should not be there at the same level going forward. So our opportunity is we made the decision to spend to be able to fulfill customer demand, and it's shown up in what we've been able to ship. It'll show up in our market share, but we need to drive – our drive is to get that back out going forward, so we get to more normalized production.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

Operator: Thank you. Our next question comes from David Raso with Evercore ISI. Your line is open. You may ask your question.

David Raso
Analyst, Evercore ISI

Q

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Hi. Thank you for the time. I can ask a lot of detailed questions, but I guess just stepping back, you're implying the fourth quarter earnings are about $7.25, $7.30, and then the most interesting thing you've said is the lack of seasonality, right? Usually the first quarter is a bit of a low quarter. It sounds like that's not the case.

So I guess just to level set everybody, just trying to think of the pros and cons when we look at that fourth quarter, I can't just multiply it by four and say that's an annualized rate. But given the lack of seasonality you're talking about, there might be a better chance than normal to annualize that number. So can you help us a little bit with the pros and cons thinking about that fourth quarter number?

Number one, is there something unique in that number that's making it that strong? And then for 2023, the pros and cons would be – obviously the pro would be hopefully more efficient production, right, just given some weaker parts of the economy, a little better improvement in chip availability, but then the cons might be just macro risk around small ag, maybe late in the year construction, we'll see, but obviously you're speaking constructively about big ag for most of 2023. So can you just sort of level set, big picture, that fourth quarter number, something unique in it, and how to think about roughly annualizing that number? Thank you.

Brent Norwood
Director, Investor Relations, Deere & Co.

A

Hey, David. Thanks for the question. As we think about the fourth quarter, it will not follow our typical seasonal pattern, as you pointed out. We do end up year-over-year with about 20% more production days on our large ag factories in North America, so that's really going to help us as we think about achieving our guidance for the quarter. We do still have some number of partially completed machines with good line of sight to clearing many of those over the fourth quarter. And then we do intend to take our line rates just a click higher from where we did and what we produced in the third quarter.

Now most of the increase in line rate did happen in the third quarter, but we're going to go even a stretch higher in the fourth quarter. So it is going to give us a very different profile coming out of the year than maybe what you've typically expected or typically seen us do in years past.

Joshua Jepsen
Deputy Financial Officer, Deere & Co.

A

Hey, Dave. It's Josh. As Brent mentioned, typical seasonality would see us come down in 4Q because we're not, for example, building and shipping combines to the extent we will this year, and then a slower ramp in 1Q. Last year, clearly impacted by going through a work stoppage, so year-over-year, we're going to see those benefits as we get into the first quarter and build at those higher rates.

Now that's not to say it's going to be perfectly linear, but we're entering the year at much higher production rates and given the demand we see, that is covering a decent part of the first part of the year – first portion of the year is helpful. And with EOP, a lot of visibility there with our other products like large tractors, but then it extends into other things like our mid-series tractors where we got visibility to what we'd expect to be at least a third of next year already covered up and we're seeing strong order activity in Brazil as well.

So too early to have a full view or perspective on 2023, but I think the takeaway is we feel really good about how we're going to exit 4Q into 1Q with strong demand and the ability to drive more efficiencies in our operation while beginning to look at our costs and take out some of those costs that Cory mentioned earlier.

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Brent Norwood
Director, Investor Relations, Deere & Co.

A

Thanks, David.

Operator: Thank you. Our next question comes from Steven Fisher with UBS. Your line is open. You may ask your question.

Steven Fisher
Analyst, UBS Securities LLC

Q

Thanks. Good morning. Just a bigger picture question on the ag cycle and your inventory planning. I didn't quite hear the answer as part of Jamie's question, but how are you deciding how much and when to restock dealer inventories for both large and small ag? It seems like maybe small, could be a little more complicated decision-making given the divergence of what you talked about between the dairy products and the consumer, so just curious how you're thinking about the re-stocking and when and how much. Thank you.

Brent Norwood
Director, Investor Relations, Deere & Co.

A

Hey, Steven. Thanks for the question. Large ag inventory, we won't see much, if any, build this year. Effectively everything that we are shipping from our factories is already retail sold. In our data in the slide deck, you'll see a slight uptick in dealer inventories. That's just reflective of the higher build rates and the higher throughput that we're pushing through into the system. It's not really a reflection of any sort of re-stocking that's happening on the large ag side. I think going into next year, maybe too early to tell where we end, but right now we are still on allocation which implies demand still running a little bit ahead of supply. In that scenario, we wouldn't expect to build a lot of inventory, if any, next year. So it's still, again, a little early, but at least from where we sit today probably limited ability to build inventory on the large ag side.

The calculus in small ag is maybe a little bit different. Probably still going to be very tight with your mid-sized equipment that's going into the hay and forage, and dairy and livestock sectors while some of the more consumer-driven products, turf and in compact utility drivers may see demand moderate a little bit as we go through the year. Now that said, we're starting from pretty low inventories, so there may be some ability to build a little bit of inventory there, but we're going to be really careful and watch demand very, very closely, so that we don't get ahead of ourselves in terms of inventory to sales ratios.

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

A

Yeah, Steven, this is Cory. We're sitting at all-time lows. We're in the low-teens in new and used. The teens that you see show up in dealer inventory are largely pipeline that are moving through to customers. Used inventory across the board for large ag equipment is all-time lows, so and if you look at how across-the-board lease returns coming back, no one is sending any back, we're in a really good spot and we're not going to really build any inventory even through 2023.

Steven Fisher
Analyst, UBS Securities LLC

Q

Thank you.

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Operator: Thank you. Our next question comes from Stephen Volkmann with Jefferies. Your line is open. You may ask your question.

Stephen Volkmann
Analyst, Jefferies LLC

Q

Hi. Good morning. Thank you. And my question is about input costs, because it looks like at least from an index perspective, whether it's metals, rubber, energy in the US, transportation and logistics, I mean all these costs seem to be rolling over pretty significantly, and so I'm wondering are you starting to see that in some of this inventory build that you're doing, or if not, sort of how should we think about that sort of ultimately starting to work its way through your cost structure. Thanks.

Brent Norwood
Director, Investor Relations, Deere & Co.

A

Hey, Steve. Thanks for the question. Regarding input prices, I think there are a few different categories of cost at play in 2022. Some of the cost increases that we've experienced are going to be a little more structural and higher for longer. Things like labor and energy are parts of the supply base where they are truly capacity constrained, right, so supply and demand dynamics for those parts of the supply base will likely keep prices higher going into 2023.

That said, there are going to be some opportunities, I think, for costs to abate a little bit. There's been in 2022 significant additional cost stemming from supply disruptions. We've talked a little bit about that. As we exit this year with higher production rates, it should ease a little bit of the overhead pressure going into next year. And then there's other parts of our supply base that are linked to raw material prices like steel and others in that commodity basket that have come down a little bit, and I think those are all going to be opportunities for cost reductions in 2023 as we go through the year.

Stephen Volkmann
Analyst, Jefferies LLC

Q

Thank you.

Brent Norwood
Director, Investor Relations, Deere & Co.

A

Thank you, Steve.

Operator: Thank you. Our next question comes from Chad Dillard with Bernstein. Your line is open. You may ask your question.

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

Q

Hi. Good morning, guys. So a couple questions for you. First of all, in your prepared remarks, you talked about share gains. I just want to get a better understanding of which products you're seeing share gains in and if you can quantify how much you're seeing. And I guess more importantly, as you're thinking about the gains, to what extent do you think they're more cyclical versus structural?

And then the second question is just about your margins in production and precision ag. It looks like the implied exit rate is about 25%. Is that a right number to kind of start thinking about in 2023?

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Brent Norwood
Director, Investor Relations, Deere & Co.

A

Hey, Chad. A couple of questions in there. I'll try to work my way through those. With respect to share this year, for the most part, we view share as a function of which players are able to produce machines, right. There's a shortage of equipment, there's not a lot of inventory available, and so where the areas where we've had the best execution on our part, I would call out Mannheim Tractors first and also Waterloo row crop tractors have been areas of strength for us as we've progressed through the year and we continue to see and forecast good production rates exiting this year and going into 2023 for both of those product lines.

In terms of margin for 2023, I would say it's too early for us to have a guide. There's going to be a lot of variables as we exit 2022 and go into 2023. We've got new pricing for model year 2023 products. There's certainly a lot of volatility in our cost structure as parts of that are coming in a little bit, but other parts are remaining stubbornly high. So no real guidance on what to expect, I would say, for margins other than we would target incrementals pretty – going into 2023, we would target incrementals that would be consistent with what you've come to expect at Deere. Ag and turf products typically in the 30% to 35% range, and construction and forestry products historically have been in the 20% to 25% range, and that would be our targeting goal as we think about 2023.

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

Q

Great. Thank you.

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

A

Yeah, Chad. This is Cory. The only thing I'd add on the share side, probably the thing we talk about large tractors which we continue to be able to consistently perform and deliver. I'm probably most excited about the share gains we see in sprayers and planters. These are the instruments of precision ag technology. These are the things that deliver on our strategy for smart industrial, the ability to take new technologies out that help us – help customers do better, grow more yield, do with less cost, and we're consistently moving share into the market with those. And I'd remind you if you look at those numbers things like sprayers, we're actually shipping late this year and continuing to build share in planters. We're shipping a lot of products later than expected and continuing to build share, so those primary instruments of our strategy, we're growing share on consistently.

Joshua Jepsen
Deputy Financial Officer, Deere & Co.

A

This is Josh. One thing on share to point out too is, well, as Brent mentioned rightfully so, ability to ship is impacting month on month how we're seeing share performance. At the root, we're seeing share gains where we're converting customers, and that is a precision ag story. The value that we can create with our dealer network, with our solutions and tools is converting customers. Now, you might not see that show up exactly in a month-to-month market share number, but that's the big opportunity we have and we see those conversions as a result of the value we can deliver to them and how we can do that seamlessly and easier to drive those outcomes whether it be financial, productivity or from a sustainable point of view.

Brent Norwood
Director, Investor Relations, Deere & Co.

A

Thanks, Chad.

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

Q

Okay, thank you.

Operator: Thank you. Our next question comes from Michael Feniger with Bank of America. Your line is open. You may ask your question.

Michael Feniger
Analyst, BofA Securities, Inc.

Q

Yeah, thanks for taking my question. In the past, you have said the cycle peak is typically at 120% to 140% of mid-cycle. I think you calculated that on a seven-year rolling average. I'm just curious based on that framework and your expectations for 2023 to be up, where you think that large ag is going to finish next year given that framework.

Brent Norwood
Director, Investor Relations, Deere & Co.

A

Yeah, hey, Mike. This is Brent. Thanks for the question. It's probably a little too early at this point to predict where in the cycle, what our math will calculate for 2023. Keep in mind, we're still on allocation for 2023, so that is implying there's still some level of unmet demand, and certainly it's way too early at this point to call what will happen after 2023. So I think the important elements that we're focused on right now is customer fundamentals are still really strong, and while we will increase volumes next year and we may even begin to bring down the age of the fleet for tractors a little bit, we're still going to be at pretty elevated levels there. And as Cory noted, inventory levels are at record lows, so these are all the things that we're contemplating as we plan our schedules for 2023 and beyond, and for us, these factors tend to point to a bit of a longer duration in the cycle which makes it really difficult to compare from one cycle to the next because they're all a little different. But these are the factors that we're focused on and think will drive our business in the next couple years.

Joshua Jepsen
Deputy Financial Officer, Deere & Co.

A

I think importantly – this is Josh. Importantly, as we go forward, as we talked about in May at our Investor Day, is how do we continue to build a business that's more resilient, that has less volatility through the cycle, and we're in the early stages of that, but we feel confident in the ability over time to do that, and that's a continued focus of how do we reduce that volatility that we've seen historically moving up and down in the cycle.

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

A

The only other thing I would add to that – this is Cory – is we tend to talk a lot about the North American market. We have the very same dynamics in the South American market. Our team is out one of the largest customers there. They're getting ready for their planting season for next year. They're likely going to plant the largest crop in the history of the region. We're seeing our shares grow, and we're seeing our precision ag technology rates grow, we're putting the connectivity, the engaged acres, so it bodes well for the future for that region as well, which I think is worth noting.

Brent Norwood
Director, Investor Relations, Deere & Co.

A

Thanks, Mike. I think we've got time for one last caller.

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Operator: Thank you. Our last question comes from John Joyner with BMO. Your line is open. You may ask your question.

John Joyner
Analyst, BMO Capital Markets Corp.

Q

Excellent. Thank you. Thank you for the time. So I had another question on planned inventory levels exiting the year, and maybe you touched on this already, but how much of it is from production rates set to improve simply from supply chain and freight challenges easing versus what it says about how you perceive demand, I guess, today heading into fiscal 2023 compared with what your assumptions were just a few months ago?

Brent Norwood
Director, Investor Relations, Deere & Co.

A

Yeah, John, thanks for the question. We would say that the primary driver of our inventory levels coming out of the fourth quarter and going into next year is really about the enthusiasm for the demand that we're seeing and our ability to carry these higher production rates into next year is going to require higher inventory levels for us. That's the primary driver, more so than just carrying more inventory because of supply constraints. There could be a little bit of that in there, but that wasn't really the primary impetus for carrying more inventory coming out of the year.

Thanks, John.

I think we're out of time for the rest of the hour, so thank you, everybody, for calling in. We appreciate the questions and look forward to following up with everybody after the call. Thanks, all.

Operator: Thank you. And that does conclude today's call. We thank you for your participation. At this time, you may disconnect your lines.

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