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Deere & Co. (DE)

Q2 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

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

Josh Beal
Director, Investor Relations, Deere & Company

Hello. Welcome and thank you for joining us on today's call. Joining me on the call today are Josh Jepsen, Chief Financial Officer; Cory Reed, President, Worldwide Agricultural and Turf Division; Production and Precision Ag, Americas and Australia; and Josh Rohleder, Manager of Investor Communications.

Today we'll take a closer look at Deere's second quarter earnings, then spend some time talking about our market and our current outlook for fiscal 2024. 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.

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This call includes forward-looking statements concerning the company's plans and projections for the future that are subject to uncertainties, risks, changes in circumstances and other factors that are difficult to predict. Additional information concerning factors that could cause actual results to differ materially is contained in the company's most recent Form 8-K, risk factors in the annual Form 10-K, as updated by 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 and Events.

I will now turn the call over to Josh Rohleder.

Joshua Rohleder

Manager, Investor Communications, Deere & Company

Good morning. John Deere concluded the second quarter with solid execution. Financial results for the quarter included a 21.2% margin for the equipment operations. Trends in the end markets that we serve remain broadly unchanged from last quarter. Ag fundamentals continue to abate, leading to more challenging market conditions in the back half of the year.

In Construction and Forestry, fundamentals remain stable at levels supportive of demand across most end markets. Demand shifts, coupled with proactive inventory management are reflected in our production schedules for the balance of the fiscal year, with many product lines anticipating retail demand underproduction to close out 2024. Notably, our projected financial performance in these dynamic market conditions demonstrates our ability to deliver better results across the business cycle.

We now begin with slide 3 and our results for the second quarter. Net sales and revenues were down 12% to $15.235 billion, while net sales for the equipment operations were down 15% to $13.61 billion. Net income attributable to Deere & Company was $2.37 billion or $8.53 per diluted share.

Digging into our individual business segments, we'll start with the Production and Precision Ag business on slide 4. Net sales of $6.581 billion were down 16% compared to the second quarter last year, primarily due to lower shipment volumes, which were partially offset by price realization. Price realization was positive by just under two points. Currency translation was roughly flat. Operating profit was $1.65 billion, resulting in a 25.1% operating margin for the segment. The year-over-year decrease was primarily due to lower shipment volumes and higher production costs. These were partially offset by price realization.

Turning to Small Ag and Turf on slide 5. Net sales were down 23%, totaling $3.185 billion in the second quarter as a result of lower shipment volumes, partially offset by price realization. Price realization was positive by 1.5 points. Currency translation was roughly flat. Operating profit declined year-over-year to $571 million, resulting in a 17.9% operating margin. The decrease was primarily due to lower shipment volumes, which were partially offset by price realization.

Slide 6 provides our industry outlook for Ag and Turf markets globally. Across all our major markets, we see continued softening in grower sentiment as the combined impacts of rising global stocks, lower commodity prices,

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high interest rates, and weather volatility weigh on customer purchase decisions. Amidst this backdrop to rising uncertainty, we're seeing customers exercise greater discretion in their equipment purchases, which is reflected in the changes in our industry guide this quarter.

Large Ag equipment industry sales in the US and Canada are now expected to decline 15%, reflecting further demand reduction in the back half of the year, primarily in large tractors.

In addition to the aforementioned factors, increases in used inventory levels, particularly late model year machines, are having an impact on purchase decisions. These headwinds are partially offset by fleet fundamental tailwinds, including elevated fleet age, stable farmland values, and strong farmer balance sheets.

For Small Ag and Turf in the US and Canada, industry demand estimates are now down 10%. In the quarter, we saw notable reductions in our expectations for the turf segment, particularly riding lawn equipment, where high interest rates are impacting purchase behavior following several years of strong market demand.

In Europe, the industry is now forecasted to be down 15%, reflecting increasing grower uncertainty in the region. Wet conditions have raised concerns for winter crop yields, while elevated input costs are weighing on margin expectations. Despite the softening, arable cash flows remain at roughly 10-year averages. And dairy and livestock fundamentals are expected to improve due to stronger pricing amid lower feed costs.

In South America, industry sales of tractors and combines are now expected to decline between 15% to 20%. Brazil remains the largest affected market, with additional pressure stemming from strong global yields, driving down commodity prices. Both soy and corn margin expectations softened over the quarter. Conditions are further impacted by elevated interest rates and an expected strong recovery in Argentina production levels following last year's drought. Industry sales in Asia continue to be forecasted down moderately.

Next, our segment forecasts begin on slide 7. For Production and Precision Ag, net sales are forecasted to be down between 20% and 25% for the full year. The forecast assumes roughly 1.5 points of positive price realization for the full year and minimal currency impact. For the segment's operating margin, our full year forecast is now between 20.5% and 21.5% due to demand softening and proactive inventory management.

Slide 8 shows our forecast for the Small Ag and Turf segment. We now expect net sales to be down between 20% and 25%. The guide includes 1.5 points of positive price realization and flat currency translation. The segment's operating margin is now between 13.5% and 14.5%, in line with slowing net sales.

Shifting to Construction and Forestry on slide 9. Net sales for the quarter were down 7% year-over-year at $3.844 billion due to lower shipment volumes. Price realization was positive by roughly 0.5 point, while currency translation was flat. Operating profit of $668 million was down year-over-year, resulting in a 17.4% operating margin due primarily to lower shipment volumes and higher R&D and SA&G expenses.

Slide 10 gives our 2024 Construction and Forestry industry outlook. Industry sales expectations for earthmoving equipment in the US and Canada remained flat to down 5%, while compact construction equipment in the US and Canada is expected to be flat.

Industry fundamentals remain vastly unchanged with stabilized demand supported by visibility into the balance of the year, and markets continue to be healthy as the US government infrastructure spending further increases. Investments in manufacturing persist and single-family housing starts improve. Tailwinds are tempered by declines in commercial real estate and softening in rental demand throughout the balance of the year.

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Global forestry markets are expected to be down around 10% as all global markets continue to be challenged. Global roadbuilding markets are now forecasted to be flat to down 5%, as strong infrastructure spending in the US is offset by continued softness in Western Europe.

Moving to the Construction and Forestry segment outlook on slide 11, 2024 net sales remain forecasted to be down between 5% and 10%. Net sales guidance for the year includes about 1.5 points of positive price realization and flat currency translation. The segment's operating margin is projected to be around 17%.

Transitioning to our Financial Services operations on slide 12. Worldwide Financial Services net income attributable to Deere & Company in the second quarter was $162 million. Net income was positively impacted by a higher average portfolio balance, which was partially offset by a higher provision for credit losses and less favorable financing spreads. As a reminder, net income in the second quarter of 2023 was also impacted by a non-repeating one-time accounting correction.

For fiscal year 2024, our outlook for net income remains at $770 million as benefits from a higher average portfolio balance offset a higher provision for credit losses and less favorable financing spreads.

Finally, slide 13 outlines our guidance for Deere & Company's net income, our effective tax rate and operating cash flow. For fiscal year 2024, our outlook for net income is now expected to be approximately $7 billion. Next, our guidance incorporates an effective tax rate between 23% and 25%. And lastly, cash flow from the equipment operations is now projected to be in the range of $7 billion to $7.25 billion.

This concludes our formal comments. We'll now shift to a few topics specific to the quarter. Let's begin with Deere's performance this quarter. We saw net sales decline roughly 15% year-over-year, yet operating margin came in at just over 21%. Across all business segments, we saw better-than-expected performance despite a more challenging macro backdrop.

Josh Beal, can you walk us through what went well for Deere?

Josh Beal

Director, Investor Relations, Deere & Company

Yeah, absolutely, Josh. This is really a story of executional discipline across the organization. We were able to outperform on the top line as demand held up slightly better than we expected. In particular, we saw a resilient earthmoving and roadbuilding market that exceeded our expectations despite a tough competitive environment.

Turning to production costs. Freight came in solidly favorable year-over-year. However, as you noted earlier, we are experiencing offsetting headwinds and overheads as we adjust production to moderating demand. All that being said, it's worth noting that this quarter's performance with equipment operations margin over 21% ranks as one of the best quarters in company history.

We're encouraged by the start of the year and we're focused on executing our plan in the remaining two quarters.

Joshua Rohleder

Manager, Investor Communications, Deere & Company

Thanks, Josh. That's a great summary and a great point you bring up. It's clearly been a strong executional start for the year, but we've revised our full year guidance.

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What's driving the delta in the back half of the fiscal year?

Josh Beal

Director, Investor Relations, Deere & Company

Right. The forecast change is really volume driven, primarily in our Ag and Turf segments. Underlying the demand decline is a tougher backdrop in global ag, which as you mentioned in your opening comments has continued to weigh on our customer base. Uncertainty has caused a decline in farmer sentiment, and as a result, we are seeing a softer retail environment today than we did just six months ago.

Primary crop margins globally are forecasted to be down, stocks-to-use are expected to be above historical averages, thanks to multiple years of favorable growing conditions and record global yields, used inventories have risen, and persistently high interest rates are impacting purchase decisions.

Despite all these headwinds, we experienced strong demand in the first half of the year, albeit down from the highs of 2023, which drove solid first half production volumes for Ag and Turf.

Given the environment that I just mentioned, we do expect incremental demand decline in the back half of 2024. Notably, our production volumes will decline more than demand in the back half as we're taking proactive steps to drive down field inventories. This is true for all of our major markets, South America, Europe, and also now for North America large tractors. We believe this approach best positions us to build the retail demand in 2025.

Joshua Jepsen

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

This is Jepsen here. Maybe, a couple things to add. First, I want to commend our employees for the work they've done to drive the overall decrementals for the business, despite the velocity of declines we're experiencing this year. We're delivering value for our customers and driving operating margins that are structurally better at this point in the cycle than ever before.

However, there's always opportunity to do better and we'll continue to take action on costs throughout the remainder of the year while still investing in our future.

Joshua Rohleder

Manager, Investor Communications, Deere & Company

Thanks for that additional color, Josh. And you make a great point about the decrementals. We're definitely being impacted more significantly than usual by the unfavorable mix associated with higher margin products and regions declining more significantly.

But I think the key differentiator this year is around more proactive management. Both you and Beal) alluded to the rate at which we're bringing in production.

Cory, I'd like to bring you into the conversation now. You've been in the ag business nearly your entire career. What is different in terms of how we have managed the changing environment in this cycle?

Cory J. Reed

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

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Yes. Thanks, Josh. We are coming down from a period of high demand, and historically, we would have, as an industry, been slow to react to that change. Often, we would drive higher levels of field inventory to the detriment of the following years.

Within Deere, we're managing this year differently, which is a testament to the fact that both we and our dealers have learned from the past cycles. This is probably best exemplified by our decision to underproduce large tractor retail demand in North America in the back half of the year.

We ended 2023 with really low levels of large tractor inventory, but we think it's prudent to drive those levels even lower as we close out our 2024. The key here is that by staying ahead of demand changes, we're giving ourselves the optionality to react most efficiently to whichever way the market moves in the next year.

I think it's important to note that we're not implying that we know where 2025 demand will be. Frankly, this season's crops aren't even in the ground yet, so it's still way too early to opine on that. But we're focused on proactive management to ensure that we keep inventories in balance with demand. This is a key component to ensuring better structural profitability throughout the cycle for our business.

Joshua Jepsen

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

This is Jepsen. One other thing to highlight, beyond the current environment, and where we see the long-term strategy leading us, is related to technology and how we engage with our customers. We're starting to think about market share, not only as the number of units sold, but as the number of acres covered by Deere products and technologies as a percentage of total acres farmed.

In the future, we're going to continue accelerating the utilization of technology as we grow our precision upgrade retrofit business, as well as Solution as a Service offerings.

Our engaged acre journey helps demonstrate the progress we've made in delivering value for customers and making their jobs easier to do. In fact, at the end of the quarter, we now cover over 415 million engaged acres globally, and importantly, highly engaged acres, which, as a reminder, means three production steps and value-creating activities in the John Deere Operations Center are performed, make up over 25% of the engaged acres amount, having grown by double digits this past quarter alone.

While all parts of the world are seeing growth, Brazil is growing faster than North America on both engaged and highly engaged acres, which is a positive sign as we bring more technology to the market, in particular, with satellite communications coming soon. And customers there see increased value given the multiple crop harvest each year as well as the ability to improve efficiency, profitability, and sustainability in their operations.

Joshua Rohleder

Manager, Investor Communications, Deere & Company

Those are excellent proof points. But one thing we haven't covered yet is costs. A key benefit of proactive cycle management should theoretically be the associated cost savings. We're seeing another year of positive price costs, but can you break down what's driving that positive differential for us?

Josh Beal

Director, Investor Relations, Deere & Company

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Yes, definitely. That's a great point, Josh, and I'm happy to start. I'd begin by referencing back to what Josh Jepsen talked about earlier. Along with structural cost reductions, we continue to prioritize managing to our structure lines, which essentially means as production and sales come in, we pull levers to bring in costs.

Our speed in pulling those levers and the subsequent timing of those actions hitting the bottom line is a top priority right now. The outcomes of these efforts show up in the production cost bar in our quarterly earnings bridge.

Given that there's a lot that goes into that cost category, it might be helpful to walk through a few of the notable components.

Starting with freight and material, we're beginning to see the benefits of our ongoing cost reduction efforts. We're encouraged by the opportunity to get back significant cost on freight and logistics, as well as in our material spend. We're truly building strategic partnerships with our supply base as we jointly work to structure sourcing in a way that ultimately creates value for both parties.

Coupled with our dual sourcing strategies, we've been able to enhance supply chain resiliency in tandem with cost savings, which has been crucial to optimizing returns amidst lower demand.

The cost reduction efforts are important, given we have seen some manufacturing overhead efficiencies associated with managing to lower production levels. This references back to my comment on the timing of lever pulling and the timing of those actions impacting financials.

We're actively taking steps to manage costs as we see demand change, essentially rightsizing the cost structure for a given production level. But in a year when we're moving down in volume, we've experienced some inefficiency as we make those adjustments. This headwind is showing up in the production cost bar as well, largely offsetting the gains that we're seeing in freight, logistics, and material spend this year.

Joshua Jepsen

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

This is Jepsen. Maybe one thing worth mentioning is we also pull levers on assets, and that's evident when you look at our cash flow guidance change, which is down less in this guide compared to the change in net income. This is reflective of the fact we're starting to see our inventory come down following our production rate reductions in the first half of the year, creating a source of cash for the business.

We're continuing to manage working capital and expect further reductions throughout the remainder of the year.

Joshua Rohleder

Manager, Investor Communications, Deere & Company

Perfect. And in the spirit of inventory management, I'd like to briefly touch on new and used inventories. Josh Beal, could you give us an update on where we stand today and what to expect in the back half of the year?

Josh Beal

Director, Investor Relations, Deere & Company

yeah, absolutely. And I'll start with new equipment. In North America Large Ag, we're seeing intra-season inventory build as expected, albeit below industry levels, and inventory-to-sales ratio increases in line with

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historical norms. That said, given our proactive underproduction previously discussed, we expect these numbers to fall by year-end, with beginning 2025 inventory-to-sales ratios down significantly from where they stand today.

Furthermore, we expect to see the largest decline in new inventory levels to occur during the fourth quarter as normal year-end seasonal declines are amplified by our planned underproduction for the year.

On the used inventory side, we've seen total used units up year-over-year. While combines are up from decade lows, they remain below the highs seen in the last downturn. Meanwhile, used high horsepower tractors have increased more rapidly and are skewing more predominantly to later models, driving up the average value of the equipment. The trend that we're seeing in used high horsepower tractors was a key factor in our decision to underproduce retail demand in North America.

Cory J. Reed

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

Hey, Josh, this is Cory. Just one thing to add here is, as you look at the industry as a whole, we've been relatively disciplined. Our Large Ag new inventory in North America currently represents less than half of the industry's unit inventory and significantly below the industry on an inventory-to-sales ratio basis. This is reflective of the discipline we're showing in this cycle.

And on the used side, our dealers are hyper-focused on used inventory, managing them appropriately to ensure that they maintain a healthy and a trade ladder for their customers. For example, this cycle, we put a strong focus on our dealer pool funds to help manage used inventories. Dealers accumulate these funds based on new equipment sales and then use them to create competitive packages to help move used equipment.

Our dealers prudently build up these funds over the last several years, nearly tripling their total available balance, which is now providing valuable support in the current market environment.

Joshua Rohleder

Manager, Investor Communications, Deere & Company

Thanks, Cory and Josh. That's a good reminder on intra-year seasonality swings and how those play into our larger production and inventory management.

Shifting now to a region we haven't talked much about yet, I'd like to focus on Brazil. There's been quite a bit of buzz down there between first crop harvest, Agrishow two weeks ago, and the recent devastating flooding in Rio Grande do Sul.

Josh Beal, do you want to kick us off with a quick overview on the state of the business there?

Josh Beal

Director, Investor Relations, Deere & Company

Yes, happy to. And definitely a dynamic market to unpack. And I'd like to first start by extending our deepest sympathies to those affected by the tragic flooding you mentioned, Josh, including a significant number of our employees, customers, and suppliers. We want to wish everyone well in the recovery, and I want to emphasize that the safety and security of our employees is our first priority as we assess and respond to the impacts of the event.

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Operationally, while we do have facilities in the region, we do not anticipate any long-term impacts to the business at this time.

Turning to the broader Brazilian ag environment. Soybean farmers saw profitability decline due to adverse weather conditions and global supply surpluses. That said, we do expect some favorable offsets with a strong cotton crop this year and a better-than-expected corn crop, which should provide some support to farmer sentiment for the 2024 season.

All in, ag equipment retail demand in the region continues to decline, driving the change in our industry guide. While production cuts came through as expected for the quarter, retail sales came in lighter than anticipated.

Nevertheless, we remain committed to underproducing retail demand in the region this year as we target year-end inventory levels, supportive of building in line with retail in 2025. Ultimately, we'll see more of the planned inventory reduction for the region in the back half of the year.

Joshua Rohleder

Manager, Investor Communications, Deere & Company

Perfect. Thanks for setting the stage, Josh. Now, Cory, I believe you were just down there for Agrishow. Could you give us an update on what you saw there and a sentiment you were hearing from dealers and customers?

Cory J. Reed

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

Absolutely. That sentiment was positive, Josh. This is not to say that we've reached an inflection point, given Josh Beal's comments earlier about retail activity. But I think the biggest takeaway was the excitement that we're seeing for our latest tech offerings. In fact, we're taking preorder interest for our Starlink connectivity solution and ended up oversubscribed by the first day of the show. We similarly sold out of our allotments for See & Spray Select and our Precision Ag Essentials bundle that was also a great success.

Fundamentally, we're at the forefront of bringing our full ecosystem of solutions to the Brazilian market, and our customers there are very calculated in their investments. They adopt when it makes financial sense, and given the double or sometimes even triple crop rotations they're able to achieve, the payback for much of our technology and equipment is significantly faster than in the North American market.

I'll take sprayers as an example. In the US, the corn or soybean farmer may only spray three times annually. But in Brazil, a farmer on a soybean and cotton rotation could spray as much as 20 times a year. This is why we're so focused on bringing our customers the solutions and connectivity that enables them to drive more value from their operations.

And the great thing is that tech adoption was only half the story at the show, at Agrishow. We saw equipment order interest rebound from last year's lows, including some of our most productive product offerings, like our new 9RX Tractors and X9 Combines. Adding in the strong fundamentals and demand for sugarcane harvesters, we feel optimistic about the future of agriculture in Brazil.

So while the competitive landscape continues to expand in the region, we feel confident not only in our ability to deliver additional value to our customers via our integrated solutions, but also through the strong dealer network that we've worked hard to build out. These dealers are providing industry differentiated support to our customers, helping to drive uptime and reliability required in an environment where there's no off-season.

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Joshua Rohleder

Manager, Investor Communications, Deere & Company

Awesome. That's really great insight, Cory. Now for the last topic, I'd like to briefly touch on Construction and Forestry, which was relatively stable this quarter. Earthmoving end markets remain largely unchanged quarter-over-quarter, while roadbuilding has seen some minimal shifts in North America, albeit remaining at strong demand levels.

Josh Beal, can you give us a little more color on this part of the business and what we should expect for the balance of the year?

Josh Beal

Director, Investor Relations, Deere & Company

Definitely, Josh. The key takeaway for the quarter is what you noted, minimal change at healthy levels of demand. As we've noted on previous calls, we expected some decline year-over-year unrelated to end market demand as we build less inventory this year relative to 2023.

While contractor backlogs remain healthy and utilization at sustainable levels, we've seen rental CapEx come in, in our new and used inventory levels currently around long-term averages. Our guide is also supported by an order book for earthmoving equipment that extends out approximately four months into the fourth quarter.

The only other point I'd highlight is around pricing. In addition to strong demand, we're also seeing strong competition, bolstered by industry inventory levels that have recovered and a shift in the competitive landscape with a stronger US dollar. However, we remain committed to a disciplined approach that balances both market share and price. Overall, our earthmoving and roadbuilding segments continue to deliver structurally better financial performance than we've seen historically.

Joshua Rohleder

Manager, Investor Communications, Deere & Company

Thanks, Josh. That's a great update. And before we open the line to questions, Josh Jepsen, any final comments?

Joshua Jepsen

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

Certainly. It was a good second quarter with strong results to round out the first half of the year. Despite a dynamic global ag market and competitive construction environment in North America, we performed at structurally higher levels across the business. Given the pullback we've seen in ag markets, we now expect to end the year moderately below mid-cycle levels.

This quarter, we also returned approximately $1.5 billion in cash to shareholders via dividends and share repurchases, and remain committed to returning cash to shareholders while concurrently investing in the business via value-accretive CapEx and R&D spending.

I want to reinforce that we're not new to market cycles. And we've learned from the past, making us a more resilient and better prepared business than ever before. Our proactive management reflects this and demonstrates that we are structurally better business today with equipment margins forecast just above 18%,

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despite unfavorable mix in a rapidly shifting global environment. And as a result, we feel that we are putting ourselves in the best position possible for the future.

Regardless of where we are in the cycle, we remain committed to our customers and their needs, ensuring our solutions drive real value to their business, while Deere and our dealers provide the support they need to be successful. The progress on technology adoption and utilization, as noted earlier, with our engaged and highly engaged acre progress, provides evidence of the value in our integrated offering of equipment, technology and digital tools.

At the end of the day, we're focused on doing more so our customers can do less, and we are more excited every day about the vast amount of opportunities that lay in front of us.

Joshua Rohleder
Manager, Investor Communications, Deere & Company

Thanks, Josh. Now let's open it up to questions from our investors.

Josh Beal
Director, Investor Relations, Deere & Company

We're now ready to begin the Q&A portion of the call. The operator will instruct you on the polling procedure. In consideration of others and 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.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Jerry Revich with Goldman Sachs. Your line is open.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Yes, hi. Good morning, everyone.

Josh Beal
Director, Investor Relations, Deere & Company

A

Hi, Jerry.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Hi. I'm wondering if you could just expand on the...

Josh Beal
Director, Investor Relations, Deere & Company

A

Hey, Jerry, we lost you. You're broken up a little bit. We can't hear what you're saying. Amanda, we might need to move back to Jerry. Jerry, if you can hear us, you're not coming through.

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Operator: Thank you. Our next question comes from Angel Castillo with Morgan Stanley. Your line is open.

Q

Hi. This is [ph] Grace (00:29:04) on for Angel. Thanks for the question. I think your updated guidance for Production and Precision Ag, I believe implies 50% decrementals and high-teens margins, so can you talk about the underlying drivers of that and what you see as ultimately the normalized level of profitability for the segment? And as part of that, what gives you comfort that we won't see margins move lower to a low to mid-teens range? Thank you.

Josh Beal
Director, Investor Relations, Deere & Company

A

Yeah. Thanks for the question. Really what we saw in Production and Precision Ag in the quarter, as we described in our comments, some further softening in markets really around the globe, and you saw that reflected in our industry guides. North America, Brazil, and Europe, we saw pullbacks across all those markets.

And as a result, we've adjusted production accordingly, again, as we talked on the call. Our number one focus is to position ourselves to build in line with retail demand. And so as we've seen those shifts in the end markets, we're making those adjustments, again, to keep us in line.

I think, the one notable change, probably from some of our prior commentary, is around North America, really the softening that we saw in that market was around the large tractors. And as we saw the pullback, we've also seen some increases in high horsepower tractor used inventory. And as a result, we've made the decision to underproduce retail demand in large tractors this year in North America to bring down our ending inventory levels. We think that positions us best for 2025, again, given what we're seeing in the market, and that's reflected in some of the declines that you've seen.

We were, first half of the year, producing at healthy levels in line with strong retail demand. We have seen some pullback. And what you're seeing in terms of decrementals and that change is related to that pullback that we've seen.

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

A

Yeah, [ph] Grace (00:30:56). This is Josh Jepsen. Maybe just to comment around decrementals, I think, full year, we expect your PPA to do around 44%, I think the back half is actually pretty similar to that, so not materially different.

And maybe an important just compare, Josh's position in terms of the structural profitability of that business is if we look back to 2020, the business was around, call it 90% of mid-cycle, which is not terribly far from where we are today for Production and Precision Ag. And we did around 16% operating margin, kind of adjusted for some one-time things that occurred during that time, so 16% today, middle of our guide is 21%.

So I think underlies the shift we're seeing from a structural profitability perspective, even with, as we noted earlier, a mix that has been less than favorable for us, both from products as well as regional shifts.

Josh Beal
Director, Investor Relations, Deere & Company

A

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Yes. Thanks for the question, [ph] Grace (00:31:53).

Operator: Thank you. Our next question comes from Mig Dobre with Baird. Your line is open.

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

Q

Thanks for the question and good morning. I'm wondering if you can maybe put a finer point and help us understand how large is this underproduction in both PPA and SAT? What percentage of revenue or the revenue decline, if you would, is related to this underproduction? And as we're looking at your disclosure on slide 15 for dealer inventories, how should we think about that two-wheel drive tractor number exiting fiscal 2024? Thank you.

Josh Beal
Director, Investor Relations, Deere & Company

A

Yeah. Thanks, Mig. Appreciate the questions. Looking at total underproduction for the year, and starting with the Large Ag segment, globally, Mig, if you think about it, worldwide underproduction to complete good retail sales, are they going to be in the high single digits worldwide? North America, large tractors, it's probably in that range, maybe a little bit higher.

On the higher end in South America and Brazil, as we bring down inventory and combines and tractors, and similarly, in Europe, our Region 2, as we call it, the tractors kind of in line with that guide in the midsize. The combine is a little bit heavier. But again, globally, if you look at Production and Precision Ag, it's about high single digit under production.

As you referenced on the slide, and the current levels of inventory for tractors, we're about 30% right now, I think 31% on the slide there. And that's pretty normal for this level of seasonal build, maybe a little bit higher relative to historical average, but kind of in that range.

I think notably, we're going to see significant reduction in that ending inventory level in the back half of the year. Last year, row crop tractors were about 15% inventory-to-sales, as we close out 2023. This year, it's probably going to be closer to 10%, and on a unit basis, significant underproduction.

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

A

Yeah, Mig, this is Cory. I'll just give a finer point to you on the inventory side. I mentioned that we're on a unit basis, significantly below – we're below the total in terms of the rest of the industry.

On a unit basis for row crops, as an example, we're sitting at half of the industry new inventory, but we're taking that down even further. So as Josh mentioned, we're going to go from that range of 15-plus-% down to 10% at the end of the year.

The net effect of that, obviously, is lower productions in the back half, while maintaining good margins throughout PPA, but putting us in the best position going forward relative to responding to retail demand in the future. So we're taking those inventories down. They'll be in the 100s at the end of the year for row crop tractors on the new side.

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

A

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Yeah. And maybe one thing – lastly to add, this is Josh Jepsen. I think, compared to historical, we are ensuring that we're getting inventories in the right place, being as proactive as possible and not prolonging demand, not stretching out, the potential to have higher demand a little bit longer, which is a lesson learned clearly from the past. So being able to do that more proactively, we think puts us in a better position. It also impacts, I think, duration of what we see from an overall cyclical impact.

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

And maybe the final point on that to support, Josh, is that actually in the month of April, we saw the industry actually peak in row crop tractors and we're proactively pulling back at the peak before the decline comes. So I think that's another indicator.

Josh Beal
Director, Investor Relations, Deere & Company
A

Mig, you had asked about Small Ag as well. I mean, just to maybe a couple points there. I don't have it for the whole segment, but if you kind of break down some of those subcomponents, small tractors, there's been high inventory, particularly in compact utility tractors. Pretty significant underproduction there. It's double-digits.

On sort of the mid tractor space, they're kind of in line with our comments around tractors, it's kind of a high single digit on the midsize. Thanks for the question, Mig.

Mircea Dobre
Analyst, Robert W. Baird & Co., Inc.
Q

Thank you.

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

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

Good morning. Thank you for the question. Mine will be somewhat of a follow-up to the last, which is, given the high level of underproduction in the back half of the year, and those mixed implications being more toward this high-value large form factors. I'm wondering if you could talk a little bit more about those offsets, what you've done already to help protect that decremental margin? Arguably, that should be actually significantly higher given the mix. So what actions you've taken already? And how to think about the cost benefits layering into the back half of the year that's offsetting that under production? Thank you.

Josh Beal
Director, Investor Relations, Deere & Company
A

Yeah. Thanks, Kristen. I'll start, and jump in as well here. I think a few things. I mean, certainly, I think as you think about 2024 and particularly, underproduction, primarily shifted towards the back half of the year, we have had some adjustments in rates and things. And we've talked about that in terms of some of the overhead inefficiencies that have come into the business as we made those changes. You're seeing that in production costs. That's a headwind there, that's offsetting the tailwinds that we see in material and freight. So that is having an impact on some of the changes. And certainly, that underproduction plays a part in terms of what we're seeing as far as decrementals.

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We're definitely taking cost steps. Our focus on taking material and freight out of the business continues, and we expect that to build in the back half. That is helping offset some of the decrementals as we pull down production in the latter part of the year.

Joshua Jepsen
Senior Vice President & Chief Financial Officer, Deere & Co.
A

Hey, Kristen, it's Jepsen. I would say definitely, we see the bigger impact in 4Q as seasonally you see higher level of retail, but then also we get into seasonal shutdowns and those sorts of things.

As we work through the back half of the year, we're resetting production rates, as Josh mentioned. We're also getting the cost structure aligned. So that will benefit us as we go forward. So the way we're exiting 2024, I would say, is not indicative of what we would expect 2025 to look like as we step into that year, regardless of where we see the end marks moving.

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

Yeah. One thing I would add, I mean, one of the additional points I'd make is we're actually preparing for probably the largest new product launch going into 2025, we ever have. So while we're pulling production down, we're also readying to launch some of the highest, most productive products we've ever had. So all new combines, all new four-wheel drive tractors, all of that's taking place and included in what we're doing to prepare in terms of the cost structure as we head into 2025 and bring the value proposition even higher for our customers going forward.

Josh Beal
Director, Investor Relations, Deere & Company
A

Yeah. I think just building on that too, Cory, excitingly, a lot of those new products are coming with great tech, harvest setting automation, predictive ground speed automation, ExactShot [indiscernible] (00:39:02). There's a lot of great solutions coming in 2025 as well. Thanks for the question, Kristen.

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

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc.
Q

Yeah, thanks for the question. Good morning, guys.

Josh Beal
Director, Investor Relations, Deere & Company
A

Hey, Nicole.

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc.
Q

Maybe just if you were willing to comment a bit on what you're seeing so far with the Crop Care Early Order Program, and I think that question may be quick. So I'm going to ask another [indiscernible] (00:39:30) question, I guess. And that's the C&F decrementals were a bit high this quarter, are you expecting that? It seems like in the guidance, it's also on decremental margins in C&F in the back half? Thank you.

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Josh Beal
Director, Investor Relations, Deere & Company

A

Yeah. You're right that the answer is quick on Crop Care Early Order Programs. So that sprayer order programs just opened up at the beginning of the month, so we're about, what, 1.5 weeks, 2 weeks in now to that. It's early, and that tends to build throughout the course of the program. So really not enough to comment at this point, just based on the very early stages of that program.

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

A

Hey, Nicole, this is Jepsen. And also on EOP, I think one thing important to note, we've seen, as we get into times of uncertainty, like order activity tends to probably push a little bit later through the phases of those programs, as customers/dealers exercise a little more optionality and want to have a little bit firmer view of how does planting season go and how is crop emerging, just another point of reference there.

Josh Beal
Director, Investor Relations, Deere & Company

A

Yeah. I think maybe shifting, Nicole, to your question on C&F decrementals for the quarter. I think the one thing to point out there is we did have lower price realization than originally anticipated. That was due to a discount accrual that we put on some field inventory that will affect really sales for the balance of the year. So it's a little bit of a timing around price realization. That's why you see us keeping that full year guide at 1.5 points. We don't expect that to continue. It's just really a timing of making that change. And back half should support that full year price of 1.5 points. Appreciate the questions.

Operator: Thank you. Our next question comes from Jairam Nathan with Daiwa. Your line is open.

Jairam Nathan
Analyst, Daiwa Capital Markets America, Inc.

Q

Hi. Thanks for your question. I just want to dig a little deeper on pricing, what are you seeing in that run across regions and segments. And just kind of what's a prime run on what we could be seeing next year on the pricing side?

Josh Beal
Director, Investor Relations, Deere & Company

A

Yeah. I mean, a bit early to talk about 2025 pricing. But I think as we talk 2024 and where it stands, and kind of do a walk around the world here, again, in Large Ag, we're talking about 1.5 points price realization for the year, as we kind of step through the different regions.

North America, I mean, we would say normal, price realization is in the range of 2% to 3%. We're actually in that range. In fact, on the top end of that, if not a little bit better there. So we've seen strong pricing and expect that to continue through the course of the year.

South America, we've talked, Brazil specifically, with the inventory that we built in 2023. We will have some negative price there this year, kind of in the mid-single digits. Candidly, as that sort of plays out through the course of the year, was higher on the front end, it starts to mitigate on the back end.

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And then Europe, very, very similar to North America. We're seeing pricing in kind of that normalized range of 2% to 3%. And we expect that really to continue through the course of the year.

Small Ag and Turf, very similar comments. I think in Construction and Forestry, again, we've seen certainly a more competitive environment there. We talked about the discounts that we accrued this year. But again, we're managing that balance and that dynamic, and then feel good about the 1.5 points price realization that we're going to maintain through the course of the year.

Jairam Nathan
Analyst, Daiwa Capital Markets America, Inc.

Q

Okay. Thanks.

Josh Beal
Director, Investor Relations, Deere & Company

A

Thanks for the question.

Jairam Nathan
Analyst, Daiwa Capital Markets America, Inc.

Q

Thanks.

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

Rob Wertheimer
Analyst, Melius Research LLC

Q

Yeah, hi. Thanks. My question is kind of a big picture one on PP&A (sic) [P&PA] in North America. And just how you think about the trade down cycle, your machines have gotten bigger, more capable, more productive, more expensive in some ways. And I'm curious if you see this as an unknown, whether they'll all find homes in second and third owners or whether you guys know the market better than anybody in the chain of buyers, or whether you see enough of the moderate-sized farms, the second buyers, to kind of absorb the equipment. Just how you think about that playing into the overall cycle? Thank you.

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

A

Yeah, Rob. This is Cory. I'll maybe take a first stab. Look, I'll use tractors as an example. One thing we watch very closely is used inventory on row crop tractors. We've seen late model used above 300-horsepower grow, and we've watched it closely. But if I can give you the example, if you went back to the previous peak, 14,000 unit industry back in 2014, it would have been about 14,000 units, but only 30% of that industry would have been above 300 horsepower.

If you fast forward today, to 2024, we're about 13,000 units above 220, and 70% of that is above 300, and that's being driven off of the structural improvement that our customers are making for how they plant predominantly.

So you think about the adoption of ExactEmerge, we're seeing ExactEmerge continue to drive forward. We're in the mid-80s, headed toward 90-plus-% electric drives on planters, high speed. That drives power requirements, the absorption of that at the top end of the market. We see those tractors being required throughout the market as all customers take on the ability to plant better.

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Take this year, we got less than 50% of the crop already planted. There's no better time, if you think about timeliness, then to be able to plant fast in an environment where you have a shortened window. So I think we're set really well. Obviously, the timing of year-over-year trade cycles, interest rates has people pause in an environment like we're in. But if you look at the age of the fleet and you look at where we're headed, we feel really confident that our solutions are set up to move through the market.

Combine that with performance upgrades and precision upgrades together with what we're doing with Precision Ag Essentials, and we'll be able to take most of the value we're creating out through the fleet into each of those customers. So we feel pretty good about that.

Joshua Jepsen
Senior Vice President & Chief Financial Officer, Deere & Co.
A

Yeah, Rob. The one thing I would add is I think the other – the piece that gives us confidence as well is no matter where the customer is in that ladder, whether they're the first owner or the fifth, there's a strong desire to keep upgrading technology, become more productive, more efficient and be able to execute those jobs in tighter timeframes.

As Cory mentioned, planting is a very tight timeframe. So that demand across, I think, continues to drive. And we're seeing this Precision Ag Essentials is a really good example where we're connecting machines. I think two-thirds or more of the machines that we've been putting those on have not had technology before. So we're bringing customers that haven't been using things like guidance or other tools into the fold and into the system. So I think that is important. And the other part is dealers work really hard. They know their customers really well. They know their AORs well, and they're working around how do they best spec those machines and how do they best get them into the right hands.

Josh Beal
Director, Investor Relations, Deere & Company
A

Thanks, Rob.

Rob Wertheimer
Analyst, Melius Research LLC
Q

Thank you.

Operator: Thank you. Our last question comes from Jerry Revich with Goldman Sachs. Your line is open.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC
Q

Yes, hi. I apologize for the sound issue earlier. I wanted to ask, you folks are hyper focused on used inventories, just normally. Based on the actions that you've taken, rising use of full funds to roughly $2 billion destock, what's your level of confidence that late model inventories will stop moving up from here? I appreciate that it's more of an art than a science, but would love to hear how you're modeling and thinking about it versus additional potential levers?

Josh Beal
Director, Investor Relations, Deere & Company
A

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Yeah. Thanks for the question, Jerry. Glad you made it back. I mean, I'll start and Cory, Josh, feel free to jump in. I think it starts with our proactive management on the new inventory side as well. I think our decision to underproduce watery row crop tractors in North America in 2024. And to bring those inventory to sales levels down as low as we're bringing them. And we're significantly below where we ended last year, it's really that opportunity, as Cory talked. And we feel pulled for the equipment. There's value there, but given where current environment is, given where rates are, it has slowed down, that equipment moving through the pipeline.

We don't want to build on that. We don't want to exacerbate that situation. And so we feel like it's prudent to bring the new inventory down to allow that focus and allow that time to work the use through. But again, as we just talked, there's definitely a pull for the value that it brings. And we certainly see it even this year with planting in the US with the delayed spring, with the wetness. I mean, the value to be able to get in quickly with high-speed planting is as important as ever, and that pull for that higher, more productive equipment is definitely there. I don't know, Cory, if there's anything you'd add?

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

A

No, I used the planting example earlier, but I think it also applies in spraying, and it applies in harvesting. In the end, those windows get tighter and the ability to both cover more ground more quickly at all levels and all customers, I think, helps us drive confidence. Together with the fleet age, it drives confidence that we will consume that product. And we've got tools in place to be able to do it. Obviously, it slows down when markets are uncertain and crops aren't in the ground. But if you look at the fleet age and you look at the technologies that are coming and you look at how customers are adopting those technologies trend-wise over time, we look at profitability coming down, but it's still solidly profitable in the business. We know that it pays to adopt these technologies, and we expect those used units to move into the market.

Josh Beal
Director, Investor Relations, Deere & Company

A

Thanks for the question, Jerry.

Josh Beal
Director, Investor Relations, Deere & Company

Appreciate all the questions today. I think we're at the end of the list here. That's all the time we have. We appreciate everyone's time. Thanks for joining us. We'll talk soon. Have a great day.

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

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