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Deere & Co. (DE)

Q4 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

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

Joshua Jepsen

Director-Investor Relations, Deere & Co.

Thanks, Robin. Hello. Also on the call today are Ryan Campbell, our CFO; Jahmy Hindman, our Chief Technology Officer; and Brent Norwood, Manager of Investor Communications.

Today, we'll take a closer look at Deere's fourth quarter earnings, then spend some time talking about our markets and our current outlook for fiscal 2021. 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 comments concerning the company's plans and projections for the future that are subject to important risks and uncertainties. Additional information concerning factors that could cause actual results to differ materially is contained in the company's most recent Form 8-K and periodic reports filed with the Securities and Exchange Commission.

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

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

Brent Norwood

Investor Relations, John Deere

John Deere demonstrated strong execution in the fourth quarter, resulting in a 12% margin for the Equipment Operations, and net income exceeding our full year forecast. Despite significant uncertainty early in the year for large ag markets, fundamentals improved throughout the fourth quarter, driving growth prospects for 2021. Meanwhile, markets for our Construction & Forestry division also improved in the fourth quarter, leading to a solid finish to the year and modest levels of recovery projected for fiscal year 2021.

Now, let's take a closer look at our year-end results for 2020, beginning on slide 3. For the full year, net sales and revenue were down 9% to $35.54 billion, while net sales for Equipment Operations were down 10% to $31.272

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billion. Net income attributable to Deere & Company was $2.751 billion or $8.69 per diluted share. Net income for the year was negatively affected by impairment charges, losses on business disposals, and employee-separation cost of $458 million after tax. For the same periods in 2019, the similar charges were $82 million.

Slide 4 shows the results for the fourth quarter. Net sales and revenue were down 2% to $9.731 billion, while net sales for the Equipment Operation were down 1% to $8.659 billion. Net income attributable to Deere & Company for the quarter was $757 million, or $2.39 per diluted share. Fourth quarter net income was negatively affected by impairment charges and employee-separation costs of $211 million after tax compared to $74 million for the same period in 2019.

Turning to a review of our individual businesses, starting with Agriculture & Turf on slide 5, net sales were up 8% compared to the fourth quarter last year, primarily due to price realization and higher shipment volumes, partially offset by the unfavorable effects of currency translation. Price realization in the quarter was positive by 5 points while currency translation was negative by 1 point. Operating profit was $860 million, resulting in a 13.9% operating margin for the division.

The year-over-year increase was driven by price realization and lower R&D expenses and reduced SG&A, improved shipment volumes and mix, and lower warranty expenses. The items were partially offset by impairments and employee-separation expenses, which totaled $164 million in the quarter. Please note that the $153 million shown on the waterfall is net of $11 million in separation costs from 2019. For the full year, the Ag & Turf division incurred $286 million in non-recurring charges, including employee-separation expenses, impairments and a loss on a sale.

Before reviewing our industry outlook, we'll first provide commentary on the regional dynamics impacting ag markets and Deere operations around the globe starting on slide 6. In the US, farmer sentiment showed improvement over the quarter as the combination of government support and improved commodity prices boosted farm income prospects for the year. Meanwhile, concerns over market access temporarily subsided with exports to China rebounding compared to last year.

Stocks to use and carryout estimates for corn and soybeans are now forecast at multi-year lows due to diminished production on account of some regionally dry weather and the derecho storm in August as well as increased export activity.

The improvement in fundamentals and farmer sentiment is reflected in the progress of our early order programs. At this time, we've concluded all three phases of our planter and sprayer programs, while our combine program recently finished phase two. Sales for planters are up 10% compared to last year with sprayers and combines up even further. Meanwhile, our large ag tractor order book has strengthened over the last quarter, with orders up nicely compared to the previous year. Lastly, retail activity picked up in the fourth quarter, leaving new and used inventory positions at multi-year lows.

Shifting to South America, record soybean production, higher commodity prices, and favorable exchange rates continue to drive positive producer margins in Brazil this year. As a result, activity accelerated in the fourth quarter and far exceeded our forecast, making a very strong finish to 2020.

For fiscal year 2021, the order book is quite strong, reflecting the positive fundamentals, with order coverage now extending well into the first half of the year. Similar to North America, the strong finish to the year in Brazil, depleted equipment inventory levels below historic averages, keeping momentum for new equipment demand healthy as we begin the year.

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In Europe, healthy prices for small grains such as wheat, have boosted sentiment for arable farmers and spurred demand in the back half of 2020. Overall, arable margins should see modest gains this year, though results vary throughout some regions experiencing lower production due to dry conditions. Meanwhile, dairy and livestock producers may experience some pressure in fiscal year 2021 from soft dairy margins and growing concerns with respect to African swine fever.

Importantly, Deere's operations in Europe have benefited from a more focused strategy and demonstrated an uptick in large ag market share as well as much improved profitability for the region. Looking ahead, the tractor order book is up relative to last year, providing solid visibility into 2021.

Turning to Asia Pacific, key markets like India and Australia rebounded nicely from the early pandemic lockdowns and are expected to resume growth in fiscal year 2021. Meanwhile, operations in other markets are benefiting from some of the disciplined portfolio actions we've taken to-date.

With that context, let's turn to our 2021 Ag & Turf industry outlook on slide 7. In the US and Canada, we expect Ag industry sales to be up between 5% to 10% for the year. The increase year-over-year reflects improved fundamentals in the ag sector as well as the historically low inventory levels at the start of the year.

Moving on to Europe, the industry outlook is forecast to be flat to up 5%, with strength in arable offsetting some weakness in dairy and livestock. In South America, we expect an industry sales increase of about 5%, with solid visibility into the first half of the year, especially in Brazil. Industry sales in Asia are forecast to be down slightly, though key markets for Deere are performing slightly better. Lastly, sales of turf and utility equipment are expected to be flat to up 5% following a solid year in 2020.

Moving on to our Ag & Turf forecast on slide 8, fiscal year 2021 sales of worldwide Ag & Turf equipment are forecast to be up between 10% and 15%. The incremental increase relative to the industry guidance reflects plans to recover inventory levels in small ag, which ended the year at historic lows for inventory-to-sales ratios.

The forecast also includes expectations of 3 points of positive price realization as well as a currency tailwind of about 1 point. For the division's operating margin, our full year forecast is ranged between 15.5% and 16.5%.

Now, let's focus on Construction & Forestry on slide 9. For the quarter, net sales of $2.461 billion were down 16% primarily due to lower shipment volumes, partially offset by price realization. Operating profit moved lower year-over-year to $196 million due to lower sales volumes and mix, impairments, and employee-separation expenses.

The decrease in profit was partially offset by price realization and lower R&D expenses and reduced SG&A, lower warranty expenses, and improved production costs. The total costs for impairments and employee-separation charges were $76 million for the quarter, while the full year costs were $184 million.

Let's turn to our 2021 Construction & Forestry industry outlook on slide 10. Construction equipment industry sales in the US and Canada are now forecast to be down about 5%, with continued uncertainty expected in the oil & gas and non-residential sectors. Meanwhile, compact construction equipment industry sales are expected to increase about 5% as the housing market fundamentals continue to be positive through 2021.

Moving on to global forestry, we now expect the industry to be flat to up 5% as the recovery in lumber demand, particularly in North America, should lead to increased production throughout the year.

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Moving to the C&F division outlook on slide 11, Deere's Construction & Forestry 2021 net sales are forecast to be up between 5% to 10% compared to last year. Our net sales guidance for the year includes expectations of about 1 point of positive price realization and a currency tailwind of about 1 point. We expect the division's operating margin to be ranged between 9% to 10% for the year, benefiting from price, volume, and non-reoccurring expenses from 2020.

Let's move now to our Financial Services operations on slide 12. Worldwide Financial Services net income attributable to Deere & Company in the fourth quarter was $186 million, benefiting from lower impairments and reduced losses on operating lease residual values and favorable financing spreads, partially offset by a higher provision for credit losses and employee separation expenses. For fiscal year 2021, the net income forecast is $630 million, which contemplates a tax rate between 24% to 26%. The provision for credit losses forecast for 2021 is 27 basis points.

Before moving on to the 2021 company outlook, I'd like to welcome our Chief Technology Officer, Jahmy Hindman, to the call. Jahmy recently assumed the CTO position and played a pivotal role in shaping our smart industrial strategy and vision for Deere's technology stack. Jahmy?

Jahmy J. Hindman

Chief Technology Officer, Deere & Company

Thanks, Brent. As noted, I recently assumed the newly created Chief Technology Officer position, and I spent the last few months finalizing our organizational design and refining our technology strategy to best enable the smart industrial operating model. I've been with Deere for over 20 years in a variety of engineering roles in both the Ag & Turf and Construction & Forestry divisions, and most recently led engineering for the global tractor product family.

Most simply put, the Chief Technology Office is responsible for delivering Deere's technology stack. Think of our tech stack as the full set of components required to deliver technology solutions to our customers. For nearly 25 years, Deere has invested in core technologies and capabilities that can be leveraged across the enterprise. These core competencies are primarily focused around machine guidance, digital connectivity, machine intelligence and, more recently, autonomy.

Historically, Deere operated within multiple, disparate business units that were spread out throughout the enterprise to pursue innovations in these core technologies. As part of our redesign, we've consolidated these units under the CTO organization. This drives a higher degree of focus and unlocks significant efficiencies for our R&D investments.

Our approach to precision technology, as shown on slide 13, is distinct within the industry as we've maintained end-to-end development responsibility for our tech stack, developing unique solutions from the embedded hardware and software in our equipment to the digital platforms our customers utilize. While we've pursued a vertically integrated path for our core capabilities, we have chosen to partner with others for non-core technologies, things like graphical processing units in cameras. Additionally, we've opened up our digital platform to include over 185 API partners.

Over time, our philosophy has remained consistent, as depicted on slide 14. We seek to develop or acquire core technologies that add value and are unique to the jobs that our customers do while outsourcing non-core technologies when partners can bring scale or offer faster speed to market. In any case, we maintain the development responsibility for the final solution to ensure seamless integration into our equipment.

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This approach has served us well, and it traces its genesis back to our acquisition of NavCom in 1999. At that time, we decided to own certain technology competencies starting with satellite guidance. The acquisition delivered a foundational element to our tech stack and it enabled us to lead the industry in innovation from the early days of AutoTrac to Turn Automation and now AutoPath, which is our latest solution for path planning.

Furthermore, by owning this technology, we've been able to scale guidance innovation throughout our entire large ag fleet. We've followed similar blueprints with other core technologies from our acquisition of Phoenix International in 1999 to the organic development of the John Deere Operations Center beginning in 2012. Our acquisition of Blue River Technology in 2017 reflects our view that machine learning and computer vision are essential competencies required for the next generation of machine intelligence and automation.

Similar to other core technologies, we see wide applicability of Blue River's competencies across our large ag product portfolio and also intend to leverage the vision systems for obstacle detection in our Construction & Forestry division. Essentially, this technology can be applied to optimize machine use and job outcomes anywhere a human operator controls or adjusts machine settings.

Ultimately, we believe that a complete tech stack delivers the most value for our customers when it's paired with the underlying equipment and a dealer network that can support it. This seamless integration is key to achieving the highest levels of productivity and sustainability and is a requirement for innovations like plant-level management and autonomy.

Furthermore, our comprehensive system delivers the ability for equipment to become smarter throughout the course of a production system. While many industry players offer point solutions for a given technology or a specific production step, we offer customers a system advantage where the combined equipment and the information from the technology stack passes insights to each proceeding and subsequent step in the production system.

For example, our sprayers leverage the guidance lines from planting for more efficiency and accuracy resulting in less crop damage, while our tillage operations are informed by the previous year's harvest data.

Slide 15 highlights the comprehensive systems we are building. The first component of our precision ag system is the most important and can't be overlooked. Our precision ag strategy begins with the underlying equipment that executes the job in the field. While our industry is attracting new players from non-traditional disciplines such as software or robotics, these technologies must ultimately be paired with ag equipment to accomplish the tasks in the field.

As a result, Deere's primary advantage comes from a product offering that spans each step in the production system paired with the industry's largest installed base and coupled with complementary technology applied to each product within that production system.

The last component required to deliver precision solutions is a dealer network that can sell, service, and support the latest technologies. Increasingly, the last mile is becoming one of the most critical enablers for precision adoption, and our channel has been leading the industry in terms of modernizing their capabilities and their staff.

In short, our precision strategy is very much a system of ag equipment combined with core technologies and a dealer support network working in concert together to make farming more productive and more sustainable.

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While we are immensely proud of the success we've achieved so far, we are even more enthusiastic about the runway of opportunity that's ahead of us. Throughout our precision journey, we've experienced several inflection points where technology advancements unlock new possibilities and extend our runway beyond our prior ambitions. Innovations and connectivity, advanced onboard computing, and artificial intelligence have reset the realm of possibilities.

Today, we see many years of runway for each of our existing core technologies individually. Furthermore, the opportunity set extends much further as we begin stacking these core capabilities to create new functionality in our future product roadmaps. Over the course of the year, we look forward to providing further details regarding the opportunity set in front of us and will also provide further color on some of the exciting product releases coming to market in the near term.

Before turning the call back over, I'd like to offer a few comments on the acquisition of Harvest Profit, a software platform that's focused on farmer profitability. We are striving to make our customers the most profitable and sustainable in their industry. We can't accomplish that without being able to help customers measure profitability. Harvest Profit gives us a significant boost in ensuring we help customers make more profitable and sustainable decisions in the years to come.

Additionally, with the precision ag opportunity set growing substantially over the next decade, we see significant value in our ability to ascribe value of our precision tools to our customers. And this acquisition provides us a path to attribute that value, thus furthering the adoption of technology.

At this time, I'll turn the call over to Ryan Campbell for year-end guidance and closing thoughts. Ryan?

Ryan D. Campbell

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

Thanks, Jahmy. Slide 16 outlines our guidance for net income, our effective tax rate, and operating cash flow. For fiscal year 2021, our full year outlook for net income is forecast to be between $3.6 billion to $4 billion. It's important to note that constraints in the supply base and labor force availability due to COVID-19 remain key risks to our fiscal year 2021 guide. The guidance incorporates an effective tax rate projected to be 26% to 28%.

Lastly, cash flow from the Equipment Operations is expected to be in the range of $3.8 billion to $4.2 billion and contemplates a $700 million voluntary contribution to our OPEB plan.

Before we respond to your questions, I'd like to offer some perspective on 2020, the prospects ahead of us, and a few thoughts on our portfolio and capital allocation strategy.

As we look back on 2020, it's important to acknowledge the exceptional efforts taken by our employees, suppliers, and dealer channel this year. Employees across our company logged extra hours and adapted to an ever-changing environment to create safe working conditions and ensure the supply of parts and equipment to our customers so that they could continue their essential work.

Similarly, our dealers quickly adjusted to the pandemic and played a critical role keeping our customers' businesses operating. This year served as a reminder of just how impressive our dealer group is, and we are grateful for the tremendous performance they put forth. And as a result of the effort put forth by employees, suppliers, and dealers, we posted one of the strongest fourth quarter performances in company history.

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Excluding costs associated with employee separations and impairments, our Construction & Forestry division achieved 11% margins, the highest fourth quarter since 2014. Similarly, Ag & Turf fourth quarter margins, excluding special items, were approximately 16.5%, which is the highest fourth quarter in the division's history, eclipsing results from 2013 despite around $1 billion less in net sales.

While encouraged by our recent results, we are even more excited by the opportunity ahead of us. In the midst of addressing a global pandemic, we also instituted a new strategy for the company over the year. In doing so, we accomplished three primary objectives. One, we've reorganized the company around production systems to mirror the way our customers do business. Two, we've taken significant strides towards optimizing our cost structure. And three, we've adapted our investment priorities to ensure a greater degree of focus on the products and solutions that are most differentiated and unlock the highest value to our customers.

A more focused R&D investment strategy is essential to realizing the value of the technology stack that Jahmy just described. While we spent decades investing in the core competencies to comprise our current technology stack, we see significant runway ahead to build on what we have done and advance technology for our next generation of solutions. And our new strategy plays a vital role in unlocking the necessary capital to achieve the potential we believe is possible.

2020 has been a year of change at Deere, and that has included some activity with respect to our portfolio. In some cases, we've made decisions to exit businesses or reduce footprint to serve markets more efficiently, while in other areas, we've added to our capabilities such as our recent purchases of Unimil and Harvest Profit. As we contemplate 2021, we expect to continue our portfolio evaluation, which may result in additional activity throughout the duration of the year. As such, we intend to provide regular updates on subsequent earnings calls as we take actions in this area.

Now, while we've made efforts to better focus the internal investments we are making, please know that our overall priorities related to our cash resources remain the same. We remain committed to our A-rating and will continue to fund our operations at levels that support our strategic initiatives. Next, we'll pay a dividend within our targeted income range. And with other priorities secured, we will return capital through our share repurchase program. We resumed the program in the fourth quarter and will continue to execute on our capital priorities in 2021.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

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

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question is from Jerry Revich with Goldman Sachs.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Yes, hi. Good morning, and happy Thanksgiving, everyone.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Hey, Jerry.

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

A

Hey, Jerry.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

I'm wondering if you can talk about Ag & Turf incremental margins from here. Obviously, you got to really strong margins much earlier in the cycle than most of us expected. How should we think about operating leverage from here assuming we do get a multi-year Ag & Turf recovery? Can you still, off of these higher-levels, deliver 30%-plus incremental margins as we think about what a multi-year recovery could look like?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, thanks, Jerry. As it relates to the margins and thinking about this next year, 2021, 15.5% to 16.5% absolute margins, we do expect that we can do the roughly 30% to 35% from an incremental basis in kind of the underlying operations. I mean, I think when you think about this this year, a few things to consider as far as potential – or not potential, headwinds in the forecast would be incentive comp has moved up and is a bit higher in 2021 from a company-wide perspective, that's about $160 million headwind. And then we are seeing a little bit higher overhead costs. Some of that's related to volume, but certainly still have some of that related to just overall caution as it relates to COVID and the impacts as we're seeing spread and contagion in a lot of our key geographies.

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

A

Yeah, Jerry, it's Ryan. I think the way to think about it, we structurally improved the profitability of the Equipment Operations, including Ag & Turf, but we intend, over the long run, to still operate with that flexibility that gives us the ability to perform on an incremental basis in the 30% to 35% range.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Thanks.

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Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Thanks, Jerry.

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

Jamie Cook
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. Good morning. Happy Thanksgiving, and nice quarter. I guess, my question, if we just – if you assume the high end of your guide on the sales and on the margin front, it implies your margins are already almost hitting the 15% mid-cycle margin target that you guys have laid out. So, I'm just – what's embedded in your view of the cycle in your 2021 guidance? And I guess the longer-term question is are we further along than we thought we would be? Do we need to revisit that target? I'm just wondering if the market underappreciates the margin story for Deere longer-term. Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

If you think about where we're at in the cycle, Ag & Turf, this year, we're projecting to be pretty close to mid-cycle. That said, mix is still not normal. We think large ag in North America is around 90% of mid-cycle, small ag overall a little bit above mid-cycle, so relatively close but not there.

That's, I think what we've seen is significant progress on the margin front. And as Ryan mentioned, we feel like we've structurally improved our ability to perform and execute and drive that margin level. So, we're continuing to work on that. And as implied with our guidance, this next year, expect being above that 15% target for Ag & Turf in 2021.

Jamie Cook
Analyst, Credit Suisse Securities (USA) LLC

Q

But in total for the company, is the 15% too low now, I guess I'm asking? Because we're getting there on a combined basis and we're not even at mid-cycle.

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

A

Yeah, Jamie, the goal was for 2022 kind of at mid-cycle. We'll continue to execute and deliver on that. And then 2022, we'll take a step back and reflect on what we want to drive into the future, particularly focusing on making the investments that really can change the game for our customers and create value for them. So, hang with us and wait until we execute and deliver in 2022, but we've got a long runway of things that we can do to make our customers better.

Jamie Cook
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Thank you. Have a great Thanksgiving.

Operator: And thank you. Our next question is Steven Fisher with UBS.

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Steven Fisher
Analyst, UBS Securities LLC

Q

Thanks. Good morning. I'm just curious to ask you about how you're factoring in raw materials costs for fiscal 2021. We're seeing some steel price increases, but I notice your COGS percent assumed is lower in the forecast, so just curious what you kind of – how you've thought about that in front half versus back half. Thanks.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Steve, when we look at material, we've had a tailwind in 2020 from a material point of view, in particular, on steel. That's after we saw increases in 2018 and into 2019, so it has been favorable at this point.

As we look forward into 2021, our contracts, we tend to cover a quarter, a little bit more in terms of the lag time between price movements and when we see those come through, so we have some coverage there. So, to your point, to the extent you see some of that inflation, probably more impactful later in the year.

That said, as we kind of step back and look at material overall, are seeing some of those trends in terms of prices moving up, but we're also pretty confident in some cost reduction projects and things we have going on that we think about material kind of coming in relatively stable year-over-year. Thanks, Steve.

Steven Fisher
Analyst, UBS Securities LLC

Q

Happy Thanksgiving.

Operator: Thank you. Our next question is from Stephen Volkmann with Jefferies. Your line is open.

Stephen Edward Volkmann
Analyst, Jefferies LLC

Q

Hi. Good morning, everybody. I'm wondering if we can spend a moment on the pricing question. You guys obviously had very good pricing especially in A&T in the fourth quarter, and I guess, the outlook is pretty good as well. Can you just kind of describe what you're seeing there and why it's as positive as it is?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Pricing, Steve, you're right, was better than expected in the fourth quarter. I think maybe backing up, what hasn't changed is our philosophy on pricing, continuing to focus on value and the upside that we can create for our customers. I think when you look specifically at what we saw in the fourth quarter for Ag & Turf, there were a few things that drove that level of pricing.

One, and we noted, Brent kind of mentioned this in his comments, we had tighter inventory positions kind of across most of our geographies and models, in particular, on small tractors and turf, that drove less spend as a result of tighter levels of inventory. That's one component.

The other piece, and we talked a little bit about this last quarter, we saw more of it this quarter, was the cost for low rate programs, so buying down interest rates to offer low rate programs to our customers, which are pretty prevalent in small tractors and turf. That cost was lower as a result of just lower interest rates in the market. So, that was impactful.

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And then, lastly, we saw pricing overseas – we had continued strength in a number of overseas markets that benefited price in the quarter. So, that – we ended the year strong, obviously, and are forecasting about 3 points next year, so continue to manage that.

I think part of that too, you think about as we go into the year with tighter inventories, we think that lends itself to a little bit lighter incentive spending as we work to recover some of that inventory in 2021. Thanks, Steve.

Stephen Edward Volkmann
Analyst, Jefferies LLC

Q

Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Go ahead and jump to our next question.

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

Ann Duignan
Analyst, JPMorgan Securities

Q

Hi. Good morning. It's Ann Duignan.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Hi, Ann.

Ann Duignan
Analyst, JPMorgan Securities

Q

Hi. I just wanted to ask you about your comment that you're only at about 90% of mid-cycle in large ag going into fiscal 2021. That seems a little inconceivable to me given that farmers are sitting there with $50 billion in excess government payments this year on top of $24 billion that they received last year. And so, the notion that if they're not spending now given the fundamentals and given the extra money they have, and with government payments expected to revert to normal going forward, why wouldn't 2021 represent the new peak, not 90% of normal?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, so maybe as we think about that – I mean, maybe a little bit of a journey. Last year, 2020, we were around 80% of mid-cycle for large ag in North America, so we're seeing that step up to about 90%, so we are seeing that.

Maybe taking a few of those pieces of your comments there as it relates to what's going on, government support obviously has been very strong. I think from a customer perspective, the preference would be access to markets over aid. And I think that's underlying and as we've seen some of the export markets open up, I think you're seeing more sentiment improve. But the aid has, in large part, in our view, been used to pay down debt and really manage and shore our balance sheets. So, I think that's been a positive. And underlying that also, you're seeing strong land values in the Midwest, seeing some upward movement in land values, so I think underpinning there a really strong balance sheet for farmers, particularly as we exit the year.

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Fundamentals have moved and they've moved really over the last six weeks, so it's been pretty recent on the back of kind of revisions down of ending inventories of commodities, China purchases, and then obviously, the aid that you mentioned, like, all of those, we've seen impact sentiment, so those things have been positive.

So, I think as it relates to looking forward, we don't expect aid to recur, but we do believe higher commodity prices are going to benefit cash receipts as we go forward, so we don't expect a huge downward movement in cash receipts for principal crops in 2021.

Saying all of that, I think we step back and say we are seeing demand pick up. We're seeing that in early order programs and the large tractor order book that Brent mentioned. So, I think we're really kind of at an inflection point right now where we're seeing demand move. So, I think, yeah, we would say there's still a long runway of replacement demand as you look at the age of the fleet and those sorts of things, so we think we're a ways off mid-cycle let alone peak. Thanks, Ann.

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

Operator: And thank you. Our next question is from Robert Wertheimer with Melius Research.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Hey, good morning, everyone, and thanks. Just, I mean, obviously, you've had a very dynamic year with a lot going on. I wonder if you have any updated thoughts on either the buckets of margin as you think the end of the year structural goal and there's a mention you're pretty far advanced on that path. And maybe if not that, I mean, do you see the same sort of long-term potential rising up in Construction margins? There's a little bit less strength there, I guess, versus Ag and then just maybe a little bit less potential on the tech side, I'm not sure. So, just your thoughts on margin buckets and/or Construction structural margin. Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, Rob, I think overall, bucket-wise, not a lot of change as we think about the path to 15%. Certainly cost, we've done a lot of work on the cost side as it relates to structure as well as we've begun work on footprint and those sorts of things, so I think that we feel good about the progress there.

Aftermarket continues to be something we're focused on. That's not something that changes immediately, but we like the organizational structure and the priorities that we've laid out there for the team and making good initial progress. And then precision ag, as Jahmy outlined, continues to be an opportunity for us and I think, as we continue to develop technologies, I think we see more and more opportunity to leverage, and that's really where Jahmy's new org steps in.

As it relates to construction, certainly, I think continuing to operate efficiently there. We've tried to be really disciplined on price, and you've seen that over the course of 2020, which has aided margins. The roadbuilding side of the business, we think is going to be a substantial contributor as we think about the overall delivering 15% margin. And this year, the roadbuilding side worked through a really choppy year and performed very, very well and proved out part of the hypothesis there that they're going to be less cyclical, and that was certainly the case. They ended the year down about 8% compared to construction, which was down much more significantly.

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And maybe the last thing, on the construction side, where we do think we have an opportunity to drive margin and differentiation is on technology. So maybe I'll ask Jahmy to talk a little bit about how we think we can leverage technology in C&F and roadbuilding.

Jahmy J. Hindman
Chief Technology Officer, Deere & Company

A

Yeah, thanks, Rob, for the question. I do think if you look at precision generally, right, many of the technologies that we're developing on the ag side have applicability at the component level within our construction and roadbuilding products as well. And the benefits of precision extend to that business also, this need to be more precise with equipment, reduce the amount of time the equipment spends on a job site to do the job, those sorts of things all factor into our ability to take technology that we're developing within the enterprise and apply it to the construction and roadbuilding products as well.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Okay. Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

All right. Thanks, Rob.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Thanks, guys.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

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

Operator: And thank you. Our next question is from Chad Dillard with Bernstein. Your line is open.

Chad Dillard
Analyst, AB Bernstein

Q

Hi. Good morning, everyone.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Hi, Chad.

Chad Dillard
Analyst, AB Bernstein

Q

Can you talk about your precision ag take rates and early order program, how are the rates for ExactEmerge and Apply, how they compare versus last year? And have you started to offer see and spray as a part of their early order program and if you could give some color on take rates there?

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And then just lastly, just maybe you could talk about the roadmap for precision ag beyond corn and soybean ecosystem, and will it require new technology beyond the current offering? Just that. Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, I'll start there. I mean, from an early order program, we saw take rates kind of in line with what we talked about a quarter ago. So, in the low 40s on ExactEmerge, high 40s, near 50% on ExactApply, and then Combine Advisor actually in the 70s. So, those specific solutions now, we've got a few years under our belt. We're seeing continued strong adoption there, which has been positive. And I think just clearly demonstrating the value of what those can do when you think about executing the job, those customers are performing.

Maybe from a see and spray perspective, Jahmy, do you want to talk a little bit just about what we're seeing from a technology perspective having it out in the field?

Jahmy J. Hindman
Chief Technology Officer, Deere & Company

A

Yeah, so we've had machines with customers over the last – prototype machines over the last 12 months, and especially this summer learned a lot. We will have machines with customers next summer as well, and the feedback has largely been outstanding, right? People gravitate to the value proposition. They get it, they understand it, and it's easily demonstrable.

I'll maybe take this a different direction past see and spray and just talk maybe about the question on how applicable is technology outside of corn and soy from a production system perspective.

I'll tell you what we're really doing is we're giving machines vision and intelligence, right? And that extends well past this – it's got sort of a multi-dimensional runway. It extends well past corn and soy into other ag production systems. It also extends past the ag production systems into several of our Construction & Forestry and roadbuilding segments. And so, there's a lot of opportunity out there just with making machines more capable from a vision and intelligence perspective, and then there's another dimension of that that's the data thread that that creates that links all of these steps within a production system together. So, really exciting stuff to come and definitely applicable outside of corn and soy.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

And maybe one last thing to add on to that, Chad, is we're also seeing the opportunity on geographic growth from a precision ag perspective. We've seen really strong upward movement in engaged acres globally, but in particular, in South America and in Europe. So, as we think about you got this opportunity on a geographic basis across Ag & Turf and C&F and then essentially every job that customers are doing.

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

Operator: Thank you. Our next question is Joel Tiss with BMO.

Joel Tiss
Analyst, BMO Capital Markets Corp.

Q

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Hey, guys. I just wondered if you can talk a little more deeply about C&F from like a structural standpoint and the ability to get to 15% operating margins? And maybe also just the touching on the ability to get paid for putting precision software into the machines. Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, I think on the margin side, we're seeing – we've seen I think the division perform pretty resiliently through a year in which sales were down pretty significantly. And we – North American construction equipment, we took out about 30% of field inventory, so pretty significant action this year to put us in position to build in line with retail next year. So, I think the actions we're taking overall as a company as it relates to cost structure are beneficial here. Jahmy's organization from a CTO perspective, pulling the technology together to be able to leverage across, we think that's a big opportunity, and that – and he just mentioned a few examples of where we think we can do that.

The roadbuilding side continues to be one where we see the opportunity to continue to grow there and grow margin as we execute both integration plans and everything else there. So, I think we feel like we've got a runway there to improve and continuing to focus on markets and products where we can differentiate to deliver margin performance.

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

Operator: Thank you. Our next question is from David Raso with Evercore.

David Raso
Analyst, Evercore ISI

Q

Good morning. With the A&T sales midpoint guide, the 12.5%, but 4% of that you note is price and currency, that's only about obviously 8.5% implied volume, so if my math is right, the way you destock small ag this year, I mean, in 2020, the small ag business alone just returning back in line with retail with their production almost accounts for almost all that 8.5% volume growth. So, I just want to make sure, if those numbers are correct, are you indeed implying large ag sales in 2021 are really not growing much at all? And if so, given the order book commentary, the inventory commentary, why is that?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, so, when you think about the kind of the sales and linking that up with the outlooks, I mean, the biggest components of that are from a large ag perspective in North America, we expect to build in line with retail. Small ag roughly we expect to be flat in North America. To your point, we will produce above retail on small tractors, and we expect to build some inventory, we're coming off historic lows. Last year, I think we ended at 55% inventory to sales. This year we ended at 20%. So, we will see some recovery there. But again, we expect that market to be relatively flat, but we will build some inventory there.

In South America, Brazil in particular, we will probably recover. We expect to recover a little bit of inventory that got depleted in 4Q as the market turned pretty strongly in the fourth quarter. So, you're right. I mean, I think when you combine price and FX with kind of North America being up some, South America being up some, and then over-production to recover, replenish inventory on small tractors, that's kind of the math to get to those numbers.

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David Raso
Analyst, Evercore ISI

Q

But a clarification, you said large ag in North America in line with retail. Is that not up in an up retail forecast? Meaning, did you not destock at all in 2020 to where you'll actually produce lower than retail is up? Again, I don't understand the flat coming off a year of some destock and you think retail is up.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, we produced in line with retail and large ag in 2020 and we intend to do the same in 2021.

David Raso
Analyst, Evercore ISI

Q

So up a little bit, okay. Okay, thanks.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

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

Operator: Thank you. Next question is from Nicole DeBlase with Deutsche Bank.

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah, thanks. Good morning, guys.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Hi, Nicole.

Nicole DeBlase
Analyst, Deutsche Bank Securities, Inc.

Q

Hey, there. Just wanted to make sure you could hear me. So, I guess, maybe looking at the October retail sales trends, I think in all the categories, ex-four-wheel-drive tractors, it looks like Deere came in a bit below the industry. Could you just maybe explain a bit about what's going on there?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, I think a few things in play there. I think, given our order fulfillment model, focus on inventory management, and obviously some of this demand is lumpy throughout the year. We will, at times, lose a little bit of short-term market share at inflection points, and I think that's some of what we saw this year particularly as we got towards the end of the year, where we were tighter on inventory. And as we work through 2020 with the uncertainty kind of broad ranged across agriculture and even on the small tractor and turf side, we were tried to pretty diligently manage those inventories and we were lighter at the end of the year when we saw the inflection.

Historically what we've seen is we've been able to recover that as we build that back up, so I think that's our expectation that you see us recover that as we go forward.

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

A

Yeah, it's Ryan. As Josh said, sometimes an inflection point, given our order fulfillment strategy, we may, on the margin, miss a few tractor or combine shares, but history would tell us that we recover that back very quickly. And over the long run, we're heads down focused on creating sustainable market share growth through creating differentiated value for our customers, so that's really what we're focused on.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

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

Operator: Thank you. Our next question is Larry De Maria with William Blair.

Lawrence T. De Maria
Analyst, William Blair & Co. LLC

Q

Thanks. Good morning, everybody. Appreciate the tech stack discussion. We don't see on there as obviously Deere-prescribed agronomy, but obviously agronomy is embedded everywhere, but now that you bought a software company and you're developing and have bought some AI capabilities, it seems logical from the roadmap that maybe you being in a position to recommend seed since you have the data and you're getting down to the individual plant level. So, I'm just kind of curious as this roadmap plays out, can you get into the prescription seed recommendation game, because it seems like it's going that way? Or alternatively, maybe it's more about making sure you can attribute value to Deere so you can attain greater pricing and greater wallet share from customers. So, just trying to think and see how this plays out over the next few years and as you maybe come into more conflict with seed companies.

Jahmy J. Hindman
Chief Technology Officer, Deere & Company

A

Yeah, thanks for the question, I'll take it. I think the way to think about that right now is we're really focused on creating the data and collecting the data that any individual grower needs in order to make decisions exactly like the one that you're talking about, what seed hybrid they might plant in any given year.

And at some point in the future, I think we'll have the growers have enough information because of the data they've collected over the previous production system steps over the previous years to optimize that seed choice, but in the end, that's their choice to make. They have a responsibility or they have a relationship with their trusted advisors whoever that might be in their agronomic community, and they're the ones that are going to end up making that decision as they see it as best for their farm in any given year, given their operations.

Lawrence T. De Maria
Analyst, William Blair & Co. LLC

Q

Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Thanks, Larry.

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Lawrence T. De Maria
Analyst, William Blair & Co. LLC

Q

Okay.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

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

Operator: Thank you. Our next question is Adam Uhlman with Cleveland Research.

Adam Uhlman
Analyst, Cleveland Research Co. LLC

Q

Hi, guys. Good morning. Congrats on the quarter. Ryan, I was wondering if you could provide us a little bit more color on the guidance for the year in terms of how you see that cadence playing out maybe first half to second half in terms of sales and margin, any important moving pieces that we should keep in mind? And then can you confirm if there's any material restructuring charges left in the guidance for this year? Thanks.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Hey, Adam, it's Josh. I'll start. I mean, as you think about kind of cadence of the year, I don't think we expect to see much abnormal from a seasonality perspective. So I think we'd expect both divisions to kind of play out relatively normally, nothing major kind of that would disrupt that.

I think as it relates to one-time charges, those sorts of things, the – on the employee-separation actions, we don't have – expect anything in 2021 in the guide. We've got that all in 2020. To the extent we continue to work on portfolio optimization, those sorts of things, we could see charges there, but as we would execute on those, we will provide updates then.

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

A

Yeah, as Josh said, nothing unique in next year's cadence and then we don't have forecasted charges in the guide for next year. We are still assessing kind of operations and footprint globally. As we make those decisions, we'll obviously identify any costs associated with those during our quarterly calls.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

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

Operator: Mig Dobre with Baird, your line is open.

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

Q

Thank you. Good morning, everyone. I wanted to go back to Construction & Forestry, the margin discussion there, and recognizing that you had a lot of sort of discrete costs that impacted you in fiscal 2020 that now are clearly going away, it seems if I'm doing the math right here that the incremental margin that you're guiding to is

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somewhere in the low 20s, low to mid-20s here. So, I guess, my question is this. First, where are we in terms of Wirtgen or roadbuilding's margin and is the path to 13%, 14% operating margin for that business still there? And how do you see that? And sort of what's being embedded here in terms of incremental margin longer term?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, I think when – for incrementals on the business in 2021, we're in that range of 20% to 25%, which is traditionally where we'd expect to be. As you think about roadbuilding, we had a really, really strong quarter in roadbuilding in 4Q, and as we look forward, we think that continues to improve, even ex-items where we were this year, we expect next year with top line moving up, call it, roughly 10%, we think that margin steps up again. So, I think we feel really good about the performance there.

And maybe just to reiterate a comment I made earlier, as we think about the 15% and how do we get there, we think the roadbuilding piece is a substantial contributor to that margin story as we go forward.

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

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

Courtney Yakavonis
Analyst, Morgan Stanley & Co. LLC

Q

Hi. Good morning, guys. Just wondering maybe following on the roadbuilding discussion, I think, on C&F, you gave us an outlook for North America construction and compact and forestry, but can you maybe just share with us what your thoughts on the outlook for roadbuilding was? And was there substantial underproduction? How did those inventory levels kind of finish this year and what we should be thinking for next year and also as it relates to North America versus China?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, so, we expect – it's a little bit hard on the industry, so we tend to talk about roadbuilding more just on what we expect from our business there and from a – we think that's up about 10% next year after being down about 8% in 2020, so seeing some nice recovery there in that business.

Inventory-wise, I think we feel like we're in good shape. I think over the course of 2019 and a little bit of 2020, we took some more targeted actions on some of the different brands to adjust inventory as we integrated order fulfillment philosophies. But now I feel like – we feel like going into 2021, we're in good shape across those brands. Thanks, Courtney.

Operator: Our next question is from Ross Gilardi with Bank of America.

Ross Gilardi
Analyst, Bank of America

Q

Thanks, guys. Good morning. Can you clarify that the 90% of mid-cycle for large ag is projected 2021 where you'll finish, or was that actual 2020?

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And then historically, how far above are you mid-cycle at the peak for Ag & Turf? I mean, some of the concern out there seems to be that 2021 is somehow peak in Ag & Turf, which seems very hard to contemplate when revenue growth hasn't even turned positive yet, and you only have 2021 Ag & Turf up 10% to 15%.

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

Yeah, so the 90% is our forecast as we stand now for 2021, so we think we've moved from basically, call it, 80% to 90% as we look forward. Now, I mean, importantly, we've really seen kind of activity turn in the last four to six weeks. So obviously we've had early order programs going, but as you think about kind of underlying fundamentals for farmers, things have improved from a commodity price perspective, lower stock levels, that's all really happened very, very recently. So, I think I wouldn't overly interpret what's happened in four weeks and that that's everything that's possible there.

So, we're still managing it, working through with our dealers and customers where we're at. We feel like we're pretty well positioned having managed new inventories tightly. Maybe more importantly, used is in really good shape, used inventory levels are down in places we haven't been since, call it, before 2014. Used prices on the large ag side are seeing upward pressure. So, I think the backdrop and all those things that we've thought would drive replacement demand and support replacement demand that have been stalled over the last year or two, we've seen some of those things turn and be more favorable for farmers. So...

Ross Gilardi
Analyst, Bank of America
Q

And, Josh, just to...

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

Thanks, Ross.

Ross Gilardi
Analyst, Bank of America
Q

...on that, wouldn't your normal peak be 20% to 25% above mid-cycle for Ag & Turf? I mean, if that's the case, historically, the trough-to-peak move would be something like a 30%-type number, not a 10% to 15% number, that's what I'm just – what I was trying to clarify in my question.

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

Yeah, sorry, I forgot that part of your question. Yeah, we would consider 120%, 20% above as peak, and that's as we plan. And certainly if you go back to 2013, large ag in North America was 130%, so that was – so we've been much higher and higher than even 120%, but that's the way we plan. So, thanks, Ross.

We'll go ahead and try to get one more question.

Operator: Thank you. Our next question is from Seth Weber, RBC Capital Markets.

Seth Weber
Analyst, RBC Capital Markets LLC
Q

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Great, guys. Thanks, and good morning. Happy Thanksgiving. Just a question on your – the South American industry Ag outlook, up 5% seems kind of conservative. It sounds like you're messaging that your order book is up materially here at the end of the year. So, can you just frame that? Are you expecting something to really sort of drop off in the back half of the year in South America? Is it just some uncertainty around financing programs, or any color you'd talk to as to the 5% growth for South America. Thanks.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, so, I mean, yeah, up 5% for all South America, I mean, I think your question may be a little more targeted on Brazil specifically. Fundamentals have been really strong. We saw fourth quarter demand was, from a retail perspective, was strong and strong enough that you actually saw the year swing from kind of a negative industry to positive, so that's moved quickly.

Brent mentioned our order books were ordered out there through March. One thing that does – when you think about the comparison then, the strong fourth quarter is now in our comp, so we'll anniversary that strong industry in 2021. So, I think that's part of it. But I think overall, we're seeing the dynamics there have been favorable and maybe a little bit of caution as it relates to China buying more grains from the US and what exactly does that mean for them but overall, I think very, very positive outlook on Brazil.

Thanks, Seth.

Seth Weber
Analyst, RBC Capital Markets LLC

Q

Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

Well, with that, I think we're at the top of the hour, so we'll wrap it up. But appreciate all the interest. Hope everyone has a good Thanksgiving, and we'll talk soon. Thank you.

Operator: And thank you. This does conclude today's conference call. You may disconnect your lines, and thank you for your participation.

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