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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to Deere & Company’s 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 like to turn the call over to Mr. Josh Jepsen, Director of Investor Relations. Thank you. You may begin.

Joshua Jepsen
Director-Investor Relations, Deere & Co.
Hello. Good morning. Also on the call today are Ryan Campbell, our Chief Financial Officer; Cory Reed, President of Production and Precision Ag; and Brent Norwood, Manager, Investor Communications.

Today, we’ll take a closer look at the second 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.

First a reminder, this call is being broadcast live on the Internet and recorded for future transmission and use by Deere & Company. Any other use, recording or transmission of any portion of this copyrighted broadcast without the expressed written consent of Deere is strictly prohibited. Participants in the call, including the Q&A session, agree that their likeness and remarks and all media may be stored and used as part of the earnings call.

This call includes forward-looking comments concerning the company’s plans and projections for the future that are subject to important risks and uncertainties. Additional information concerning factors that could cause actual results to differ materially is contained in the company's most recent Form 8-K and periodic reports filed with the Securities and Exchange Commission.

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

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

Brent Norwood
Investor Relations, John Deere
John Deere demonstrated strong execution in the second quarter, resulting in a 19.5% margin for the Equipment Operations. Ag fundamentals improved significantly throughout the first half of the year, and the improved sentiment is reflected in the most recent status of our order books, which extend through the rest of the year, and in some cases, into fiscal year 2022.

Meanwhile, markets for our Construction and Forestry segment also strengthened in the second quarter, leading to improved levels of profitability and a heightened outlook for the rest of the year.

Slide 3 shows the results for the second quarter. Net sales and revenue were up 30% to $12.058 billion, while net sales for the Equipment Operations were up 34% to nearly $11 billion. Net income attributable to Deere & Company was $1.790 billion, or $5.68 per diluted share.
At this time, I’d like to welcome to the call, Cory Reed, President of Production and Precision Ag, for a discussion of the segment results and an update on the global ag environment. Cory?

Cory J. Reed  
President-Agriculture & Turf Division: Large & Precision Agriculture, Americas and Australia, Deere & Co.

Thanks, Brent. Let's start with second quarter results for Production and Precision Ag on slide 4. Net sales of $4.529 billion were up 35% compared to the second quarter last year, primarily due to higher shipment volumes and price realization. Price realization in the quarter was positive by nearly 9 points, while currency translation was positive by 2 points.

Operating profit was just over $1 billion, resulting in a 22% operating margin for the segment compared to a 17% margin for the same period last year. The year-over-year increase was driven by price realization and higher shipment volumes and sales mix. These items were partially offset by higher production costs.

With respect to price realization, the above-average results for the quarter were primarily driven by a few different factors. The primary driver of price came from significant midyear adjustments made last year and this year for select foreign markets to offset unfavorable currency movements, which resulted in low-double-digit price realization for markets outside of North America. North American list prices were up slightly above average and benefited from prices for new product launches during 2020.

Lastly, the current low inventory levels across the industry have led to lower overall incentive spending, thus boosting net price realization. We do anticipate net price realization to moderate some in the second half of the year.

Shifting focus to Small Ag and Turf on slide 5, net sales were up 30%, totaling $3.39 billion in the second quarter. The increase was driven primarily by higher shipment volumes, price realization and the favorable effects of currency translation. Price realization in the quarter was positive by nearly 6 points, while currency translation was positive by 4 points.

For the quarter, operating profit was $648 million, resulting in a 19% operating margin for the segment compared to an 8.7% margin for the same period last year. The year-over-year increase was due to higher shipment volumes and sales mix, price realization and the favorable effects of foreign currency exchange. These items were partially offset by higher production costs.

Before moving on to our industry forecast for regional ag markets, I’d like to first offer some perspective on the current global ag environment beginning on slide 6. Over the course of the last nine months, fundamentals for large ag production systems have steadily improved, driving stronger economic results for our customers and enhanced visibility for our equipment order books. Global stocks of grain have tightened significantly this year on account of multiple factors, such as increased Chinese grain imports and recovery in ethanol usage and weather-related production losses in South America.

For a second consecutive year, we expect grain and oil seed consumption to outpace supply, supporting fundamentals in the next marketing year. While government support is expected to decrease this year, principal crop – cash receipts in the US are forecast to increase 30%, with improvements in commodity prices more than offsetting the decline in government aid.
In addition to higher cash receipts, US customer sentiment has benefited from better market access over the last few quarters with elevated exports to China. Given the positive environmental backdrop, order activity is up significantly, and all of our large ag order banks are now complete through the end of the fiscal year. For select product lines such as 4WD and 8R tractors, we’re now taking orders for fiscal year 2022 and have visibility through the first half of the year. Furthermore, we’ll open our early order program for planters and sprayers in June, which will yield some additional data points on demand for 2022.

The current market dynamics, coupled with production constraints for the industry, point to a multi-year cycle for ag equipment. Current global inventory levels for both new and used equipment remain at historic lows, while the average age of the North American fleet is at its highest level in two decades. Even with double-digit growth expected for the industry in 2021, shipments of North American large ag equipment remain 40% less on average than the previous cycle.

At this point, in 2021, it’s clear that demand will carry over into subsequent years due partially to limitation on the industry’s production capabilities. Suppliers and logistics providers are currently stretched thin as economies begin recovering from the lows of the pandemic. Furthermore, labor markets are extremely tight, delaying efforts to ramp up.

To date, we have experienced frequent disruptions. However, our factory managers and supply management teams have done an extraordinary job keeping our production schedules mostly intact without yet resorting to material work stoppages.

While many of these spot disruptions are on account of various supplies, procurement of semiconductor chips remains a significant risk to our production schedule for the remainder of the year. To-date, our suppliers have worked diligently to ensure our products continue their vital role in providing food security and critical infrastructure. And we’re cautiously optimistic that they will continue to meet demand and help us ensure continuous service to our customers.

In addition to supply constraints, we’re also managing through significant inflation for both raw materials and logistics, which will continue to hit us throughout the second half of the year. Lastly, despite progress in the US with respect to the pandemic, COVID remains a challenge as we face disruptions to some of our foreign operations and supply base, with India as the most recent example. As we’ve done since last March, we continue to work through these challenges, ensuring safe working conditions for our employees and continuous support to our customers.

Before addressing our industry outlook, I’d like to first offer my gratitude to our employees and dealers who have worked through so many unique circumstances over the last year. We owe our results to the incredible efforts of our frontline employees, who kept our factories running during the pandemic and managed to keep production schedules on time amidst various supply constraints. Similarly, our field employees and dealers keep finding ways to serve our customers and have gone above and beyond during this last year.

Slide 7 shows our industry outlook for ag and turf markets globally. In the US and Canada, we expect industry sales of large ag equipment to be up roughly 25% for the year, reflecting improved fundamentals in the ag sector. At this point, we’re anticipating producing in line with retail demand for the year, keeping inventory levels relatively tight heading into fiscal year 2022. Meanwhile, we expect industry sales of Small Ag and Turf equipment in the US and Canada to be up roughly 10%. Similarly, our shipment schedules imply production roughly in line with retail demand for most products.
Moving on to Europe, the industry is forecast to be up roughly 10% as higher commodity prices strengthen business conditions in the arable segment, offsetting some weaknesses in dairy and livestock. Our Mannheim tractor order book extends through the end of the fiscal year, demonstrating continued progress towards executing our regional strategy focused on large and precision ag.

In South America, we expect industry sales of tractors and combines to increase about 20%. The combination of higher commodity prices, strong production and a favorable currency environment have boosted profitability of farmers, driving orders through the remainder of the year. Despite limited government-sponsored financing programs, private financing is more widely available this year and supporting continued strength in equipment demand.

Industry sales in Asia are forecast to be up slightly, though key markets for Deere such as India are performing slightly better.

Moving on to our segment forecast, beginning on slide 8, for Production and Precision Ag, net sales are forecast to be up between 25% and 30% in fiscal year 2021. The forecast includes a currency tailwind of about 2 points and expectations of nearly 7 points of positive price realization for the full year. For the segment's operating margin, our full year forecast is ranged between 20% and 21% and contemplates consistent performance across the various geographical regions.

Slide 9 shows our forecast for the Small Ag and Turf segment. Net sales in fiscal year 2021 are forecast to be up between 20% and 25%. The guidance includes expectations for 3 points of positive price realization and a favorable currency impact of about 3 points. The segment's operating margin is forecast to range between 16.5% and 17.5%.

I'll now turn the call back to Brent.

Brent Norwood
Investor Relations, John Deere

Thanks, Cory. Now, let's focus on Construction and Forestry on slide 10. For the quarter, net sales of $3.079 billion were up 36%, primarily due to higher shipment volumes, price realization and the favorable effects of foreign currency translation. The quarter results were boosted by 4.5 points of positive price realization and a currency tailwind of about 4 points.

Operating profit moved higher year-over-year to $489 million, resulting in a 15.9% operating margin, due to higher shipment volumes and sales mix and price realization, partially offset by higher production costs. Also keep in mind that last year's results included employee separation and impairment costs totaling $85 million.

Let's turn to our 2021 Construction and Forestry industry outlook on slide 11. North American construction equipment industry sales are now forecast to be up between 15% and 20%, while sales of compact construction equipment are expected to be up between 20% to 25%. To date, end markets for earthmoving and compact equipment have benefited primarily from strength in the housing market as well as some recovery from trough conditions in the oil and gas sector.

Additionally, we are beginning to see positive indicators for non-residential investment, as well as strengthening order activity from independent rental companies. Furthermore, current demand levels are still benefiting from the industry's collective response of managing inventories tightly during the early days of the pandemic.
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In Forestry, we now expect the industry to be up between 15% to 20% as lumber demand remains very strong, particularly in North America.

Moving to the C&F segment outlook on slide 12. Deere’s Construction and Forestry 2021 net sales are now forecast to be up between 25% and 30%. Our net sales guidance for the year includes expectations of about 3 points of positive price realization and a currency tailwind of about 2 points. We expect the segment's operating margin to be ranged between 12% to 13% for the year, benefiting from price, volume and non-reoccurring expenses from 2020.

Let’s move now to our Financial Services operation on slide 13. Worldwide Financial Services net income attributable to Deere & Company in the second quarter was $222 million, benefiting from a lower provision for credit losses, improvement on operating lease residual values and more favorable financing spreads, while last year’s results included impairments on lease residual values. For fiscal year 2021, the net income forecast is now $800 million. The provision for credit losses forecast for 2021 is 9 basis points when compared to the average portfolio managed.

Slide 14 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 now forecast to be between $5.3 billion and $5.7 billion. The guidance incorporates an effective tax rate projected to be between 23% and 25%. Lastly, cash flow from the Equipment Operations is expected to be in a range of $5.1 billion to $5.5 billion and contemplates a $700 million voluntary contribution to our OPEB plan.

I will now turn the call over to Ryan Campbell for closing comments. Ryan?

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

Thanks, Brent. Before we respond to your questions, I'd like to offer a few thoughts on our financial results as well as address some of the opportunities and challenges that lie ahead.

With respect to the results for the quarter, we are encouraged by the progress we’ve made in improving our structural profitability. While unit volumes for large ag equipment remain below prior cycles, we are achieving significantly higher levels of profitability. These favorable results are due in part to the work we’ve done over the last 18 months to reposition our organization. During that time, we have, one, reorganized the company around production systems; two, taken significant strides towards optimizing our cost structure; and three, adapted our investment priorities to drive a greater focus – greater degree of focus on the products and solutions that are most differentiated and then unlock the highest economic value for our customers.

Underlying this is the unique tech stack that we have built over the last two decades. We believe it is a combination of best-in-class products, of best-in-class dealer channel and the tech stack that will drive the solutions that make our customers the most profitable and sustainable in the industry.

In addition to our new strategy, we are also benefiting from the improved fundamentals for our customers. Despite the broad economic challenges brought on by the pandemic, grain and oil seed consumption is outpacing supply and driving increased need for more productivity and efficiency by our customers.

Furthermore, the market access challenges of the last years have moderated, boosting customer sentiment and spurring increased confidence in equipment investment. These improved fundamentals, combined with an aged
fleet and low inventory levels give us confidence that the investment cycle will continue beyond 2021. This dynamic is evidenced by order books for large tractors extending well into fiscal year 2022.

While these operational and industry tailwinds are currently supporting our business, many challenges and risks remain, particularly with respect to our supply base, global logistics and COVID-related interruptions. As Cory highlighted, these risks have caused spot disruptions in production and we anticipate those to continue throughout the remainder of the year. However, the incredible effort of our production and supply management teams have allowed us to avoid lengthy stoppages to-date.

One risk I’d like to again highlight relates to the supply of semiconductors, which is experiencing a global shortage. To-date, our suppliers have worked closely with us to provide enough supply to allow us to provide our essential equipment without significant disruption. Our forecast contemplates a continuation of this trend. This is important in order to help ensure we keep our customers fully operational and meeting the growing need for grain, oil seed and critical infrastructure.

In addition, prices for key raw materials such as steel have significantly increased over the last quarter. Freight and logistics costs have also experienced upward pressure and our utilization on premium freight has increased. As a result, our current forecast contemplates $1 billion in costs related to higher material and freight, with approximately three-quarters of that occurring in the second half of the year.

Despite these challenges, we are encouraged by the strength in our end markets as well as the execution our team has delivered so far this year. Furthermore, we see many opportunities to accelerate our investments in technology and sustainability. Although early, we are convinced that our new strategy is the right one and will drive differentiated outcomes for our customers and for all stakeholders.

We look forward to updating you on our progress over the next few quarters.

Joshua Jepsen  
Director-Investor Relations, Deere & Co.

Thanks, Ryan. We’re now ready to begin the Q&A portion of the call. The operator will instruct you on the polling procedures. In consideration of others and our hope to allow more of you to participate in the call, please limit yourself to one question. If you have additional questions, please rejoin the queue.

Jill?
QUESTION AND ANSWER SECTION

Operator: Thank you so much. [Operator Instructions] Our first question will come from Kristen Owen with Oppenheimer. Your line is open.

Kristen Owen  
Analyst, Oppenheimer & Co., Inc.

Hi. Good morning. Thank you for taking the question. Wanted to ask a little bit about the small ag cycle, and hoping you could provide some additional commentary there in light of several quarters now of very strong industry growth, continued lean inventories. And then maybe if you have a sense of how many new Deere buyers you're seeing in this space versus sort of a replacement or fleet expansion. Thank you.

Joshua Jepsen  
Director-Investor Relations, Deere & Co.

Thanks, Kristen. The small ag market has gone through a fair bit of growth over the last few years. We've seen more buyers on small acreages, small hobby farms. I think that's been one of the secular growth components of that. The stay-at-home impact over the last year has grown that as well, when you think about not just small tractors, but also riding the lawn equipment, and those sorts of things. So, that has – those have been drivers. It's really difficult to determine how many are new versus replacement, but we would say there is much less trading and trade-ins that occur in that small ag and small tractor business in particular.

Cory?

Cory J. Reed  
President-Agriculture & Turf Division: Large & Precision Agriculture, Americas and Australia, Deere & Co.

Yeah, Kristen, this is Cory. I would say it varies by the product lineup in Small Ag and Turf. As you move into the more traditional hay and forage mid-tractor, we'd have a lot of traditional customers in that space. But we're seeing conversions in that space which is good. Those are new customers to us. When you move down the line into turf equipment, small tractors, compact utilities, very many of those are new customers to us. So, it's a strong business. That industry continues to increase. The COVID pandemic has had an impact on that, but we're seeing more people move to the countryside, to acreages, and buy turf equipment. So, it's been a great market and we think that's continuing.

Joshua Jepsen  
Director-Investor Relations, Deere & Co.

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

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

Hi. Good morning, and nice quarter. Just color in decision on – to open that order book up early for 2022, if you could give any more color on what you're seeing relative of to what you said on the call? And then also how you're
approaching pricing for 2022, given the strong pricing this year and just given concerns next year about supply chain and material costs. Thanks.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

The order book, as was mentioned earlier on the call, we are ordered out through 2021. So, as it came to large tractors, which is a rolling order book, not run on an EOP, because the decision was to start to gauge visibility and take orders there. And as mentioned, we’ve seen quite a bit of that activity come in. So, it does reflect the strong underlying fundamentals that we’re seeing, the demand, low used inventory and strong used prices are reflected in that, in the orders that we’re seeing come through.

As it relates to price, we haven’t talked yet significantly about 2022 pricing, but contemplating strong price as we think about the inputs that we’ve seen come through this year.

Cory, anything you’d add there?

Cory J. Reed
President-Agriculture & Turf Division: Large & Precision Agriculture, Americas and Australia, Deere & Co.

Yeah, I would say Josh hit the high points. So, our large tractor order book indicates a very strong demand cycle all the way in and through 2022. I would suggest we take a very different approach to opening those books, depending on what region we are in the world. If we face a part of the world that’s more volatile relative to both cost and currency, we will open those books later. We know there’s demand in markets like South America, but we’re very cautious about how we map our pricing to the headwinds that we face, particularly as it relates to currency.

So we’re very confident as those order books open up what we’ll see in demand going through 2022.

Jamie Cook
Analyst, Credit Suisse Securities (USA) LLC

Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

Thanks, Jamie. We’ll go ahead and go to our next question.

Operator: Thank you so much. Our next question is from Jerry Revich with Goldman Sachs. Your line is open, sir.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Yes. Hi. Good morning, everyone. I’m wondering if you could talk about based on the initial orders for fiscal 2022 and indications of interest from customers, how do you expect Precision Ag take rates to expand over the next year for your primary products? And if you can, can you comment on ExactRate and AutoPath specifically? Thanks.
Joshua Jepsen  
Director-Investor Relations, Deere & Co.

Thanks, Jerry. We are seeing continued adoption on the Precision Ag front. As you think about things like tractors, for example, with CommandCenter and Premium Activation, that's grown pretty significantly this year, which is a positive trend. And we would expect as we move forward and we're bringing out new products that that trend would continue. Things like ExactRate, which will be coming through the Early Order Program, See & Spray Select coming out as well, the Hagie Sprayer with ExactApply, outfitted on it as well. So, I think the continuation there of the trend we've seen of adoption and growth is something we do expect.

Cory, anything you would add?

Cory J. Reed  
President-Agriculture & Turf Division: Large & Precision Agriculture, Americas and Australia, Deere & Co.

Yeah, I would say, Jerry, one of the exciting things is we're seeing all three cylinders of the strategy hitting. So, we've got a all new line of product that's coming out. So, you mentioned ExactRate on the planters, but we also have continued improvements in our large tractor line. We have new sprayers hitting the market in limited production that will go into our EOP for next year, so – and new combines, our X9 Series Combine. So, it's both the underlying products that are new, the tech stack is being embedded in some cases into them, but also new options available, and then we're seeing further penetration in the aftermarket side across the installed base. So, all three of the cylinders of the strategy are hitting right now.

Jerry Revich  
Analyst, Goldman Sachs & Co. LLC

Thank you.

Joshua Jepsen  
Director-Investor Relations, Deere & Co.

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

Operator: Thank you so much. Our next question is from Rob Wertheimer with Melius Research. Your line is open, sir.

Rob Wertheimer  
Analyst, Melius Research LLC

Thank you. Good morning, everyone. My question is, I guess, is for Cory. You seem to have the cycle pretty well enhanced as it starts off. Can you give us any update on Blue River, on product launches there and in the future, just sort of the timeline and how that part of the technology stack, I guess, is progressing? Thank you.

Cory J. Reed  
President-Agriculture & Turf Division: Large & Precision Agriculture, Americas and Australia, Deere & Co.

Yeah, Rob. Thanks for the question. It's exciting time because our first commercial product of that is hitting the market this year, so we talked about See & Spray Select, which is the first version that's a green on brown solution in See & Spray, but it's really the very first of a series of technologies we'll launch from Blue River that help enable us to move from field down to plant level in terms of how we manage the crops.
So, See & Spray Select is going into the market right now. Next year we'll be in the market with See & Spray Ultimate, and being able to deliver what we've been talking about with Blue River, but that's the first of several iterations across not only our current sprayer lines, but also being able to take that technology back across the installed base and then take that technology to other areas in our portfolio, to be able to move from how we do a lot of the work today at the field level or even down to the zone level, and manage at the individual plant level. At the end of the day, it's about driving greater profitability through higher yield and being able to manage cost for our customers no matter where they are in the cycle.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

Rob, the other thing I'd mention there is, Cory alluded to this, but the idea of leveraging sense and act in each of the jobs that we execute on in the production system. So, See & Spray is really the first of that of sensing, determining weed and spraying it, but we see that continuation and the ability to do that across all the jobs in the production system.

Rob Wertheimer
Analyst, Melius Research LLC

Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

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

Operator: Thank you, sir. Our next question comes from Ross Gilardi with Bank of America. Your line is open, sir.

Ross Gilardi
Analyst, BofA Securities, Inc.

Good morning, guys. I just wanted to check in on your thoughts on just where we are in the cycle and are you thinking of mid-cycle differently. I think a comment was made about being – still being 40% below prior cycles. And I think your definition of mid-cycle, being a trailing seven-year average doesn't include most of the super cycle years when the North American market was selling upwards of 13,000 combines a year. So, what are the prospects for getting back to those numbers? And if we did, are we potentially at a much lower percentage of mid-cycle now or a smaller premium mid-cycle now than your kind of seven-year trailing analysis would suggest?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

Sure. When we think about percent of mid-cycle for the business, for PPA and really for SAAT, Small Ag and Turf, we're in the – between 110% and 115% of mid-cycle. And you're correct in that the underlying math there would exclude the previous peak. So, we're past those peak years of 2012 and 2013.

When we think about where we are today, though, given the demand we're seeing, the underlying fundamentals, the age of the fleet, constraints in the supply base, seeing demand push out, we do believe there are continued legs to the demand picture and to the cycle that we're in. And maybe a little bit of comparing and contrasting back to 2013 because we get this question a lot, how – what is different now versus then, certainly, ag fundamentals
are very strong. Stock-to-uses are healthy. They're actually lower than they were back in 2013 if you look at ex-China stocks.

Cash receipts are forecast this year to be higher by about $10 billion compared to 2013. Land values are higher than they were even a year ago but compared back to that time as well. Used inventories, Cory mentioned, lower than where we were back to 2012. Prices have been – seen upward pressure. The large ag fleet is the oldest that it's been in two decades compared back to that 2013 timeframe when it was at the youngest that it had been. And then, as noted, our volumes, unit volumes of large ag in North America are significantly lower than we were back in 2013.

And maybe importantly, we don't expect or count on those – meeting those levels of volume to deliver higher margin performance. This year is a good example. On much lower volume, our net sales are, call it, $0.5 billion to $1 billion lower than 2013. But our margin performance is about 3 points higher. So, I think we feel really good about the ability to deliver innovation, deliver technology to the customer and create value, and that's translating to higher average selling prices, better margins per machine, so much less reliant on unit volume than maybe we would have been in the past.

Anything you'd add, Cory?

Cory J. Reed
President-Agriculture & Turf Division: Large & Precision Agriculture, Americas and Australia, Deere & Co.

No, I think Josh hit all the factors. I think the one thing I would add, Ross, is, in addition, we're bringing all new levels of technology in the new machines we're bringing out. So, those customers, if you take the average age of combines or tractors, the 9.5 or 6.5 years and you think about the technology difference in that last decade that's gone on with the products, that's pulling a lot of product into the industry. These are higher capacity machines, but there are people demanding the highest productivity, best technology on the machines that are coming through.

And if you look at where used inventory levels are, even our last generation machines, there's not a lot available in the market for people to upgrade, so that points to a cycle that extends. It also points to a lot of used machines out there that are 8, 9, 10 years old that are ripe for what we can do in the performance upgrade space. So as that population is coming forward, it represents an all new opportunity for us to take this latest technology back across those machines.

So, we're really excited about doing both. In fact, as our dealers are thinking about their early orders for this year, they're trying to get their orders even earlier so they can retrofit a number of those machines to get them ready with the next generation of technology for customers.

Ross Gilardi
Analyst, BofA Securities, Inc.

Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

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

Operator: Thank you, sir. Our next question is from Joel Tiss with BMO. Your line is open, sir.
Joel Tiss  
*Analyst, BMO Capital Markets Corp.*

All right. Hold on, just got to take off my mute button. I just wonder if you guys can talk a little bit about lowering the cyclicality of the company beyond Precision Ag, some of the internal things you’re doing, and just how you’re thinking about it and maybe some examples of what you’re implementing. Thank you.

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

Joel, thanks. As we think about the cycle and how do we dampen the cyclicality, one of the drivers is certainly the Precision Ag side, which you mentioned, and the ability to be less reliant on units and units driving where we go and how we perform. So, I think that is one piece.

As we go forward and you start to include sense and act capabilities, that’s one of the areas that we see the opportunity to begin to deliver more of a recurring revenue model, which takes some additional cyclical nature out of the business as we can create value across each acre that is covered.

And then the aftermarket side, and Cory alluded to this when he talked about performance upgrades or retrofit, the ability to go deeper into the population, the installed base and upgrade those machines, bring them closer to the most current technology. And that — what it also does is it brings them more into the Precision Ag ecosystem, thinking about the operations center, the flow of data and how that creates a sticky environment and value creation for the customer.

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

Hey, Joel, it’s Ryan, maybe just to add on that. We’re thinking about this with respect to building blocks and the building blocks of our equipment position around the world, our dealer channel, our tech stack, the engaged acres and connected machines, and so those building blocks are in place for us to now utilize the tech stack and all of our resources to stack features and offers on top that create value for our customers. And those features and offers that we’ll be delivering — we’re delivering today and we’ll be accelerating the delivery of those in the future should have less cyclical nature associated to them.

Cory J. Reed  
*President-Agriculture & Turf Division: Large & Precision Agriculture, Americas and Australia, Deere & Co.*

Hey, Joel. This is Cory. The only thing I would add, I think our customers and dealers are even asking for us to think about how do we give them the opportunity to bring the latest technology to them every year. And that doesn’t always mean buying a new machine one year and waiting three years and buying everything new. It means being able to manage with them how those next steps they can take in each of their operations to improve, whether it’s new bushels coming into the combine or whether it’s lower cost to give them the opportunity every year to invest in that next increment that helps them on the farm. So, we’re thinking about what are the new models that we can use to be able to do that and that will have a leveling effect to be able to take some of those large cycles out.

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

Joel, maybe one other thing I’d mention too on cyclical nature is as we think about regional performance and we’ve seen improved performance across the globe, whether it’s Small Ag and Turf or Production and Precision Ag, that
also aids in being less reliant on any one given market and the cyclicality of those markets and end customer segments. So, thank you.

So, we can go to our next question.

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

Ann Duignan
Analyst, JPMorgan Securities LLC

Thank you. I just want a point of clarification before I ask my question. That is, you kind of glossed over the Blue River Technology. You said you've launched the green on brown and as I can tell, that is – that equipment currently only differentiates between a plant and dirt, and as such has not been launched in any corn or soybean planting applications at this point. So, that was just – if you would just clarify that.

And then my question's around pricing. While pricing is strong, could you also talk about the increasing costs given that you're embedding most of the Precision Ag features in the new equipment, new costs have obviously accordingly gone up. So, if you could just talk about maybe net pricing, not including like discounting that, but how much of the price increases are actually to cover the increased cost of those?

Cory J. Reed
President-Agriculture & Turf Division: Large & Precision Agriculture, Americas and Australia, Deere & Co.

Hey, Ann. This is Cory. Maybe I'll take the first one. You're correct, that first iteration of See & Spray is See & Spray Select. It is a green on brown solution. It's what we would call a solution for burn-downs. So, when you're going into the field, it only sprays weeds. It won't spray on the bare ground and it's a tremendous advantage in the burn-down time. So, the season we just came through relative to burning down before crop, it's a great advantage, and in many cases, a small grain advantage too. So, that's the first iteration.

We're also out with our pilot machines and test machines on the See & Spray Ultimate, which is the full AI computer vision enabled set of solutions that are in the pipeline and scheduled in limited production for next year.

I'll let Josh take the second half of your question.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

Cory, that is – the test on the green-on-green solutions in corn and soybeans.

Cory J. Reed
President-Agriculture & Turf Division: Large & Precision Agriculture, Americas and Australia, Deere & Co.

It is. In fact, it's in all crops, yeah.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

Thanks. From a pricing point of view, I think it's important to kind of delineate how we view price. In this – over time it has gotten maybe a little bit confusing, but I want to be clear. The price numbers that we talk about in terms of net price realization is pure like-for-like model, year-over-year price that we've taken. So, if we're thinking about
the Production and Precision Ag point of view, 9 points of price, that is like-for-like model, last year to this year, what have we seen from pricing.

So, we have seen strong price. Cory mentioned this in his comments. They're really driven by the overseas price adjustments that's we've taken as it's related to FX movements and a shift to be maybe a little more dynamic in terms of how we've responded to some of those FX movements. So, that's really the price realization.

Maybe separately, we think about average selling prices over time, and over time if we look at, call it, the last seven or eight years for large ag equipment North America, average selling prices have been up between 5% to 7% on kind of an annual basis. And that would include traditional price increases, which have been in the range of 3 points and then on top of that would be the feature piece. So, if you call that 7%, 3% roughly kind of inflationary price but then on top of that would be features such as Precision Ag, things like ExactApply or others that would drive additional price.

And I'd tell from a cost perspective is, those features tend to be very margin attractive. A lot of that is software activated, so there's a lot of upfront cost to develop the first unit but from a margin point of view is attractive.

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

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

Steven Fisher
Analyst, UBS Securities LLC

Q

Thanks, Good morning. I think you guys were previously looking to build some inventory in small ag, but now it sounds like you're maybe planning to produce in line. If that's right, what drove the change? And then why not try to build inventory more broadly across both small ag and large ag, given the strength of the demand, to the extent that the supply chain will allow it. Do you need inventory to be tighter to kind of get the pricing you need to offset your cost increases? Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Thanks, Steve. For Small Ag and Turf, we did expect – we had planned to build a bit above retail a quarter ago. And really supply tightness and continued strength in demand has pulled that back to be essentially in line, building in line, so, more of a constrain from a supply base than it is a shift in our view of what we'd like to have out there. We're going to end the year on small tractors at near historic low again from an inventory to sales perspective in the 20s, 20% range. So, still quite a bit lower. So, that's the dynamic there.

And I'd say broadly kind of across all categories, the biggest constraint to building inventory is just that. It's supply challenges and the ability to get those out paired with really strong demand across the board.

Steven Fisher
Analyst, UBS Securities LLC

Q

Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Thanks, Steve.
Micrea Dobre  
*Analyst, Robert W. Baird & Co., Inc.*

Yeah. Thank you. Good morning. Cory, you talked quite a bit about challenges as far as supply chain and also obviously the entire industry basically is running into some capacity issues. But I guess I'm curious from your perspective, maybe looking at your business, how much of this is sort of transitory versus structural, right? I mean, are we talking about just lower capacity given everything that's happened over the past decade? And I'm sort of curious, when I'm looking at your CapEx guidance, only a very modest increase you guys are still expecting your CapEx to still be below fiscal 2019. Should investors expect a more meaningful drag in fiscal 2022 and 2023 from CapEx on free cash flow as you're looking to adjust capacity or are CapEx levels sort of sustainable where they are? Thank you.

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

Yeah, I'll start, Mig, on the CapEx side. I wouldn't expect to see significant shifts or changes there. We've, over the last decade or so, kind of cycled in and around this, where we're at, $900 million or so. We've been up or down some but not foreseen significant change there.

Cory J. Reed  
*President-Agriculture & Turf Division: Large & Precision Agriculture, Americas and Australia, Deere & Co.*

Yeah, and I would say that capital planning that we've had for multiple years allows us to invest in things like capacity where we need it, Mig. So, where those lines are limited today, we're investing, and our suppliers are investing, and they're all ramping up at this point. We're investing in what we think is going to be a prolonged cycle here.

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

I think one of the biggest challenges on the supply side is labor and it's at our suppliers but it's also in the logistics channel, whether it's warehousing or truck drivers or port labor, all of those things are a challenge. And certainly there's work going on there to improve that but that's been one of the bigger constraints when we think about the ability to get supply and produce.

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

Okay. Thanks.

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

Thanks, Mig.

Operator: Thank you for your question. Our next question is from Brett Linzey with Vertical Research Partners. Your line is open, sir.
Brett Logan Linzey  
Analyst, Vertical Research Partners LLC

Hi, good morning. Thank you for the question. Maybe you answered part of this, but not surprised there's very little room to flex up production this year given the supply constraints but as we shift to 2022 and supply availability improves, assuming it does, strategically how are you thinking about potentially flexing up your own internal capacity to run a little bit harder, given demand does look like it should sustain and be pretty strong next year?

Joshua Jepsen  
Director-Investor Relations, Deere & Co.

So, we have added shifts through the course of this year, in a number of our facilities, in Waterloo, in Montenegro, where we built tractors in Brazil. So, that activity has happened or continues to happen. The Early Order Programs and that's part of open up order books maybe a little bit earlier on tractors, it gives us a little more visibility to plan accordingly, and not only for our operations but to be able to provide those requirements back through the supply chain, so that's – I'd say that's a significant piece.

We've been doing a lot of work with the supply base in terms of where are their constraints, where do they have challenges and trying to get ahead of those, ahead of 2022. So, there's a lot of work going on in that regard.

Brett Logan Linzey  
Analyst, Vertical Research Partners LLC

Great. Thank you.

Joshua Jepsen  
Director-Investor Relations, Deere & Co.

Thanks, Brett.

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

Stephen Edward Volkmann  
Analyst, Jefferies LLC

Great. Most of my questions have been answered, but maybe on cash flow, obviously if you're sort of getting set for a number of pretty positive years here, if you can do kind of $5 billion a year in cash flow, you're only paying out maybe 20% of that in dividends, gives you a lot of excess capital, I think, to think about. How should we think about dividend, repurchases? Is there anything on the M&A front that we should be watching? Thank you.

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

Yeah, this is Ryan. Thanks for the question. I think, as you indicated, very, very strong cash flows and you look at our cash priorities, A rating investing in the business, dividend at 25% to 35% and then repurchase. Taken with the dividend, we just raised by 18%, but with the structural improvement in our profitability, we're probably more towards the lower end of that range, so that's something that we'll continue to look at.

We're going to have enough cash to execute against all the priorities. So, you'll see us continue with buyback. One thing I would highlight, as you'll probably see us a little more active in M&A. And as you think about M&A, we're thinking thematically in M&A, things like autonomy, things like sense and act, sustainability, performance...
upgrades, digital solutions, those are the things that, with the new strategy, are really going to drive the future, while we also look at are there any portfolio gaps that we have around the world that will also allow us to drive additional value for our customers through the system we've established. So, that's how we're thinking about it. But thanks for the question.

Stephen Edward Volkmann  
Analyst, Jefferies LLC

Thank you.

Operator: Our next question is from Chad Dillard with Bernstein. Your line is open, sir.

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

Hi. Good morning, everyone. So, just a question for you on retrofit. Just wanted to go back and understand just from like an internal perspective what else needs to be done internally at Deere as well as the dealers to fully stand up this business. And then you talked about you having a lot of 8 to 10-year old tractors right now. What portion will be ripe for retrofit? And then secondly, just a question on your 2022 order book, can you talk about what if any changes in terms of dealer incentives you're making to drive more Precision Ag penetration?

Joshua Jepsen  
Director-Investor Relations, Deere & Co.

Performance upgrades, the opportunity we see there is immense. When you think about the installed base on planters, sprayers, we can go back to about model year 2012. So, you think about a lot of machines that were going out at that time that are upgradeable. So, that's a large part of the installed base at this point if you consider just how many machines are out there.

So, I think that lays out just the opportunity set. And I think for us, there's a lot of work going on. The team's really focused on how do we make it easy, easy to order, easy to actually install, and those things are really, really critical.

Cory mentioned dealers thinking about their EOP trades, the machines they're going to be bringing back in from trade, and how can they make — accelerate that and get those in sooner so they can upgrade those and get those machines into customers' hands. So, there are a few things there that we're doing. Lots of potential. We're beginning off a relatively small base.

Anything you would add, Cory?

Cory J. Reed  
President-Agriculture & Turf Division: Large & Precision Agriculture, Americas and Australia, Deere & Co.

Yeah. I would add to Josh that he mentioned the primary platform, so our starting point in performance upgrades had started in the planter side because of all the great work that ExactEmerge — if we looked at the penetration relative to what our customers told us in terms of the value, we've taken and tried to cover as many of our previous models with ExactEmerge upgrade kits as we can and we continue to take new technologies that come in both planting and spraying and take them back. So, in the sprayer world, today the existing technology, ExactApply, is going back across, so individual nozzle control, and being able to take it back across as many sprayers as we can. In the future, it will be the See & Spray
technology. Maybe the difference is we're now designing and working toward designing at the same time we're planning for the new to design to be able to take it back across the installed base. And that will allow us to accelerate. We're working on making sure that our dealers have the bandwidth. Dealers are busy right now too and they're working to put their plans in place to be able to accelerate that effort.

We see significant growth rates not only in the parts side of the business, but performance upgrades gives us the opportunity to accelerate growth in the aftermarket.

Joshua Jepsen  
Director-Investor Relations, Deere & Co.

Thank you.

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

Nicole DeBlase  
Analyst, Deutsche Bank Securities, Inc.

Yeah, thanks. Good morning, guys.

Joshua Jepsen  
Director-Investor Relations, Deere & Co.

Hi, Nicole.

Nicole DeBlase  
Analyst, Deutsche Bank Securities, Inc.

So, can we talk a little bit about the margin guidance for the rest of the year? I mean, obviously, that was a really strong driver of performance this quarter. You guys are kind of embedding a step-down I think across all businesses relative to 2Q. I know there's some seasonality in there. But I guess, is the bulk of that being driven by the material and freight cost that you highlighted that are coming through?

Joshua Jepsen  
Director-Investor Relations, Deere & Co.

That's correct, Nicole. That's the biggest piece. We talked about roughly $1 billion in the forecast, about 75% of that is in the back half of the year in quarters three and four. So, that's the biggest component. Maybe a few other things, as you can see with our – with the forecast price, our price forecast moderates a little bit as we start to anniversary some of the actions that we were taking middle of last year. And then we do see a little bit higher overhead spend as it relates to inefficiencies, really driven by the supply chain constraints and some of the disruptions and starts and stops that happen that make us run a little bit less efficiently. So, I think those are probably the biggest items.

When we step back, though, and think about the back half of the year, I think excluding the one-time items from last year, we're running about a 35% incremental, and that's at the top end of the range that we've historically talked about, and that's with that heavy material and freight drag on that. It would be significantly higher in the 10 to 15-point range higher if not for that material and freight.

So, I think that's – those are the drivers there that we see. I think the performance, though, I think we feel really good about where we're at in light of that heavy cost coming through. Thank you.
Lawrence T. De Maria  
*Analyst, William Blair & Co. LLC*

Thanks. Good morning. Just a little bit confused, maybe you can help. I believe the previous forecast you noted that there’s a $500 million contingency in there above and beyond for materials and freight kind of outside of the guidance. Wondering how much of that is being used and if we’re going through that and then some in excess. And as you’re locking in orders for next year, are you also locking in costs and hedging at this point or are we – obviously, you’re raising price, and are you a little bit rolling the dice assuming the steel costs, et cetera, come down next year, just curious how you're thinking about that? Thank you.

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

The $500 million that we talked about last quarter was material and freight cost that we expected to see for the year. That $500 million is now $1 billion. So it effectively doubled between where we were a quarter ago and now. And that's in the forecast. That's in the segments and we expect to see that. And you see that somewhat impacting gross margins and things in the back portion of the year.

From a – thinking about 2022 order perspective, as we’ve noted, we’ve started taking some of those orders. From a purchasing point of view, we haven't made significant shifts. I think now, given where commodity prices are, we're not – we haven't locked anything in at this point. The steel prices are higher, much higher than we saw coming into the year, so we'll continue working through that and working through the processes as we think about how do we lock in and what shifts or changes on procurement.

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

Okay.

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

Thanks, Larry.

Operator: Our next question is from Tim Thein with Citigroup. Your line is open, sir.

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

Thank you. So, the question is on channel inventories in North America, specifically on large ag. Can you guys give us some context in terms of what the plan assumes? Obviously just given the supply base, there’s not really any room I would assume for much or any kind of build there. But can you kind of help us from a unit perspective and how you measure it, where you would expect to end the year, again, just channel inventory at large? Because obviously that has important implications for production plans, assuming a more capable supply base next year. So, just kind of the interplay between year-ending inventories and then how that potentially dovetails into production for 2022. Thank you.

Joshua Jepsen  
*Director-Investor Relations, Deere & Co.*
We project that we'll end this year at a similar level that we ended last year coming in, so pretty low levels of inventory, so pretty lean. You'll recall, the row crop tractors were in I think below or near below 20% inventory sales, particularly when you think about row crop, were relatively tight. And then combines, seasonality wise, tend to end the year quite low because you've just come through harvest. So that's normally a mid-single digit. So, I think we do believe that we'll exit that same – in that same position given we're kind of producing in line with retail from a large ag point of view.

Cory J. Reed  
President-Agriculture & Turf Division; Large & Precision Agriculture, Americas and Australia, Deere & Co.

No, I'd just echo. It's tight inventory, particularly in the large ag space. These orders are moving from our factories onto dealer lots into the field, and there's not a lot of slack in that system for dealers and they're working hard to make sure they're taking care of customers when they do that.

We've had a lot of efforts in the field to make sure we have continuity at the customer level. This is the biggest thing. If you think through what our field teams have done, there's been no disruption to our customers and our dealers have played a big role in being able to make sure that even when we had a slight disruption, they took care of customers and we got them in, got their machines in and got them running, so very little inventory on both new and used in the market right now.

Joshua Jepsen  
Director-Investor Relations, Deere & Co.

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

Operator: Our final question will come from Jerry Revich with Goldman Sachs. Your line is open, sir.

Jerry Revich  
Analyst, Goldman Sachs & Co. LLC

Great. Thank you for taking the follow-up, Josh, can we just go back to your incremental margin comments earlier. Given the stronger performance in margins, very early on in this cycle, how do you folks feel about your ability to deliver over 30% incremental margins over the balance of the recovery? At which point do we start to get concerned with margins giving the competition too much air cover? Thanks.

Joshua Jepsen  
Director-Investor Relations, Deere & Co.

We've been really focused on being very disciplined. I think on both the cost structure as well as thinking about how we're pricing and managing inventory. I think that continues and I think that is a driver of what we've seen from a performance point of view. So, I think that continues. And as we continue to bring in and see higher levels of precision ag adoption, that has – that drives additional opportunity for us to continue to deliver margin as well. I think those are probably the couple of biggest drivers.

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

Yeah, Jerry, I think as we think about total pricing, whether inflation plus features and those types of things, average selling price, it's really the value that we're delivering through the system and through innovation is the strategy that we use. And we think over the long run that's not only going to be very supportive of our margin profile but also from a share perspective.
Jerry Revich  
Analyst, Goldman Sachs & Co. LLC

Okay. Thanks.

Joshua Jepsen  
Director-Investor Relations, Deere & Co.

I think the other driver too there, Jerry, is — yeah, I mentioned that earlier, is just the regional performance and the lift in regional performance that we’re seeing helps pull everything as well. Europe is a great example. We've talked some about our strategy there being very focused on large ag and precision ag. As we’ve done that, we’re in a second year of seeing growth in market share in 150-plus horsepower tractors. That's not only driving share but it's driving margin. We're doing that on value, not on price. From a discounting point of view, so we're taking price and we're growing share and differentiating ourselves. And we think that's a really important piece when we think about going around the globe and everyone having strong margin performance, that is different than where we would have been previous cycle.

Jerry Revich  
Analyst, Goldman Sachs & Co. LLC

Terrific. Thanks.

Joshua Jepsen  
Director-Investor Relations, Deere & Co.

Thanks, Jerry, thanks, everyone. We appreciate your time. Have a good day.

Operator: This does conclude today's conference call. We thank you all for participating. You may now disconnect and have a great rest of your day.