

18-Aug-2023

Deere & Co. (DE)

Q3 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to Deere & Company's Third Quarter Earnings Conference Call. Your lines have been placed on listen-only until the question-and-answer session of today's conference. I would now like to turn the call over to Mr. Brent Norwood, Director of Investor Relations. Thank you, sir. You may begin.

Brent Norwood

Director-Investor Relations, Deere & Co.

Hello. Also on the call today are Josh Jepsen, Chief Financial Officer; and Josh Rohleder, Manager of Investor Communications. Today we'll take a closer look at Deere's third quarter earnings. Then spend some time talking about our markets and our current outlook for fiscal year 2023. After that we'll respond to your questions. Please note that slides are available to complement the call this morning. They can be accessed on our website at johndeere.com/earnings.

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

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

I will now turn the call over to Josh Rohleder.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Good morning and thank you all for joining. John Deere finished the third quarter with another strong performance, resulting in 22.6% margin for Equipment Operations. Performance exceeded expectations as a result of sustained demand for both farm and construction equipment, as well as sound operational execution across all business units.

Ag fundamentals continue to remain healthy with a full order book and positive customer sentiment supporting a strong finish to fiscal year 2023. Meanwhile Construction and Forestry remain sold out for the remainder of the fiscal year with robust shipments driven by strong retail demand and rental re-fleeting.

Slide 3 begins with results for the third quarter. Net sales and revenues were up 12% to \$15.801 billion, while net sales for the Equipment Operations were up 10% to \$14.284 billion. Net income attributable to Deere & Company

was \$2.978 billion, or \$10.20 per diluted share. Third quarter net income results included \$243 million tax benefit and \$47 million of associated interest income stemming from a favorable tax ruling on Brazilian VAT tax subsidies.

Turning now to slide 4, let's begin our segment review with the Production and Precision Ag business. Net sales of \$6.806 billion were up 12% compared to the third quarter last year, primarily due to price realization. Price realization for the quarter was positive by just under 12 points. Currency translation was also positive by approximately 1 point.

Operating profit was \$1.782 billion, resulting in a 26.2% operating margin for the quarter. The year-over-year increase was driven by favorable price realization, improved shipment volumes, and favorable sales mix, which was partially offset by higher production costs, increased SA&G and R&D spending, and unfavorable currency exchange.

Shifting to Small Ag and Turf on slide 5. Net sales were up 3%, totaling \$3.739 billion in the third quarter. The increase was a result of price realization, which was partially offset by lower shipment volumes. Price realization was positive by slightly over 9 points. Currency was also positive by slightly under half a point.

Operating profit improved year-over-year to \$732 million, resulting in 19.6% operating margin. The year-over-year increase was primarily due to price realization and was partially offset by higher production costs, lower shipment volumes, and increased SA&G and R&D spending.

Slide 6 shows our industry outlook for Ag and Turf markets globally. In the US and Canada, we expect industry sales of large ag equipment to be up approximately 10% during the fiscal year, reflecting a continuation of strong demand. Ag fundamentals remain solid with farm net income expected to be near historical highs, even if down from last year's record levels.

Drier weather conditions over the summer put some downward pressure on yields, tightening ending grain stock estimates and further supporting commodity prices. Solid order visibility provides a high level of confidence as we move into the fourth quarter.

Within Small Ag and Turf, we estimate industry sales in the US and Canada to be down between 5% and 10%, as strength from midsized equipment continues to be offset by weaker consumer oriented products, which have been pulled down in part by high interest rates. Midsized tractors in the 100 to 180 horsepower range are sold out for the remainder of the year, while production cuts in the sub-40 horsepower compact tractor range have helped bring inventory levels down from April highs.

Hay and forge continues to see significant year-over-year increases as production shortages in 2022 fully abate.

Turning to Europe, the industry is forecasted to be flat to up 5% for fiscal year 2023. Our visibility for the rest of 2023 remains excellent as order books are largely presold at this point in the year. In South America, we expect industry sales of tractors and combines to be flat to down 5%, following a record year of equipment in 2022.

Positive sentiment around record grain production in 2023 was somewhat offset by political uncertainty and a delayed government sponsored financing plan. The market remains stable and order books now provide visibility through the remainder of 2023. Industry sales in Asia are forecasted to be down moderately as volumes in India remain subdued when compared to record levels in 2021.

Moving now to segment forecasts on slide 7. For Production and Precision Ag, net sales continue to be forecasted up around 20% for the fiscal year. The forecast assumes a roughly 15 points of positive price realization for the full year and minimal currency impact. Segment operating margin for the year remains between 25% and 26%, reflecting strong execution globally.

Slide 8 gives our forecast for the Small Ag and Turf segment. Net sales are expected to remain up around 5% in fiscal year 2023. Guidance includes about 9 points of positive price realization and approximately 1 point of currency headwind. The segment's projected operating margin is now between 17% and 18%, reflecting stronger than expected operational efficiency, notably in Europe.

Now switching to Construction and Forestry on slide 9. Net sales for the quarter were \$3.739 billion, up 14%, primarily due to price realization and higher shipment volumes. Price realization was positive by nearly 10 points and currency translation was also positive by approximately half a point.

Operating profits increased year-over-year to \$716 million, resulting in a 19.1% operating margin due to price realization and improved shipment volumes. These were partially offset by increased SA&G and R&D expenses, higher production costs, and unfavorable currency impacts.

Slide 10 shows our 2023 industry outlook for Construction and Forestry. Industry sales of earthmoving and compact construction equipment in North America are both projected to remain flat to up 5%. Demand for earthmoving and compact construction equipment remains robust, driven primarily by the early stages of infrastructure spending and rental re-fleeting.

The industry has also benefited from some stabilization in housing, as well as reshoring efforts in the manufacturing sector, which are helping to offset weaknesses in office and commercial real estate.

In forestry, we estimate the global industry will be flat to down 5%, with growth in Europe offset by softening markets in the US and Canada. Global roadbuilding markets are forecasted to be flat to up 5%. Strong performance in North America and emerging markets in South America and India are supporting flat fundamentals across Europe.

Continuing on with the C&F segment outlook on slide 11. Deere's Construction and Forestry 2023 net sales are now forecasted up between 15% and 20%, with results likely to converge towards the middle of that range. Our net sales guidance for the year contains about 11 points of positive price realization. Operating margin is now expected to be between 18.5% to 19.5%.

Next, we'll transition to our Financial Services operations on slide 12. Worldwide Financial Services net income attributable to Deere & Company in the third quarter was \$216 million. The 3% year-over-year increase was due to income earned on a higher average portfolio, partially offset by less favorable financing spreads.

For fiscal year 2023, our outlook remains at \$630 million, reflecting less favorable financing spreads, the second quarter correction of the accounting treatment for financing incentives, a higher provision for credit losses, increased SA&G expenses, and lower gains on operating lease dispositions. These were partially offset by benefits from higher average portfolio balance.

Finally, slide 13 outlines our guidance for net income, effective tax rate, and operating cash flow. For fiscal year 2023, we are raising our outlook for net income by \$0.5 billion, to be between \$9.75 billion and \$10 billion, reflecting another quarter of strong results and continued optimism for the remainder of the year.

Next, our guidance incorporates an updated effective tax rate between 21% and 23%, which reflects the impact of a favorable tax ruling in Brazil, as mentioned earlier. Lastly, cash flow from Equipment Operations is now projected to be in the range of \$10.5 billion to \$11 billion.

This concludes our formal remarks. We will now turn to a few specific topics relevant to the quarter before opening the line for Q&A.

Let's begin with Deere's performance this quarter, Brent. We had another really strong quarter with operational results coming in just ahead of our own expectations. Net sales for Equipment Operations were up 10% year-over-year, while operating margins came in at 22.6% for the quarter. Can you break down what went well for us this quarter?

Brent Norwood

Director-Investor Relations, Deere & Co.

Thanks, Josh. First, our factories ran really well in the third quarter. We saw continued progress from our supply base, enabling our operations to hit production schedules almost exactly as planned. This precise execution from our factories is evident in our top line quarterly cadence, which will show a return to normal seasonality in 2023 when compared to 2022. And a return to normal seasonality is incredibly important to us, because it means that we are delivering on our customer commitments to get them machines in season. Importantly, this is a real testament to our factory teams.

And the real story, as you alluded to, is around margins. All three divisions saw lower than expected production cost inflation as our operational teams continue to deliver on cost reduction activities, having eliminated many of the inflationary and disruption-driven cost over the last couple of years. This was especially notable for Construction and Forestry, which delivered record year-to-date margin performance.

In addition to exceptional near-term execution, Construction and Forestry is also benefiting from executing on our business strategy, as shown by our successful integration of Wirtgen, the dissolution of our Deere/Hitachi joint venture, and the strategic portfolio actions that have helped us focus the business.

As it relates to the quarter, these results underpin our commitment to operational excellence. With supply chains continuing to improve, we have been able to reduce delinquencies and improve resiliency in our supply base. In premium freight alone, we've been able to reduce cost by nearly 50% this year when compared to last year.

From a production standpoint, we've seen material cost inflation come down meaningfully throughout the year. We expect this trend to continue throughout the rest of the year.

And when you successfully execute on all of these different initiatives simultaneously, you get factories that fundamentally run better. Across the board, we're seeing smoother operations, leaner in-process inventories, and better ability to meet our delivery commitments, which ultimately lead to a better customer experience.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

That's great. Thanks, Brent. With operations running much more smoothly, maybe we can flip to the other side of the equation. There's been a large amount of focus on industry fundamentals, both from a construction and an ag perspective. I'd like to start with construction equipment.

We've seen record amounts of government funding announced in the past few years. Alongside the IIJA and CHIPS Act, the IRA has already announced more than \$130 billion worth of clean energy projects. How are construction fundamentals faring today?

Brent Norwood

Director-Investor Relations, Deere & Co.

Yes, that's great context, Josh. Earthmoving industry fundamentals remain quite strong driven by construction job growth across most sectors and, in particular, large infrastructure project spending. Coupled with continued rental industry re-fleeting, demand is expected to remain steady throughout the remainder of the year. And while we see nice tailwinds from megaproject spendings tied to government funds, most of these projects will primarily benefit 2024 and, potentially, even 2025, supporting an elongated cycle for construction equipment sales.

In the near term, the residential housing market, while down from the highs in 2021, has stabilized despite elevated interest rates. For non-res demand, reshoring trends are driving manufacturing projects, while sectors linked to office space and apartment building construction remain quite sluggish.

Ultimately, this demand backdrop translates to a strong six-month rolling order book extending into the second quarter of 2024. And finally, while we have had some success increasing inventory from historic lows, inventory to sales ratios still remain well below target levels.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Okay. That's perfect. So, near term, construction fundamentals remain resilient and the business appears to be very well positioned on the construction side heading into 2024. Focusing now on ag fundamentals, farmers are expected to have another strong year relative to historicals. WASDE just released its latest forecast last week showing crop yields down and stocks tightening. How should we be thinking about farmer fundamentals, Brent?

Brent Norwood

Director-Investor Relations, Deere & Co.

Grain prices have definitely seen a large amount of volatility this year, but equipment demand has remained strong, particularly for large ag. While down year-over-year, crop prices are forecasted to be the third highest in over a decade. And in North America, farmers are projected to have another year of healthy net income.

Additionally, farm inputs have trended back down to pre-COVID levels, providing a benefit to next year's farm margins. And finally, as grain production remains subject to ever-volatile weather patterns and adverse geopolitical events, expect stocks-to-use to remain tighter for a bit longer.

So, in summary, ag fundamentals are still supportive in the North American market. Farmers will continue to see relatively healthy economics supported by downward trending input cost and continued constraint on grain supplies globally.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Thanks, Brent. That's great color on the US and Canada. If we look outside North America, how will we see these fundamentals impacting Brazil?

Brent Norwood

Director-Investor Relations, Deere & Co.

Yeah. Brazil has been a real dynamic market this year. Earlier in this year, we saw some of the political uncertainty and the delayed government sponsored financing plans weigh on sentiment. And while profitability has been very good, some farmers generated lower than expected income due to lower grain prices combined with a strengthening Brazilian currency relative to the US dollar.

As such, we saw the industry forecast come in a bit and as a result, we trimmed our equipment production some in the back half of 2023. At this point, the order book extends through the fiscal year and our presold position is robust eclipsing 90% for combines.

Joshua Jepsen

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

Hey, Brent, this is Josh Jepsen. Just to add to that, Brazil still experienced record production this year. We're seeing continued acreage expansion and a supportive government-sponsored financing program is now in place. So, long term, Brazil remains a key market for us that we'll continue to invest in for the future as we accelerate precision technologies in the region.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Thanks, Josh. Now switching back to the North American market, with order books full through the end of the year, how are new field inventory levels shaping up as we exit 2023 and begin planning for 2024?

Brent Norwood

Director-Investor Relations, Deere & Co.

That's a great question, Josh. Starting from the top, all of our North America large ag production is sold out for this year. We expect ending year-over-year changes and new field inventory to be modest.

In-season inventory increases have largely corresponded to our quarterly production schedules, which will come down in the fourth quarter. Combine inventory, for example, saw its highest level in the second quarter and is currently down from its peak. We will see that figure step down further in connection with seasonal retail activity ahead of harvest.

And while high horsepower tractor inventory remains sequentially flattish in the third quarter, we'll see that drop off at the end of the fourth quarter, which is typically the highest retail quarter for tractors. Keep in mind that combines and high horsepower tractors are 95%+ retail sold to customers already.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Perfect. So, we will expect to see inventories wind down further throughout the fourth quarter. Now, what about used inventories? We've seen those rise pretty significantly year-over-year from their historic lows last year.

Brent Norwood

Director-Investor Relations, Deere & Co.

We have, but the key phrase here is historic lows last year. When you are starting with a historically small existing inventory base, like we had in 2022, even modest changes in units will reflect large percentage increases.

That said, our dealers have been watching used inventories very closely and have been managing them proactively. Large ag equipment has roughly four to five owners over its useful life in North America. So, for every combine or tractor we sell, a dealer will typically facilitate three to four additional transactions as used equipment works its way down the trade ladder.

Now, when you put it in the context of my previous comments around new inventory, it would make sense that we saw inventory levels rise during the middle part of the calendar year. However, if we look at used combines, for example, we saw a 10% decrease in used inventory since May.

Also, August tends to be an important month for used inventory, so we'll watch closely how that trends. Importantly, used Deere inventory for both combines and tractors remains about 20% lower than the seven-year average on a unit base.

Joshua Jepsen

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

This is Josh. Maybe one thing to highlight. Just, I think, the important takeaway here is that by year-end we expect both new and used inventory levels to be below historic levels on a unit basis. So, that really positions us well as we exit 2023 into 2024.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Perfect. But how are we doing from an EOP perspective in North America?

Brent Norwood

Director-Investor Relations, Deere & Co.

At this point, we've kicked off, and in some cases closed, our early orders for a few product lines. I want to caveat here that it is still early and while we don't have a fully formed view, the early order programs are giving us some early data points.

We launched our sprayer EOP back in May and the program ended July 31. We have sold out all of our model year 2024 production slots with unit sales up double digits when compared to model year 2023 sprayers. The 2024 year-over-year increase reflects improved supply conditions, which had disproportionately limited sprayer production in 2023.

Phase two of planters opened in mid-July and has just under two weeks left to go in the program. Orders are relatively flat compared to the same point in time as the program last year and down 5% relative to the end of last year's EOP. However, we won't have the final read on this year's early order program until the end of August.

Importantly, we are seeing favorable mix towards our larger planters and higher take rates on technology. Our combine early order program just opened at the beginning of this month and gotten off to a nice start, but it remains too early to extrapolate any data points for 2024 as the program will continue through the end of November.

Likewise, our tractor order book has just opened this week for 2Q 2024 and we don't have any data points to share at this time. I would note, however, that the order book is currently full through the calendar year 2024.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Thanks for the color on North America, Brent. Clearly, too early to tell here, but it sounds like preliminary data is supportive. To round out our discussion, can we focus on Europe and discuss how things are shaping up there for next year?

Brent Norwood

Director-Investor Relations, Deere & Co.

Yeah, absolutely. And actually, Josh, I just want to amend my prior statement. Tractors are sold out through calendar year 2023, not 2024. In Europe, however, order books are stretching into the second quarter of 2024 providing decent visibility but with some early order programs having just kicked off. It remains too early to form a view on 2024 outlook.

Expect markets in Europe to remain dynamic, with outlooks varying a bit between Western Europe versus Central and Eastern markets. Western markets are seeing arable cash flow stabilize at supportive levels, while declining input costs will help buttress financials going into next year. Meanwhile, dairy margins may see some pressures in 2024.

On the other hand, markets with close proximity to Ukraine will contend with lower commodity prices as reduced port access means grains are flowing over neighboring borders pressuring local prices. All in, expect Europe to remain a dynamic market going into 2024, and we'll have a more informed view as we get closer to the start of our fiscal year.

Joshua Jepsen

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

And one point I'd add to highlight in Europe is our dealer network. We continue to see higher levels of sales flowing through dealers of scale. This has driven better market share, higher rates of precision ag adoption, and overall stronger businesses for our dealers and Deere.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Perfect. That's great insight. I now have one last question for you, Josh. Given the high level of cash flow this year, we've had an opportunity to execute on all elements of our capital allocation priorities. Can you walk through some of the decisions we've made this year with respect to funding further investments in our business, both organic and inorganic, while at the same time returning higher levels of capital back to investors?

Joshua Jepsen

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

Yeah, great question, Josh. This is first and foremost a direct reflection of the strong performance this year, which is projected to yield between \$10.5 billion and \$11 billion in operating cash flow for the Equipment Operations. We're very proud of what we've been able to accomplish this year and are encouraged by our ability to both invest aggressively in the business, while at the same time returning a significant amount of earnings to our shareholders.

During the year, we've increased R&D 15%, we've pulled ahead some CapEx projects into 2023, and have still managed to simultaneously deliver over \$5.5 billion to shareholders year-to-date through dividends and share repurchases. It further reinforces our excitement for the future and the opportunities we see ahead as we execute on the strategy unlocking value for customers.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Thanks, Josh. Before we open up the line for questions, do you have any final thoughts you'd like to share?

Joshua Jepsen

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

Yeah, thanks. As previously noted, the team is executing at a high level in 2023, which is evident in our results. We're actively working to reduce some of the inflationary and disruption costs experienced over the last couple years and we expect to see that benefit continue.

Over the last decade, we've been on a journey to deliver more value per unit. This is clearly visible today through our higher revenues on lower new units; making us less dependent on new unit sales to drive increased levels of performance.

As we continue to execute our strategy, this trend should accelerate even faster over the coming years. By utilizing our production systems approach and leveraging the tech stack, we can help our customers do their jobs more profitably and sustainably. That is our purpose, and we are more excited about it each day.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Thanks, Josh. Now let's open up the line for questions from our investors.

Brent Norwood

Director-Investor Relations, Deere & Co.

Now we are ready to begin the Q&A portion of the call.

QUESTION AND ANSWER SECTION

Operator: Thank you very much. [Operator Instructions] Our first question is from Jerry Revich with Goldman Sachs. Sir, your line is open.

Jerry Revich

Analyst, Goldman Sachs & Co. LLC

Q

Yes, hi. Good morning, everyone. Josh, I'm wondering if we could just continue the discussion you just touched on in terms of higher value per unit. So, in the past, you folks have been able to outgrow ASPs by 3-4% per year beyond price. Do you have a finer point that you can share on what that might look like in 2024? And if you could just touch on precision ag take rates and how they're tracking as part of that conversation as well if you don't mind.

Joshua Jepsen

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

A

Yeah, thanks, Jerry. Appreciate the question. I think we're seeing that continued trend of 3-4 points on top of the inflationary price as it relates to technology and the appetite we're seeing to continue to drive technology into the machines.

As we look forward and start to drive the business model shift, that may change a little bit as we see and build a little more recurring revenue. But I think all in, we're continuing to see the benefits on the unit economics through what we're doing in technology and the value that we can create for customers.

Brent Norwood

Director-Investor Relations, Deere & Co.

A

Yeah, Jerry, and as it relates to take rates on technology, obviously, we just finished up our sprayer early order program and are near complete on planters. Those are two product lines that have a high degree of technology embedded in those solutions, and for some of those mainstay technology innovations like ExactEmerge and ExactApply, we continue to see those take rates increase mid-single digits year-over-year. I mean, both of those are really approaching high levels. I think ExactEmerge is around 60% for 2024, ExactApply is a little over 70%. So, great progress on those.

Other products like Combine Advisor have almost just become standard. I think we're at almost 100% take rate there, and the same is true for our premium and automation activation suite for our tractors, which is almost at near 100% take rates. So, these things are really driving that higher average selling price that Josh talked about. And as we begin to launch some of those next-generation technologies, I think we've got opportunity to supplement the higher average selling prices with some reoccurring revenues as we get into 2025, 2026, and beyond.

Joshua Jepsen

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

A

Yeah, Jerry, maybe one last thing I'd add, too, that bodes well in terms of the direction we're headed is we're seeing growth in engaged acres and we're seeing growth in highly engaged acres. So, the interaction we're seeing, the value that we can create with our digital tools and having that all in one place in the John Deere

Operation Center for our customers is continuing to drive value and we're seeing that continue to aid in our business. Thanks, Jerry.

Jerry Revich

Analyst, Goldman Sachs & Co. LLC



Thank you.

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

Jamie Cook

Analyst, Credit Suisse Securities (USA) LLC



Hi. Good morning. Congrats on a nice quarter. I guess my first question as it relates to – it sounds like supply chain is getting better, which probably bodes well for 2024. So, as you're thinking about supply chain getting better and you're looking at your – what you're seeing so far in terms of the early order program, can you talk to your approach with inventory next year both for Deere and both at the dealer level, whether you think you would overproduce retail demand and build up more normalized inventory levels? I guess that's my first question.

And then my second question, Josh, again just on the margin performance of the company, can you talk to where you are with regards to reducing the volatility of your margins? So, that news that there was a downturn coming, how resilient you are and would be, how decrementsals will be as a result of internal initiatives? Thank you.

Brent Norwood

Director-Investor Relations, Deere & Co.



Hey, good morning, Jamie. Thanks for the question. I'll start with some comments on supply chain and what that means for our inventory position next year, and Josh can comment on the margin progress.

But I think you've been able to see from our results that our factories ran really well in the third quarter. We've got a robust cost agenda still to come in the next year, but we're really pleased the progress we've made on reducing production cost inflation particularly in the third quarter. If you look at our production cost inflation numbers in Q3, I mean, they came in about half what we had originally anticipated. So, that was really good work by our factory teams and our supply management teams.

And I think what you're seeing is we're driving a lot of progress in terms of getting delinquencies down to almost pre-COVID levels. We're driving freight costs down. We're still seeing a little bit of pressure on some of the purchase components, and labor and energy are up. But things are trending in the right direction and I think we've got a really robust agenda for next year around further cost reduction in the supply base, further resiliency in the supply base, and then just designing out cost for future programs next year.

All of that's going to help us manage inventory. As we noted, for large ag inventory, we've been sort of below historic levels and below target levels now. We'll end the year relatively low as we sort of work through sort of the fourth quarter retail sales that we would anticipate to happen.

That said, our starting position or sort of our default position, if you will, beginning any fiscal year is always to produce in line with retail sales, and then we'll leave ourselves some optionality to build as we get through the selling season. So, once we have a fully formed view on next year after all of our early order programs are done and after we've made some progress on our tractor order book, we'll leave ourselves a little optionality to determine what's the right level of inventory.

And obviously, our dealers will help with that input as well. But again, right now our default position is to produce in line. But given the exit position that we'll have, which will be really attractive from an inventory perspective, we'll leave ourselves some optionality for next year.

Joshua Jepsen

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

A

Yeah, Jamie, if you think about reducing volatility, I think there's some near-term things that we're working on. Brent mentioned what we're doing as it relates to cost management, continuing to take some of the costs that we've seen through inflation and disruption out of the system. That's an important one.

Continuing to drive technology into our machines, driving, as I just mentioned, more value per unit from an economics perspective will be beneficial. There's a lot of work – great work going on in terms of life cycle solutions and how we take care of our customers through the life of our products from first owner down to the fourth and fifth owner, and that activity will help dampen some cyclical as well.

And I think the last one is – maybe a little bit longer term, is we are building the infrastructure to drive solutions as a service for our business in terms of how we shift business model on some of our new technologies. And that's going to help us to deliver more value to customers and, importantly, to more customers and more acres more quickly. So that's a focus area. Some of those we're early in the journey. Others, we feel really good about what we're executing on.

And I think importantly, structurally, we feel like we're performing, from a profitability perspective, at a different level. And our expectation is you look at where we're performing today with volumes as they shift and move up or down, we would move up or down that line based on where we're performing. So, we think this is a meaningful structural shift in profitability and one that we're going to keep working on. So thanks, Jamie.

Jamie Cook

Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you.

Operator: Our next question is from Tim Thein with Citigroup. Sir, your line is open.

Tim W. Thein

Analyst, Citigroup Global Markets, Inc.

Q

Hi. Great. Thanks. Good morning. Maybe just on ag, just going back to the comments on Brazil, if you can just maybe help us frame that up a bit just in terms of you mentioned some of the production cuts you made or you're, I guess, targeting in the second half of the year. How do you think that – obviously, again, a lot of moving parts in a volatile market. But how do you think you end the year from an inventory perspective in Brazil as we go into 2024 and, obviously, the dealer inventories? That's the question. Thank you.

Brent Norwood

Director-Investor Relations, Deere & Co.

A

Yeah. Hey, Tim. Yeah, good morning. As it relates to Brazil, as we noted in our opening comments, it's been a really dynamic year. I think a lot of puts and takes. At this point the order book is full for the rest of 2023. And managing the year has been interesting, we've seen record production for corn, soy, and near record production for cotton and sugar, really healthy profitability for customers there, down from 2022.

And again, to refer back to our opening comments, probably a little bit less than expected from our customers there as they had lower levels of forward selling this year and I think some difficulty in marketing the sizable crop that they had in 2023. You had a little political uncertainty and the delay in the government-sponsored financing program.

And that was all kind of embedded in our reduced industry guide from – we went from flat to flat to down 5%, and that really reflects for us lower production in the fourth quarter. But a great example of kind of how we intend to be proactive in managing a dynamic market in almost real-time. Brazil has always operated that way. We're more dynamic in terms of our order book, our pricing strategy, and how we manage production there.

So, the goal with some of the modest production cuts that we took in the fourth quarter is that we would end the year there with inventory really at target. And so that we would start the year again in that default position of an intent to produce in line with retail sales for 2024.

The good news is there, from a combine perspective in particular, I think we're over 90% retail sold. So, we should have a pretty good read on where inventory's heading for the end of the year, which should well position us for next year.

Longer term, though, despite maybe some of the market dynamics of this year, Brazil is still one of our most important growth markets and it's going to be a market that we're going to continue to invest in for the long term even while we manage production in the short term. Thanks, Tim.

Operator: Our next question is from Steven Fisher with UBS. Your line is now open.

Steven Fisher

Analyst, UBS Securities LLC

Q

Thanks. Good morning. So, the year-over-year step-down in pricing in Production and Precision Ag from Q2 was a bit bigger than the kind of headwind you had from tougher comparison in the year before. I guess were you expecting such a big step-down in pricing?

I mean, you didn't change your pricing forecast, so maybe it's really not any surprise. But I'm curious if the environment and what you're seeing in the order activity is still supportive of a 2-3% pricing including incentives. And how is the need for incentives kind of shaping up here?

Brent Norwood

Director-Investor Relations, Deere & Co.

A

Hey, Steve. As it relates to pricing, I would say that the second quarter came in almost right on the forecast for Production and Precision Ag and Construction and Forestry. Small Ag and Turf probably fared just a shade better as they're retaining a little more price than we had in the forecast.

But all of this is largely in line with our expectations, particularly as we lap some of the midyear price increases that we took in 2022. We would expect from a percentage basis to see that price realization come in. For production and precision ag, I think we were 12% in the third quarter. That should be high single digits in the fourth quarter as expected.

And importantly, though, we're seeing production cost inflation ratchet down at a similar pace. So, when you look at the absolute delta between price and cost for Production and Precision Ag, for example, I think we were \$1.4 billion positive in the first half. Second half should be something – not dissimilar to that. So, we are maintaining that price/cost discipline, I think, throughout the entire year.

Now, as it pertains to next year, yeah, no change in some of the early pricing that we've put out there, which has been in the sort of 2-4% range. And we are certainly managing our incentive spend as well embedded in that. So, we would expect overall realization to be within that range inclusive of whatever discounts begin to get layered back into the market for 2024. Thanks.

Steven Fisher

Analyst, UBS Securities LLC

Q

Perfect. Thank you.

Operator: Our next question is from Kristen Owen with Oppenheimer. Ma'am, your line is open.

Kristen Owen

Analyst, Oppenheimer & Co., Inc.

Q

Great. Thank you for taking the question. Wanted to ask about the construction margins. You lifted the target once again and really narrowing the gap with your ag businesses at what is arguably a different point in the cycle.

Just given some of the comments of normalization in pricing across the portfolio and what you talked about in the prepared remarks for 2024, how we should think about the sustainability of that improved margin performance in the construction segment? Thank you.

Brent Norwood

Director-Investor Relations, Deere & Co.

A

Hey, good morning, Kristen. As it relates to Construction and Forestry margins, I would kind of refer back to some of the comments we made in our opening remarks around the structural things that we've been doing in Construction and Forestry for really the last four to five years that have really reformed that business into a more sound and solid business that, to your point, has closed some of the gap between large ag over the last couple of years.

First and foremost, the most important move we made was the inclusion of a road building business. That's an end market that we view as high growth, lower volatility, and it's a very attractive market to be in. And we acquired the number one asset in that business via Wirtgen.

We're really still early days executing our excavator strategy. The first important step there was the dissolution of the Deere/Hitachi joint venture, which we successfully negotiated last year, and we're on our way to delivering a full line of Deere-designed excavators, which I think is really sort of the next phase of the strategy there and how we'll see that business continue to drive further margin performance going forward.

And we didn't tout this a lot publicly, but we were very active in portfolio management over the last couple of years, really focusing that portfolio on the products where we're most differentiated and in the markets where we really have a right to play and a right to win. So, we think all those things are structural and continue on a go-forward basis.

Joshua Jepsen

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

A

Yeah, Kristen, one thing I'd add is as we look forward and you think about is there another leg in this journey for C&F, and we believe there is, and it's around technology, how do we integrate technology to help do the jobs that our customers do and do them better and more efficiently and more productively and more sustainably. So, we're seeing that with our first suite of automation tools, things like grade control.

We see more and more opportunities to leverage technology into construction, into road building in particular, that are going to create real value for customers. We think we can differentiate in the marketplace and as we create that value for customers, in turn get paid as well. So, we're excited about the future there and we see continued opportunities. Thank you.

Operator: Our next question is from Rob Wertheimer with Melius Research. And your line is open.

Rob Wertheimer

Analyst, Melius Research LLC

Q

Thanks. And actually, I wanted to follow up on exactly what Josh was just talking about. Construction pricing, what you've achieved to date, is that largely market related, or do you feel like you've had enough technology flow in to sort of support a rising price overall?

And maybe as a part of that question, I suppose definitionally if you have a tech widget, you charge for that built-in volume I think, but I assume there's just an overall price halo as your products deliver more value to customers. So, maybe just talk about where you are in technology in construction. Thanks.

Brent Norwood

Director-Investor Relations, Deere & Co.

A

Yeah. Rob, as it relates to – I'll first start with the comment around pricing and then we could talk about technology more broadly. But as it relates to the pricing that we've achieved, I mean, I think you've seen that broadly in the construction equipment markets. We work hard to lead in price as best we can. We try to be one of the most disciplined industry players as it pertains to price.

I think we're still early days in terms of getting higher average selling prices on account of more technology, more innovation in the equipment. So, we are starting to see that. I think on specific product lines, we can definitely see that in terms of the entire portfolio rising. We're still early days there.

So, I think more headroom for us as we begin to integrate technology. Wirtgen is certainly going to be one of the product lines that benefit the most from a higher average selling price as we include more technology in the coming years.

Joshua Jepsen

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

A

Rob, I'd say timeline-wise, you think about this journey we went on the large ag side in 2013, 2014, when we began, I would say we're probably similar to that timeframe, so maybe not quite a decade. But we're in those early days of starting to drive more of that technology in.

And the excavator is a good example where we're just getting started, as we design that fully integrated machine, where we're going to see in our minds what we're seeing and what we're hearing from customers that are testing really tremendous technologies and usability. So, we're excited about the future there and we think we're very early days. Thanks, Rob.

Rob Wertheimer

Analyst, Melius Research LLC

Q

Perfect.

Operator: Our next question is from Steve Volkmann with Jefferies. Your line is open.

Stephen Volkmann

Analyst, Jefferies LLC

Q

Hey. Good morning. Thanks for fitting me in here. I wanted to go back. I think a couple of – you have used the words robust cost agenda for next year a couple of times. I'm just wondering if there is any way for us to think about sizing that. Is this sort of a big deal where we could see these sort of production costs in your waterfall chart? Could they actually be positive next year? Or is this kind of continuous improvement a better way to think about that?

Brent Norwood

Director-Investor Relations, Deere & Co.

A

Hey, Steve. It's a great question. We've seen over the last couple of years billions of dollars of cost inflation flow into our operations. Some of that is coming from systemic inflation. A portion of that, though, is coming from, just I'll call it, COVID disruption costs, inefficiency costs, also associated with our deferred ratification of our UAW contract in 2022. All of those things caused overheads to run higher than they normally do.

So, we're bringing a lot of those back in 2023. I think there's more room to run certainly in 2024. I would not probably characterize it as just a normal continuous improvement program here at Deere, because we do have line of sight to specific costs that we want to take out.

Particularly as some commodity prices have come down, it's really easy to capture that in our raw material spend and we did see a tailwind in raw mats in the third quarter. But for a lot of our purchase components that have those raw materials embedded in their purchase price, there's an opportunity to go back and actively renegotiate. So, we're very proactive there on executing the strategy and we do have a formalized process in place to take further action in 2024.

Joshua Jepsen

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

A

Yeah, Steve, the only thing I'd add on top of that is, just coming through the last three years, which have been far from usual operating procedures in terms of pandemic, supply chain disruptions, etc. is continuing to root out that disruption in cost that had come in and made its way in, on top of we were seeing strong demand.

So, I think there's going to be work done certainly and, I think, ongoing getting back to a cadence that we would expect in terms of continuing to take cost out and drive efficiency in the operations. So, we think there's more room to go here, for sure. Thanks.

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

David Raso

Analyst, Evercore ISI

Q

Hi. Thank you very much. The comment earlier about the construction -the demand backdrop, right, you were saying the six-month rolling order book extends into the second quarter of 2024. Can you give us a sense of that order book? Are your orders up year-over-year? Is that implying growth in construction and forestry through the second quarter? Is that what that comment meant? And any help on the pricing within that order book would be great.

And then a quick question on large ag. Maybe I'm misreading it, but for the fourth quarter for large ag, I know – go back to normal seasonal times, the fourth quarter does have a pretty weak sequential margin. But large ag you have profit sequentially down almost as much as revenues are implied down. I'm just making sure I understand are there any unique costs or you mentioned Brazil negative mix. Just something on why the profits would fall almost as much as the revenues are going to fall sequentially. Thank you.

Brent Norwood

Director-Investor Relations, Deere & Co.

A

Yeah, hey, David. Let me start with the last part of that question on the ag side, and then I'll let Josh comment on Construction and Forestry. If you think about the fourth quarter, we'll see revenues flattish to maybe down a little bit in ag. A big driver there – and then, to your point, margins will come in a shade from where they were in the third quarter.

The big driver there is we are seeing a return to, again, this normal seasonality, which does mean that we will institute normal factory shutdowns particularly at Harvester Works, which historically we've done factory shutdowns in the month of September and/or October. And so, I think what you're going to see is the impact of shutting that down.

We haven't done that the last couple of years as we've been running behind on delivering machines to customers late in 2021 and then all the way really through 2022. So, that's really the big impact that we're going to see happen in the fourth quarter.

I think the other thing I would note specific to the fourth quarter, and this would actually be true for all three divisions, we'll see a heavier R&D spend in the fourth quarter. That's a timing thing. Our fourth quarter does tend to be a little heavy most years from an R&D perspective. That is certainly going to be true this year as well.

And then, the other thing I would add on the fourth quarter is you'll see a little less Brazil mix as well in the fourth quarter. So, kind of all three of those things will conspire together to bring down margins just a shade in the fourth quarter when you compare them to third quarter results.

Joshua Jepsen

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

A

Yeah. As it relates to C&F and if you look at the order book, I'm going to say, comparing year-over-year is a little bit difficult because we were constrained last year, so probably not a good way to compare just total order activity. But what I would say is, on the order book that we have, we're looking at similar production rates in 2023 to 2024. So, not a significant change there. And realistically, obviously, less disruption expected as well in 2024 than we saw in 2023. Thanks, David.

Operator: Our next question is from Tami Zakaria with JPMorgan. Ma'am, your line is open.

Tami Zakaria

Analyst, JPMorgan Securities LLC

Q

Hi. Good morning. Thank you so much. So, I wanted to step away from the quarterly print and ask you about your new battery plant. I think you just picked a new battery manufacturing location. Can you tell us a bit more on that, when it will be operating exactly, what volume you expect, what products you expect it to feed into, any impacts on margins or potential cost savings? So, any thoughts on this initiative.

Joshua Jepsen

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

A

Yeah, certainly, Tami. Thanks for the question. So, this stems from the acquisition we made a little over a year ago with Kreisel – Kreisel Electric. So, this is really the next step as we continue that evolution to build manufacturing capacity for batteries and charging, which was announced here early this week in North Carolina.

I would say, stepping back and looking at this, this is a strategic investment in growing our production capacity, aims to being the leader particularly in off-highway. As off-highway is evolving, we're prioritizing development of robust charging technology, in addition to a battery portfolio that can support the long-term adoption of electrification in our products.

So, timeline, we're probably a year or so out in terms of this facility up and running. We're producing them in Europe today at a relatively small scale. But we see the opportunity with the technology we have to really drive charging here in the near term. And we've developed a relatively robust pipeline or portfolio plan for Deere products that will begin to incorporate the Kreisel batteries here as we go forward starting probably below 125 horsepower, and then we'll continue to evolve that portfolio as we go forward and you'll see hybrid technologies and the like. Thanks, Tami.

Tami Zakaria

Analyst, JPMorgan Securities LLC

Q

You're welcome.

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

Chad Dillard

Analyst, AllianceBernstein

Q

Hi, everyone. So, I want to spend some time on the average age of the fleet. Can you just talk about where we will be exiting the year versus normal? And I recall you talking about how there are, I guess, five different owners within the fleet. Like, where's the bulge in age in terms of the fleet? And then, just last question is, is this higher average age structural? Why or why not?

Brent Norwood

Director-Investor Relations, Deere & Co.

A

Hey. Morning, Chad. As it relates to the average age of the fleet, I think what you're seeing is the impact of this replacement cycle really having a sort of delayed or deferred start, right? If you think about when demand really inflected, it was the beginning of 2021. And you really had three factors conspiring to slow down the production

really not just for Deere but the industry at large, right. The industry was suffering from labor shortages, supply chain delinquencies, delays, as well as significant inflation affecting production.

So, in the last three years, demand has outpaced supply, and what that's done is it has really slowed the ability for the industry to bring down the age of the fleet. If I look at four-wheel drives and 220-plus horsepower tractors, those we continue to age out most years since really 2013. We've started to sort of flatten the curve a little bit. I wouldn't say we brought down the age significantly or even at all for either one of those, and we're still probably a couple years older than historic averages.

Combines is one where we – this last year we were probably – the industry was able to make a little bit of progress bringing down the age of that fleet a little bit. We'll make further progress in 2024, but we'll still be just above kind of historic averages there.

So, I think it's going to take a little more time on tractors, just given some of the challenges that we've had, I think particularly for four-wheel drives, which you guys can see this in the AEM data. It's just been one of the more constrained product lines from an industry perspective, kind of similar to sprayers, where it's just going to take maybe a little more time to bring down the age of the fleet.

If you ask kind of where is the bulge, so to speak, in the age of the fleet, I mean, it's really, if you go back to the vintages of machines that were kind of 2010 to 2014, that's still a big part of the installed base. And those are the ones that are really aging out on us at a faster rate than the industry has been able to replace it in the last couple years. So, thanks for the question, Chad.

Joshua Jepsen

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

A

Yeah. Maybe one thing I'd add just on top of that is, I think the important piece, too, is we're continuing to see demand for technology across the trade ladder in our equipment. We were just speaking with a dealer principal a couple weeks ago, and he was talking about this very fact. It's not just demand for the latest technology by the first owner, but it's the second, third, fourth, the fifth. And I think when we think about the age of the fleet and the health of the trade ladder, that is a big, big driver, because there's a desire to upgrade technology no matter where the customer may be in that chain. So, I think that's an important piece that underlies not only the age but the demand.

Brent Norwood

Director-Investor Relations, Deere & Co.

A

Yeah. Chad, thanks for the question. Fran, I think we have time for one last caller.

Operator: Thank you very much. So, our last question now is from Seth Weber with Wells Fargo Securities. And your line is open.

Seth Weber

Analyst, Wells Fargo Securities LLC

Q

Hey, guys. Good morning. Thanks for fitting me in. I wanted to ask about the small ag business. Margin was a lot better than what we were expecting, I think I heard you say something about Europe. I'm just wondering are those structural changes that we should think about as being in place going forward. And then, just your comment about small ag inventory kind of coming off the peak, do you think that we're past the challenges there and things are going to start getting better or just less bad going forward? Thanks.

Brent Norwood

Director-Investor Relations, Deere & Co.

A

Yeah, hey, Seth. Thanks for the question. As it relates to Small Ag and Turf, it's certainly a structurally sounder business today than if you went back to prior cycles. And I'll talk a little bit more about some of the margin puts and takes there. Let me answer your question on inventory first though.

As it relates to inventory for Small Ag and Turf, I know there's been a lot of focus on what I would call the small end of Small Ag and Turf, so like the under 40 horsepower category of compact utility tractors. I think we've seen the industry level out and even come down a little bit here recently. So, it does appear as though maybe we're kind of past that elevated – or we're in the early stages of getting past those elevated inventory levels on the compact utility tractor side.

But the bulk of that business really revolves around midsized tractors that are going into dairy and livestock operations, hay and forage operations, or high-value crops. And I think we're probably closer to target level inventory there. So, we don't see quite the abundance of inventory for those categories of machines.

And so, we're also going to see just some seasonality impact just as it relates to the rest of the year from a margin perspective. We'll do a factory shutdown in Mannheim, which is our single source location for those 6 series tractors, those mid-series tractors that makes up a significant portion of the Small Ag and Turf revenue and margin for that matter.

Going forward, though, from a margin perspective, I think what you'll see particularly on those midsized tractors is higher levels of technology that is going to be leveraged from Production and Precision Ag. I would say, if you went back to prior years, you wouldn't see a lot of technology that gets leveraged from Production and Precision Ag into Small Ag and Turf.

But you're going to see more of that as our customers, particularly in like high-value crop production systems, they're demanding solutions like autonomy and electrification, and so that's going to be an opportunity to, I think, further buttress the margin profile that we've achieved this year and extend that into years to come.

Joshua Jepsen

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

A

Yeah. Seth, one last thing I would add is just the geographic diversity of Small Ag and Turf. So, it's much broader in terms of global coverage and we're seeing performance really strong across the globe. And to Brent's point on driving technology, we're seeing technology be driven into utility tractors in India, leveraging telematics and bringing connectivity to the farm there. So, there's a lot of activity that we see that is going to both create customer value and also drive a different business in Small Ag and Turf than you've seen in the past. So, thank you.

Brent Norwood

Director-Investor Relations, Deere & Co.

So that concludes today's call. We appreciate everyone's time and thank you for joining us today.

Operator: This conference is concluded. Again, thank you for your participation. You may please disconnect at this time.

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