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Q4 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to Deere & Company's Fourth Quarter Earnings Conference Call. Your lines have been placed on listen-only until the question-and-answer session of today's conference. I would now like to turn the call over to Mr. Josh Beal, Director of Investor Relations (sic) [Mr. Brent Norwood, Head of Investor Relations] (00:00:17). Thank you, you may begin.

Brent Norwood

Head-Investor Relations, Deere & Co.

Hello. Good morning. Also on the call today are Josh Jepsen, Chief Financial Officer; Josh Beal, Director of Investor Relations; and Josh Rohleder, Manager of Investor Communications. Today we'll take a closer look at Deere's fourth quarter earnings, then spend some time talking about our markets and our current outlook for fiscal year 2024. After that, we'll respond to your questions. Please note that slides are available to complement the call this morning. They can be accessed on our website at www.johndeere.com/earnings. First a reminder. This call is being broadcast live on the Internet and recorded for future transmission and use by Deere & Company. Any other use, recording, or transmission of any portion of this copyrighted broadcast without the express written consent of Deere is strictly prohibited. Participants in the call including the Q&A session agree that their likeness and remarks in all media may be stored and used as part of the earnings call.

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 www.johndeere.com/earnings under quarterly earnings and events.

I will now turn the call over to Josh Rohleder.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Good morning, and an early happy holidays to everyone. John Deere finished the year with an excellent fourth quarter, thanks in part to strong margins of 20.3% for equipment operations. Continued outperformance throughout the year resulted in 16% top line net sales and revenue growth for 2023. Operating margins came in for the year just shy of 22%, helping generate nearly \$12 billion in operating cash flow. Across our businesses, performance was driven by strong market demand, operational execution and improved production costs. Looking ahead to 2024, shifting Ag market dynamics will lead to a decline in demand; however, we expect to hold the structural gains and profitability achieved over the last few years, delivering expected decrements off our 2023 baseline financial performance.

Meanwhile, the Construction & Forestry market demand outlook remains mixed with uncertainty in housing and commercial investments, partially offset by tailwinds from mega projects and infrastructure spending. Slide 3 opens with the results for fiscal year 2023. Net sales and revenues were up 16% to \$61.3 billion while net sales for equipment operations were also up 16% to \$55.6 billion. Net income attributable to Deere & Company was \$10.2 billion or \$34.63 per diluted share. Next, fourth quarter results are on slide 4. Net sales and revenues were down 1% to \$15.4 billion while net sales for the equipment operations were down 4% to \$13.8 billion. However, net income attributable to Deere & Company increased to \$2.4 billion or \$8.26 per diluted share. Moving to slide 5. We'll review our fourth quarter segment results starting with our Production & Precision Ag business. Net sales of \$6.965 billion were down 6% compared to the fourth quarter last year.

This was primarily due to lower shipment volumes partially offset by price realization. Price realization in the quarter was positive by about 10 points. Currency-translation was also positive by about 1 point. Operating profit was \$1.836 billion resulting in a 26.4% operating margin for the segment. The year-over-year increase in operating profit was primarily due to price realization partially offset by lower shipment volumes and sales mix, as well as higher SA&G and R&D spend. Notably, production costs came in favorable for the quarter. Recall that tough fourth quarter year-over-year comps for PPA were expected due to supply chain issues in 2023 which drove late shipments and out of season deliveries into the fourth quarter. Turning to Small Ag & Turf on slide 6. Net sales were down 13% totaling \$3.094 billion in the fourth quarter due to lower shipment volumes partially offset by price realization. Price realization in the quarter was positive by nearly 5 points.

Currency was also positive by approximately 1 point. For the quarter, operating profit declined year-over-year to \$444 million resulting in a 14.3% operating margin. The decrease was primarily due to lower shipment volumes and mix along with higher SA&G and R&D expenses partially offset by price realization and production costs. Please flip to slide 7 for the fiscal year 2024 Ag & Turf industry outlook. We expect Large Ag equipment industry sales in the US and Canada to decline 10% to 15% reflecting softening sales on the heels of three years of strong demand coupled with moderating farm fundamentals and high interest rates weighing on discretionary equipment purchases. Headwinds will be tempered by healthy farm balance sheets, declining input costs, supportive fleet fundamentals and continued profitability following record years. For Small Ag & Turf in the US and Canada, industry demand is estimated to be down 5% to 10%.

The dairy and livestock segment continues to remain steady thanks to elevated protein and hay prices. This is offset by subdued demand in the turf and compact utility tractor markets which are closely tied to single-family home sales and home improvement spending, both of which remain under pressure from higher interest rates. Shifting to Europe. The industry is forecasted to be down around 10%. Farm fundamentals in the region continue to be mixed with opposing dynamics between Eastern and Western Europe. Eastern Europe continues to be impacted by grain inflows from Ukraine driving down commodity prices while Western Europe remains profitable with favorable grain prices and declining input costs stabilizing equipment demand in 2024. Dairy and livestock risks have also abated in recent months, with livestock prices forecasted roughly flat after coming down from record highs in early 2023 and dairy and cash flow beginning to bottom.

In South America, we expect industry sales of tractors and combines to be down about 10% moderated by strong headwinds during 2023. Brazil in particular was challenged with political uncertainty early on and a delayed government ag financing plan announcement. Coupled with already-high interest rates and lower commodity prices that reduced farm profitability, the cumulative impact of these headwinds ultimately led to slower retail sales in the second half of 2023. This has been exacerbated most recently by severe dryness in Northern Brazil and flooding in the South to start the 2024 planting season. Across the rest of South America, elevated interest rates and heightened economic uncertainty primarily in Argentina are further dampening expectations. Industry sales in Asia are also projected to be down moderately notably with India, the world's largest tractor market by units, down around 5%.

Turning to our segment forecasts on slide 8. We anticipate Production & Precision Ag net sales to be down between 15% and 20% in fiscal year 2024. The forecast assumes approximately 1.5 points of positive price realization and flat currency translation. Segment operating margin forecast for the full fiscal year is between 23% and 24% reflecting our ability to sustain gains in structural profitability. Slide 9 gives our forecast for the Small Ag & Turf segment. We expect fiscal year 2024 net sales to be down between 10% and 15%. This includes about 1 point of positive price realization and flat currency translation. The segment's operating margin is projected to be between 15% and 16%. Shifting to Construction & Forestry on slide 10. Price realization and higher shipment volumes both contributed to an 11% increase in net sales for the quarter to \$3.742 billion. Price realization in the quarter was positive by over 6 points.

This was supported by just over 1 point of positive currency translation. Operating profit increased to \$516 million resulting in a 13.8% operating margin. Favorable price realization more than offset higher production costs and unfavorable currency exchange during the quarter. Slide 11 provides our 2024 Construction & Forestry industry outlook. Industry sales for earth moving equipment in the US and Canada are expected to be down 5% to 10% while compact construction equipment in the US and Canada is expected to be flat to down 5%. While end-market segments vary, oil & gas continues to be stable and while housing starts and non-res investments require caution due to the current interest rate environment, US infrastructure and mega project spending supports continued equipment investment. Global forestry markets are expected to be down around 10% as all Global Markets continue to be challenged.

Global roadbuilding markets are forecasted to be roughly flat, reflective of continued strong infrastructure spending in the US, offset by softening in Europe. Continuing with our C&F segment outlook on slide 12, 2024 net sales are forecasted to be down around 10%. Our net sales guidance for the year includes about 1.5 points of positive price realization and flat currency translation. The segments' operating margin is projected to be between 17% and 18%, reflecting the continued structural shift in profitability for C&F. And ultimately, let's transition to our Financial Service operations on slide 13. Worldwide Financial Services net income attributable to Deere & Company was \$190 million for the fourth quarter. The year-over-year decline was mainly due to unfavorable

derivative market valuation adjustments, coupled with less-favorable financing spreads and a higher provision for credit losses.

These factors were partially offset by income earned on a higher average portfolio. For fiscal year 2024, the net income forecast is \$770 million. Results are expected to be higher year-over-year primarily due to income earned on a higher average portfolio and a non-repeating one-time accounting correction that occurred in 2023. These will be partially offset by less-favorable financing spreads and lower gains on operating-lease residual values. Finally, slide 14 outlines our guidance for net income, our effective tax rate and operating cash flow. For fiscal year 2024, our full year net income forecast is expected to be between \$7.75 billion and \$8.25 billion, demonstrating executional discipline despite increasing pressure from industry headwinds. Next, our guidance incorporates an effective tax rate between 24% and 26%. Lastly, cash flow from equipment operations is projected to be in the range of \$8 billion to \$8.5 billion.

To close, our ability to generate approximately \$8 billion in net income at near-mid-cycle sales levels in fiscal year 2024 is a testament to the positive structural impacts we've seen from executing our strategy. This now concludes our formal remarks. Let's turn to a few key topics of interest before opening the line for Q&A. I'd like to start with the year-in review before we jump to 2024. Not only did we have a record fourth quarter in terms of net income but we finished the full year with net sales and revenues as well as net income eclipsing the \$60 billion and \$10 billion mark respectively.

Brent, can you break down what went well, both the quarter and the year?

Brent Norwood

Head-Investor Relations, Deere & Co.

Sure, Josh, that's a great question. Let's start with the quarter which was a tremendous finish to the year and really boiled down to solid execution as we delivered against the year's backlog of orders. During the quarter, our factories resumed normal seasonal shipment patterns, meaning we consistently hit forecasted line rates in our factories and delivered on our commitment to customers. In markets like North America Large Ag, nearly all shipments were pre-sold, enabling us to demonstrate disciplined inventory management. Furthermore, pricing remains strong through the close of the year, helping us keep pace with some of the inflationary pressures over the last few years. On the execution side, we saw positive year-over-year production cost comps in the fourth quarter for the first time in over three years for both Production & Precision Ag and Small Ag & Turf.

This is a direct result of our team's efforts to reign in inflationary costs combined with some relief on raw materials and freight prices which have come down from record highs. Overall, these factors drove a strong finish to an incredible year, making 2023 a story of disciplined execution. Following multiple years of a disruptive and challenging environment, we worked through our order books with on-time deliveries, enabling most products to move off restricted allocation. Pricing caught up with inflation and we saw supply chains revert to normal, which ultimately meant we were able to deliver products to customers on-time and at expected costs.

Joshua Jepsen

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

This is Jepsen here, maybe to add. I think the overarching takeaway here is that we're finally getting back to steady state of execution. As Brent mentioned, factory production schedules and customer deliveries have returned to traditional seasonal patterns which has been very good for the business. And we expect that 2024 will be much the same, meaning we'll see the highest levels of production in the second and third quarter, aligning with the primary use periods for farm and construction equipment. Meanwhile, the first quarter will embed lower

production rates, allowing for model year changeovers, required factory maintenance and shutdowns during the holiday season. So, similar to last year, we expect the first quarter top line to be down 20% to 25% sequentially and for first quarter margins to be 300 to 400 basis points lower than the full year guide.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

That's great color, Brent, and thanks for the reminder on seasonality, Josh. It's been a few years since we've been able to use seasonal trends as a guide for future expectations. And speaking of future expectations, this is a perfect segue into my next question which is probably top-of-mind for everybody today. Our 2024 guidance indicate that markets will be a bit more dynamic next year. I know there's a lot to unpack here, Brent, but maybe you could walk us through what we could expect by segment and geography?

Brent Norwood

Head-Investor Relations, Deere & Co.

Thanks, Josh. Definitely a lot to unpack here. Why don't we start with Large Ag in North America? Farm fundamentals are expected to remain sound in 2024, albeit down from record highs of the last few years. That said, customers are still profitable heading into 2024, with balance sheets bolstered by multiple years of record net income. Farm debt-to-equity ratios are forecasted to remain at historic lows thanks in part to continued increases in farmland value. And while commodity prices trend lower, we still expect crop cash receipts to be the third highest in 2024. Similarly, corn and soy cash margins will be down from highs but remain above levels experienced in the back half of the last decade. Lower input costs are offsetting some of the impact from lower prices for soft commodities. Fertilizer costs, for example, is now below 2021 levels.

Finally, North American yields are coming in better than expected which could drive some tax buying for used equipment during the remainder of the calendar year. There's certainly a lot of puts and takes to farm fundamentals this year, but the takeaway is that lower commodity prices and higher interest rates are weighing on equipment demand. But even still, cash margins are still supportive of replacement at mid-cycle volumes. And after three years of healthy fleet replacement levels, customers will have a little more discretion on equipment CapEx decisions, creating a more dynamic volume environment for the next year. Now, turning to an equipment sales perspective, we see a really mixed bag in 2024. To give a little color, I'll start with our Early Order Program results by products.

As previously noted on the third quarter call, our model year 2024 Sprayer Early Order Program ended strong, up year-over-year; and planters were flat year-over-year, with revenues bolstered by a strong mix for larger equipment and higher Precision Ag take rates. And while early orders are flat to up for our crop care products, we will be making minimal post-season deliveries in 2024 which will put some downward pressure on shipment volumes when compared to 2023. While our Combine Early Order Program does not finish until the end of November, we expect volumes to be down double-digits when compared to 2023. Finally, we manage tractors on a rolling order book basis. Our row crop tractor orders are booked through most of the second quarter, with similar production levels to 2023. Meanwhile, four wheel drive tractors are sold out through the end of the third quarter, reflecting continued strong demand and restricted availability for the product line in 2024.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Okay, so it sounds like EOPs are running the full gamut across our product lines. I guess that purports the next question. How are we positioned going into the year from an inventory perspective?

Brent Norwood

Head-Investor Relations, Deere & Co.

Our teams did a tremendous job in 2023 managing North America production in line with retail demand. To put that in context for new equipment, year-end inventory-to-sales ratios are at 15% for 220-plus horsepower tractors, 9% for four-wheel-drive tractors, and just 4% for combines. We are well positioned to produce in line with retail demand again this year for the North American market. Furthermore, on the used inventory side, dealers have done an amazing job proactively managing volumes. Take combines for example. Ending fiscal year inventory is down 22% from its intrayear high in May and down nearly 40% below the 10-year average, and while used high-horsepower tractors have recovered from historic lows, they are still about 20% below the 10-year average. So all-in-all we feel really good about the starting position for 2024 from an inventory basis, which is really important as end markets inflect a bit next year.

When compared to prior replacement cycles we've managed inventory much tighter in North America than ever before.

Joshua Jepsen

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

This is Jepsen. Just to add-on here. While markets ebb and flow, we've learned from prior cycles and know how to manage through them and execute on the things we control, as demonstrated by Brent's comments on North American Large Ag inventory.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

That's great to hear, Josh. And, Brent, I'd like to pull on a thread you hinted at just a second ago. Our guide would imply that demand modulates in some markets for 2024. Could you compare how we're positioned today relative to prior replacement periods?

Brent Norwood

Head-Investor Relations, Deere & Co.

Absolutely. There are really a few different variables that make this replacement period distinct from prior periods in the North American market. First, is Large Ag inventory levels which we've already talked about, these remain significantly below long-term averages. In fact, new inventories for both combines and 220-plus horsepower tractors are 30% below 2013 levels and while four-wheel-drive tractors are 60% below that same year. Secondly, fleet age is significantly older today than in 2013, when the fleet was the youngest in recorded history. Combines are roughly in-line with long-term averages, while large tractors remain nearly two years above the mean and have yet to inflect downward meaningfully. Importantly, the higher fleet age helps dampen the amplitude of the cycle. Additionally, farmer balance sheets are much healthier today driven primarily by higher farmland values and years of profitable seasons.

Finally, even with higher interest rates, financing options remain prevalent for farmers. At the same time, we've decreased the size of our leasing portfolio and limited leasing options to three- to five-year terms, eliminating short-term leases which drove higher used inventory levels in the 2014 to 2016 period. The key message here is that the production constraints of the last few years combined with better inventory discipline from Deere positions the company really well as demand pivots in 2024.

Joshua Jepsen

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

And this is Jepsen. Two things to point out here. First, is that we're a different company today versus a decade-ago and we've managed replacement cycle better than the past. Certainly we have work to do but we know where we need to focus and we'll execute. The second is around our ability to deliver solutions that help farmers reduce cost and increase profits is much greater today than it was in the past. Farmers now have a breadth of new Precision Ag technology which can help differentiate their operations in an increasingly competitive global market.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Okay. Thanks, Brent and Josh. That makes a ton of sense. We spent quite a bit of time now on North America. Can we shift over to South America? Josh, would you walk us through what's happening down there?

Joshua Jepsen

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

Of course. I think it's best to start with what happened in 2023 which is driving much of our expectations for 2024 and as we noted Brazil has been very dynamic market with a number of temporary headwinds. We experienced industry demand weaken much faster than expected in the second-half of the year for the reasons, Josh Rohleder, you mentioned earlier. For example, we saw combine retail sales down about 25% and large tractor retail down close to 10% in the second half of 2023, demonstrating the volatility we experienced. As a result, we, along with the rest of the industry, ended up building more inventory than planned even though we pulled back production in 2023. Therefore, we will under-produce demand next year and our 2024 guide reflects us bringing inventory back to target levels.

Importantly, we will continue to invest in the market due to the tremendous potential of our integrated offerings across production systems to drive productivity, profitability and sustainability for producers in the region, all the while building a more resilient and responsive business to handle market fluctuations.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Okay. Thanks, Josh. Now let's finish up on the Ag side with Europe. What are the dynamics over there, Brent?

Brent Norwood

Head-Investor Relations, Deere & Co.

While volumes will be down a bit next year, Europe remains more stable relative to the other markets we've already discussed. It's been a consistent story and we expect 2024 to be no different. While large tractor demand finished strong, we did see moderation across mid tractors and combines. We were able to manage production accordingly and feel well-positioned heading into 2024. Given the continued headwinds and a competitive market environment, we expect orders for 2024 to be down in line with industry demand, and with order books approximately 45% full, this gives us visibility through most of the first half of the year. Ultimately, we remain committed to executing our business strategy in Europe. Our focus remains on offering differentiated value to our customers through increasing Precision tech adoption.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Thanks Brent. That's really helpful. Let's shift now to C&F. With 2023 being a story of rental and dealer re-fleeting following two years of constrained production, what should we expect to see in 2024? And then secondly, we've heard a lot about mega project and infrastructure spending still to come, yet guidance is down for the next fiscal year. Can you walk us through what's going on there?

Brent Norwood

Head-Investor Relations, Deere & Co.

You bet, Josh. On one hand, you have strong end-markets and infrastructure as you noted earlier which are offset by some caution in our guide around residential and the office and commercial sector given elevated interest rates. On the other hand you have these mega projects and systemic investment in US manufacturing which will be significant, albeit hard to predict on timing. Where we've seen the most consistency is in roadbuilding as US government funding both local and federal has driven expectations for another solid year for the Wirtgen Group. With respect to inventories, the broader industry built field inventory at a faster pace than we did in 2023. While we did recover from the historic low inventories of 2022, we still trailed the industry, so we'll have a few pockets of further inventory build in 2024.

Market dynamics aside, we are a structurally better business today than we were just a few years ago which is evidenced by our nearly doubled margins in the last four years, from the acquisition of Wirtgen, which gave us exposure to an excellent roadbuilding end-market to our decision to develop a Deere-designed excavator, we've really concentrated our focus on the margin-accretive areas of that business.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

That's helpful insight into the various end-market dynamics, Brent. The sound execution of our C&F business really looks to be paying off as we see another year of high-margins and reduced decrementsals relative to our historical performance. I'd like now to switch the focus over to our tech stack. Brent, could you give us an update on the business model and where we stand across See & Spray, autonomy and the latest Gen 5 display and operating system?

Brent Norwood

Head-Investor Relations, Deere & Co.

Sure. We've made big strides across our entire tech product portfolio this year, with much of the focus on our retrofit solutions or what we refer to as Precision upgrades. With See & Spray, which is our down payment on Sense & Act technologies, we successfully launched See & Spray Ultimate for model year 2024 and have significant interest in our limited release of See & Spray Premium, the retrofit kit which can be applied all the way back to model year 2018 sprayers. We are targeting a significant push for Premium into the installed base in 2025, supported by our solutions as a service business model. For See & Spray Premium, we've kept the upfront capital costs for hardware and installation to a minimum, followed by a per-acre use model that aligns our monetization with our customer's value. Meanwhile, our autonomy journey is progressing nicely with plans for acreage expansion through our paid pilots in 2024.

Our 2023 pilots generated substantial insights in model training while our key metrics improved significantly year-over-year for KPIs like up time without intervention, mean time between interventions and reductions in false positives. The progress here will set us up for broader commercialization with opportunities to accelerate utilization through retrofitting autonomy in the installed base of our tractors. What we've started seeing is that when a customer tries out new Precision technology for the first time they rarely go back. So the key here is adoption and utilization which is made easier through our Gen 5 display, another innovative example of our focus

on production systems and lifecycle solutions. This new display is key to helping farmers unlock significant productivity gains across their entire fleet of equipment.

Coupled with the latest StarFire receiver and modem, a farmer can add basic Precision features such as auto track and section control to tractors more than a decade old. This is a critical step in helping farmers enable less-seasoned operators to do tasks that would have historically required someone with years of experience to do. Overall, our continued investment in the tech stack and business model transformation reflects our commitment to delivering customer value and productivity regardless of the equipment age.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

That's all really exciting, Brent. And it looks like we continue to demonstrate our commitment to the business strategy with stable through-cycle investments in innovation. To that extent, maintaining the gains in structural profitability we've achieved over the last few years requires diligent cost management across the business. We've already noted the significant effort we've put into reducing costs in 2023 but, Brent, can you share how we're thinking about cost management for 2024?

Brent Norwood

Head-Investor Relations, Deere & Co.

That's a great question, Josh. 2023 was really all about getting the low hanging fruit. From premium freight to declining raw-material costs, we did a good job at wringing out a decent amount of disruption-related inefficiencies. As we look forward into 2024, we remain focused on continuing to tackle inflationary costs and we think there's substantial opportunity across both direct and indirect material as well as logistics and overhead. We've already begun to see these impacts show up in our financials to an extent. The fourth quarter was the first time we've seen production costs flip positive for both Production & Precision Ag and Small Ag & Turf, primarily driven primarily by material and freight. Our 2024 guide implies that overall production costs will be slightly favorable for the full year. As price realization moderates to normal levels, the focus on cost becomes an increasingly more important component to maintaining and improving our structural cost position.

The focus on reducing our direct and indirect materials, as well as our logistics costs becomes especially acute given the continued rise in labor costs across many of our markets.

Joshua Jepsen

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

Hey. This is Josh Jepsen again. One thing to add to Brent's comments is just the effort of our teams. These costs don't come out overnight nor do they come from the work of one lone group. It takes a lot of hard work across the board to make this happen. Part of our success over the past few years has been our ability to manage our business running a lean operation capable of adapting quickly to changing environments while maintaining the clear priority of taking care of customers. Our teams remain focused on cost management, and I expect we'll see the benefit of these efforts as we move forward.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Okay. Great. And my final question is back to you, Josh. We've had a significant year from a cash flow perspective. Can you talk briefly about our use-of-cash priorities and capital allocation in 2023 and then what we might expect in 2024?

Joshua Jepsen

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

Sure. We saw excellent cash flow conversion in 2023 allowing us to execute on all of our priorities. Liquidity along with our single-A credit rating remains in good shape which has allowed us to reinvest diligently in the business. This has never more important than today. Despite top line guidance being down in 2024, we're well-positioned to continue our organic and inorganic investments in the business. In particular, we plan to maintain a similar investment level in R&D next year. Next, we're able to increase our dividend by nearly 20% this year, reflecting our confidence and a structurally more profitable business today than in years past. And finally, we completed the year with nearly \$7.2 billion in share repurchases. Over the last three years, we've returned nearly 75% of our cash from the equipment operations to shareholders via dividends and buybacks. And as we execute on this strategy, we remain committed to disciplined uses of cash.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Thanks, Josh. Now 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, that'd be great. It's been a truly phenomenal year for us in 2023. Our teams executed well, recovering from some of the production challenges in 2022. As a result, we ended the year setting new levels of structural profitability on margins, net income, and earnings per share while investing significantly in the business and returning cash to shareholders. Since 2020, we focused on four key things which are driving our results. We restructured the entire enterprise to mirror the production systems of our customers to focus on value unlock via incremental addressable market. This also delivered improvements in empowerment and autonomy for the organization. Next, we centralized our technology development to leverage tech across the enterprise, increase speed and reduce redundancy. Third, we stood up an organization to help us better serve our customers throughout the entire lifecycle of our products and solutions.

And lastly, we embraced a more disciplined capital allocation framework focused on prioritizing the greatest opportunities for customer value unlock, optimizing our business portfolio which included exiting some unprofitable markets and product lines that didn't serve our strategy or create significant customer value, and accelerating development and deployment of value-creating technologies. We're confident when we create customer value, we are making their jobs and lives easier while enabling them to do more with less. And as a result, we'll in turn grow and create value-adding margin-accretive solutions. Our guide for 2024 contemplates our equipment operations being right around mid-cycle sales levels. As a result of our structural improvements combined with our execution, we will deliver nearly 2 times the margin and 2.5 times the net income than the last time our businesses were near mid-cycle in the 2018-2019 timeframe.

It's important to note that we'll achieve this level of profitability while continuing to protect our most important investments in products and services that further differentiate our customers. R&D and new product-related CapEx remains at the highest level in the company's history, and we continue to invest in lifecycle solutions and business model transformation. Fundamentally, we're operating very differently than in the past. As a result of these actions we've taken in executing the strategy and the significant opportunity in front of us, we're confident in our ability to produce higher levels of returns through-cycle while dampening the variability in our performance over time. This will lead to higher highs and higher lows for our business.

The runway of opportunity ahead of us is still greater than what we've unlocked to-date which gives us confidence in our strategy and enthusiasm to deliver for our customers and all stakeholders through the balance of the decade.

Joshua Rohleder

Manager-Investor Communications, Deere & Co.

Thanks, Josh. Now let's open it up to see what other questions our investors have.

Brent Norwood

Head-Investor Relations, Deere & Co.

Now, we are all ready to begin the Q&A portion of the call. The operator will instruct you on the polling procedure. In consideration of others and our hope to allow more of you to participate in the call, please limit yourself to one question. If you have additional questions, we ask that you rejoin the queue. Sue?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question is from Steve Volkmann with Jefferies. You may go ahead.

Stephen Volkmann

Analyst, Jefferies LLC

Q

Great. Good morning, all the Josh's and Brent. My question, I guess, is around kind of the cost side of this. I guess historically, I've been through a few cycles with you guys. I might have thought that there would be more opportunity on the cost side relative to the sort of top line guide that you're giving. I'm calculating kind of a 35% decremental. I guess that's kind of okay, but it feels like there should be some levers for you to pull to maybe mitigate that a little bit. So any thoughts around that? I'd love to hear.

Brent Norwood

Head-Investor Relations, Deere & Co.

A

Yeah. Hey, Steve, good morning. Thanks for the question. Regarding our cost management for 2024 and sort of the level of structural profitability embedded in the business, you'll see that some of our most profitable markets are down from a top line perspective, so Production & Precision Ag will be down 15% to 20% while at the same time maintaining a 35% decremental. And as we look at sort of the execution in the fourth quarter, we're starting to see some of our disciplined cost management come into play. I mean, that's the first quarter in a number of years where we've seen production costs actually become deflationary and serve as a tailwind for our business. And I would say there's a significant agenda that we'll be executing towards for the remainder of 2024, but we're pleased to see the progress we've made already in the fourth quarter of 2023.

Our goal from a cost management perspective is to really neutralize all of the, to the extent possible, the production cost inflation in next year and, where possible, actually drive some of that to a production cost deflation tailwind for us. If you think about some of the areas where we're most focused, it's really around reducing costs in our supply chain while at the same time increasing resiliency in the supply base. Over the longer-term, we'll also work on designing costs out of our equipment. And so, if we break that down into some of the subcomponents, we'll have opportunities both in raw material and freight costs which were tailwinds for us in the back half of 2023;

those will continue to be tailwinds for us in 2024. And then logistics will be another area of focus, and I think we're seeing that come down across really all forms of logistics, from rail, ocean, trucking, and air freight as well.

If we go back to 2022, we saw our air freight expense increase almost six-fold during that year and we got about half of that back in 2023 and we'd look to get more of that back over the course of 2024.

Stephen Volkmann

Analyst, Jefferies LLC

Q

And just to be clear, you're expecting that within that 35% decremental you're expecting kind of all those pieces of goodness that you just described?

Brent Norwood

Head-Investor Relations, Deere & Co.

A

Yeah, certainly our guide would contemplate achieving further reductions and that's already included in our 35% detrimental. There's certainly going to be opportunities to continue to control decrementals with further supply management and cost activities for 2024.

Stephen Volkmann

Analyst, Jefferies LLC

Q

Thank you, Josh.

Joshua Jepsen

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

A

Yeah, Steve. One thing I would add is, I mean, if we compare back to periods when we've been at or around mid-cycle which we're projecting 2024 will be, our margins will be nearly double net income, about 2.5 types greater. So I mean, if you think about being around mid-cycle, delivering this decremental and significant improvement from a mid-cycle-to-mid-cycle perspective in profitability, we feel good about where we're at. We have opportunities to keep working on and we'll methodically work through those and as we execute, we'll see those benefits come through, but we feel good about where we're at from a guide perspective. We know we need to execute, but really, structurally, see a significant shift forward even as just call it the last five, six years. So, thank you. We'll go ahead and go to the next...

Stephen Volkmann

Analyst, Jefferies LLC

Q

[indiscernible] (00:40:33)

Brent Norwood

Head-Investor Relations, Deere & Co.

A

...question.

Operator: Thank you. Our next question is from Stanley Elliott with Stifel. You may go ahead.

Stanley S. Elliott

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Good morning, everyone. Could you just talk a little bit about the implied pricing as roughly kind of 1%, coming off of difficult compares? Help us with maybe the exit rate into next year or the end of this year or 2024. Are we talking about negative pricing? Just any kind of help that you can provide there would be great.

Brent Norwood

Head-Investor Relations, Deere & Co.

A

Hey, good morning, Stanley. Regarding our pricing strategy for 2024, we'll be at about 1.5 points for both PPA and CNS and then 1 point for SAT. We will see some carry over early in the year but we would expect the entire year to remain positive for all three segments. Importantly, that forecast does include a return of some retail discounts, so that is a net price realization figure, again inclusive of incentives, and I think what you've seen is with Brazil being maybe the only notable exception, in most markets we've really controlled our inventory position which helps us protect our pricing strategy in most markets for 2024, so we wouldn't expect to see any segment go negative through the course of 2024. Thanks, Stanley.

Operator: Thank you. The next question is from Seth Weber with Wells Fargo. You may go ahead.

Seth Weber

Analyst, Wells Fargo Securities LLC

Q

Hey, guys, good morning, and Happy Thanksgiving. I wanted to see if you could just give a little bit of context around your guidance for PE and PA, and the other segments, where your growth is expected to be, your decline is expected to be bigger than the industry declines. If you could just maybe contextualize that for us, why Deere would be underperforming what you're calling for, for the industry end-markets. Thanks.

Brent Norwood

Head-Investor Relations, Deere & Co.

A

Yeah, Happy Thanksgiving to you, too, Seth. Regarding our guide to our financial guide relative to our industry forecast, you'll notice some slight differences between the segments. Maybe starting with Production & Precision Ag. In North America, we have positioned ourselves really well and we will be able to produce in-line with retail demand for 2024. Where you're seeing our financial guide a little bit lower than our broader industry guide is really due to Brazil, where we will be under producing retail demand in 2024 as we work to bring inventory levels back to our targeted levels for that particular market, so that's really what's affecting our financial guide relative to the industry guide for Production & Precision Ag. For Small Ag & Turf, the story there continues to be around small tractors, our compact utility tractors, where we'll see another year of under-production to bring inventory levels back down a little bit.

That market continues to be affected by the slowdown in single-family housing starts and can also be relatively sensitive to interest rate increases, and so as that end-market continues to be slow, we'll under-produce yet another year in 2024. I would say for the rest of Small Ag & Turf we'll have the ability to produce largely in-line with the industry. As it relates to Construction & Forestry, the story there is a little bit different. You saw the industry at large build inventory in 2023. We did build some inventory but certainly not at the pace that the broader industry did and so we actually may have a little further inventory build yet to come in 2024 but it will be an inventory build to a lesser extent than what happened in 2023 so that'll drive lower shipment volumes year-over-year relative to the industry there, so it's a little bit different story depending on what segment we're talking about, but that's the reconciliation – broad reconciliation of our financial guide to the industry.

Joshua Jepsen

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

A

Yeah, Seth, this is Josh. Maybe one thing to add is just to reiterate the position in North America on the Large Ag side. We've managed that very well and very different than the prior cycle. I think both new and used we're really well-positioned as Brent mentioned both to build in-line with retail as we go-forward but the work that's been done on the new-new side we've highlighted earlier but for example, new inventory on combines, inventory sales of 4% at the end of the year, four wheel drive tractors 9%, or something like 15% on row crop, so both the new side and then what the dealers have done working through used proactively and we've supported that activity has been really positive and positioned us well when you think about our biggest market. Thanks, Seth. We'll go ahead and go our next question.

Operator: Thank you. The next question is from Tim Thein with Citigroup. You may go ahead.

Tim W. Thein

Analyst, Citigroup Global Markets, Inc.

Q

Thank you. Good morning. Maybe just coming back to the comments on production costs and I guess it's a bit more of a clarification, but I thought I heard you say earlier that you expect that the production cost to be favorable overall for the company in 2024 but then later, it sounded like maybe there were pieces of it that you expected to be favorable so just so we're on the same page in terms of the EBIT bridge you provide by segment. That production cost for the company as a whole, you expect that to be on the plus side throughout 2024. Is that correct? Or is that not? Did I mishear that? Thanks.

Brent Norwood

Head-Investor Relations, Deere & Co.

A

Yeah, regarding production cost for 2024. Our guide would contemplate production cost to be flat to a tailwind next year, a slight tailwind I should say. There are some subcomponents within production costs that will still be inflationary but net-net we should be moderately positive in the year 2024. Specifically, we would expect tailwinds to come from further material and freight reductions in 2024 when compared to 2023. Labor would be the largest inflationary item within the production cost bucket for us, and what we're seeing is many of the labor contracts that we have within our factories do have scheduled step-ups in the year, so we'll have to offset those to bring total production cost to a deflationary state in 2024, which again our guide does contemplate.

Joshua Jepsen

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

A

Yeah, in short, Tim, you add up those bars for production costs. They should be green is our current expectation for production cost in 2024. Thanks, Tim.

Tim W. Thein

Analyst, Citigroup Global Markets, Inc.

Q

Okay. Yeah. Got it. Thank you.

Operator: Thank you. The next question is from Kristen Owen with Oppenheimer. You may go ahead.

Kristen Owen

Analyst, Oppenheimer & Co., Inc.

Q

Great. Thank you so much for taking the questions and Happy Thanksgiving. Wanted to ask on a broader capital allocation question, just given the outlook. You've got operating cash flow conversion, greater than 100% guided in 2024 and so my question is twofold. First on the internal investments. Can you talk about the technology spend

through-the-cycle and how you're prioritizing those projects, and then externally, maybe touch on the dividend given the 25% to 35% payout ratio at mid-cycle how we should think about that influencing your dividend outlook next year. Thank you.

Joshua Jepsen

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

A

Hey, Kristen, this is Josh. Thank you for the question. I'll start with the R&D side. So yeah, we'll be up slightly from an R&D perspective, so we're talking \$2.2 billion or more. A tremendous amount of that continues to be focused on what we're doing from a technology perspective and bringing Sense & Act technologies across our portfolio, across the enterprise. Autonomy, significant opportunity there and as Brent mentioned we saw good progress this year there as well and we have significant opportunities there. We spoke to a dealer principal a week ago and he talked about being out with customers here over the last month and every single customer across many different crops and production systems all asking about autonomy so we know the appetite there and the labor challenges being faced by our customer base, so that remains very real.

And we also have some significant new product development coming where we're integrating hardware and technology over the course of the next couple years, so there's a tremendous amount of focus from an R&D perspective on that. And as you've heard us talk about before, we're continuing to think about alternative propulsion solutions that are going to reduce emissions and reduce cost for our customers, and we've got to focus on that space for sure. As it relates to the dividend. We've mentioned, we've taken it up nearly 20% this year. I think that underlies the confidence we have in where we are and where we're going. As it relates to our payout percentage in the range, we're still working our way to that range, to the bottom of that and recognize over time as we continue to execute the way we are, that range will continue to move.

So that is something we likely chase as we demonstrate and deliver continued structural profitability, but I would say all-in-all, given the cash we expect to generate, we'll be able to handle all of our use cash priorities from investing in the business, organic and inorganic, the dividend, as well as to use the residual cash to repurchase shares and we think over the long term, we can drive value-enhancing actions there. So, thanks, Kristen. We'll go ahead and jump to our next question.

Operator: Thank you. The next question is from Jerry Revich with Goldman Sachs. You may go ahead.

Jerry Revich

Analyst, Goldman Sachs & Co. LLC

Q

Yes, hi. Good morning, everyone, and Happy Thanksgiving. Nice to see the production cut in the business before used inventories got out of hand the way they did in prior cycles. I'm wondering if we could just unpack the 15% to 20% production cut in Large Ag and how you're thinking that will drive a balancing in used inventories because obviously, used inventories are at absolute low level but rising rapidly off the bottom. So what's the level of comfort based on your modeling that the 15% to 20% cut is going to get us where we need to be versus needing to cut production further if used inventories continue to build? Would love to hear how you're thinking about all of that.

Brent Norwood

Head-Investor Relations, Deere & Co.

A

Yeah. Good morning, Jerry, and Happy Thanksgiving to you as well. There's a couple of puts and takes as we think about production for next year. Certainly, we and the industry at large have benefited from some of the production constraints over 2021, 2022, and 2023. Certainly, didn't feel like a net benefit during those years, but

the constraints that we faced as an industry during that time period limited the amount of new equipment that we introduced to the fleet in a short period of time. And I think ultimately, we'll see that have a dampening effect on the cycle itself. As it relates to used, we have seen used get depleted significantly during those lean years in 2022 and the first part of 2023. Some of those used inventories have started to come back up in the early part of 2023, and this is where the dealer response has been really phenomenal in terms of their proactive engagement to keep those used inventories well below historic target averages.

And so, we look at combines, we're I think something, 40% below the historic average there, and tractors were around 20% below that historic average. Part of that was, again, our dealers being proactive. But then also, in the back half of 2023, we did increase our incentive spend on used to help dealers manage that used inventory. And I think the other part of the story here is just around how we've changed some of our leasing options relative to the last cycle. If we go back to 2012 and 2013 and 2014, John Deere and the industry at large was engaging in a lot of short-term leases that produced machines coming back to OEMs within one or two years, and that exacerbated some of the used inventory balances that we saw at the end of the cycle.

And so as we intend to produce in line for new next year, combined with better inventory management on the used side, we think that balance of new and used should be relatively healthy going into 2024. Thanks, Jerry.

Operator: Thank you. The next question is from Rob Wertheimer with Melius Research. You may go ahead.

Rob Wertheimer

Analyst, Melius Research LLC

Q

Hi, thank you. I just wanted to circle back to decremental margins in Large Ag. I think Production & Precision is more like 38% versus the 35%, obviously not a huge difference. But I was curious if there's any mix headwind within that segment or R&D. And actually curious how you interpret what sounds like a more negative kind of Combine Early Order Program versus some of the others. Is that a shift in time? Is that a combine-specific cycle? How do you interpret that differential, if there is one? And is that kind of what's dragging down on the margins? Thank you – in the outlook?

Brent Norwood

Head-Investor Relations, Deere & Co.

A

Yeah. Thanks, Rob, for the question. Regarding our decrementals for next year, I think, I mean, there's a number of things to consider. We are seeing a significant double-digit volume decline in our shipments while, at the same time, we've held our R&D investment relatively flat to up a little bit next year as we intend to invest somewhat consistently through cycle here. As you think about sort of the mix impact that's having in our decremental, certainly with combines down more than the group average, that's certainly a little bit of a negative mix headwind there. And I would say over the last few years, we've seen profitability in Brazil approach our North America margins, and so that market being down more than the entire segment average also is a little bit of a mix headwind.

And this is where our focus on cost management is really helping us maintain our traditional decrementals because with those mix headwinds, it would be difficult to do otherwise. Specific to combines in terms of why is that down more than the group segment, combines have a slightly shorter useful life than other pieces of farm equipment. And so over the last two to three years, we saw the fleet age come down more in combines than tractors. And right now, the fleet age is about in line with long-term averages, and so I think that's given producers a little more discretion on their combine CapEx decisions going into next year.

Joshua Jepsen

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

A

Yeah. Rob, great question. This is Josh. One thing to add. At the same time, Brent mentioned R&D, and we're also investing in parts of the business like our business model transformation and how we build out the go-to-market plans there. Over time, we expect that will drive more stable business, better margin as we deliver on that and grow that at scale. I think in the near-term, we're building that and investing in it knowing the benefits that can deliver here as we go through the balance of the decade. So, thanks, Rob.

Brent Norwood

Head-Investor Relations, Deere & Co.

A

And, Sue, I think we have time for one last caller.

Operator: Thank you. Our last question comes from Mike Shlisky with D.A. Davidson. You may go ahead.

Michael Shlisky

Analyst, D.A. Davidson & Co.

Q

Hi. Good morning. Happy Thanksgiving and thanks for taking my question here. Mine's really a very simple one. Just a little more granularity on your comments about this being a mid-cycle year in 2024. I guess I want to know are all three segments looking to be at mid-cycle for fiscal 2024? And are the margin expectations for each segment also about where it should be at mid-cycle as well? Just kind of your thoughts on whether any segment will be below or above mid-cycle and kind of balanced out by the other one. Thank you.

Brent Norwood

Head-Investor Relations, Deere & Co.

A

Hey, Mike. Happy Thanksgiving to you as well. I would say broadly, segments are somewhat close to mid-cycle. I think Production & Precision Ag is probably the closest, Construction & Forestry running a little bit higher and Small Ag & Turf a little bit lower is sort of the directional breakdown there and I think for us, as we think about structural profitability, we measure that at similar points in the cycle across a long period of time. And so for us, we look at 2024 as a good proxy for mid-cycle. We would compare that to 2019 would be the last year our businesses were running around the same level of volume, and so we're pleased that we can generate 2.5x times the net income at these levels and given the mix is most of them are closer to mid-cycle than not, we feel like it's a pretty good example of what we can deliver at mid-cycle volumes.

Joshua Jepsen

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

A

Yeah, Mike, this is Josh. I think maybe just to add-on to what Brent mentioned. I think, importantly here, what we can deliver here at near mid-cycle is fundamentally different than how we performed in the past, so we're talking about roughly \$8 billion of net income, \$28, \$29 of EPS. You can compare that back to 2013, a period we often get compared to, and we are significantly better than that point in time. And I think that's important, because you're seeing a significant shift in terms of how do we perform mid-cycle. Obviously, you saw how well we performed in 2023. I think the implication is at the bottom of the cycle, we would expect to perform significantly better than we have in the past as well. So we're excited about the opportunities ahead of us. It's not just around how we manage the cycle because we see more opportunity for growth from a ability to create value for customers through technology as well as reducing volatility for both customers and their operations and for Deere.

So there's a tremendous amount of room for us over the balance of the decade to continue improving.

Brent Norwood

Head-Investor Relations, Deere & Co.

That concludes today's call. We appreciate everyone's time and hope you all have a great Thanksgiving.

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

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