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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Deere & Company 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. Josh Jepsen, Director of Investor Relations. Thank you. You may begin.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

Good morning. Also on the call today are Ryan Campbell, our Chief Financial Officer; Cory Reed, President of Production and Precision Ag; and Brent Norwood, Manager 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 2020. After that, we'll respond to your questions.

Please note slides are available for the call this morning. They can be accessed on our website at johndeere.com/earnings.

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

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

I'll now turn the call over to Brent.

Brent Norwood

Investor Relations, John Deere

John Deere demonstrated strong execution in the third quarter, resulting in a 14.6% margin for the Equipment Operations, and an increased net income forecast for the full year. Despite persistent uncertainty in large ag markets, profitability increased year-over-year for the division, and take rates for precision technology improved markedly. Meanwhile, markets for our Construction & Forestry division slowed year-over-year, but came in ahead of our forecast and showed progress towards right-sizing inventory levels.

Now, let's take a closer look at our third quarter results beginning on slide 3. Enterprise net sales and revenues were down 11% to $8.925 billion, while net sales for our Equipment Operations were down 12% to $7.859 billion. Net income attributable to Deere & Company was down 10% to $811 million, or $2.57 per diluted share.

In the quarter, the company recorded impairments and closure costs totaling $37 million both pre-tax and after-tax. In addition, the quarter's net income was unfavorably affected by discrete income tax adjustments, while the third quarter of 2019 had favorable discrete income tax adjustments.

At this time, I'd like to welcome to the call, Cory Reed, President of Production and Precision Ag for a discussion of the division's results and changes to the recently-announced operating model. Cory?

Cory J. Reed

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

Thanks, Brent. Let's start with the Worldwide Ag & Turf third quarter results on slide 4. Net sales were down 5% compared to last year, primarily driven by lower shipment volumes and the unfavorable effects of currency translation, partially offset by price realization. Price realization in the quarter was positive by 4%, while currency translation was negative by 3%.

Operating profit was $942 million, resulting in a 16.6% operating margin for the division. The year-over-year increase is primarily due to price realization, lower SA&G and R&D as well as a decrease in warranty costs. These items were partially offset by the unfavorable effects of foreign currency exchange, lower shipment volumes and impairments and closure costs.

During the quarter, the division incurred charges of $37 million related to the closure of a small tractor facility in China and the sale of a European turf business. With that context, let's turn to our 2020 Ag & Turf industry outlook on slide 5.

In the US and Canada, we expect Ag industry sales to be down roughly 5% to 10% for 2020. During the quarter, sales for small tractors have remained strong as the pandemic has driven an increase in projects for home and property owners. The strong retail environment, combined with our planned under production, have reduced our field inventory position for the year and should provide a healthy entry point for 2021.

Meanwhile, demand for large ag machines is still forecast to be down relative to 2019, but demand has remained relatively stable throughout the year as our long lead order books and early order programs now provide visibility through the end of 2020 and beyond.

Farmer sentiment continues to be fluid due to the many uncertain variables impacting our customers headed into 2021. Unresolved issues around global trade and continued government support, combined with a sharp decline in ethanol during the early months of the lockdown have kept grain stocks elevated going into the harvest season.

At the same time, the farm equipment fleet continues to age out and new and used inventory positions are low, especially as it relates to Deere equipment relative to competitive machines. Additionally, precision ag advancements for new and retrofit solutions continue to unlock economic headroom for our customers. The balance of these factors was reflected in the results of our phase one early order program for planters and sprayers, which both ended up relative to the previous year's program.

In comparison to last year, keep in mind that 2019 was adversely affected by the delayed planting season. Encouragingly, nearly all of our advanced precision features, such as ExactApply and ExactEmerge saw higher take rates compared to the previous year. The results give us confidence in our precision ag strategy and demonstrate customers' willingness for sustained investment in technology in the face of uncertain market conditions. Specifically, we see the significant levels of investment in solutions that have the highest demonstrable impact on improved customer economics.

Moving on to Europe, the industry's outlook is forecast to be down 5% to 10%. Over the quarter, the outlook for arable farmers declined slightly amid lower grain prices and weakening yields, especially in the UK and France, where dry conditions have persisted throughout the growing season. Additionally, dairy margins continued to soften albeit from recent peaks. Meanwhile, pork producers continue to enjoy favorable conditions as exports remain strong.

Despite some modest headwinds this year, we continue to make progress in the region through our focus on precision ag. Over the year, we've seen increased market share in the 150-plus horsepower tractor category, while engaged acres in our operations center has nearly doubled since the start of the year.

In South America, industry sales of tractors and combines are projected to be down 10% to 15% for the year. Despite positive fundamentals in Brazil, the effects of COVID and the global trade uncertainty have weighed on farmers throughout the first half of the year. While industry sales will be lower for the fiscal year, we've seen sales momentum building in recent months, and our order books now extend well into the first quarter of fiscal year 2021, indicating a solid start to the year.

Shifting to Asia, industry sales are expected to be down slightly as key growth markets like India are recovering after significant impacts of the country-wide lockdown. Lastly, industry retail sales of turf and utility equipment in US and Canada are projected to be down about 5% in 2020.

Moving on to our Ag & Turf forecast on slide 6. Fiscal year 2020 sales of worldwide Ag & Turf equipment are forecast to be down roughly 10%, which includes expectations of 2.5 points of positive price realization, offset by a currency headwind of about 2 points. For the division's operating margin, our full year forecast is roughly 11.5%, which is inclusive of cost related to both employee separation programs, as well as facility impairments and closures. In total, we estimate these costs to be roughly $260 million for the division in fiscal year 2020.

Before moving on to the Construction & Forestry division, I'd like to first offer a few remarks on the new operating model announced in June. As noted in our release, our smart-industrial strategy is designed to unlock new value for customers, helping them to become more profitable and sustainable, while revolutionizing agriculture through rapid introduction of new technologies.

To accomplish this, we focused our strategy and organization around the three primary areas shown on slide 7: production systems, our technology stack and lifecycle solutions. Over the last few years, we've integrated a production systems perspective into our product planning roadmaps. However, our recent redesign now formally organizes our entire business around these systems, which has important implications for how we plan our product portfolio and how we allocate capital.

A production system is illustrative of how our customers get work done, and includes both the jobs they perform and the decisions they make to produce an output. In Ag, for example, we contemplate every single job and decision required to prepare the soil, to plant the seed, to protect and nurture the crop and to harvest it at the end of the season. The work done preparing the soil has implications for how to plant seeds and promote uniform emergence, which impacts how we care for that crop throughout the growing season, ultimately informing the harvesting job. This entire series of decisions and jobs create the systems in which our customers operate.

Our solutions will empower customers to do their jobs more productively while making better decisions that minimize inputs, maximize outputs and create a complete cycle, where each step informs the next.

Also, critical to unlocking value for customers is the accelerated development and leverage of our technology stack across our suite of products. Think of our technology stack as the full set of components required to deliver solutions to our customers. For nearly 25 years, we've been investing in core technologies that can be leveraged across the enterprise, from our early development of embedded controllers, software and telematics and guidance systems to more recent investments in computer vision, machine learning and data platforms.

Today, we're better positioned than anyone to provide seamless, integrated solutions, with the sum of our product suite in the production system is greater than each of these machines operating in isolation. Our technology stack is also the key enabler to extract data from one step in the system in order to make the next step more effective. The value creation is powered by our core technologies and provides us the greatest opportunity for differentiated solutions in the marketplace.

Bringing this all together, our production systems approach, combined with the precision delivered to our technology stack, will deliver a seamless cycle that unlocks the ability to utilize resources in the most precisely-targeted manner to achieve optimum output, which means delivering our customers increased productivity, greater profitability and enhanced environmental outcomes throughout the full production system.

Lastly, our strategy puts a renewed focus on lifecycle solutions to enhance our aftermarket and support capabilities. We see significant opportunity to improve our penetration throughout the entire life of our products, while simultaneously improving customer experience and uptime for their equipment. Our connected machines, the supporting tools and applications and our highly differentiated dealer organization are critical elements to our initiative.

Furthermore, we'll focus on enhancing our e-commerce tools, while leveraging a tiered offering through our [ph] all-mix (00:12:29) and remanufacturing segments. Lastly, we'll accelerate our performance upgrade, or retrofit business, with the intent to proliferate precision ag solutions deeper into our installed base, at price points that enable owners of used equipment to upgrade into more productive and sustainable equipment.

Moving to slide 8, I'd like to spend a few minutes expanding on our production systems framework and give a few examples of what's changing with our new operating model. In the early days of precision ag development, some of our solutions offered hard-to-prove benefits and faced lower take rates in the marketplace. As we progressed in this journey, we formed production system teams to assess the agronomic and economic impact that our solutions play in the jobs and decisions that farmers make each year. The result of these teams helped produce key innovations over the last few years, such as our ExactEmerge planters and ExactApply sprayers.

In effect, we've spent the last several years putting the building blocks in place to deliver differentiated solutions to our customers in the production systems in which they operate, and now is the time to accelerate our vision by formally reorganizing the company around these targeted systems.

In our new organizational design, each division president owns the end-to-end production system for our customer segments. That means the entire suite of products for any crop system is organized and reports to one leader. We think this has important implications for how we allocate capital, shifting more resources toward projects that unlock the most economic value and deliver the most sustainable outcomes for any given system.

In the Ag & Turf division, for example, my team will lead and maintain end-to-end responsibility for the corn and soy, small grains and cotton and sugar production systems, which includes all of the engineering, manufacturing and marketing from large tractors, combines, crop care and crop harvesting. Meanwhile, my colleague and partner, Mark von Pentz, and his team will oversee turf and utility, dairy livestock and high-value crop production systems. The new design will be key to bringing innovative and integrated solutions to market faster than ever before.

The real power of our model comes from our ability to scale solutions across geographies and across different production systems. Today, many of our leading technologies are designed for and introduced in the US corn and soy production system. We see an enormous opportunity to adapt our solutions for different geographies and accelerate the pace of adoption for farmers.

Brazil is a great opportunity, a great example of this opportunity. Over the last 18 months, we've introduced nearly all of our leading North American technologies in planting, spraying and harvesting to the Brazilian market. Additionally, we've launched a key initiative to drive adoption of our digital platform. To date, take rates and market acceptance has been very positive, with many of our initial introductions selling out within days.

With respect to digital adoption, engaged acres have tripled in the region in the last 18 months, while driving higher utilization of the John Deere Operation Center. In addition to leveraging technology in the new geographies, we're also adapting our solutions to scale across different crop production systems.

As I mentioned, while technology has tended to be first developed for corn and soy customers, we see significant potential to utilize these innovations for small grains production. Key technologies such as section control, or precise seed placement, represent enormous near-term opportunities for products like air seeders, while the inclusion of customer vision and computer-vision and machine learning hold long-term potential for further automation of the small grains market.

Ultimately, our new operating model is essential to capturing the immense opportunities ahead of us and will help us accelerate and accelerate the pace of adoption for the industry.

At this time, I'd like to turn the call back over to Brent Norwood to cover the details on the quarter for Construction & Forestry. Brent?

Brent Norwood

Investor Relations, John Deere

Yeah, let's focus on Construction & Forestry on slide 9. For the quarter, net sales of $2.187 billion were down 28%, primarily due to lower shipment volumes and the unfavorable effects of currency translation, partially offset by price realization. Operating profit moved lower year-over-year to $205 million, due largely to lower shipment volumes and sales mix, partially offset by price realization and lower SG&A.

Let's turn to our 2020 Construction & Forestry industry outlook on slide 10. Construction equipment industry sales in the US and Canada are now forecast to be down about 20%, reflecting sharp declines in the oil and gas sector, rental CapEx, as well as overall moderation and general economic activity.

Moving on to global forestry, we now expect the industry to decline between 20% and 25% this year, with the US and Canada markets declining more than the rest of the world.

Moving on to our C&F division outlook on slide 11, Deere's Construction & Forestry 2020 net sales are now forecast to be down by about 25% compared to last year. The incremental decline relative to the industry guidance reflects plans to under produce retail sales as we take further action to reduce field inventory by about 20% to 25% for earthmoving equipment. The order book remains within our historical 30 to 60-day replenishment window, but at a much-reduced production schedule relative to last year.

Our net sales guidance for the year includes expectations of about 1 point of positive price realization and a currency headwind of about 1 point. For the division's operating margin, we are increasing our forecast to approximately 5% due to modest improvement in the Construction Equipment segment and a strong third quarter performance in road building. Our margin forecast is inclusive of costs relating to both employee separation and impairments. In total, we estimate these costs to be about $130 million for the division in fiscal year 2020.

Let's move now to our Financial Services operations on slide 12. Worldwide Financial Services net income attributable to Deere & Company in the third quarter was $183 million, benefiting from lower losses on operating lease residual values, decreased SG&A and a reduced provision for credit losses, largely offset by a higher provision for income taxes related to unfavorable discrete adjustments in the current quarter and favorable discrete adjustments last year.

For fiscal year 2020, net income forecast is now $510 million, which contemplates a tax rate between 24% and 26%. The provision for credit losses forecast in 2020 remains at 37 basis points, reflecting a higher degree of uncertainty relative to last year.

Slide 13 outlines our guidance for net income, our effective tax rate and operating cash flow. Our full year outlook for net income is now forecast to be about $2.25 billion, which includes the impact of our most recent employee separation program, estimated to cost $175 million in the fourth quarter. The guidance also contemplates an effective tax rate projected to be between 27% and 29%, which moved higher for the year, due to discrete tax items primarily in the third quarter. Cash flow from the Equipment Operations is now forecast to be about $2.8 billion.

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

Ryan D. Campbell

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

Before we respond to your questions, I'd first like to offer some perspective on our liquidity, recent strategic actions and our financial results for the quarter.

During our second quarter earnings call, we outlined the actions taken to enhance our overall liquidity and financial position. These actions involved raising over $4 billion in total through two medium-term note offerings in addition to renewing our credit facilities. We also announced the indefinite suspension of our share repurchase plan. The environment remains very dynamic, and accordingly, we expect to hold additional liquidity for an indefinite period. However, given the strength of our operating results and our strong cash generation, we are now comfortable restarting our share repurchases.

To be clear, we will execute any repurchases in accordance with our use of cash priorities, that start with maintaining our A rating, funding our capital expenditures, paying a dividend, and finally, using residual cash flow for repurchases as conditions warrant.

During our Analyst Day at CES, we laid out the new priorities for the company. First, was a more focused capital allocation process, including both capital investments and R&D to reallocate our resources to areas of the greatest potential for differentiation and profitability with a specific intent to: one, intensify our precision ag investments; two, enhance our capabilities in our aftermarket and retrofit business; and three, actively address any lower-performing product lines.

Secondly, we committed to adjust our cost structure, including both our organizational design and footprint, to create a more agile company, to respond faster to market dynamics and best capitalize on the immense opportunity in front of us.

During the first three quarters of this year, we've taken significant action towards achieving those properties. As Cory noted, we announced our new operating model in June, which represented a critical step executing our vision. As part of this new model, we've redesigned our organization around production systems, increasing our focus and accountability, while aligning our organization with how our customers work.

We created a chief technology officer role to better leverage our technology stack throughout the enterprise and sharpen our focus on the next generation of precision ag innovations. Lastly, we redesigned our aftermarket and retrofit organization to better serve our customers.

These organizational changes have significant implications for how we allocate capital and will ensure that we prioritize solutions that have the highest potential to unlock value for our customers.

With respect to our cost structure, we've announced two employee separation programs in 2020, costing $138 million and $175 million respectively. In total, these programs will incur estimated expenses of approximately $315 million and will provide for an annual run rate savings of around $260 million.

We expect to complete our organizational design work in fiscal 2020, with continued focus on creating an organization with higher levels of autonomy, accountability and the speed necessary to quickly respond to changing market conditions as well as capitalize on the opportunities to unlock differentiated value for our customers.

We've also completed an initial portfolio review to assess each product line's strategic fit and financial contribution. As a result, we announced the closure of a small tractor facility in China and the sale of a European lawn mowing business. These actions resulted in costs of $37 million for the quarter. Importantly, our portfolio actions will continue, and we'll provide updates during our quarterly earnings calls as additional decisions are made and executed.

As it relates to our third quarter performance, the operating results are directly attributable to the hard work and dedication of our employees and dealers, who have worked diligently to implement our strategy while simultaneously adjusting operations and pulling cost levers in response to the global pandemic.

Looking forward, there are many uncertainties facing both our operations and those of our customers in the near term. Given this uncertain environment, we are even more convinced that our strategy is the right one, allowing us to focus on what we can control and deliver differentiated products and services to our customers that drive profitable and sustainable outcomes.

More than ever, our industries require solutions that reduce costs, enhance productivity and deliver sustainable outcomes. We have spent the last several years putting the building blocks in place, to deliver differentiated and integrated solutions to our customers and the production systems in which they operate. Now is the time to accelerate our vision through the new strategy and operating model.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

Now, we're 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.

Julie?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Rob Wertheimer with Melius Research. Your line is open.

Rob Wertheimer

Analyst, Melius Research LLC

Q

Howdy. That was actually a great overview of the new operating model and the importance of it. You touched a little bit more on the external features than the internal, and I wonder what if you can just do a little bit more on nimbleness or responsiveness or the internal costs that you sort of see potentially changing as a result of the way you've organized yourselves? Thank you.

Joshua Jepsen

Director-Investor Relations, Deere & Co.

A

Yeah, thanks, Rob. Maybe I'll start and ask Cory or Ryan to add in. I mean, I think as we think about this, there's obviously the customer-facing component and being more aligned to how they do their work, and I think that's a critical component.

As we think about internally what this does in addition to accountability and then fewer handoffs and those sorts of things, we also think [indiscernible] (00:26:36) create speed and that speed is important because it's, one, to react and make quicker decisions as market dynamics shift, but also in the way that we're able to implement and execute technology and execute it throughout the portfolio, and deliver it to customers in a more rapid way.

Ryan D. Campbell

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

A

Yeah, Rob. It's Ryan. We've talked about the cost and savings component and from the employee-related programs, and as we said, we'll continue to look at the portfolio, and we'll talk about any decisions or actions that we have when we make those on our quarterly calls, and so those actions will still continue.

I think a testament to the new organization is what we've just been through with COVID. We've taken some layers out of the organization. We've been able to respond much quicker in this very, very dynamic environment, and that's given us a lot of confidence with the path we're going forward on.

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

A

Yeah, Rob...

Rob Wertheimer
Analyst, Melius Research LLC

Q

Thank you. Yeah, Cory.

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

A

This is Cory. I'd just say if you think about how we were organized in the past around platforms and product lines, it served us very well, but it also required a lot of effort, time, energy spent on aligning the organization for what we're going to do next.

In the new model, we're operating by empowering teams closer to the business and creating less of those handoffs. And the production system teams responsible will have the capital allocation responsibilities to make decisions faster and to bring those products to market more quickly to enable customer profitability. And we see it starting already, with although the model is just going in place right now.

Rob Wertheimer
Analyst, Melius Research LLC

Q

Thanks.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

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

Operator: Our next question comes from Andy Casey with Wells Fargo Securities. Your line is open.

Andrew Casey
Analyst, Wells Fargo Securities LLC

Q

Thanks a lot. Good morning, everybody. Wanted to ask a couple questions about the updated – kind of shorter-term updated forecast implications for the fourth quarter. Revenue guidance seems to imply down around 18% in the quarter, and then roughly mid-teen percent decremental margin if I exclude the $175 million charge you disclosed.

If I look at it ex-charge and account for the inventory actions in C&F, what factors, other factors, are leading you to anticipate both the weaker revenue and reduced ability to hold margins as well as you did in Q3, which was quite extraordinary, but could you help with that?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, Andy. Thanks. I think you're right. I mean, one of the biggest pieces is just the continued inventory management, so we do expect to see under production in the construction equipment for North America, as well as small tractors on the ag side, so that is one of the components as it relates to the top line.

I think things to consider when you think about margin, one is the employee separation costs, that's in the fourth quarter, so $175 million across the company. That's one. Material, we've seen pretty positive material movements this year. As we get into the fourth quarter, we start to lap reductions that we saw in the fourth quarter of 2019, so while we see that improving, nearly not to the extent that we have seen during the year because of lapping those.

Price in the fourth quarter, we don't expect to be as strong as we've seen year-to-date or particularly in the third quarter. And then, one other thing that I would point out is we still are in a pretty dynamic and fluid environment as it relates to COVID, so we have costs embedded in both of our divisions, whether it's overhead disruptions in the factories or premium freight, just because it's still a moving target in terms of the environment with the coronavirus and how that's impacting us. So, those would be the biggest drivers and puts and takes.

I think when we look at it and you go kind of ex-items, ex the voluntary separation costs, decrementals from an equip ops perspective are in the 20s, so we feel like pretty reasonable given what we're seeing from a top line.

So, thank you, Andy. We'll go ahead and jump to our next question.

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

Stephen Edward Volkmann
Analyst, Jefferies LLC

Q

Hey. Good morning, guys. I'm wondering if we could kind of go back. I think both Cory and Brent talked in the opening comments about early order programs being good and take rates for the precision ag being strong. I'm wondering if we could, perhaps, put any bookends in terms of numbers around those. And then did that help the margin in the quarter as well, in Ag & Turf, because that was obviously very strong? And I'll leave it there. Thanks.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

As it relates to the early order program, Steve, yeah, so we – Cory referenced the orders were up and what we saw in the first phase, planters were up about 10% on a unit basis, sprayers were up a little bit more than that, so that's clearly positive from a directional point of view. I think maybe more importantly is what we're seeing from an adoption of technology, so on planters, ExactEmerge in the low-40s, so up again compared to where we were a year ago, ExactApply on sprayers in the high-40s, so continuing to see strong adoption.

And I think when you step back and look at the current environment we're operating in and our farmers are operating in, I think it's a testament to the willingness to be able – to want to invest in technology and the ability to deliver clear outcomes for those customers.

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

A

Yeah, I would add – this is Cory. I would add that in addition to the strong program, I think the most important thing for us is to see that our customers continue to buy into those features. And we often reference ExactEmerge and we reference ExactApply, but it's across the board. So, individual row hydraulic down force, row cleaner adjust, closing wheel controls, electric drives on our planters, all the way through what we're doing in air seeding and what we're doing across sprayers. In addition to a good program, what we have is the technology suite that is being adopted increasingly by our customers to drive profitability.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, and, Steve, on your question relative to margin. No impact on margin. We were taking those orders. We will start to build a little bit of that as we get into 4Q, but really see more of that as we roll the fiscal year into 1Q.

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

A

Yeah, and it's Ryan, maybe just a point on that. The margin performance that we've shown in the quarter is reflective of all the work that we've done with respect to developing technology and delivering solutions to our customers. As you think back what Ag produced this quarter, it's the second highest operating return on sales that we've had. You have to go back to 2013 in the third quarter to get a higher number, and in that period, our sales were about $2 billion higher. So, if you take a step back and think through what's driven that margin performance this time on lower sales, it's really the technology and the solutions we're offering our customers.

Stephen Edward Volkmann
Analyst, Jefferies LLC

Q

Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

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

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

Steven Fisher
Analyst, UBS Securities LLC

Q

Great. Thanks. Good morning. Just want to ask a big picture question on margins, and so with the good outcome that you had this quarter overall, I'm wondering if there was anything in this particular quarter's results that you would say is – kind of serves as a proving point for your 15% targets. And I'm wondering if the construction contribution to that margin is more or less worrisome than it has been. I know you've thought that that areas needed a bit more work, it sounds like maybe more of the employee separation is focused on that side of it. I'm just curious about kind of the bigger picture, longer-term confidence in that margin now.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Hi, Steve. I mean, certainly, I think the performance in the quarter and what we see for the full year continues to give us confidence in the direction and the ability to deliver 15%, and doing that at when we think about where we're at from a large ag perspective, our relatively low volumes is – I think it speaks to the power of what we've been able to do.

As you think about Construction & Forestry, with a significant destock occurring through the year, we were able to ex-items, like I said, we're going to do margins kind of in the mid – or excuse me, decremental margins in the mid-20% range, so continues to perform pretty well, given those challenges. And maybe importantly, is that as you think about the road building side of the business, in the quarter, we did about 15% margin on road building, and that's with volume compared to a year ago down by about 20%. So, we're seeing really strong performance there.

And I think that continues to give us guidance too and just the power of the combination of our earthmoving and forestry business with that road building business, and what that's been able to deliver.

One of the big questions was how cyclical was that road building business, and I think we've seen that come in as less cyclical, for a full year, we expect that business to be down about 10% compared to much more significantly on the construction business. So, I think that does give us continued confidence in what we can do there.

And then one other thing to add is when we start to think about the opportunity to further leverage technology and technology that we've put in place in Ag and that we can leverage into both earthmoving, forestry and road building, we think that's a considerable opportunity for us as we go forward.

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

Steven Fisher
Analyst, UBS Securities LLC

Q

Thank you.

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

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Yes. Hi. Good morning, everyone. I'm wondering if you can expand on your comments on the used market, the industry data that we track shows really big step down in used inventories for the industry this year. Is that consistent with what you're seeing somewhere in the range of with tractors down 45% off the peak? And is that decline in used, is that's what's driving the strong results in the early order program while farmer economics are obviously up pretty tight?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, I think, Jerry, when you think about used, it is – and we feel like used is in a really healthy place. We've done a lot of work. Our dealers have done a ton of work pulling that down, and we're at – when you think about row crop, which has been the one area that's been an area that we've needed to work on for quite a while, we're at levels we haven't seen since 2014, or below so it's come down, inventory has come down, and then on top of that, we're seeing price stable to up, on late model, so it's been really, really supportive of the overall environment. Cory?

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

A

Yeah, this is Cory. The only other thing I would add, if you just look at late model used and you take a look at what's going on in auctions, you look across the board, it's clear that the aging of the fleet has led to a need for new – more new product to go into the market. We've seen very positive results not only in the levels of used that we have but the values that those used products are bringing in the marketplace.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah. Thanks, Jerry.

Jerry Revich
Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

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

Operator: Thank you. Our next question comes from Joel Tiss with BMO. Your line is open.

Joel Tiss
Analyst, BMO Capital Markets Corp.

Q

Hey, guys. How's it going?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Hi, Joel.

Joel Tiss
Analyst, BMO Capital Markets Corp.

Q

And can you just give us any more color on sort of your product line reduction? And I know you're going to update us quarter-by-quarter, but I'm sure there's a bigger picture plan there. And can you give us an idea like what inning you're in or how far the way through? Are you just beginning or are you halfway through or just any sense there? Thank you.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, Joel, I'd say, I mean, I think from a where are we, I think it's early, I think we're trying to take a methodical approach to this and really thinking about, as we look, what are the products where we can differentiate most and create the most value, and that includes how do we leverage technology, so that's kind of the first component of that. And then just where do we have strategic fit with our overall business, so I think those are kind of two of the lenses we're using and I'd say we're continuing to work through that.

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

A

Yeah, and this is Ryan. You'll see us take action throughout probably 2021 on this. And as we said, we'll update as we make decisions, but as Josh said, kind of the areas that we can focus on, the financial potential, ability for us to unlock value for our customers, those are the areas that we're going to refocus. It's not that we're going to turn our back on a lot of things. It's that we'll take a look at those things, and see how we can serve those customers in just a different way, so that's how we're thinking about it.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, thanks, Joel.

Joel Tiss
Analyst, BMO Capital Markets Corp.

Q

Okay. Thank you.

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

Ann Duignan
Analyst, JPMorgan Securities

Q

Hi. Good morning.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Good morning, Ann.

Ann Duignan
Analyst, JPMorgan Securities

Q

Good morning. Can you just talk a little bit about the fundamentals in US Agriculture, in particular, the growing competition from South America? And is there any risk that as you make US farmers more and more productive that we end up with just a continuation of global supply outstripping global demand, which is where we are today on most of the crops, and just how you think about that? But we are at a point where we have excess supply of all crops, and just making farmers more productive means we continue to grow the supply as opposed to focusing on growing demand.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

As we think about that, we look at the fundamentals, and I think it's important to kind of step back and look at what's happening big picture from a consumption perspective, what are some of the macro events driving activity. I think what one thing that we've looked at, and as China rebuilds their hog herd, for example, we're seeing consumption of soybeans and really consumption of other commodities too, like corn, growing and growing at a faster rate, as that herd rebuilds as that is further commercialized. So, I think fundamental backdrop, what is happening from a consumption perspective is really, really important.

Now, as it relates to production, certainly we've seen heavy crop – strong crop this year, and as you think about some of the coronavirus impacts as it relates to lower ethanol demand, which has pulled some consumption of corn out in the near term, there are some of those impacts within the year. But I think what I'd say, we continue to focus on is how can we work on what we can control, delivering technology that can drive outcomes for our customers, whether that's through tighter use of inputs, higher yield and increased sustainability. And we think we can create – continue to create value. And as it relates to US, Brazil, soybeans in particular, those two countries produce about more than two-thirds of the world's soybeans, so those are the two key places to grow and we really like our position in both of those places to serve customers.

Cory, anything you'd add?

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

A

Yeah, Ann, this is Cory. The only thing I would add is – in a little more detail is that the technologies we're delivering apply equally to whether we're trying to grow output, so productivity or efficiency, which is to grow the same with a lower cost and lower environmental footprint.

The good news, I think, is that the long-term fundamentals remain the same, population growth and our overall incomes over time being higher going to drive that demand, we're 25 going into 26 years consecutive. So while we're going to have short-term issues on over and undersupply, our technologies that we're delivering scale appropriately either for production or for the efficiency of the crop. And I think that's what our customers are buying into. And at a time when commodity markets are tight, they're still buying the technology to lower their breakeven cost for producing the crop.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

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

Operator: Thank you. Our next question comes from Joe O'Dea with Vertical Research. Your line is open.

Joseph John O'Dea
Analyst, Vertical Research Partners LLC

Q

Hi. Good morning, everyone. Could you expand a little bit on the pricing experience in the quarter, the degree to which that came in better than you anticipated? What the drivers were there? Why we don't see a little bit more sustainability and I think in particular, in C&F, given more of the demand challenges there and yet very strong pricing experience in the quarter?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

As it relates to price, Joe, I mean, I think one thing [ph] and I'd say this (00:43:52) on both divisions, we've really tried to maintain discipline in how we're managing price and how we're addressing our markets. I think what we've seen is really on both markets, we were able to run with a little bit lower discounts in the quarter. We had some benefits of just lower interest rates as it relates to low-rate financing, which has helped. And also in both divisions, we saw stronger pricing from an overseas perspective, which contributed in the quarter. So, those are the things that we saw in the third quarter that led to push our price maybe a little bit higher than what we would have expected.

Joseph John O'Dea
Analyst, Vertical Research Partners LLC

Q

And why that doesn't persist into Q4?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, I think some of it's timing as it relates to the overseas price, and then the – we've just got lower volume also, when you think about the fourth quarter, so just we're expecting that not to be as strong as what we saw in the quarter. Thanks, Joe.

Joseph John O'Dea
Analyst, Vertical Research Partners LLC

Q

Thanks.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

We'll ahead and go to our next question.

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

Ross Gilardi
Analyst, Bank of America - Merrill Lynch

Q

Hey. Good morning. Thanks, guys. I just wanted to – I was wondering if you could give a little more color on just your rationale for another round of employee separation in light of industry demand trends that seem to be accelerating, and obviously very strong margins in Ag & Turf in the quarter?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, I mean, I think as you think about what we're doing from an org perspective, I would decouple that a little bit from the kind of current market conditions. I mean I think that what we're doing from an organizational perspective is strategic in nature, and really trying to align around the things that Cory talked about, and the key tenets or hallmarks of what we see in delivering the smart-industrial strategy that we've outlined. And from a market conditions perspective, I'd say more of the work there has been really focused on inventory management and being – position ourselves as best we can to exit this year given the uncertainty, and that – I think those would be – that's the way that I think we frame that up. I think they're somewhat separate issues.

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

Operator: Our next question comes from Adam Uhlman with Cleveland Research. Your line is open.

Adam Uhlman
Analyst, Cleveland Research Co. LLC

Q

Yeah, hi, guys. Good morning. I was hoping we could expand a little bit more on the construction equipment business. A decent amount of upside this year, and demand from what you were looking for before. Could you just talk about your thoughts on housing, rental demand, non-res, construction? And then just more broadly as I think about 2021 demand, how do you think about the average age of the fleet? I would assume that it's younger on average, but perhaps utilization's been stronger than I would have thought, so maybe that's not the case. Could you just maybe unpack that a little bit more?

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, when you think about the construction and kind of the macro backdrop, I mean, I think we have seen housing coming back somewhat. Obviously starts in July were, I think, surprised to the upside, so that's a good thing. I think when we look at what's going on there, rental has been slow as they pulled back. We saw a little bit of that come back in the quarter, so that's a good thing. Certainly, something we're watching and the rental companies are managing that tightly, as are our dealers that have their own rental fleets, they're managing those inventories as well.

When you think about the age of the construction fleet, so, relatively young given the strong markets we've been through, and on top of that, we've – you just had machines through the course of the spring and summer that haven't been operating, so not putting hours on them can be a bit of a challenge as well. But – so, we think about that backdrop overall as continued uncertainty as it relates to when do things really pick back up. Non-res, as you mentioned, has been particularly weak, so we're mindful of that. And I think the best thing that we can do is really manage inventory. We're going to take 20% to 25% of our field inventory out in North America, and we think that puts us in a position to produce to retail in 2021.

So, thanks, Adam.

Operator: Our next question comes from Seth Weber with RBC Capital Markets. Your line is open.

Seth Weber
Analyst, RBC Capital Markets LLC

Q

Hey, guys. Good morning. Hope you're doing well. Just wanted to circle back on the early order program for a second, you commented that up double-digits year-over-year, but 2019 was obviously kind of a squishy year with weather and stuff. Can you just talk about where you feel like it's at relative to say 2018 or more of a normal year? Thanks.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, Seth, you're right. I mean, we did see – last year was an odd year with weather. I mean, people were still planting well into the June timeframe. I think as it relates to 2018, it's probably closer to kind of flattish with that from a unit perspective, but maybe importantly, given the technology and some of the things Cory mentioned, we're seeing the average kind of unit price of those machines, it's higher as a result of greater adoption of technology.

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

A

Yeah, I would say on a unit basis, it's pretty similar, but what we are seeing are larger machines, we're trending toward larger, higher capacity machines and more technology-intensive offerings, so you think about a higher average per machine going out the door.

Seth Weber
Analyst, RBC Capital Markets LLC

Q

Okay. That's helpful. Thank you, guys. Appreciate it.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yes. Thanks, Seth.

Operator: Our next question comes from Courtney Yakavonis from Morgan Stanley. Your line is open.

Courtney Yakavonis
Analyst, Morgan Stanley & Co. LLC

Q

Hi. Good morning, guys. I guess maybe I'm just curious about the build-up to your 15% mid-cycle margin target, especially with something like the additional voluntary separation program sounding like it's more structurally related to your reorganization, so do you see any upside to that?

And then maybe, Josh, you mentioned a couple of the headwinds that may be coming through on the margin side in the fourth quarter as it relates to lapping over material costs and pricing being a little bit lighter, but can you also just help us think about maybe the puts and takes of margins in 2021, especially as we start to see maybe more of the work in synergies or some benefits from international productions? Thanks.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Courtney, I think when you think about 2021, I think important as you think about some of the one-time costs we've had this year as it relates to employee separation and some of these things, that we expect to yield about $260 million run rate next year, from a savings perspective. It's worth noting, we expect in 2020 we see about $65 million of that in savings, but the full run rate on those would be about $260 million next year. So that's the biggest thing, as you think about benefits that we would see in the upcoming year.

I think the other piece is some of the footprint, some of those things will – we should see some benefits. As Ryan mentioned, we're continuing to work through that, so we'll potentially have actions down in the future that could impact that as well, but I think the biggest thing would be to think about that run rate from a savings perspective.

Thanks, Courtney.

Operator: Our next question comes from David Raso with Evercore ISI. Your line is open.

David Raso
Analyst, Evercore Group LLC

Q

On the puts and takes for the margin 2021 versus 2020, you just highlighted the $195 million incremental savings from the separation programs. But just so we have the list here, there were separation costs this year of about $315 million. Those don't repeat, so that's the largest year-over-year, correct? And if we can just go through the $37 million of impairment and factory closure costs this quarter, they also don't repeat, if you can clarify that.

And the carryover of current pricing gains, if nothing changed at all, what's the carryover on the price? Because it seemed like there's a lot of tailwinds there but then the big headwind to ask is what was the number on discretionary cost savings this year that come back next year? So, if you can help us with that on the tailwinds versus the discretionary savings that don't repeat that do come back in 2021.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Yeah, thanks, David. So, if we sit back and say what were the one-time costs that we incurred in 2020, so in separation, impairments, exit, closures those sorts of things, that's about $435 million, so that's the number of all-in costs that you saw in 2020 for the full year.

As you think about kind of levers or costs that may come back, we've been really thoughtful as we pull levers and taking actions to really focus on what can we do structurally, but we certainly think there will be some discretionary costs or some costs that comes with whether it's volume or other things that come back in, but that's something we're going to try to manage really diligently. To put a number on it, it's way too early to try to project what that would be in 2021, but I think those are the two things.

As it relates to price, I mean I don't think there's a whole lot to read into price other than we expect to have strong price this year, and as we think about price from a delivering value perspective, we're confident in the ability to be able to get price as we go forward.

So, thank you, David. We'll go ahead and jump to our next question.

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

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

Q

Yes. Thank you. I want to go back to construction if we can. And I'm trying to put the pieces together here on your revised outlook. It sounds to me like you haven't really changed your destocking assumptions for the year, correct me if I'm wrong on that. Wirtgen, or rather the road building business, seems to be a lot better than what you expected last quarter. My recollection is you thought that business was going to be down [ph] 25% (00:54:56) and it's now apparently only going to be down [ph] 10% (00:54:59). So, I'm curious as to what drove this change.

And in your kind of base earthmoving business in North America, I'm wondering how you're thinking about the end market demand because from what I could tell through the quarter, things haven't really changed that dramatically from an end-market demand standpoint. Obviously, you're seeing something different, so I'm trying to understand that dynamic if we can.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

A

Mig, yeah, that's a – it's a good question. I mean I think when you think about those two components, I think certainly on the road building side, we saw that come through stronger than we expected, as activity picked back up kind of coming out of a lot of lockdowns in different parts of the world, led probably by markets like China, and Europe was a little bit mixed but we saw some strength in some Western European markets. So, I think there we just saw recovery happening faster. And you're right, and we thought that was down about [ph] 25% (00:55:58), it ended up more like down around [ph] 10% (00:56:02).

I think on the construction side, North America in particular, as we think about that business, yeah, our outlook there from a revenue perspective maybe has gotten a little bit better. I think some of that was the uncertainty that we faced a quarter ago in terms of what exactly was that going to look like, and I think you've also seen some things like housing that was mentioned a little bit earlier, has been a little more stable, a little more positive than we would have expected a quarter ago when we – if you go back, we saw housing starts below [ph] $1 million (00:56:36), so I think those are probably the biggest drivers that we've seen impacting that have changed our outlook there, from a top line perspective.

So, thanks, Mig.

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

Q

Yeah. Thank you.

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

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

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

Jamie Cook
Analyst, Credit Suisse Securities (USA) LLC
Q

Hi. Good morning. Most of the questions have been answered, but I guess just one question, obviously, you're seeing with Deere and other industrial companies that the decremental margins this year given the challenges are proving much better than people would have expected, so we get a lot of questions on does that sort of limit incremental margins, I mean, as we come out of the downturn, so are there any structural reasons or changes in your cost structure or how you're thinking about things that would prevent Deere from putting up the same type of incrementals they've done historically while managing pretty good decrementals assuming the mix is there and the volume's there? Thanks.

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

Jamie, I wouldn't expect to see significantly different incrementals. I think we're confident in what we think we can do there as it relates to the margins. You think about what we're doing from a technology perspective and as we make some of these adjustments to our portfolio too, those things certainly help as well, when we think about overall margin.

Thanks, Jamie. We'll go ahead and jump to one more question.

Operator: Thank you. Our last question comes from Stanley Elliott with Stifel. Your line is open.

Stanley Stoker Elliott
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Hey. Good morning, everyone. Thank you all for fitting me in. The commentary on the housing market and the shrink there, can you help us with what's happening within the – on the forestry side of the business with that market? It looks like it's being revised down a touch. Just trying to see if that's destocking, if there's something else going on there. Thanks.

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

Forestry, yeah, when you look at forestry, yeah, we've seen it weak globally. I think the markets where we're seeing more weakness have been US and Canada and Russia. And Russia's really been driven by more Chinese and Asian demand. In the US, lumber prices have started to move up. You're seeing futures move up, but mills have still been either closed or working through inventory that they had, so I think as we look at lumber price in the futures, moving up that's probably a positive sign, but we haven't seen that come through from a demand perspective as it relates to our customers yet. So, thanks for the question, Stanley.

Joshua Jepsen
Director-Investor Relations, Deere & Co.

We're at the top of the hour, so we appreciate all the interest and we'll be in touch and chat with everyone soon. Thanks a lot. Have a good weekend.

Operator: Thank you for your participation. Participants, you may disconnect at this time.