Deere & Company (DE)

Updated August 16th, 2019 by Eli Inkrot

Key Metrics

Current Price:	$150	**5 Year CAGR Estimate:**	5.9%	**Volatility Percentile:**	69.3%
Fair Value Price:	$135	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	67.0%
% Fair Value:	111%	**5 Year Valuation Multiple Estimate:**	-2.1%	**Growth Percentile:**	54.2%
Dividend Yield:	2.0%	**5 Year Price Target**	$181	**Valuation Percentile:**	33.6%
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**Total Return Percentile:**	26.6%

Overview & Current Events

Deere & Company is the largest manufacturer of farm equipment in the world. The company also makes equipment used in construction, forestry & turf care, produces engines and provides financial solutions to its customers. Deere was founded in 1837, is headquartered in Moline, Illinois and is currently valued at $48 billion.

On August 16th, 2019 Deere reported Q3 2019 results for the period ending July 28th, 2019. (Note: Deere's fiscal year ends October 29th.) For the quarter sales came in at $10.04 billion, representing a 2.6% decline compared to Q3 2018, as a 1% improvement in Construction and forestry was offset by a 6% decline in Agriculture and turf. CEO Samuel Allen indicated that the results "reflected the high degree of uncertainty that continues to overshadow the agricultural sector" with many farmers postponing major equipment purchases. Reported Net Income came in at $899 million or $2.81 per share, compared to $910 million or $2.78 per share in the prior year period. On an adjusted basis, Deere's bottom line improved from $$2.59 in 2018 to $2.71 this year.

Deere also updated its outlook for fiscal year 2019. The company now anticipates equipment sales increasing 4% year-over-year (from 5% previously), including a 2% negative foreign currency translation. In addition, Net Income is forecast to come in at about $3.2 billion (down from $3.3 billion and $3.6 billion previously). With ~320 million common shares outstanding, this implies $10.00 or so in anticipated earnings-per-share. We have reduced our forecast accordingly.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$2.82	$4.35	$6.36	$7.64	$9.08	$8.63	$5.77	$4.81	$6.68	$9.34	***$10.00***	***$13.38***
DPS	$1.12	$1.16	$1.52	$1.79	$1.99	$2.22	$2.40	$2.40	$2.40	$2.58	***$3.04***	***$3.80***
Shares[1]	423	422	406	388	374	346	317	315	322	318	***320***	***305***

Deere's earnings-per-share are relatively cyclical. Depending on the conditions in the markets the company addresses (agriculture, forestry, and construction), demand for Deere's products can wary widely on a year-to-year basis. Overall the earnings-per-share growth trend is positive, but it took Deere five years to grow its EPS above the peak from 2013. Still, over the last decade Deere has been able to grow its earnings-per-share by an average compound rate of 7.1% per annum. Moving forward we believe 6% annual growth is achievable, despite recent uncertainties.

During fiscal 2019 and beyond there are several factors that should prove positive for the company's profitability. The first one is the takeover of Wirtgen Group that closed during December of 2017. Wirtgen is a German manufacturer of construction machinery, which has increased Deere's market share in this segment considerably. Expanding its presence in the construction machinery industry is an opportunistic move by Deere, as growth rates in the construction machinery business are higher than in the agriculture & turf business. With a wider presence in construction machinery Deere should be able to benefit from strong construction activity in markets such as the US and China. Although, the current trade war with China puts a large question mark over this area and indeed over the business in general.

Deere has also forecasted that its financial solutions business, *Worldwide Financial Services*, will be significantly more profitable going forward. With rising profits and cash flows Deere could ramp up its share repurchases in the near future. The company reduced its share count by 25% in the 2008 to 2016 timeframe, but its share count has been

1: In millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

stagnant since. During fiscal 2018, Deere spent $1 billion on buybacks, which is still well below the peak buyback level from 2015, when Deere bought back $2.5 billion worth of stock in a single year.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	14.0	13.7	12.5	10.4	9.5	10.1	15.2	16.7	17.1	16.1	***15.0***	***13.5***
Avg. Yld.	2.8%	1.9%	1.8%	2.3%	2.3%	2.5%	2.7%	3.0%	2.1%	1.7%	***2.0%***	***2.1%***

During the past decade shares of Deere have traded hands with an average price-to-earnings ratio between 13 and 14 times earnings. We believe this is a fair starting place, considering the company's reasonable growth prospects coupled with its cyclical nature. With a current valuation at 15 times earnings, this could imply a small valuation headwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	40%	27%	24%	23%	22%	26%	42%	50%	36%	28%	***30%***	***28%***

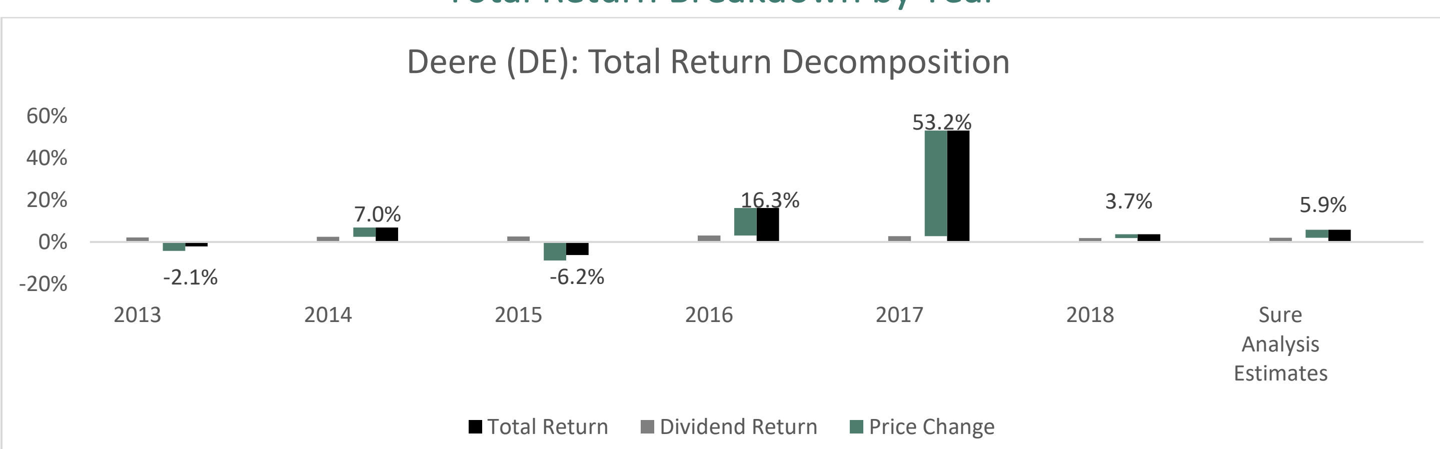
Deere's dividend payout ratio has never been especially high. The company paid out a maximum of ~50% of its net profits during 2016. Since then, the payout ratio has trended downwards as earnings-per-share have risen considerably. We believe that the dividend is quite safe, but dividend growth has not been overly reliable in the past – during 2015 to 2017 the company froze its dividend at $2.40 each year.

Deere is the largest player in the agricultural machinery manufacturing industry. This means that it is hard for new competitors to steal market share from Deere, especially since it is difficult to replicate the company's global sales and dealership network. Deere has also been growing its presence in the higher-growth construction machinery market, both organically as well as via takeovers. The company is impacted by downturns in the industries it addresses. During the last financial crisis Deere remained profitable, but its earnings-per-share declined by 40%.

Final Thoughts & Recommendation

Shares are up 7% since our last report, while earnings expectations have declined. Deere is the market leader in the agricultural equipment industry. The company's global presence provides sizeable competitive advantages. Growth has been acceptable during the last decade, and quite strong during 2018. Total return potential comes in at 5.9% per annum, stemming from 6% expected growth and a 2.0% dividend yield offset by the potential for a -2.1% valuation headwind. Overall shares appear to be reasonably valued and earn a hold rating at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	21270	25873	31842	35963	37621	35816	28609	26364	29116	37358
Gross Profit	4825	7464	9048	10051	11069	10225	7626	7189	8115	10583
Gross Margin	22.7%	28.9%	28.4%	27.9%	29.4%	28.5%	26.7%	27.3%	27.9%	28.3%
SG&A Exp.	2948	3115	3362	3662	3810	3608	3056	2952	3254	3456
D&A Exp.	N/A	915	915	1004	1140	1307	1382	1560	1716	1927
Operating Profit	540	3015	4212	4720	5468	4781	2755	2133	2761	4071
Op. Margin	2.5%	11.7%	13.2%	13.1%	14.5%	13.3%	9.6%	8.1%	9.5%	10.9%
Net Profit	874	1865	2800	3065	3537	3162	1940	1524	2159	2368
Net Margin	4.1%	7.2%	8.8%	8.5%	9.4%	8.8%	6.8%	5.8%	7.4%	6.3%
Free Cash Flow	677	969	646	-953	879	867	933	815	-393	-1130
Income Tax	460	1162	1424	1659	1946	1627	840	700	971	1727

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	41133	43267	48207	56266	59521	61336	57948	57919	65786	70108
Cash & Equivalents	4652	3791	3647	4652	3504	3787	4162	4336	9335	3904
Acc. Receivable	3520	3464	3295	3799	3758	3278	3051	3011	3925	5004
Inventories	2397	3063	4371	5170	4935	4210	3817	3341	3904	6149
Goodwill & Int.	1173	1116	1127	1026	922	860	790	920	1251	4663
Total Liabilities	36314	36963	41393	49404	49254	52271	51190	51388	56226	58817
Accounts Payable	1721	2007	2675	2986	2739	2325	1872	2096	2551	10111
Long-Term Debt	24551	24349	26589	32421	34476	36958	36850	35612	40045	42256
Total Equity	4819	6290	6800	6842	10266	9063	6743	6520	9557	11288
D/E Ratio	5.09	3.87	3.91	4.74	3.36	4.08	5.46	5.46	4.19	3.74

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	2.2%	4.4%	6.1%	5.9%	6.1%	5.2%	3.3%	2.6%	3.5%	3.5%
Return on Equity	15.4%	33.6%	42.8%	44.9%	41.4%	32.7%	24.5%	23.0%	26.9%	22.7%
ROIC	3.0%	6.2%	8.7%	8.4%	8.4%	7.0%	4.3%	3.6%	4.7%	4.6%
Shares Out.	423	422	406	388	374	346	317	315	322	321
Revenue/Share	50.12	60.37	75.38	89.57	96.66	97.83	85.15	83.27	90.06	114.14
FCF/Share	1.59	2.26	1.53	-2.37	2.26	2.37	2.78	2.57	-1.21	-3.45

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.