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Corteva, Inc. (CTVA)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Corteva Second Quarter 2023 Earnings Call. Today's conference is being recorded. At this time, I'd now like to turn the conference over to Kim Booth. Please go ahead, ma'am.

Kim Booth
Vice President-Investor Relations, Corteva, Inc.

Good morning and welcome to Corteva's second quarter and first half 2023 earnings conference call. Our prepared remarks today will be led by Chuck Magro, Chief Executive Officer; and Dave Anderson, Executive Vice President and Chief Financial Officer. Additionally, Tim Glenn, Executive Vice President, Seed Business Unit; and Robert King, Executive Vice President, Crop Protection Business Unit, will join the Q&A session. We have prepared presentation slides to supplement our remarks during this call, which are posted on the Investor Relations section of the Corteva website and through the link to our webcast.

During this call, we will make forward-looking statements which are our expectations about the future. These statements are based on current expectations and assumptions that are subject to various risks and uncertainties. Our actual results could materially differ from these statements due to these risks and uncertainties, including but not limited to those discussed on this call and in the risk factors section of our reports filed with the SEC. We do not undertake any duty to update any forward-looking statement.

Please note in today's presentation, we'll be making references to certain non-GAAP financial measures. Reconciliations of the non-GAAP measures can be found in our earnings press release and related schedules along with our supplemental financial summary slide deck available on our Investor Relations website.

It's now my pleasure to turn the call over to Chuck.

Charles V. Magro

President & Chief Executive Officer, Corteva, Inc.

Thanks, Kim. Good morning, everyone, and thank you for joining us. In the first half of 2023, Corteva continued to deliver top and bottom line growth with over 180 basis points of operating EBITDA margin expansion driven by strong demand for Corteva's proprietary technology. This is translating to another year of anticipated growth and significant margin improvement as we remain on track to deliver the 2025 financial targets we laid out at Investor Day last September.

Seed continues what can only be called a terrific performance in the first half of the year with about 240 basis points of operating EBITDA margin expansion and double-digit organic sales gains in corn. North America is benefiting from higher corn acres and pricing actions, both of which offset higher input costs.

Our market share in Seed remains strong. In the US, the first half of the year saw double-digit revenue growth in Pioneer and Brevant as customers recognize the value our products provide. We are pleased to see Enlist E3 recognized by the market. This year, Enlist E3 is the number one selling soybean technology in the US. We expect E3 beans to be on at least 55% of US soybean acres in 2023.

Further strengthening our portfolio, we launched PowerCore Enlist Advanced RA for corn, providing farmers with the added flexibility of integrated refuge along with advanced combination of above-ground insect control, herbicide tolerance and industry-leading genetics. Available to farmers in 2024, this enhances the strong technology position for our leading Seed brands as well as creates new outlicensing opportunities.

In Crop Protection, farmers continue to invest in products to enhance and protect crop yields. However, customers are adjusting their purchasing patterns to reflect the macroeconomic environment. A combination of factors from interest rates to supply availability to working capital management is motivating buyers, including retailers and distributors, to adjust the timing of their purchases to be closer to their intended use. We see these actions as a result of supply chain rebalancing and believe they could persist at least through the end of 2023.

Our Crop Protection business remains resilient by focusing on levers within our control. The team is delivering on our strategy, including pricing for our new and differentiated technologies as well as executing on portfolio and productivity actions. We have made excellent progress on building our Biologicals business, including the integration of our recent acquisitions which are on track to deliver $90 million of EBITDA in 2023.

And we continue to advance our pipeline of new AIs with the expected global launch of Reklemel active later this year, pending regulatory approval. This is a first of its kind selective nematicide that targets harmful organisms while not impacting beneficial organisms in the soil. This reflects the continued journey of introducing new, sustainable, differentiated tools to the farmer.

Agriculture fundamentals remain positive. Our products continue to be in high demand and we are laser-focused on executing our strategy and becoming more efficient. At the same time, to reflect the current industry environment, we are adjusting our full year net sales guidance down by about 4% versus the midpoint of what we guided last quarter driven by muted sales growth in Crop Protection as the channel destocks. We are also modestly reducing the midpoint of our 2023 EBITDA guidance reflecting the revenue reduction partially offset by strength in product mix, royalty reductions and cost actions.

Now let's turn to the market outlook. Recent USDA estimates have yields in the US to be below trend line for the third year in a row. Even with below trend yields, given forecasted production in the US and Brazil, ending stocks are expected to build which may put pressure on prices. Commodity prices for the 2023 crop are expected to be down from recent highs but still remain above historical averages. The continued impact of Russia's war on Ukraine along with projected record demand for grains and oilseeds for food, feed and biofuels are currently expected to keep prices at profitable levels.

The demand for biofuels hit a record in 2023 with the expectation this will grow again in 2024. At the end of the day, the world needs to produce more crops with less land and a reduced environmental impact. This, we believe, is a recipe for our top-tier seed genetics and differentiated crop protection technology solutions. We're seeing strong demand for biologicals and biofuels and we're investing in those areas. Therefore, our overall view is that we will continue to see favorable farm income and demand for inputs.

In this environment, farmers are more incentivized to increase and protect their yields. Following a record year in 2022, 2023 is estimated to be in the top five on record for US farm net income allowing farmers, particularly in the Americas, to expand planted acres and also invest in proven technology to safeguard their profitability.

Now let's take a look at the crop protection market in more detail. When we spoke to you in early May, we highlighted a change in buying patterns driven by improvements in supply chain reliability as well as higher interest rates, particularly in Latin America where we were expecting order patterns in the second half of 2023 to look closer to pre-2022.

We also noted two weather-driven hotspots of elevated channel inventories, fungicides in Latin America due to drought and insecticides in Asia Pacific due to wet conditions. What became clear in the latter part of the second quarter is the combination of events that has caused orders to shift to a more just in time approach. This focus on inventory levels has resulted in a pullback in orders late in the second quarter, which was most pronounced in Latin America followed by North America.

Order books are closer to where we'd expect them to be in Brazil at this time of year based on historical patterns. We've included in our updated guidance the push-out of Latin America volume to the second half and continued destocking in North America. Against this backdrop, farmers continue to invest in top-tier technology to drive productivity at the farm.

For Corteva's perspective, we believe our renewed focus on differentiated and sustainable solutions makes us more efficient and better able to lead through these dynamic market conditions. The strategic and operational decisions we made last year have allowed us to get ahead of the Crop Protection industry-wide channel destocking and sets us apart from our peers.

We continue to advance our strategy by strengthening our portfolio and investing in R&D to drive strong, sustainable growth. Our first half performance and continued demand for our differentiated technologies provides confidence in our 2025 targets with clear value creation levers largely within our control.

And now let me turn the call over to Dave.

David John Anderson
Chief Financial Officer & Executive Vice President, Corteva, Inc.

Thanks, Chuck. And welcome, everyone, to the call. Let's start on slide 7 which provides the financial results for the quarter and the half.

As Chuck said and you can see from the numbers, we had a solid first half against quickly evolving market conditions. Briefly touching on the quarter, organic sales were down 4% compared to prior year with pricing gains in both segments more than offset by declines in volume in Crop Protection. Volumes were impacted by strategic portfolio actions and the exit from Russia, which combined represent an approximate $240 million headwind in the quarter.

In addition, we saw delayed customer purchases due to weather, higher interest rates and supply availability, again, particularly in Latin America and North America. Despite the reduction in top line growth, the improved product mix and ongoing productivity and cost actions translated to earnings growth of 2% and nearly a 140 basis points of margin expansion.

Now focusing on the half. Organic sales grew 2% with broad-based pricing gains. Global pricing was up 11% with strong execution in both Seed and Crop Protection. Seed volumes were down 5% versus prior year largely driven by the decision to exit Russia with Crop Protection volumes down 16%, which includes a 5% headwind from strategic portfolio exits. The top line performance translated into operating EBITDA of nearly $3 billion for the half, an increase of 8%. Pricing, favorable product mix and productivity more than offset higher input costs and volume and currency headwinds driving more than 180 basis points of margin expansion.

So let's go to slide 8 where you can see how the performance of our Seed business offset the Crop Protection market headwinds in the first half for total company sales growth of 1% compared to prior year. Seed net sales were up 8% in the first six months to more than $6.9 billion. Organic sales were up 9% on strong price execution as we continue the price for value strategy and also offset higher input costs.

Global Seed price was up 14% for the half with pricing gains in every region led by North America and EMEA. Seed volumes were down 5% versus prior year. Gains in North America driven by increased corn acres more than offset fewer soybean acres. Volume declines in EMEA were driven by the exit from Russia and lower corn planted area with Latin America and Asia Pacific volumes down due to delayed plantings and also seasonal timing shifts. And importantly, the exit from Russia represented a 3% headwind for the Seed segment.

Crop Protection net sales were down 9% compared to prior year to more than 3.9 billion. Organic sales were down 9% for the half with pricing gains more than offset by lower volume. Global Crop Protection pricing was up 7% for the half versus prior year reflecting pricing for value of our differentiated technology as well as to offset higher raw materials globally as well as currency impacts in EMEA.

Crop Protection volumes were down 16% for the first half impacted by the shift in order patterns that Chuck referenced as well as the roughly $240 million headwind from the strategic portfolio actions and exit from Russia. Currency headwind on both Seed and Crop Protection was 3% largely driven by European currencies.

And finally, the Biologicals acquisitions added $135 million of revenue since we closed on the deals in early March, which is reflected in portfolio and other. Taking a step back, the performance in the first half showcases the strength and complementary nature of our diverse portfolio.

With that, let's go to slide 9 for a summary of the first half operating EBITDA. You can see that operating EBITDA increased approximately $220 million to just under $3 billion. Pricing and product mix coupled with productivity and cost actions more than offset declines in volume and higher costs and currency headwinds. And we took a significant step in the journey towards royalty neutrality with more than $150 million of combined benefit from increased royalty income and a decrease in royalty expense driven by the continued penetration of Enlist.

The nearly $450 million of net cost headwind was related to Seed commodity costs, an unfavorable yield impact as well as Crop Protection inflation. Crop Protection raw material costs were up about 5% versus the prior year as we sold through higher cost inventory. In total, market-driven cost headwinds and other costs were mitigated by the improvement in net royalty expense and $175 million of productivity savings.

SG&A spend in the first half of the year was about flat versus prior year. It reflects the inclusion of approximately $50 million in SG&A from the Biologicals acquisitions. So excluding the acquisitions, SG&A is down versus prior year as we maintained disciplined spending and execution on cost actions.

Investment in R&D was up roughly $80 million for the half aligned with the targeted spend increases to support our leading position in ag technology. Portfolio and other gains in the half were driven by the Biologicals acquisitions, which contributed $22 million of EBITDA. Currency was a $228 million headwind again driven primarily by European currencies.

Turning now to slide 10, I want to take you through the updated full year guidance which reflects the current market dynamics. The change in order patterns and industry-wide destocking is reflected in the Crop Protection segment. We now expect net sales to be in the range of $17.9 billion to $18.2 billion or 3% growth at the midpoint, roughly $700 million lower than the previous guide. This is largely driven by North America and Latin America Crop Protection. And consistent with the prior guide, we expect approximately $450 million of net sales for the full year from the Biologicals acquisitions.

Operating EBITDA is now expected to be in the range of $3.5 billion to $3.65 billion, 11% growth versus the prior year at the midpoint. The updated guidance is driven by lower top line growth partially offset by improved product mix and greater-than-expected benefits from reduced net royalty expense as well as productivity and cost actions. Importantly, with the strength of Seed performance in the first half and Crop Protection's improved product mix, we now expect operating EBITDA margin of 19.8% at the midpoint of guidance or more than 130 basis points of margin expansion over prior year with growth in both Seed and Crop Protection.

Operating EPS is expected to be in the range of $2.75 to $2.90 per share, an increase of 6% versus the prior year at the midpoint. The change in guidance reflects lower earnings partially offset by lower forecasted effective tax rate and also a lower share count. Now it's important to point out that the allocation of earnings between the third and fourth quarters. Again, we expect order patterns to be more consistent with historical timing. This timing in Latin America sales, coupled with the seasonal patterns of the Biologicals acquisitions, is expected to result in nearly all of our second half earnings to be delivered in the fourth quarter.

Free cash flow is now forecasted to be in the range of $1 billion to $1.2 billion. We expect share repurchases to be approximately $500 million for the year, including $330 million that we completed in the first half. And of course, we recently announced a 7% increase in the dividend consistent with the dividend growth strategy.

On slide 11, I want to remind you importantly of the value creation framework we introduced at last year's Investor Day to accelerate our performance and deliver greater value to shareholders. The 2025 financial targets we presented included operating EBITDA of $4.4 billion or 22% margin at the midpoint. This slide includes those 2025 financial performance targets and it also reflects today's guidance for 2023.

Execution on our strategic decisions, including exiting low margin commodity products while delivering a cumulative $250 million reduction in net royalty expense and disciplined cost actions, is driving margin expansion while also enabling increased R&D investment. And while we're revising our 2023 revenue and EBITDA guidance, we're confident that we're on track to deliver the 2025 earnings targets.

With that, let's go to slide 12 and summarize the key takeaways. Again, we believe ag fundamentals remain positive and demand at the farm level is stable despite the significant Crop Protection market pullback that we're experiencing. We believe Corteva is well positioned relative to the market despite the industry-wide destocking trends and some macro level headwinds. And our revised full year guide is proof of the strength of our portfolio with continued sales and earnings growth in 2023. We believe this performance differentiates us from others in the industry. And finally, our expected 2023 performance supports our 2025 financial targets and provides us confidence that we're able to execute and grow.

And with that, let me turn it over to Kim.

Kim Booth
Vice President-Investor Relations, Corteva, Inc.

Thanks, Dave. Now let's move on to your questions. I would like to remind you that our cautions on forward-looking statements and non-GAAP measures apply to both our prepared remarks and the following Q&A. Operator, please provide the Q&A instructions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And we'll take our first question from Vincent Andrews from Morgan Stanley. Please go ahead.

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

Q

Thank you and good morning, everyone. With the new 2023 guidance and the reiteration of the 2025 targets and obviously the complexity of the crop chemical market right now, could you help bridge us through 2024 to 2025? In other words, what's changed about the algorithm or the growth by segment on the top line? It's still going to let you get into that zone or is it more likely that you're going to just be at the lower end of that 2025 revenue target now and make up the EBITDA maybe with more productivity? Or sort of what's changed today versus I guess a little less than a year ago in the algorithm between 2023 and 2025?

Charles V. Magro
President & Chief Executive Officer, Corteva, Inc.

A

Good morning, Vincent. Yeah, so let me give you a couple of thoughts and then I'll turn it over to Dave to talk a bit about the specifics. So look, we don't think a whole lot has changed. If you think about what's happened with the channel and the industry-wide destocking, obviously it came up – it was a larger issue and it happened a lot faster than anyone expected. But we do think that this situation is temporary and it's certainly not sustainable.

So when we start thinking about the plans for 2024 and then, to your question, 2025; we do think that we're on the same trajectory that we were when we laid this out back in September. And if you start thinking about what we have to deliver; as we've communicated a couple of times now before, a lot of this journey is well within our own control. And so what we're trying to do is reshape the overall strategy and the portfolio of the company. So what we're going to need to do in 2024 and 2025 is some of the same things that we've been working on for the last two years.

So we are expecting, for example, our Spinosyns and our new products in CP to continue to grow. They actually held up pretty well in 2023 so far and we're expecting growth through the rest of the year. We're about 80% complete through the product and country exits by the end of this year. So we'll finish those in the next two years. We did indicate in this morning's call already that our royalty expenses are running a little lower than we had expected. So we had previously thought about $100 million of expense reduction. We're closer to $150 million now and well on track for the $250 million by 2025.

I think some of the other things that we're seeing and it's a little too early to talk about the specifics. We are expecting some lower costs now to flow through the P&L. I'd say that both in Seed and CP through 2024 and certainly through 2025. It's too early to give specifics, but that's sort of how we're thinking about things. There's going to be some offset because we are planning to continue to invest in R&D. We're targeting 8% of revenue.

So when you put all of this together, I don't think we should talk about the low end or the or the top end. We feel very comfortable that we're basically on the same path and that this channel destocking issue that's happening right now, I think, will be behind – a significant portion of it will be behind us this year. There could be pockets that move into next year. But certainly the framework we've laid out, I think, is still one that we're very confident in. Dave, anything to add?

David John Anderson
Chief Financial Officer & Executive Vice President, Corteva, Inc.

A

I think maybe just a couple of quick points, Vincent. I think, first of all, as Chuck said, what we're seeing is very good performance, obviously, on EBITDA and margin despite the volume headwind that we're experiencing in the Crop Protection business this year. So it's a real tribute, obviously, to our cost performance and cost management but also the shifts that have taken place related to our portfolio refinements and the upgrade, if you will, the strengthening and the quality of the businesses, the technology delivery in Seed and the enhanced differentiation and technology in the Crop Protection business. So it's really, I think, that formula that's working. And if anything, it's working faster in terms of that margin rate and that EBITDA delivery, again, despite the volume headwind.

So we'll obviously be updating all of this. The march will proceed now forward to 2024. And it won't be long before we'll be talking with you about our guide for 2024. But what we see right now, as Chuck said, is continued positive setup in terms of the overall fundamentals. We're going to work through, obviously, as an industry, this destocking issue and this phenomenon in terms of inventory correction particularly in the channel in 2023. That's going to work its way through. It's going to take time. But our outlook right now remains quite constructive, quite positive when we look forward with, again, an acceleration of what we've seen in terms of our cost performance and our margin performance. Hopefully, that helps.

Operator: Thank you. And our next question comes from David Begleiter from Deutsche Bank. Please go ahead.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Good morning. Chuck, on the Crop Protection destocking, can you talk to the cadence of the destocking in May, June and July and what you're now expecting or seeing in August? Are we close to or are we past the peak of the destocking, do you think?

Charles V. Magro
President & Chief Executive Officer, Corteva, Inc.

A

Yeah. Good morning, David. So look, this came up on the industry pretty quickly. It sort of became very clear that how we were thinking about it in terms of pockets – if you recall that at the end of the last quarter, we were talking that we knew there were pockets of higher inventories, some areas of LATAM and Asia Pacific, really weather-driven. By the end of May, it became very clear that what we were talking about was more systemic and broad-based.

And at that point, what we're seeing – so just to set the stage, the one thing that this industry has is it has a pretty good line of sight for data that goes into the channel and that leaves the channel. And what we're seeing is that on-farm demand actually is very, I'd say, positive. And it's been consistent over the last two to three years at low single-digit growth when you're talking about organic revenue. So that's the good news is we – and then you can imagine since May, we have spent a lot of time looking at this. But we're feeling very good that the overall fundamentals, farmer's health and they're applying the products they need to preserve their crop and to drive yield.

But what happened since the end of May is that there has been a very significant pullback by the channel because they've had too much inventory. And so what we're expecting now is that by the time we get through the end of this year, that I'd say most of it will be behind us. But that doesn't mean that we're out of the woods when it comes to 2024. There's probably going to be some product lines and some geographies that this will persist into 2024. And we're planning for that. We understand that. We're going to work with our channel partners.

But overall, I think what we're also finding is that it wasn't just an inventory perspective. But with the higher cost of capital, higher interest rates specifically; there is a move clearly back to the way the industry operated pre-2022, where the industry really was used to – especially in North America but also I'd say in Latin America, where these supply chains are quite sophisticated. They have high fidelity. And the channel plus the farming community got very comfortable that the product can be delivered just in time. So we're going to see that. So unfortunately, what'll happen is you're going to see that in the seasonality, especially around Q3. That's why Dave communicated sort of the earnings split between Q3 and Q4.

But I wouldn't say that we're not constructive about 2024. The 2024 setup still looks to us to be pretty good. You've got record demand for grains and oilseeds. You have record demand for biofuels in 2023. We think there'll be another record in 2024. As we talked about, crop prices have come down, but farmer margins are still really healthy. And we haven't seen a change in buying behavior in terms of the products that they're investing in. But is it possible that there's going to be some carryover in terms of the destocking in 2024? Certainly, in the first part of 2024, that's entirely possible.

Operator: Thank you. And we'll take our next question from Kevin McCarthy from Vertical Research Partners. Please go ahead.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

Yes, good morning. Just to peel the onion a little bit more on the Crop Protection destocking. As you survey the world, do you think there is more access at the distributor level or the end user or grower level or both? And I guess maybe a related question. Can you speak to the 3Q-4Q earnings cadence? I think you made a comment that earnings would be mainly in the fourth quarter. Obviously, you have a lot of seasonal effects even in a normal year. But just kind of wondering how the destock will affect that in terms of your current planning view.

Charles V. Magro
President & Chief Executive Officer, Corteva, Inc.

A

Good morning, Kevin. Let me take the question on where the inventory is or our belief. And then, Dave, you can cover the Q3-Q4 split, please. Look, this is, I'd say, mostly an issue in the channel. So the distributor and the retail channel is where the surplus inventory is and where it needs to move to the farm.

It depends on where you're talking around from on-farm storage. But I would say broadly speaking, there isn't a lot of on-farm storage in our major markets. If you look at the United States, for example, over half the product is supplied by the channel. So there would not be typically a lot of on-farm storage. So we believe that this is clearly an inventory issue in the channel. Could there be some leftover [indiscernible] (00:32:50) on the farm? Yes, absolutely.

But I think if you step back, Kevin, and you think about how did we get here; I think what clearly happened is when the supply chain issues were front and center, I think the channel ordered more than they needed just to ensure reliability of supply. And farmers typically wouldn't take that product. So we're pretty confident that we know where it is and it is moving out. I think there has been a lot of progress made in the last few months and we can see it in the data. And so we're optimistic that this is heading in the right direction. Dave, you want to talk about Q3 and Q4?

David John Anderson
Chief Financial Officer & Executive Vice President, Corteva, Inc.

A

Sure. And maybe the way I could start that, Kevin, start the conversation of Q3 and Q4 is maybe just talk a little bit about the half, sort of what's implied in terms of guide for the half just to give you some perspective. So to the midpoint of our revenue guide, the [ph] $18.050 billion (00:33:51), that would imply a revenue increase on a year-over-year basis of $500 million. Now, importantly, when you look at that, it includes our Biologicals acquisitions. So there's about $300 million of that $500 million that's coming about as a result of the acquisitions.

On the EBITDA, what's implied – our actual last year for the second half was $466 million. This year, round numbers, it's about $600 million. And again, very importantly, the Biologicals acquisition represents about $70 million. If you look at that $90 million number that we've given you; it's the full year guide for Biologicals contribution to EBITDA, $20 million roughly in the first half, $70 million in the second half. So keep that in mind just in terms of giving some perspective on kind of what's assumed here, if you will, and the growth that's assumed for the second half.

Now to your question in terms of 3Q-4Q, it really has to do with timing of LATAM and timing associated with the acquisition contributions. The acquisition contributions are really mostly now, in terms of second half, will be in the fourth quarter, specifically the Stoller acquisition and its business, which is really for the second half, really focused on Brazil. And then for LATAM, in total, when you look at both our Seed business with a normal distribution 3Q to 4Q and then for [indiscernible] (00:35:32) Crop Protection business; you're really looking again at that recalibration from 1H to 2H, from the first half to our second half that we communicated back in May, that's playing out. We've got more insights on that now. And that really is the other reason, the other big component of the fourth quarter and the significance of the fourth quarter. If you look at it historically, it's not atypical compared to when you go back to 2021 – 2020. It is different than 2022. But 2022 really was anomalous in terms of the distribution, particularly the distribution pattern that we experienced in Latin America. Thanks, Kevin.

Operator: Thank you. Our next question comes from Chris Parkinson from Mizuho. Please go ahead.

Christopher Parkinson
Analyst, Mizuho Securities USA LLC

Q

Great. Thank you so much. As we're all beginning to think about 2024 as well as a few variables which you perhaps have better line of sight on or in some cases are directly in your control, can you just hit on a few of those? When we're thinking about net royalty reductions, E3 penetration; how we're thinking about germplasm cost based on the presumably lower payments to your certified growers, CPC inputs looks like they're even a little bit. So when we're taking ourselves outside of just the price-volume side of it, can you just kind of give us some initial thought processes on how we should be approaching that and once again considering 2024? Thank you so much.

Charles V. Magro
President & Chief Executive Officer, Corteva, Inc.

A

Yeah. Good morning, Chris. So look, lots of time to talk about 2024. We haven't really started our detailed planning sessions yet. But the way we're thinking about it just to give you sort of the directional thoughts.

First, the ag setup looks pretty constructive as I've mentioned. We still think that we're going to have above average historical pricing. Obviously, with the size of the crop in Brazil right now, we're going to have some rebalancing of stocks. But still I think relative tight market conditions. We've got healthy farmers around the world. They've just come off two record years. This year won't be a record; but it's still going to be, at least in the US, we think, a top five year. So the setup's very constructive. And then as I mentioned already, very strong demand for grains and oilseeds, food, feed and fuel.

So when you think about that backdrop and you place sort of what's happening at Corteva, the bottom line is that we see another year of growth and of margin expansion very consistent with the 2025 framework. And the levers are the same levers we've talked about. So we're going to see and we expect to see significant growth in our new products, our new Crop Protection products. As you recall, last year we finalized the Spinosyns expansion. So we're seeing incremental volume go into the market this year and we'll see growth in 2024 and 2025. I already mentioned royalty expenses. But we're probably trending a little ahead of plan to get to the overall $250 million by 2025.

And then the thing that we need to unpack a little further, but obviously with crop prices the way they are today and raw material on the chemical side; we are going to see and start to see lower costs flow through the P&L. And so when we put this all together, the construct looks very, I think, similar to what we've laid out historically. We don't see any sort of major deviations from what we've communicated. It is early days. So I'll caution you that that this is just our initial thinking. But so far what we would say is that the setup for 2024 looks quite constructive.

Operator: Thank you. Our next question comes from Joel Jackson from BMO Capital Markets. Please go ahead.

Joel Jackson
Analyst, BMO Capital Markets Corp. (Canada)

Q

Hi. Good morning. I'll just throw a couple of questions in together. Can you just tell us what you expect crop chem volume performance to be like in the second half of the year? I'm not sure if you're projecting growth year-over-year. Just reiterate that. And then maybe for Dave on free cash flow conversion. You dropped free cash flow $200 million this year. I know you were hoping to find some way to increase conversion and to get to the 40% plus number over the next year or so. Can you give us an update on what's going on there and how you might improve it over the next little while?

David John Anderson
Chief Financial Officer & Executive Vice President, Corteva, Inc.

A

Sure. Let me give you the crop numbers. So it's a really good point because when look at our numbers, you really have to consider product exits, the strategic decisions that we've made. Just to put that into perspective, on a reported basis, the volume change for the crop business would be round numbers about 16% down for the first half. But it's really minus 10% when you take into consideration the exits. So there's about 6 points there of impact in the first half from those decisions.

When you look at the second half; what you're looking at, Joel, is on a reported basis, we've got a volume change of about 4%. But on an adjusted basis – and by the way, this also includes the Stoller acquisition in it. So this is sort of an all-in. When you look at it all in, it would be up 8%. So we're looking at – that growth is really a transference significantly of LATAM from 1H to 2H in addition to what we're seeing is sequentially for Brazil. Specifically, when you look at the market research data; we're seeing sequentially, 1Q to 2Q in the channel, some improvement in overall inventory levels. And we're seeing pretty good strength in terms of actual sell out, if you will, in other words, product that's going to the farm gate. So essentially, what we're seeing in the second half is the improvement in terms of related to the timing of [ph] LATAM (00:42:04).

Charles V. Magro
President & Chief Executive Officer, Corteva, Inc.

A

Yeah. Just one comment before you talk about free cash flow. Joel, the way Dave has described that, the way we think about the market is excluding glyphosate.

David John Anderson
Chief Financial Officer & Executive Vice President, Corteva, Inc.

A

Yes.

Charles V. Magro
President & Chief Executive Officer, Corteva, Inc.

A

So it's a very important callout because we don't play in that market. It's such a large market and it's such a commodity that when Dave references sort of our volumes against the market backdrop, you need to exclude glyphosate just to call that out. So, Dave, over to you on free cash flow.

David John Anderson
Chief Financial Officer & Executive Vice President, Corteva, Inc.

A

Yeah. So just very quickly, just to kind of go through a couple of the numbers and that goes specifically to your question in terms of directionally what do we see in terms of cash flow and cash flow conversion going forward. So for the first half, as you pointed out, we've had higher use of cash on a year-over-year basis. That's really related to the phenomena of working capital including payables. And payables has to do with more cash outflow in terms of growers comp on the Seed side, which is all explainable by the size of the business, the growth of the businesses as well as commodity costs and our pricing actions.

On the other side of the payables is trade payables, which is really attributable to what we're doing in terms of inventory management on the Crop Protection side of the business. We're really pulling back, obviously, very understandably in terms of procurement there. For the full year, the $1 billion to $1.2 billion translates to, let's say, at the midpoint, $1.1 billion against our EBITDA translates to about a 30% cash conversion at $1.1 billion using our midpoint of our EBITDA guide for the full year. About a 30% conversion to EBITDA, which by the way, is about a 50% conversion if you used the cash to operating earnings relationship – in other words, the numerator of our EPS calculation – which is another way to calculate and communicate conversion.

When you look at what's happening in the second half of the year, working capital is really becomes a source of cash and it's really attributable to the fact that we're growing but holding working capital levels basically on a year-over-year basis, holding it constant, coming down obviously from our first half levels in terms of inventory, but also increasing in terms of payables. When you look out to 2024 and 2025, again, these are sort of directional numbers; what we would be looking at for the two years, 2024, 2025, something in the neighborhood of 50% plus in terms of cash flow conversion if you look at, again, in a cash to EBITDA relationship. That would translate to around 80%, 80% plus when you think of cash relative to operating earnings for those periods. And that's dialed in. We've got, we think, all the right disciplines, capabilities, et cetera. And it's consistent with what we referenced earlier in terms of our confidence in our outlook in terms of our earnings targets for 2024 and 2025.

Operator: Thank you. We'll take our next question from Frank Mitsch from Fermium Research. Please go ahead.

Frank J. Mitsch Q
Analyst, Fermium Research LLC

Hey, good morning. I wanted to focus in on the Seed side of things because that was obviously a clearly impressive performance. And congrats on E3 or Enlist E3 getting to the 55% mark. So you're clearly gaining share on the soybean side. Your corn growth, 20%, was also pretty impressive. Can you talk about your overall feelings on market share gains and what are some of the underlying factors behind that?

Charles V. Magro A
President & Chief Executive Officer, Corteva, Inc.

Hey. Good morning, Frank. Yeah, I appreciate the kind comments on the success of Enlist and how the year turned out. So in terms of market share, maybe a few thoughts here. So as we came through the year, we could sense – obviously, we see customer level order activity. And we knew that there was good momentum towards corn and felt like soy was definitely a little bit slower in terms of order and the farmers' attentions had shifted a little bit.

As we as we sit here right now, what I would say is it's very early to declare one way or another. At the time that the June 30 USDA report was included, I think there was still on the order of about 2 plus million acres of corn to be planted from farmers and something north of 6 million acres of soybean still to be planted. So it opens the door for there to be revisions. We know the USDA will revise those over time. So given where we're at right now at, call it, the 83 plus million acres on soy and 94 plus million acres on corn; we'd be looking at a slight share gain with obviously very strong value capture on corn. But that's at the current level of area.

In terms of soy, again, where I would have said I felt a little bit more uncomfortable with our order position throughout the year. It's actually quite a bit stronger of a share gain at that 83 plus million acres. So we feel good about how the year turned out. Clearly, from a value capture standpoint, it was outstanding. And from a volume standpoint, very satisfied at those levels. We're going to continue to look, as the USDA revises here over the coming months, if there's material adjustments that are made that could impact the final share numbers. But that kind of summarizes how we look at share right now. We're not going to declare victory at this point in time, but we feel good about where we sit.

Operator: We'll take our next question from Jeff Zekauskas from JPMorgan. Please go ahead.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

[Technical Difficulty] (00:48:19-00:48:24) reach your 2025 EBITDA guide. Do you assume positive pricing in Seeds overall for 2024 and 2025?

Charles V. Magro
President & Chief Executive Officer, Corteva, Inc.

A

Dave, did you hear the question?

David John Anderson
Chief Financial Officer & Executive Vice President, Corteva, Inc.

A

Yeah. Jeff, did you say did we assume – sorry, Jeff. Did you say did we assume positive pricing in the Seed business relative to our...

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

Yes...

David John Anderson
Chief Financial Officer & Executive Vice President, Corteva, Inc.

A

...2024-2025 financial targets? Yeah, the answer would be yes.

Jeffrey J. Zekauskas
Analyst, JPMorgan Securities LLC

Q

...in order to reach them, yeah.

David John Anderson
Chief Financial Officer & Executive Vice President, Corteva, Inc.

A

Yeah, another way of saying it is that we think that the Seed business, we're going to again price for value and that the pricing versus cost assumptions will be accretive to margins.

Charles V. Magro
President & Chief Executive Officer, Corteva, Inc.

A

Yeah, Jeff. It's Chuck. So I think Dave hit it. But we've communicated this before is the way we try to price for Seed is price for value. We have a big R&D machine. We're bringing out new hybrids every year. If you've looked at some of our recent announcements, we've also brought out what we called our next-gen trait packages. I called out PowerCore actually in our prepared remarks. But we also announced Vorceed as well. So these are our trait packages that are going to be very important for farmers in the next generation. Significant value creation will be there and we'll certainly price for that. I'd also say that what it does, and it helps a lot, is it opens up the door for us to outlicense this new technology. And maybe, Tim, you can talk a little bit about some of the progress we've seen even with Enlist.

Timothy P. Glenn
Executive Vice President-Seed Business Unit, Corteva, Inc.

A

Yeah, absolutely. And I'd say David or Jeff, the way we think about 2024-2025 is getting more back to that traditional pricing metric where it's about new products that we bring in. We're constantly bringing in new varieties and hybrids into our lineup that bring more value and that opens the door for us to price. And as Chuck said, it's really exciting when you think about the outlicensing opportunity.

So just four years ago, we really didn't participate from a licensing standpoint. And as we sit here today, we got four traits that we're able to license in the marketplace. So Enlist E3, as we shifted, made the significant shift this year into our proprietary germplasm. It opens up the door for us not just to have the 100 trait licensees that are out there today, but all of a sudden we've got our own proprietary germplasm that are accessible. And we're making nice gains into that licensing. So Enlist E3 soybeans in our own Corteva germplasm. In Latin America, we've got Conkesta E3 soybeans. And again, we're a couple of years out from our proprietary germplasm being there. But we've got the most successful breeding organization in Latin America that is introducing varieties into the marketplace there.

Chuck talked about PowerCore, Enlist, Refuge Advanced and what that means to us. That is the largest segment of corn in North America, that above-ground insect protection with the integrated refuge. So all of a sudden, we have the opportunity to go out there and participate with our trait and germplasm. And then on the smaller scale, we have Optimum GLY Canola, which we got approval for. Again, not on the same scale as those other opportunities. But again, it allows us to leverage our investment in that technology and again be able to go out there and generate good returns in the canola market. So it's an exciting time from an outlicensing standpoint in addition to our ongoing business in the brands.

David John Anderson
Chief Financial Officer & Executive Vice President, Corteva, Inc.

A

And Jeff, just – this is Dave. Just one final comment to just add to what I said earlier. Just as a reminder – and you'd recall this from our as early as Investor Day last year communications – that most of the Seed pricing will have taken place through 2023. So that's just kind of a reminder in terms of relative significance of those forward years.

Operator: Thank you. We'll take our next question from Steve Byrne from Bank of America. Please go ahead.

Steve Byrne
Analyst, BofA Securities, Inc.

Q

Yes, a couple more Seed questions. The 12% pricing that you're getting in Seed, what fraction of that is underlying like-for-like pricing versus the share gain or the mix shift because of growers shifting to higher yielding genetics and then the other bucket being the acreage shift from soy to corn? Can you split that 12% that way?

And then the net royalty reduction, the $150 million, that was ahead of the guide. Did you pull some from the $100 million target you had for 2024? Did you pull some of that forward and that Enlist maybe has penetrated faster than you thought? And then just lastly, I'd like to hear your view on the value to you if the Europeans do adopt their gene editing rule for seeds.

Timothy P. Glenn
Executive Vice President-Seed Business Unit, Corteva, Inc.

A

Okay, a lot there. And I'll take a shot at the start off, Steve. And good to hear from you today. So when you look at the 2023 pricing in North America, obviously very strong Seed pricing overall. And in terms of how you think about it between corn and soy, it would have been driven more by corn than soy.

The benefit we had in soy, I would say, is we upgraded a fair amount of our Enlist sales to our proprietary germplasm. So our A-series varieties give us more opportunity. Higher performing product, so it opened the door for more pricing opportunities on that side. So it was a combination of mix, if you want to think about it, in terms of new products, new varieties as well as just flat out pricing for value and pricing performance across the board. So good mix on both corn and soy and it went well.

In terms of royalty neutrality, we're on track for our, call it, $250 million reduction that we've talked about between 2022 and 2025. I guess the overperformance, if you want to think about that, this year was driven by a couple of things here. First thing on the Enlist side is that we kind of overdelivered on a couple of fronts, if you will, from a US business standpoint. We ended up with a higher level of our business, of our mix in Enlist versus Xtend. So we're now at about 75% of our – roughly 75% of our branded soy business with Enlist. That's a little bit higher than what we had planned for.

In addition, the adoption of our proprietary germplasm was higher. We're a little over 80% on that side in terms of what our proprietary germplasm is for Enlist. So all those things coupled to allow us to, call it, convert a little bit faster. So it is – in the end, we're going to be fully converted over here in the next few years. So the fact that we overperformed this year, you can think of it as an acceleration into 2023. And I think Chuck wanted to take the question around gene editing.

Charles V. Magro
President & Chief Executive Officer, Corteva, Inc.

A

Yeah. Steve, great question on gene editing and what's happening in Europe. First of all, just to set stage. So we believe that gene editing is sort of that next level of agricultural science, a very powerful set of tools. And it has the potential to be more impactful to seed development and crop development than BT was 25 years ago. So we're very excited. We've got a full on R&D program. And this is a space where we are increasing our investment in R&D.

The EU proposed policy that came out early July, what I would say, is a good start. It's a workable framework, I think, for the industry. It's going to take some time to get through the specifics. I understand that they're on a timeline, hopefully, to have clarity of the policy, I'd say, in the next one to two years. But so far what we see is a framework that is relatively connected to the rest of the policy landscape around the world.

So what we're hoping is that we'll be able to have freedom to operate in the next one to two years. And we are actively investing in a whole suite of gene editing products and tools so that we will be ready when the market says that we can start putting these products into the ground. So it is a very exciting part of our overall future development. And I think that what we saw in Europe was a very good first step.

Operator: Thank you. And we'll take our next question from Arun Viswanathan from RBC Capital Markets. Please go ahead.

Arun Viswanathan
Analyst, RBC Capital Markets LLC

Q

Great. Thanks for taking my question. So I had a question about the trajectory from 2023 to 2025, going from that $3.6 billion to, say, $4.4 billion, $4.3 billion in the midpoint in 2025. It looks like a relatively ratable growth. And that would kind of imply 10% EBITDA growth in 2024. I know there's a lot of uncertainty and you're still going through the planning process. But how should we think about that? Are there any major buckets that you could help us with? I understand that – or maybe you could kind of bucket that out by restructuring program gains, royalty reduction, market growth and pricing. Is there any way you could help us with that? Thanks.

David John Anderson
Chief Financial Officer & Executive Vice President, Corteva, Inc.

A

Arun, I would say there's – first of all, again, it's early for us to comment on specifics for 2024. And that's going to be a very important component or installment for us and will give us also, all of us, obviously a lot of more detail and color around the components that you're asking about.

I think the way I think about it is going back to Investor Day where we provided the bridge or the walk, if you will, from 2022 forward. And I think the way to think about that – again, it's something we provided. We called it the value creation framework. And it's the same buckets and it's the ones that you just mentioned. The royalty neutrality, we said greater than $250 million lower net royalties driven by Enlist. We said that we were going to have in-product mix. We were going to get the benefit of that. That's going to be margin lift for us not only on the Seed business and Seed side as Tim articulated, but also on Crop Protection with greater than 60% of our Crop Protection revenue coming from differentiated products.

SG&A, what we talked about is translating into $400 million of savings. And by the way, just to put a plug in for that. In 2023, on a, call it, apples-to-apples basis – in other words, excluding acquisitions – on a full year basis, we're going to be down north of $50 million despite merit and inflation. So that's a fairly significant testimony to what we're doing on that front. So operational excellence and then more to come, obviously, from both businesses in terms of their, if you will, cost of revenue.

And then against that backdrop, as Chuck said, still very much committed to our increased R&D investment. Chuck cited the target of the 8% of revenue for 2025. So those are the same building blocks that are – they're there today very much. I think what you're seeing in terms of our results for the first half and our guide for 2023 really reinforce that. So again, a lot more color, a lot more detail on that to come as we develop and flesh out our 2024 plan and communicate that guide to you later. Thank you.

Operator: Thank you. And I'd now like to turn the call back over to Ms. Booth for any closing remarks.

Kim Booth
Vice President-Investor Relations, Corteva, Inc.

Thank you. So that concludes today's call. We thank you for joining and for your interest in Corteva. We hope you have a safe and wonderful day.

Operator: Thank you. And ladies and gentlemen, that does conclude today's conference. We appreciate your participation. Have a wonderful day.