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Corteva, Inc. (CTVA)

Q4 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

Kimberly Booth

Vice President-Investor Relations, Corteva, Inc.

Good morning and welcome to Corteva's fourth quarter and full-year 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 statements.

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

Chief Executive Officer & Director, Corteva, Inc.

Thanks, Kim. Good morning, everyone, and thanks for joining us. I hope your year is off to a great start. There are several key takeaways I'd like to share with you today, including an overview of the market fundamentals, our solid 2023 performance and an update on our path to incremental value creation by 2025, with a closer look at what's ahead for 2024.

First, I would say that our 2023 performance validates the effectiveness of our value creation strategy and its key levers of portfolio simplification, royalty neutrality, product mix and operational improvements. At our core, we are a technology company and last year, we had more than 400 new product launches. In Seed alone, we introduced 300 new hybrids or varieties, 2 new product concepts and 41 new trait or stack registration approvals. In Crop Protection, our team delivered and launched about 140 new products in 2 new actives, Adavelt and Reklemel, the latter being the first of its kind selective nematicide that also has beneficial soil characteristics. The outcome of the strategic and operational actions implemented over the last two years demonstrates the significant progress we have made in converting every dollar of sales into more cash and earnings. With this solid momentum, we enter 2024 well-positioned and are confident in our ability to deliver value to our customers and other stakeholders.

As we look ahead, overall, Ag fundamentals remain constructive. Large global crop production is being met with record demand for grain, oilseeds and biofuels. In North America, corn production yield for the 2023-2024 crop year is expected to hit a new record despite the productivity challenges that farmers must face related to weather and disease, a testament to the importance of Ag technology. Brazil could be the exception with weather influencing crop stress and planting decisions. Commodity prices have declined from their peaks as global stocks to use have grown but remain elevated as demand continues to keep pace with production. Global crop area is forecasted to increase in 2024, with a modest shift in the US from corn to soybeans. In addition, US farm income remains above the historical average, though down from its 2022 peak.

What has not changed is farmer demand for breakthrough innovation and technology, including seeds that maximize yields, which in turn boost farmer revenue. With on-farm demand remaining overall strong, the Crop Protection industry is still going through what we'd refer to as a rebalance as it recovers from the destocking that had a challenging and abrupt impact on the market in 2023. While we expect this to continue to normalize throughout the first half of 2024, we're seeing signs of improvement, which gives us more confidence in what the Crop Protection market should look like as we enter the second half of this year. Once we get into 2025, we expect the imbalance between product going into the channel versus what is being applied on the farm to be back in sync.

On full year results for 2023, Corteva continued to deliver with 5% operating EBITDA growth and 116 basis points of margin expansion. Our Seed business in particular had an outstanding year, with Enlist E3 soybeans achieving the status of being the number one selling soybean technology in the United States, where it reached 58% market penetration. The Enlist system, including our herbicide offerings, reached $1.7 billion in sales in 2023, growing in a well-supplied market. Our new product sales held steady year-over-year at about $1.9 billion for the full year, and the Biologicals business had a strong year delivering both top and bottom line growth.

Between strong demand for our innovative Seed technology, costs and working capital discipline as well as healthy farmer income levels in North America, our free cash flow in 2023 exceeded our previous estimate coming in at about $1.2 billion. We returned approximately $1.2 billion to shareholders via dividends and share repurchases for the full year, while also funding approximately $1.5 billion of acquisitions.

Turning to 2024, and I'll turn this over to Dave in just a minute. But at a high level, we should expect to see another year of meaningful margin expansion with a heavy focus on cash generation. As a result, we expect to deliver 2% top line and 6% operating EBITDA growth at the midpoint, which reflects another incremental EBITDA margin improvement of nearly 100 basis points. We foresee another year of strong cash flow generation and plan to execute $1 billion in share repurchases over the course of 2024.

Now, let's spend a few minutes on key themes as we transition from 2023 into 2024. In 2024, we expect Seed to have another strong year as farmers continue to look to effective technology to boost yields while offsetting the effects of climate change and increasing pest pressures. In Crop Protection, we're expecting volume growth, but also continued pricing pressures, so low single digit sales growth overall. We expect to increase our Biologicals sales by double digits and nearly double earnings. And although we expect the effects of destocking to linger through the first half of the year in certain regions, we're beginning to see the benefits of cost deflation.

All in, we believe, volume gains from our differentiated portfolio as well as operational improvements and a modest recovery in Brazil will more than offset expected price headwinds. We plan to launch more than 300 new Seed hybrids and varieties, putting much needed solutions in farmers' hands. Our Seed pipeline is the best in the industry. Promising technologies like gene editing will make our innovation more effective, sustainable and accessible to everyone from start-ups to large customers. The incremental yields from the advanced technologies in our pipeline allow us to continue our longstanding price for value strategy.

Importantly, we have adjusted the 2025 financial framework based on current market factors. The expectation is for continued strong EBITDA growth off the 2023 base, an EBITDA margin rate of 21% to 23% in 2025. Benefits from our self-help actions give us the ability to invest in R&D and future innovation. The overall strategy is very much intact. Differentiation in our portfolio, strengthening our route to market and cost performance are all driving value. This is the formula that has been working and will continue to work for Corteva.

With that, 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 6, which provides the financial results for the quarter and full year. You can see from the numbers that both for the fourth quarter and the full year we continued to deliver operating EBITDA growth and margin expansion. Quickly touching on the quarter, sales and earnings were largely in line with our expectations. Organic sales were down 8% compared to prior year, with Seed pricing gains offset by volume declines in both Seed and Crop Protection. Seed volume gains in North America and Europe were offset by volume declines in Latin America and Asia Pacific. In Crop Protection, as expected, we saw a continued inventory destocking in both Latin America and Europe. Importantly, we did see volume gains in North America as destocking in the region seems to be largely behind us.

Turning to the full year, organic sales were down 3% versus last year, with pricing gains offset by lower volume. This includes a 4% impact from product exits. Total company pricing was up 7%, with double digit Seed pricing and price gains in all regions. Despite the reduction in top line growth, strong operational performance translated into operating EBITDA of nearly $3.4 billion for the year, an increase of 5% over prior year and margin expansion of 116 basis points. And finally, free cash flow for the year 2023 was approximately $1.2 billion or 35% conversion rate on EBITDA. The improvement in free cash flow from last year was driven by increased earnings and working capital improvement, primarily inventory and accounts receivable, with a partial offset from accounts payable.

Let's now go to slide 7 and review sales by segment. Seed net sales were up 5% to nearly $9.5 billion. Organic sales were up 7% on strong price execution as we continue to price for value. Global Seed pricing was up 13%, with gains in every region and across the portfolio. Seed volumes were down 6% versus last year. Gains in North America, driven by increased corn acres, were offset by declines in Latin America due to lower expected corn planted area and delayed planning in Europe, driven by the exit from Russia and lower corn planted area. The exit from Russia represented a 2% volume headwind for the Seed business. Crop Protection net sales were down 9% compared to last year to approximately $7.8 billion. Organic sales were down 12%, with pricing gains more than offset by volume. Crop Protection pricing was up 2%, driven by demand for new products. Crop Protection volumes were down 14% for the year, impacted by channel destocking and Brazil market dynamics as well as more than $400 million headwind or 5% impact from exits. Finally, the Biologicals acquisitions added approximately $400 million of revenue, which is reflected in portfolio and other.

With that, let's go to slide 8 for a summary of full year operating EBITDA performance. For the year, operating EBITDA increased approximately $160 million to about $3.4 billion. Pricing gains coupled with improvement in net royalties, productivity and cost actions more than offset declines in volume and higher costs and currency headwinds. The approximately $380 million of cost headwinds was related to Seed commodity costs and unfavorable yield impact as well as Crop Protection inflation on input costs. Crop Protection raw materials costs were up 2% versus prior year. Importantly, we're starting to see the impact of lower input costs.

During the second half of the year, Crop Protection raw material costs transition to low single digit deflation. Market-driven and other costs were mitigated by approximately $200 million of improvement in Seed net royalty expense and $285 million of productivity savings. SG&A spend for the full year was roughly flat versus prior year, including $130 million in SG&A from the Biologicals acquisitions. If you exclude the acquisitions, SG&A was down nearly 5% versus prior year, as we maintain disciplined spending coupled with lower incentive comp accruals despite year-over-year inflation.

Let's now transition to a discussion on the guidance for 2024 on slide number 9. We expect net sales to be in the range of $17.4 billion and $17.7 billion, representing 2% growth at the midpoint, driven by Seed pricing and volume growth in both Seed and Crop Protection on demand for new and differentiated technology. Volume growth will be muted by approximately $100 million of product exits in 2024. Operating EBITDA is expected to be in the range of $3.5 billion and $3.7 billion or more than 6% improvement over prior year at the midpoint. Margin is also expected to improve with price and product mix, cost deflation and productivity actions translating to 90 basis points at the midpoint. Operating EPS is expected to be in the range of $2.70 and $2.90 per share, increase of 4% at the midpoint, which reflects earnings growth and lower average share count, partially offset by higher net interest expense and a higher effective tax rate. We expect free cash flow to be in the range of $1.5 billion and $2 billion, with higher earnings and working capital improvements, partially offset by higher net interest and cash taxes. At the midpoint, it translates to a free cash flow to EBITDA conversion rate of roughly 50%. Note that the free cash flow was revised to utilize cash from operations on a continuing basis.

Turning to slide 10, you can see the operating EBITDA bridge for 2024 from approximately $3.4 billion in 2023 to $3.6 billion at the midpoint for 2024. Total company pricing in 2024 is expected to be flat to modestly up with low single digit pricing in Seed to be offset by declines in Crop Protection pricing given ongoing destocking, particularly in Brazil and global market dynamics. Importantly, we do expect volume gains in both Seed and Crop Protection. Seed volume gains are driven by expected increased US soybean acres and planted area in Brazil Safrinha for the 2024-2025 season.

In Crop Protection, we expect mid-single digit volume growth in 2024 led by Latin America and driven by global demand for new and differentiated products. New Crop Protection product volume is expected to be up high single digits, driving incremental organic revenue. Additionally, we'll benefit from the Spinosyns capacity expansion as we expect high single digit growth from the Spinosyns franchise. 2024 will be another significant step in our path to royalty neutrality, with $100 million improvement in net royalty expense with increased benefits in both out-licensing income and royalty expense, driven by Enlist E3 penetration. And after two years of high levels of input cost inflation, we expect to see low single digit deflation in Crop Protection raw material costs. Productivity and cost actions in both Seed and Crop Protection combined with input cost deflation are expected to add approximately $300 million of benefits. We expect an increase in SG&A spend in 2024 driven by normalized bad debt and compensation accruals. We'll also continue to invest in the future with increased investment in R&D, which is expected to now be approximately 8% of sales. And finally, the Biologicals franchise is expected to add approximately $90 million of operating EBITDA, with improved margins in 2024.

Regarding the timing of sales and earnings in 2024, we're expecting over 60% of sales and roughly 80% of EBITDA to be delivered in the first half of the year. We also expect to see a timing difference between the first two quarters versus prior year, due primarily to the strength of Crop Protection in the first quarter of 2023. You'll recall the Crop Protection's first quarter 2023 was prior to the significant impact of channel inventory destocking. For Seed, we're assuming a normal delivery pattern in the Northern Hemisphere, which could shift significantly between first and second quarter, depending on weather conditions.

With 2024 guidance in mind, let's go to slide 11 to review the key drivers of earnings growth in 2024 and 2025. And as Chuck said, we've adjusted the 2025 financial framework based on our actual results for 2023 and the expectation for continued earnings growth and margin expansion in both 2024 and 2025. Now, in 2023, we delivered an incremental $800 million in EBITDA versus 2021. Given the market dynamics in 2023, this was no small feat and clearly differentiates us from our peers. We've a plan to generate an approximate $800 million of additional EBITDA growth by 2025, which translates to low double digit compound annual growth rate between 2023 and 2025. A number of the drivers of our anticipated performance of about $4.2 billion of EBITDA and 22% margin in 2025 are within our control. We've demonstrated our price for value strategy in Seed and we expect this strategy to continue. Our royalty neutrality strategy delivered more than $200 million in benefits in 2023 alone and is going to add another $100 million per year in both 2024 and 2025. What's even more exciting is that we're starting to see benefits from our out-licensing business as we migrate a greater portion of our portfolio to our own proprietary technology and we expect that to meaningfully grow in the next decade.

The rebalance in the Crop Protection industry will take some time. We expect it to be achieved by 2025, but underlying demand in applications at the farm gate remain solid. The differentiated portions of our Crop Protection portfolio, including our new products together with the Spinosyns franchise and our Biologicals franchise, will continue to outpace market growth in 2024. The differentiation will also protect our business from the most severe elements of pricing competition, which are largely in the non-differentiated portions of the industry. And we delivered more than $350 million of combined productivity and cost actions in 2023 across the business. And our plan is to deliver another $200 million per year in both 2024 and 2025. And this does not include an additional improved net royalty or the deflation benefit that we anticipate will grow into 2025. Importantly, we'll also continue to invest more in R&D and our future innovation.

With that, let's go to slide 12 and transition to the setup for 2025 and the assumptions included in the base case as well as what could drive EBITDA to the low and high end of the range. Now in both 2024 and 2025, we expect low single digit Seed pricing, driven by demand for yield advantage technology. One of the biggest variables in our assumptions is how much growth we'll see in the Crop Protection business given the current market imbalance. While on-farm demand remains relatively consistent, we're not assuming a significant rebound in the market. New and differentiated products, including Biologicals, will drive much of the Crop Protection growth in 2024 and 2025 as we move towards differentiation in two-thirds of the Crop Protection portfolio.

In 2024, we expect to see modest input cost deflation in Crop Protection, with Seed costs relatively flat. By 2025, we expect to see more benefit from cost deflation in both Seed and Crop Protection. Our assumption – assumptions include increased SG&A due to normalization of bad debt and compensation accruals as well as increased investment in R&D as we reach our target of 8% of sales. Together, we have a balanced set of assumptions which gives us confidence in our ability to grow earnings and margins out to 2025 and beyond in both Seed and Crop Protection.

So with that, let's go to slide 13 and summarize the key takeaways. First, full year operating EBITDA performance for 2023 was in line with expectations, led by the strength of the Seed business and we're able to grow EBITDA by 5%. Self-help levers helped improve operating margin by roughly 115 basis points. And importantly, this is going to continue into 2024 and into 2025. The bottom line is that our guidance for this year and the setup for next year 2025 that we shared with you today reflects continued earnings and margin growth, much of which is in our control. And finally, the significant financial strength and balance sheet flexibility give us confidence in our ability to continue to grow and supports our track record of returning cash to shareholders.

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

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

Thank you, 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 go first to Vincent Andrews from Morgan Stanley.

Vincent Stephen Andrews
Analyst, Morgan Stanley & Co. LLC

Q

Thank you and good morning. Could I ask on the Crop Protection business, if you could just talk about volume and price in the following manner? From a volume perspective in 2024, could you talk about markets where destocking is still ongoing, how bad are you expecting the volume to be versus markets where you think it's sort of finished? What are you expecting from a volume perspective? And then likewise, on the price side of the equation, can you differentiate at all about how price is performing in destocking markets versus those markets that have maybe completed or closer to the end of it?

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

A

Yeah. Good morning, Vincent. It's Chuck. What I'll do is I'll give you the overview and then Robert can talk about some of the specifics in the market, and we'll try to do this as quickly as we can. Look, if you think about the overall situation, last year was a pretty tough year in global CP. Where we think we are this year is that the CP market, what I'd say broadly speaking, there's still imbalance but only in a few regions. So Brazil is still a market where we have ample supply and there are pockets, I would say, in Europe. But the US, the destocking is largely behind us now and the market is functioning quite normally and I'd say is healthy.

When you look at it globally though the situation that we see for 2024 is that the overall global industry most likely will be down low single digit. And that is, as you rightly called out, it's really a function of price. Volumes seem to be stable and growing and we expect that in 2024. And then our early look, so then if you think about this, the first half I think is going to be fairly tough in CP. Things should normalize and stabilize in the second half of the year and this is a broad statement globally. And then as we look to 2025, we believe that 2025 will look more like the historical CP industry, so low single digit return to normal growth is how we're sizing up 2025 and then that growth will be on off of a new lower base. So that's sort of the setup for 2024 and a first look at 2025.

Robert, you want to just talk specifically around markets?

Robert King
Executive Vice President-Crop Protection Business Unit, Corteva, Inc.

A

Yeah, add a little bit of color there around markets and some of our product groups. Start with, as Chuck talked about, the industry being down overall but growth in volume and we will reflect that as you think about walk around the world with our regions that by and large, we're up everywhere on volume. Price will continue to be a competitive market in all of our regions. Specifically in Brazil, where destocking, as you pointed out, still needs to take place. We'll be watching to see how the rest of the season works out to see how are we positioned for that 2024-2025 season there. But as you look at our portfolio, we're able to really begin to use or leverage our differentiated portfolio, the new products and Biologicals. And as you'll have seen in 2023, new and differentiated products were up 5% on pricing with a market that was in very much a headwind of price. And so we expect that those products, the new products, Spinosyns, Biologicals are all going to see upward gains in price and volume over this next year.

Specifically in our Biologicals, when you think about the acquisition and the pricing that that's part of the portfolio uses, our EBITDA actually is going to be up 2x on a year-over-year basis with Biologicals as you look at the second year of the integration of the acquisitions and coming to full fruition there. So we're looking for great things out of those three areas of our portfolio. And then specific to pricing, we will continue to follow the strategy that we had of price for value. Yeah, it's competitive. There's always going to be a price/volume pull. But like I said, when you think about our portfolio of new, differentiated and Biologicals making up nearly a majority of our entire earnings, we think we're in a pretty good position to be able to price through this as we continue to work through the year.

Operator: Thank you. I'll go next to David Begleiter from Deutsche Bank.

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. Good morning. Chuck, on your 2024 and 2025 guidance, you're expecting at the midpoint EBITDA to $200 million in 2024, but up $550 million in 2025. Can you discuss why the accelerated growth in 2025 versus 2024 on EBITDA? Thank you.

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

A

Yeah. Yeah. Good morning, David. And Dave can give me some perspective as well here. But if you start thinking about the situation, just the way we've looked at the market, the Seed market remains very healthy and we've talked about sort of on-farm demand for top technology in Seed, but also for CP being very stable and very steady. So that is sort of the backdrop. And then when you consider the fact that you've got the CP industry and if you take the comments we've just made where we still have some destocking in 2024, that's going to impact our business and that's reflective in how we've setup sort of the guide and then where we believe we can hit in 2025 is really the impact of having that global CP market stabilize and then start to grow again in 2025.

And then there's this large bucket of sort of value creation, which is, we call it controlling our controllables, it's self-help, it's cost, it's productivity, it's the royalties that we've seen improvement in expenses and our out-licensing royalty growing. If you think about that, in 2023, that number was approaching while was over $500 million. And we're going to see now going forward in 2024 and again in 2025 somewhere between $350 million and $450 million of sort of self-help, controllables, and that has some deflation. But that's really the – one of the big issues here is we're starting to see deflation move through our P&Ls, primarily now in CP and because of how we manage risk management and hedging in our Seed business, there's going to be even more benefit as we get into 2025. So to your specific question, some of it has to do with just the rate and the timing of seeing some of the deflation come through the P&L. And then there are some accounting normalizations, Dave, that you should hit.

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

A

Yeah, I think the other key thing, David, related to this is in 2024, we've got some assumed headwinds and really known headwinds. We've got those particularly in SG&A as we lap 2023 where we had benefits of lower incentive compensation accrual, we've also got increase in our assumption in terms of merit and then there's just a number of other sort of discrete items that affect 2024. And as a result, 2025 – when you look at 2025 compared to 2024, you won't have those same increments facing us. So that provides some of the lift as well, in addition to the controlling the controllables that Chuck referenced.

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

A

Yeah, and maybe one last point here, David. If you think about the last two years, Corteva actually grew by about $800 million of EBITDA. That's the same plan for 2024 and 2025, a little less in 2024, more in 2025, but we saw that within 2022 and then a little less in 2023. So it should give – at least, when we look at it, it gives us some comfort that this path that we're on the 2025 with the adjustments we've made and by the way, we did not adjust the margin, we're feeling very comfortable about that. We feel we are on the right path here.

Operator: Thank you. We'll go next to Joel Jackson from BMO Capital Markets.

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

Q

Hi. Good morning, everyone. Want to go back to slide 10, which is the 2024 operating EBITDA bridge. So looking at the bridge, look at the drivers, the text on the right-hand side, the cost component is interesting, because we're talking lot about controllables and costs, but actually your bridge is showing that net-net costs are not driving any of your growth [indiscernible] (00:34:56). So, you've got all these cost benefits, cost programs, Seed royalties out – paying out. You also have, I guess, higher costs in SG&A and R&D. Can you explain that a bit and try to put us all together why net-net high level you're showing costs as not driving growth, but [indiscernible] (00:35:13) talking point on the right-hand side?

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

A

Yeah, it's a really good question, Joel. Really plays into the response that I gave to the prior question, but let me give you a little bit more color. Number one, the cost benefits, we think are really very much there, we're going to get. In CP manufacturing as well as overall productivity between both businesses, we've got important contribution coming through. So, probably call – let's call it around $250 million of benefit of goodness, another $100 million in terms of net royalties. Now offsetting that, we've got higher R&D and I'm talking now just the cost line. Some of the benefits and some of the self-help shows up in either price or volume, but just on the cost piece of the walk, which is reflected in the slide that you're referencing, so $100 million of R&D and then over $200 million in SG&A. And that SG&A again is made up of merit, incentive comp accrual, we've got some additional bad debt. As you know, we begin each year with a normalized accrual in terms of bad debt, that's about $40 million. And then we've got other items, including the annualization of the SG&A for the Biologicals business. And that's against the backdrop of what Robert referenced in terms of the significant increase in EBITDA that we'll – we believe we'll experience and deliver in 2024.

And then we just have a lot of other things that comprise the tail. One of those prominently, which you would recognize is ERP. In 2023, with our Latin America deployment, which is our last major deployment in the ERP sector, having completed US and Europe, we're now Latin America, that will shift from capital in 2023 to expense in 2024. That's about $40 million. So when you add it all up, that's why the line shows optically what it is. So significant self-help, some of that is outside the cost area, shows up in price and volume. That then shows up in costs. We've got some headwinds as well. But importantly and references in the earlier question, that if you will increase for 2024, it becomes significantly less, in fact goes – that increase goes away for 2025. So looking at that lift as part of the lift from 2024 to 2025. Hope that helps.

Operator: Thank you. We'll go next to Kevin McCarthy from Vertical Research Partners.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

Yes, thank you and good morning. My question relates to your direct input costs for each segment. In Crop Protection, it seems to me that maybe you're baking in for 2024 about $100 million of raw material cost relief or 2% to 3%. Is that fair? And then on the Seed side of the equation, are you anticipating any cost relief in 2024 given the decline in commodity prices or is it really more of a benefit to you in 2025? Maybe you could speak to that flow through would be helpful.

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

A

Sure – Kevin, sure. So in Crop Protection, as we indicated, the anticipated benefit we're going to see on the direct materials side in terms of looking at really the call it the addressable spend and the opportunity for improvement and what we're experiencing the second half of this year, so that low single digits I think is an appropriate kind of range to be thinking about for 2024. On the Seed side, as you know, what you have is you have a delay when you look at spot or commodity costs in the market versus what shows up in the P&L. It's associated with, as Chuck said and as you know, the commodity hedging strategy that we utilize. So for 2024, a very important percentage of those costs in terms of that commodity costs is actually related to grower compensation and procurement activity that occurs in 2022 and 2023.

The other part of it is the FIFO accounting, which also influences the numbers on the Seed side. There's a lot of other variables besides commodity costs, but as Chuck said, we don't anticipate or aren't currently planned, haven't baked into our guidance a meaningful change in terms of year-over-year cost of goods sold for the Seed business.

Operator: Thank you. We'll go to Frank Mitsch from Fermium Research.

Frank J. Mitsch
Analyst, Fermium Research LLC

Q

Thanks so much. I want to focus in on Latin America. Obviously, you had weather impacts, which you had kind of foreshadowed in the last conference call. I'm curious, as to what you thought that might overall impact have been and just staying with that region, obviously you're expecting destocking to continue into the early part of the year, but you also referenced [indiscernible] (00:40:57) market dynamics in CPC, which I assume was referring to generic competition. I'm wondering what – if you could provide an update on what you're seeing there in terms of the generic impact in Brazil in particular? Thank you.

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

A

Okay. Good morning, Frank. So, yeah, let me give you the high level and then I think it would be instructive if Tim gives you a situation that's happening in Seed and then if Robert has anything to add in CP. But look, you're right, so – and I'll just zero in, Latin America is a big diverse region for us but really this is a Brazil phenomenon. And if you look at 2023, I'd call it the perfect storm, right? We had – CP destocking was probably the most pronounced in that country. It was hit with pretty severe weather challenges, which actually slowed down the destocking and certainly has impacted planted acreage of the Safrinha crop. And then you've got all the kind of macroeconomic conditions on top of that. So it is going to take some time to sort out. We do see that we are heading in the right direction. The positive, I think, comment I can make is the long term trends in Brazil. The structural opportunity that we see in that country has not changed. This will be an Ag growth market for the future. But there's been some moving parts in Seed and CP, and I'll turn it over to Tim now to talk about Seed.

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

A

Yeah, thanks, Chuck, and good morning, Frank. So, yeah, I mean, you go back to kind of the backdrop heading into the season, we saw a pretty significant rapid decline in the commodity prices that was a result of the big yields and the resulting high carryover stocks from the last Safrinha season. And then when you couple that with the what I would describe as highly variable weather conditions that really delayed the start of the soy planting season in the key markets across the marketplace in Brazil and in some cases that was drought or lack of moisture early on or in some places it was excessive moisture as you went further into the south. And what it ended up doing was pushing a significant share of the soy into a later planting window that really impacts the ability of the farmer to follow up with a corn crop that falls into an ideal planting window.

So as we – as you said, we talked about that in November and we were sort of at that – call it, at that critical point when we needed to get that crop planted in and my best guess is somewhere around 20%, 25% of the corn – or, excuse me, of the soybeans were planted in a window that was not ideal for following up with corn. And I'm not going to try to peg how much corn won't be planted at this point in time. I spent a lot of time in the marketplace over the last three months traveling across the major Safrinha growing areas, discussions with customers and channel partners and certainly a lot of feedback from our frontline commercial team there. But as we sit here today, we believe it'll be somewhere, I'll call it a double digit reduction in terms of the area that's planted of corn for both the Safrinha and the summer season that has already been planted.

That being said, farmers are still planting corn hectares where the timing works out. And last week I was in Brazil and I saw firsthand where they were harvesting beans and coming right in with corn. So the momentum is still there for corn and a lot of support even with the reduced commodity price. And our expectation is, as Chuck just said, that we're going to see something more back to a typical level of corn planting as we go into next year where think of something on the order of the Safrinha hectares for 2022 and 2023 being a reasonable target for the 2024-2025 crop that'll be important in the second half of next year. Corn remains a profitable crop. Demand for grain in Brazil is still growing. And so that's very important.

And the other thing that we've seen is that there's a real strong agronomic reason to plant corn. And the soy that is being harvested right now that followed corn from last year is performing better than those that were not on rotated acres from corn. So we're still very optimistic and the fundamentals remain strong, but it is a really challenging Safrinha season in Brazil. So pass it over to Robert for CP.

Robert King
Executive Vice President-Crop Protection Business Unit, Corteva, Inc.

A

Yeah, Frank, when we began to look at or unpack a little bit more of Brazil, what's going on there, I think it's fundamental to reflect on what Chuck said, Brazil will get back to growth. It's just going to take a little bit of time. From – looking at 2024, this destocking is going to last a little bit longer and we need to work through the first part of the year to have a little better view. But overall, this next year, we see the industry down in low single digits overall, but we expect to be up modestly, primarily due to further penetration of our new products, the differentiated products and then adding in Biologicals there.

Specific to your question though around generics and the pressure there of pricing and the competitive environment, off-patent and generics have always been part of this market overall in the global market. It is a little bit stronger in Latin America and in Asia, but we've not seen any further pricing degradation coming out of the generic manufacturers. Production capacity, we've not seen any significant changes there either. However, there have been some plants built of late that are focusing on big molecules that are coming off-patent in the next few years that will play a factor there, none of which are any of our molecules. In the last half of 2023, Brazil imports began to slow overall and we continue to see that the generic profits are struggling in this low pricing environment. So we expect that there'll be some changes there as we walk through this year and next year.

Specific to the pricing pressure, yeah, [ph] it is exacerbated (00:47:10) a little bit in Brazil due to the farm profit environment and the macroeconomic factors that Chuck mentioned there earlier. What this does is farmers begin to look at what are the next best alternative to save on the input cost. But our strategy that focusing on the higher value, the differentiated products and the higher service is one that we think is still a winning combination. These high technology products and high quality agronomic service, being excellent in these areas is things that will differentiate us from the competition. And we think we're in pretty good position as we head into 2024 and then 2025 with our strategy in those areas, so thank you.

Operator: We'll go next to Steve Byrne from Bank of America.

Stephen Byrne
Analyst, BofA Securities, Inc.

Q

Yes, thank you. I assume your Seed order book for North America is full at this point. And just wanted to ask your view on within that how much of an increase in Enlist are you expecting in as a percent of soybeans for 2024 and can you partition that $100 million reduction in net royalty into the buckets? How much of it is trait fee versus germplasm fee, both out-licensing and in-licensing? Those are four buckets there, can you split that $100 million and do you see any risk of Seed pricing going into the spring with potential competitive actions?

David Begleiter
Analyst, Deutsche Bank Securities, Inc.

A

All right, Steve. Hey, good morning. I'll take a shot at all those. That's – we're going to spend a little bit of time on North America Seed here. So I'd say where we're at right now, you touched on it. I mean, we've been live in the market since August 1 and we spend kind of that August, December window working closely with customers, building proposals and securing commitments and we feel very good about where our order book sits today. And I'd say, pattern – order pattern in terms of timing was consistent with past experiences and our expectations and we're not seeing any change in terms of the mix of technology and so that feels like a good spot right there.

In terms of the question on pricing, is always a competitive marketplace and I'd say this year, I'd say soybeans are probably a little bit more competitive than maybe on the corn side and a lot of folks battling for the spots there, but as we sit here today and we're roughly 70 days out from the planting window opening in the heart of the corn belt, our prices are holding and we feel good about where we sit there. Customers understand the value proposition and our team is focused on staying close and executing our plan. And so, you never know what's going to happen, as I said, 70 days until the season really breaks here. But I think we're in a positive spot in terms of, call it, the stability around price.

When you get into the E3, I'd say where we sit today, order position is tracking as expected and our best estimate in terms of the market right now is about 60%. We see the soy market at about 60% converted to E3 this year. And again, remember, we don't have full visibility to our licensees and there's over 100 other companies that are selling Enlist E3 soybeans. And so we don't have perfect visibility there. But I think that 60% level is confidence. So no surprises and things are tracking as expected.

In terms of that royalty bucket, I'd say this year, and I don't know if I can split it into four, I probably won't try to, but the majority of the benefit that we're getting this year would be from reduced payment of royalties primarily in soybeans. So that's the – think of that as the primary bucket. I think as maybe Chuck had said earlier in his comments, we're going to see that transition, especially beginning in 2025 and beyond, where royalties and our – the benefit from royalties then will be greater than what the benefit is from reduction of royalties paid. So pretty significant – yeah, that'll be a significant milestone as we transition there. So I think I touched on all your points there.

Operator: Thank you. We'll go next to Adam Samuelson from Goldman Sachs.

Adam Samuelson
Analyst, Goldman Sachs & Co. LLC

Q

Yes, thank you. Good morning, everyone. I was hoping to maybe just get a little bit more color on the free cash flow outlook, both the outperformance in the fourth quarter as well as kind of the cadence in 2024. How do we think about the normalization in Crop Protection production, which will – should your payables balance increase? How do – just how does that working capital kind of inflection maybe work through the year and maybe any differences you would call out in the working capital trends between Seed and Crop Protection, because obviously there's very divergent trends happening in those two businesses.

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

A

Sure Adam, this is Dave. So as you know, in 2023, we benefited, we had a strong finish, particularly in receivables and also advance payments, which, by the way, really underscores the health of the US farmer in terms of the income as well as their liquidity. So we had strength in terms of collections, which really enabled us to achieve that round numbers of $1.2 billion in terms of cash flow for 2023. For 2024, what our guide includes is continued progress in working capital, notably though the mix is going to be a little different. We had accounts receivable in terms of the change of change and the same with inventories were positive in 2023 and significant. Payables was a use net for the reason you cited in terms of just the reduced procurement, particularly in the Crop Protection side related to managing inventories.

For 2024, we're going to see receivables and payables both being, again, change of the change being contributors in terms of cash and receivables is going to go the other way. We've got a little moderation assumed in terms of the cash to credit ratio for the collections at year-end. And we've got – just with some of the market conditions, we think DSO is going to go up on a year-over-year basis, modestly, still very healthy on a year-over-year basis but that essentially, that mix shift in working capital, but in overall the theme is overall continued benefit from working capital in terms cash contribution in 2024. So we're excited to be at near 50% conversion in terms of the guide that we're giving you, the precise number is more like 49%, but round numbers 50% conversion, cash flow to EBITDA for 2024.

Operator: Thank you. We'll go next to Aleksey Yefremov from KeyBanc Capital Markets.

Aleksey Yefremov
Analyst, KeyBanc Capital Markets, Inc.

Q

Thanks. Good morning, everyone. Last quarter you discussed influx of generic Crop Protection imports into Latin America. Has situation changed at all in – over the fourth quarter?

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

Yeah. So I think Robert covered some of this already. Good morning. I'd say, look, what we saw in the third quarter was that elevated imports from – broadly speaking from generics entering Latin America. What we've seen since then, as we work our way through the fourth quarter in and so far in 2024, is that generally speaking, imports into Latin America are down and they're trending – they're slowing down, they're trending down and that includes generics. So I think we commented that what we're seeing at a price level is that – we didn't expect that what we saw at – I'll call, at the peak, was sustainable. And that's exactly what we think is happening here is, is there is a rebalancing happening. I think there's a kind of a view of that you need to be profitable when you're moving these products around the world and into these regions. And so that's exactly what we saw is a slowdown. But I will counsel, generics are part of this market. They're not going away. They serve a role, but it's not the primary area. In fact, we've made portfolio decisions to move almost our entire portfolio away from these product lines because we feel that where we want to add value is differentiated technology service with strong agronomic support, because I think that's what farmers need and they're willing to pay for that. But to answer your direct question, yeah, we've seen a slowdown in imports into Brazil, including generics.

Operator: Thank you. And we'll take our last question from Josh Spector with UBS.

Joshua Spector
Analyst, UBS Securities LLC
Q

Yeah, hi. Thanks for taking my question. Just a quick one, if I could ask on, you didn't talk about the shift from corn to soy as being a negative in your EBITDA bridge. Just given where you're at from a profitability in soy and higher Enlist share, is that a meaningful factor when you look at the acreage shifting between corn and soy or is that more neutral? What's the sensitivity we should be looking at? Thanks.

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

Hey, Josh, good morning. I'll take a shot at this. So, yeah, I mean, I don't think it's any secret that corn is always more profitable for us than soy in North America. I think what's changing is that, first, we anticipated this. This isn't a shock. And so we've been planning for this and it's baked into our numbers right now. And I think the other important part is it's still – there still is a difference, but the difference isn't quite as great as it had been. And the reason is today because we're not dependent on somebody else's technology on soybeans. So soy, relative to where we would have been three, four or five years ago, is much more profitable. So there is still a difference there. We factored it in. But it's not quite the difference we would have had prior to the significant shift to Enlist E3 within our business.

Operator: Thank you and I'll turn it back over to Kim for any additional or closing remarks.

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

Great. And that concludes today's call. We thank you for joining and for your interest in Corteva, and we hope you have a safe and wonderful day.

Operator: And that does conclude today's conference. Thank you for your participation. You may now disconnect.