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F - Ford Motor Credit Company First Quarter 2016 Conference Call

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PRESENTATION

Operator

Good morning. My name is Holly and I will be your conference operator today. At this time we'd like to welcome everyone to the First-Quarter Ford Credit earnings conference call.

(Operator Instructions)

I will now turn today's conference over to Stephen Dahle, Associate Director, Ford Investor Relations.

Stephen Dahle - *Ford Motor Company - Associate Director, IR*

Thank you, Holly, and good morning ladies and gentlemen. Welcome to all who are joining us either via phone or webcast. On behalf of the entire Ford team I'd like to thank you for spending time with us this morning.

With me this morning from Ford Credit are Bernard Silverstone, Chairman and Chief Executive Officer; Marion Harris, Chief Financial Officer. We also have a Neil Schloss, Ford Vice President and Treasurer.

Before we begin I would like to review a few items. As noted on our media advisory the format of this call will differ from prior quarters. Commencing this quarter we are moving to a call focused only on Ford Credit earnings.

With this change we are expanding the content of our communications to provide increased disclosure on topics for which we commonly receive questions from the fixed income investment community. All automotive-related questions should be directed to the Ford equity investor relations contacts detailed in the Ford press release.

A copy of this morning's press release and the Ford Credit slides that we will be using on our call today have been posted on Ford Motor Company's investor and media websites for your reference. The Ford Credit investor website also contains the slides.

The financial results discussed herein are presented on a preliminary basis. Final data will be included in our Form 10-Q.

Additionally the financial results presented here are on a GAAP basis and in some cases a non-GAAP basis. Any non-GAAP financial measures discussed on this call are reconciled to the US GAAP equivalent as part of the appendix to the slide deck.

Finally, today's presentation includes some forward-looking statements about our expectations for Ford's and Ford Credit's future performance. Actual results could differ materially from those suggested by our comments here.

The most significant factors that could affect these results are summarized at the end of this presentation. These risk factors and other key information are detailed in our SEC filings including our annual, quarterly and current reports to the SEC.

With that I would like to turn the call over to Ford Credit Chairman and CEO Bernard Silverstone.

Bernard Silverstone - *Ford Motor Company - Group VP & Chairman and CEO, Ford Motor Credit Company*

Thank you, Stephen, and let me add my good morning to everybody. I'm delighted to be able to present our First Quarter operating results and I'm joined here as Stephen said by Marion Harris, our Chief Financial Officer.

So this was another very strong quarter for Ford Credit with profits in excess of $500 million and ahead of the same period in 2015. So here we're turning to slide 1. I firmly believe that our continued solid performance can be attributed to a consistent focus on maintaining robust operating principles executed by our very experienced team.

So our team is relentlessly focused on creating value in everything we do, through a deep understanding and analytically supported risk management, consistent and disciplined originations practices, world-class customer service, and of course all underpinned by a competitive funding built upon a foundation of diverse funding sources to ensure we have credit available for Ford dealers and our customers throughout the cycles.

And we will be covering the key data points behind these areas of our business in coming slides.

So can we go to the next slide, please?

Ford Credit has been profitably supporting Ford Motor Company and our dealers and our customers for more than 55 years and in the First Quarter there was no change to that. The business continued to grow while remaining strongly profitable.

Contract volumes overall were largely unchanged when compared to the same period last year with slightly lower volumes in the United States and continued growth around the rest of the world.

The resulting managed receivables grew in line with our guidance and the profit as I said was higher than the same period last year.

So let me turn things over to Marion now to go through the results in more detail.

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

Thank you, Bernard. Before I get started, Steve had mentioned that we've made a few format changes to our presentation and have added some new materials. For these materials we've also included five years of history in the appendix. We hope you find our new presentation useful and we'd love to hear your feedback.

So on slide 3, pre-tax profit in the quarter was $514 million, up $31 million from the First Quarter of last year. The improvement was led by volume, mix, and margin with partial offsets in credit losses, residual performance, and exchange.

Favorable volume and mix reflected growth in receivables and higher leasing in North America.

Credit losses were higher as we increased the reserve and had higher charge-offs in North America, primarily reflecting higher severities.

The lease residual variance reflects higher depreciation on our lease portfolio as we expect lower auction values in the future.

Slide 4 shows North American financing share and contract volume. Total volume was lower in the First Quarter, reflecting lower volume in share in the US. Within this lower US share, lease share was higher and retail financing share was lower.

Slide 5 shows financing share and contract volume for our International operations. Share was relatively flat and contract volume was higher, reflecting higher industry volume in Europe and higher Ford sales in China.

So turning to slide 6, placement at FICO in the U.S. in the First Quarter was 732 which is consistent with our experience over the last of five years and within normal quarterly variances. As you know, FICO is only one part of our proprietary scoring models.

With these models, we buy a full spread of business and our higher risk portfolio consistently represents about 5% to 6% of our portfolio.

In terms of longer-term lending, the industry average retail contract terms have been extending. Recently, our average retail term has remained relatively flat and lower than industry. Our mix of 73 months and longer remains a relatively small part of our business.

Our underwriting practices have been consistent for years and our consistency of originations and risk management delivers robust portfolio performance.

Bernard Silverstone - *Ford Motor Company - Group VP & Chairman and CEO, Ford Motor Credit Company*

Just before we go on, Marion, can I just comment on underwriting practices? When we originate our business we of course as you mentioned use our own proprietary models. And they project the expected losses and of course we price accordingly.

And a particular strength of our models is they recognize not all FICOs are created equal. So we're able to both serve a range of customers across the credit spectrum, and also ensure that our business fits our own risk appetite.

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

That's a good point, Bernard.

On slide 7, this shows our US retail and lease credit loss metrics. Delinquencies of 14 basis points remain at historically low levels.

Repossessions were up slightly in the First Quarter, but it was still our second lowest First Quarter result on record.

Severities in the quarter averaged $9,800 per unit, up $1,500 per unit from last year and up $200 per unit from the Fourth Quarter. Increasing severities reflect lower auction values, higher balances at repossession and higher amounts financed.

Charge-offs and the loss-to-receivables ratio was higher year-over-year, reflecting higher severities.

On slide 8 our worldwide credit losses remain very strong. The worldwide loss-to-receivables ratio of 29 basis points in the First Quarter is higher, reflecting primarily the US retail and lease business.

Our credit loss reserves were $463 million at quarter-end. The increase in reserves reflects credit losses normalizing and growth in receivables. The reserve as a percent of managed receivables was 35 basis points in the First Quarter, up 4 basis points from last year.

On slide 9, our lease mix was 26% in the First Quarter. A lot of discussion about that this morning in the Ford earnings call, as industry leasing has been growing and Ford Credit's lease share has also grown but remains below industry levels.

We work together with Ford under our One Ford Lease Strategy to manage lease mix. We consider a number of things such as share, term, model mix, geography and other factors to support our Ford sales, protect residual values, and manage the trade cycle.

So as such we expect our Full Year lease share to be lower than the First Quarter, reflecting the parameters of our One Ford Lease Strategy.

On slide 10, we had 59,000 units of lease return volume in the First Quarter, up 15,000 units from last year, reflecting higher lease placements in prior years. Our 36-month auction prices in the First Quarter were almost $700 per unit lower than last year but about $250 higher than the Fourth Quarter. We saw prices rise seasonally in the First Quarter, but not as much as we had expected.

With the growth in leasing we have been planning for lower used auction values. We continue to see good demand at auction, and we do not expect to see rapid declines in auction values.

Bernard Silverstone - *Ford Motor Company - Group VP & Chairman and CEO, Ford Motor Credit Company*

Again, maybe I can add there that while auction values are actually lower year-over-year it reflects the growth in the volume. So as Mark commented earlier in the earlier call it's more on the supply side, and of course that's something we've known and planned for.

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

Okay, good.

So on slide 11 this shows our trend in funding of our managed receivables.

At the end of the First Quarter, managed receivables were $132 billion, up $19 billion from the same period last year and up $5 billion from year-end.

Securitization funding was 38% of managed receivables. And we continue to project managed receivables in the range of $134 billion to $139 billion at year-end.

Slide 12 shows our public term funding plan. We're off to a terrific start this year. Through April 27th, we have completed about $14 billion in public term funding. This represents about half of our projected range of $26 billion to $34 billion in public term issuance.

Credit spreads have improved, reflecting our recent ratings upgrades and improvements in the capital markets.

So turning to slide 13 you can see our managed leverage and liquidity metrics. We continue to target managed leverage in the range of 8 to 9 to 1. Leverage ended the quarter at 9.4 to 1, down from 9.5 to 1 at Year End. Leverage was above our targeted range, reflecting growth in receivables and the impact of a strong US dollar.

For liquidity, we target $25+ billion to protect our business against downturns and market disruptions. We ended the quarter with $35 billion of liquidity, reflecting new committed securitization facilities and higher cash balances to meet our near-term debt maturities.

With that I will hand it back to Bernard.

Bernard Silverstone - *Ford Motor Company - Group VP & Chairman and CEO, Ford Motor Credit Company*

Thanks, Marion. So we can now move to slide 14.

Here you see that our guidance for pre-tax profit and managed receivables remains unchanged.

We do not expect now to pay distributions in 2016. And that's to support returning managed leverage to the upper end of our targeted range.

Now we can go to slide 15 and here you can see before we go to your questions I'd like some summary points and key takeaways.

So in summary we're off to a solid start in 2016, delivering a First Quarter profit which is ahead of the same period in 2015 at $514 million.

We've also enjoyed a solid quarter in the capital markets and have completed a significant portion of our planned funding.

The growth we've seen is consistent with Ford's overall growth and we remain resolutely focused on a disciplined and consistent approach to how we grow.

So the data we've shared with you this morning underscores the strength of our portfolio.

Our funding structure and stress tests leave us confident that we will be able to go on serving Ford and Ford dealers and customers throughout the business cycles ahead, whenever they may occur.

So with that we are ready to take your questions. I will hand back to Stephen to open up the lines.

Stephen Dahle - *Ford Motor Company - Associate Director, IR*

All right, thank you Bernard. With that we will start the question-and-answer session.

As a reminder, we will take Ford Credit questions on this call. Automotive-related question should be directed to the Ford equity investor relations contact detailed in the Ford press release.

Holly, may we have the first caller, please?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Eric Selle, SunTrust.

Eric Selle - *SunTrust Robinson Humphrey - Analyst*

Hey, good morning. You are making my job hard here because after a phenomenal quarter like that we are supposed to scrutinize these results and I'm going to have to stretch a little bit to dent the veneer here.

So awesome work and wonderful long-term efforts in metastasizing in profits and cash. So heads up and great work there.

But in that regard we're supposed to scrutinize these and I see that loss severity is up. I know we expected that, but when you look at auction value, your decline in auction value, and this is more of a probably an industry question than anything, but your auction value decline is worse than the Manheim trend.

I think Manheim was down 1% in the quarter. Is that a fair comparison or is that apples to oranges due to mix or other measurement factors?

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

It's a bit of an apples to oranges, Eric. First of all, thanks for the great comments. We really appreciate the feedback.

It's a bit of an apples and oranges. When you look at the Manheim index it is, all vehicles through auction I think it's one to six years old or something like that. And what you're seeing here are three-year-old vehicles coming through auction and as you know the way the lease product works generally if the lease is below what the lease-end value is, significantly below, we would expect that unit to be returned and sold at auction.

If it's above you would not necessarily see that come to auction as the dealer may keep the vehicle. And within the performance, you see this in the Manheim index, we've seen relatively weaker prices on smaller cars. And for us, our number one lease vehicle is the Ford Fusion.

So we've had proportionately more cars come through auction than SUVs and trucks.

Eric Selle - *SunTrust Robinson Humphrey - Analyst*

That's great color. I really appreciate that. You are making me smarter.

One of the things that I thought I'd set out was, I think I'm getting this right, was your decremental margin actually, sorry, that's an auto question, I will strike it, I will ask Steve after the call, I will stick to the script so I will not ask that.

Ford Credit target leverage of 8 into 9, given the quality of your assets, why not increase that target? Is it the agencies or is it just a conservative approach to be able to finance through the cycle?

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

That's a good question. As you know, we believe that the riskiness of our balance sheet would support leverage significantly higher than 8 to 9 to 1. But we do look at what our competition is doing and rating agency guidance and so forth and we set that range. And for now I think we're pretty comfortable operating in that range.

Eric Selle - *SunTrust Robinson Humphrey - Analyst*

I like that. I'm a conservative buying guy but I just got to ask it.

Speaking of the agencies, I mean you guys know I've been bullish on you guys since 2009 and tried to help educate investors and agencies, but it's kind of frustrating sitting here today.

You guys have better credit stats than your A rated peers, you've proven your profit diversity with a bang this quarter and you have less luxury exposure to the one the sedan kind of luxury side of the market that is a little bit of a risk right now.

How are the agencies looking at you? I know the same analyst doesn't analyze the G3 over there but you've got to bring some sort of relative value amongst your global analysts. And how do they respond to you guys when you could put up your stats and prove the diversity and your profitability and cash generation versus your peers?

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

That's a good question. Eric, as you know we meet with them all the time. We tell our Ford story. We try to differentiate ourselves as much as we can. And in the end, the ratings are what they are. But we're so focused on continuing to deliver our plan and grow our business and deliver value.

Eric Selle - *SunTrust Robinson Humphrey - Analyst*

And you still have the A rated 2018 goal.

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

Yes, absolutely. That's our objective is to operate with a strong investment-grade balance sheet with a single-A outlook.

Eric Selle - *SunTrust Robinson Humphrey - Analyst*

And then I've written about this and tried to refute some articles out there that try to bring up the subprime and the leasing bogeyman, every three months the Wall Street Journal tries to bring it up and it creates a lot of calls on my phone that I have to educate investors.

But you guys are on the front line of this and it's easy for me in the ivory tower to thwart some of these concerns. But have you guys seen any behavioral change in any of your competitors in auto financing whether it be credit unions, capitalist financials, banks, whatever in regards to underwriting standards, lease residuals enhancements or other consumer dealer incentives. Are you guys seeing anything that's off base in the First Quarter versus say the fourth quarter?

Bernard Silverstone - *Ford Motor Company - Group VP & Chairman and CEO, Ford Motor Credit Company*

So, Eric, I think other than what we're seeing in the public domain, and I think there was even some comments in the last couple of days from others, so I will let them speak for their positioning there, but as you also know we've had a very consistent approach to how we manage our risk profile overall that we want to buy and support a spread of risk in ways that we can liquidate efficiently and effectively. And I think our track record shows with the quality of the portfolio and how it liquidates, that that's one of the areas that we continue to invest in and have strength in.

So we really haven't seen a change in our profile. As you saw on the slides that our high-risk business, as we measure it, is still right around 6% and at the same time as we measure and look at what comes through the door through our dealerships, we're the dominant supporter. We finance basically three out of four of customers with a higher risk profile that actually buy vehicles from Ford and Lincoln.

Eric Selle - *SunTrust Robinson Humphrey - Analyst*

That's great color. Hey, I really appreciate you all's time this morning. Great work.

Operator

Brian Jacoby, Goldman Sachs.

Brian Jacoby - *Goldman Sachs - Analyst*

Great numbers. So a couple of quick ones. Can you tell us a little bit about just the industry, generally it's got a lot of off-lease vehicles hitting the market.

When you guys look at your planning, obviously you have to consider what's going on across the industry in terms of off-lease vehicles. What do you guys follow or track and do you have kind of a rough estimate on what you are expecting for off-lease vehicles broadly speaking? Because obviously if you're setting your residual value assumptions you have to consider what's coming from other competitors that's going to hit the used market as well.

I'm just trying to get my arms around how you guys think about that. And maybe even if you had some type of view on how many vehicles could hit the market, the used market this year.

Bernard Silverstone - *Ford Motor Company - Group VP & Chairman and CEO, Ford Motor Credit Company*

Well I think, Brian, there's been a number of external reports on what the total might be. We obviously know what we expect and we take the factors that Marion covered earlier when we are setting residuals, because obviously we use all of our internal data as well as external factors to set them. And we use what we call the One Ford Lease Strategy to make sure the result is that we don't have any single concentration in any one sector, whether it be geographically or vehicle sectors.

So it is growing and we've taken that account. I think we commented on that we know there's going to be more off-lease vehicles coming back this year and again next year. Because again, after all, we know what was put on the books three years ago for three-year leases and for two-year leases.

So, yes, we take all of that into account, and then we manage our business to make sure we don't have an over-concentration. That kind of relates to all the other questions, we've got a spread of products that we offer and it's about being competitive and then making sure it's sustainable by managing it in a very responsible fashion.

Brian Jacoby - *Goldman Sachs - Analyst*

Would you go as far as saying what your expectations are for the industry for off-lease this year that will hit the market?

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

I'm not going to quote an industry number, but we said this morning that we would expect more than 200,000 units of Ford volume to come back through auction this year.

Brian Jacoby - *Goldman Sachs - Analyst*

Okay and then --

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

In fact, I'd point you on this phenomenon to the appendix where we've included five years of data. And you can see our lease placement volume and the lease return volume as well. And it's no surprise that with a growing lease mix and a growing industry we're going to have more return volume coming back off-lease and we've been planning for that and we expect lower used-car prices.

Brian Jacoby - *Goldman Sachs - Analyst*

Right, right. Okay. And by the way the appendix, that is great.

And that's my next question is appendix slide A2, you show the retail installment and lease share of Ford retail sales for the United States. It's grown from 52% to 65%. Can you just talk a little bit about that?

Is there kind of a level there, I mean obviously it's gone up quite a bit to the success of Ford Motor Credit, but I'm just curious on how you're thinking about maybe tell us a little bit of how that grew or why that grew so much and then what level could that potentially cap out at? I think have you been as high as 70%? I think you were at one point in the 1990s, is that right?

Bernard Silverstone - *Ford Motor Company - Group VP & Chairman and CEO, Ford Motor Credit Company*

I don't have that in front of me right now, but certainly the pattern that you've seen in the last five years has been a result of working together with our marketing sales folks on the kind of offers in the marketplace to make sure we're competitive. And certainly we're comfortable at that level, but we tailor it.

So we mentioned earlier our U.S. volume was a little lower in the First Quarter. That's not shown on A2, but we updated that in the main deck. So yes, we're comfortable at that level and it's really a combination of the offers we put in the marketplace.

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

One other thing on this, Brian, if you go back to say 2010, even before, we've been working hard as a business to improve our balance sheet and our overall credit rating. And with that we've had significantly better access to funding and more competitive funding to allow us to have a better share with Ford.

Brian Jacoby - *Goldman Sachs - Analyst*

Right, makes sense.

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

And the reason we do this is it builds loyalty. We know the customers that finance with Ford Credit return back to Ford more than those that don't.

Brian Jacoby - *Goldman Sachs - Analyst*

Okay. And then last one for me and then I will hand it off, you made it very clear it's very low percentage for you guys, particularly relative to the industry for the amount of loans at 73 months or longer.

But the tone you're giving, it doesn't sound like you have big, big concerns broadly speaking for the industry. Am I interpreting that right that obviously you're watching it, you're seeing what other players are doing, but is it fair to say that you don't see some major tipping point here where it's going to come back to bite the industry later down the road? Is that a fair statement?

Bernard Silverstone - *Ford Motor Company - Group VP & Chairman and CEO, Ford Motor Credit Company*

I think there's a couple of factors that we watch closely. And I'll firstly say little bit segueing from Marion's last comment, the loyalty advantage has to be managed to deliver that. So we're firm believers in keeping an eye on the trade cycle, because we know that if it extends too far then it affects our customer satisfaction and their loyalty.

So clearly we balance those things. So I think from an industry point of view the concern would be if it got out too far. But as long as we have a very low interest rate environment also, that also enables some extended terms.

So we have all the products to be competitive in the marketplace, and then we go to market in a way that delivers these kind of average results, because we think in terms of, if you're looking at the 64 months for example, as our average term in the First Quarter, obviously that's the contract terms. But we know within that customers will come back more frequently and renew at a cycle that keeps them satisfied with their products and able to enjoy another new Ford or Lincoln product.

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

Yes, I would just say that in this low interest rate environment that Bernard was talking about it gives an opportunity to advertise a low monthly payment. And what we actually see is that the customers that are taking this financing are generally very high credit quality customers.

And so the broader question would be what happens when interest rates start going up. But that's not what we're seeing today.

Brian Jacoby - *Goldman Sachs - Analyst*

Right, right. Okay, great, thanks again and great numbers.

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

Thanks, Brian.

Operator

Mark Alter, Credit Suisse.

Mark Alter - *Credit Suisse - Analyst*

Hi, good morning. Just to follow up a little bit more on the retail in the quarter, you said it was driven somewhat by the offerings. Was it different in the U.S. versus Canada and was it just we tried something and, gee, that didn't work this quarter, so you go back to something else or did the competition decide to go after share?

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

No, it really is just changes in marketing program. We had different programs in the U.S. and Canada, and I think just in the U.S. we had fewer subvented programs from Ford in the quarter.

And subvented programs tend to attract higher credit quality customers. And that's why we saw just a slight tick down in the FICO score. But nothing changed in terms of underwriting or our go-to-market, and we would expect that as marketing programs change through the course of the year we would expect to see the typical pattern.

Mark Alter - *Credit Suisse - Analyst*

Okay. And what would drive in wholesale, is it just a tickdown so nothing really, but is that again driven by your dealers are getting a better deal from competitors or that just happens to be a point?

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

It can be that. It can be just the actual wholesale lending that happens at that particular point in time, based on the dealers that have inventory as well. So there's movements, dealers come in and out of Ford Credit financing for banks or other sources, but nothing really to be concerned about there.

Mark Alter - *Credit Suisse - Analyst*

Okay. And I guess in the financing part of it, nothing that you're seeing that is driven by your credit rating as a disadvantage? Just lower margin then you would have if you were an A right now or versus a disadvantage.

Marion Harris - *Ford Motor Company - Assistant Treasurer & CFO, Ford Motor Credit Company*

Well that's a clear reason we want to be a single-A rated Company is just to have better access and more cost effective funding. It's very difficult as a captive finance Company to be competitive with bank funding, but where we excel is around scale cost efficiency and credit loss performance. So we're very focused on continuing to improve our ratings.

Mark Alter - *Credit Suisse - Analyst*

Great, thank you.

Operator

At this time there are no further questions. I will turn the conference back over to Stephen Dahle for closing remarks.

Stephen Dahle - *Ford Motor Company - Associate Director, IR*

Thank you, Holly. At this point we will conclude today's call. Thanks for all who have joined us.

Operator

Once again we'd like to thank you for your participation on today's conference call. You may now disconnect.
