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F - Ford Motor Co to Host CFO "Let's Chat"

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PRESENTATION

Operator

Good morning, my name is Kalia and I will be your conference operator today. At this time I would like to welcome everyone to the Ford Motor Company CFO Let's Chat conference call. (Operator Instructions). Thank you. I would now like to turn the conference over to Ted Cannis, Executive Director Investor Relations. Please go ahead.

Ted Cannis - *Ford Motor Company - Executive Director of IR*

Thanks very much, Kalia. Good morning everybody here in the room and everybody online. Thanks for taking the time today to join us with the Ford Motor Company Let's Chat. You know we do this event twice a year.

Today I am joined by Bob Shanks who is our Chief Financial Officer; also Marion Harris who is the Chief Financial Officer of Ford Credit. We have with us Sabrina McKee who is the Director of Investor Relations and our colleagues and the industry analysts here in the room.

After Bob takes us through a short presentation we will open it up for Q&A in the room (inaudible) only online today. The materials for this are on our website and there are some GAAP reconciliations to non-GAAP references in the back of the presentation. Also we have some forward-looking statements as usual and expectations about our future performance. Actual results may vary. With that I am going to turn it over to Bob.

Bob Shanks - *Ford Motor Company - EVP & CFO*

Thank you, Ted, good morning, everybody. For those of you on line we are here with a room full of great sell side analysts who can't wait to ask us questions. But before we do that, you guys know the drill; we are going to go through the slides that we prepared in advance.

And again, it is not a presentation per se; you know exactly what the point of the meeting is. We take the opportunity in between the first and the -- or the fourth quarter and the first quarter call to kind of give you an update on what we are hearing from you in terms of what is of interest, what has been in the media and the press and what we are hearing from one-on-one investor engagements that we have.

If there is something that we are not specifically covering today, obviously just ask us a question and we will be happy to get your point of view.

So let me just start on slide 2. So this is what we are going to cover today. Just a few comments around our strategy; we are establishing guidance for the first time for the first quarter. We are going to give you an update on the business environment, touch on some aspects of our business in the US, Europe, at Ford Credit, that has really been in the news a lot the last couple of days or so.

A couple of points around autonomy. Reaffirm our 2017 guidance. We've put a specific about number, if you will, on the slides that we have been sharing with you since November which is unchanged. But we will give you a more specific number around that.

Ted Cannis - *Ford Motor Company - Executive Director of IR*

Hey, Bob, I am just going to have you pause. They are having a hard time hearing your mic. I am going to have you sit next to Marion. Hey, Matt, can you switch over please?

Unidentified Company Representative

Sure.

Ted Cannis - *Ford Motor Company - Executive Director of IR*

Something about that mic. Thank you very much, this is how we roll.

Bob Shanks - *Ford Motor Company - EVP & CFO*

All right, can you hear me now better? I guess they can. And then finally a confirmation of our outlook including 2018 because we've had that out there since September.

All right, let's go to the next slide. I just wanted to spend a couple of minutes on this because I think it is important to set up the framework in terms of how we are thinking about the business. We do believe that we are a solid investment with attractive upside and not just from the areas of emerging opportunities.

And it comes from a point of view that we are a strong global enterprise, we have weathered and we have thrived over the last seven years, which has been a period of growth in relatively good economic conditions, particularly in the United States. Maybe not at the robust level that we all wish they had been at, but nonetheless fine. But within that period there have been a lot of ups, a lot of downs that we have been able to manage and yet yield pretty consistently strong results over that period.

In 2017 we expect results again to be solid. They will be down as we have been guiding to since September and we will talk about that more in just a minute. From the level that we are forecasting for this year we do expect the business to improve in 2018. And as we said back at Investor Day and again at Let's Chat back in November, that will be driven by improvements in the core business.

We think the effect of the emerging opportunities, which is the biggest factor that is driving down results this year, will be about the same next year so the improvements of the core will just flow through to the bottom line.

In terms of the areas of strength that we have, most of it is, as you can see in the first column there under the fortify pillar, we believe that these parts of our business, trucks, vans, utilities, performance vehicles, Ford Credit, parts and service, there are many aspects about those businesses that are very defensible that we consider to be profit moats, not impermeable if you will, but we think we have got very, very strong positions.

And the thing that is interesting about that, we have been spending a lot of time working obviously in the transform part of the business, which I will touch on in a second, as well as in the grow. We believe there is a big opportunity in Fortify. We think we can do more with trucks, we think we can do more with utility vehicles, we can do more with performance. And we have got plans in place to do that, but actually we are working on incremental actions that we think can take that to an even stronger position for us in the years ahead.

In terms of the transform, the way you should think about those parts of the business, they underperform, they underperform today. We may or may not have the clear path to profitability and appropriate returns in those parts of the business based on what we are looking at today. So what we have underway in the business is a lot of work in each of those areas to understand what we have to do differently.

What could we do differently? Are there different business models? Are there different approaches that we can make to the markets? How do we think about capital allocation? Should we rethink the amount of capital we are deploying in those parts of the business if we can't find a clear path to profitability and appropriate returns over an appropriate period of time?

That work is underway and what I would expect -- what you should expect from us is as we get clarity around the direction that we will take in those areas you will hear more from us on that at the appropriate time.

And then the last area around growth, electrification, autonomy and mobility. We talked about that a lot at Investor Day. We are making continued progress in the initiatives that we outlined in those areas at that point in time. And again, there -- I think you will be hearing from us proof points, bread crumbs, however you want to describe it, of the progress that we are making in each of those areas in the periods ahead.

And then lastly what I would say is that all of this and this work is sitting on top of a very strong business structure, particularly in North America, that we believe will give us the ability to weather a downturn in the future and continue to pay a dividend, continue to invest in the business, a very strong balance sheet. And again, a clear strategy and track record since 2012 in terms of providing healthy distributions to shareholders.

If we go to the next slide, slide 3 (sic), this is our strategic framework. And certainly as we undertake all the work that I just talked about, this is something that is right in front of us. This is our map, if you will, in terms of how we think about the business and where we want to take it.

And again, I just want to underscore that in every single part of the business, if we don't have a clear path to profitability, appropriate returns, then that is something that is up for a challenge, for change, and for different choices in the future in terms of how we participate or participate at all in that part of our business.

So let's move into slide 5, and this is the first of the new topics. We thought we would hit right up front the first-quarter guidance. If you go back to the earnings call back in January, all that we said about guidance -- because frankly quarterly results are pretty volatile for us. And so, we wanted to wait until we were within the quarter to see where we were coming out.

This is coming about what we had expected frankly at that point in time. And what you will see here is that we are expecting adjusted EPS of about $0.30 to $0.35. That could still move because we still have basically one more forecast, internal forecast to roll as well as the actuals. So there will still be some change I am sure on the way to the earnings call in late April. But this is -- based on what we know today, this is where we are.

The way to think about that is if you look at the comp versus a year ago, it was the best quarter a year ago that we ever had as a business. So the comp is a pretty difficult comparison. There was a number of factors behind that. If you remember, we had frontloaded our fleet business last year, so we were building to support that. We also were building ahead on the Super Duty, the old Super Duty in anticipation of the launch in the third quarter. So there was some very specific factors in the first quarter a year ago that were unique to that period we certainly aren't repeating today.

When you look at the puts and takes that we have on the slide, essentially it is around higher cost in terms of the year-over-year change. That will include product cost and other efficiencies; commodity costs, which we talked about in the earnings call back in January. We see higher warranty expense and also the investments in emerging opportunities. And also lower volume and this is around some of the non-repeats of the factors that I mentioned earlier.

The one thing I will say we've provided, and I will get to it in just a minute, a put and take slide like this for the full year. You can see that there will be some differences in the full year versus the quarter. So the quarter is not the full year.

Although I will say when you go back and when we get to the slide on the full year, you can see that we have put a number to that stacked bar that we have had since November in terms of what the outlook is for the year, about $9 billion. That is exactly the same slide we had in November, the same slide we had at Deutsche Bank in January. We are just putting the number on it in terms of what that reflects.

That slide is unchanged. When we get to the first-quarter call to the extent that we have got a different view in terms of the puts and takes we will show those differences and highlight them for you so you can see what is changing.

What I will say for the full year that we are seeing so far that is different than what we saw in January is around commodity costs. If you remember in January I talked about the fact that the $900 million improvement that we had achieved roughly in 2016 versus 2015 on commodity costs, we thought that was going to flip this year and it would be $900 million-ish of bad news.

We have seen more bad news on that front as we have updated our outlook for the year. That has been offset in other parts of the business. We have actually seen favorable market factors volume and mix and net pricing that so far is basically offsetting that. But that is probably the most significant change that we have seen in terms of our view looking beyond the quarter.

But the way to think about the quarter is if you go back and think about what we did last year, we did $10.4 billion, which was the second best result that we have done. We are saying about $9 billion this year, so $1.4 billion, it basically is going to happen in the first quarter. So the first quarter is where the year-over-year decline comes.

The factors again on a year-over-year basis may not be exactly the factors that you will see when we get to the full year. But essentially the bottom-line impact is happening in the first quarter. From this point forward the comps will still be a little bit different year over year by quarter, but basically the rest of the year, if you look at it, is pretty much similar to what we had last year.

Let's go to the next slide on slide 6. This is an update in terms of GDP and industry assumptions. So we continue to see growth both in terms of global GDP we see growth in industry volume.

The US industry we still believe is going to decline this year and I am sure we will talk about what the factors are behind that. But it is related in part to what we are seeing with used vehicle prices, auction values and the impact that is having on the overall industry. So we expect that to be a factor.

But [17.7] million, I mean it is early in the year; we have only got January and February results so far. But everything tells us that is a very reasonable call at this point in time.

If you look at the China numbers and if you were to go back and look at what we showed you in January at the call, these have been adjusted, both the actuals as well as 2017 and 2018. What we have done, as you might know, the China industry data on a retail basis, the agency that provided that stopped providing that back I think in September of 2015 if I am not mistaken. So we have been all estimating those numbers.

We have concluded that we can get the best estimate from insurance data. And so, we have moved and our analytics have moved to using that to estimate what the overall retail industry is, and so that is just in plain adjustment from moving from one base to another base. But given that, you can see that we expect the volumes to be very strong obviously. But a bit of a decline in 2017 versus 2018 and then a further very, very slight decline in 2018 versus 2017.

Our assumptions behind that also are that there will be a pull ahead of volume from first quarter of 2018 into the fourth quarter like you saw this year, because our expectations are that the purchase tax reduction that was halved, if you will, in terms of the restoration of that this year versus last year, that that will be eliminated, if you will, and it will go back to 10% at the beginning of 2018.

So that will have the same effect at the end of this year that we saw at the end of last year, which is having an effect in the first quarter of this year as there is a bit of a payback to that.

If you go to the following slide we have more factors (multiple speakers) and we've shared that with you in the past in terms of a look ahead of what are key leading indicators to indicate a recession. And everything tells us that we are on track for continued growth in the US. There is nothing that we see that would suggest that the economy is getting ready to tip over.

So the fact that we see an industry decline -- or a very slight industry decline at a very high level is consistent with this. But we don't see further growth ahead, at least in this cycle, unless there is something that comes up in Washington in terms of policies that would trigger more growth or something very specific to our industry such as a big infrastructure project.

Let's go to slide eight, we thought -- this is an important trend that has been with us for quite some time. It is certainly continuing in 2017 and we actually believe it is going to continue in years ahead. And this is the shift by consumers from cars into utilities and to a lesser extent into trucks. Obviously that is good for us because that is where we get better margins and that is where our brand strength is strongest.

(Multiple speakers) certainly is happening and it is happening not only in the US, it is happening in all major markets around the world. The only region we don't see it happening to the same degree as others is in South America. South America is still -- it is moving in that direction a little bit, but it is still largely a car, a [B] car market along with smaller utility, compact utilities.

Now what I'd like to do is just go through a few factors that would indicate, if you will, the health of our business and how we are managing it. In the US it is something that you guys frequently write about and that is often asked of us as we are having investor discussions.

So the first one is around stocks. Our stocks in the US are in very good shape. You can see the comparisons here, December, January, February on a year-over-year basis. And then below that there is a comparison versus the industry. And recognize we do have on average higher levels in the industry because of the number of trucks that we have and the mix of our portfolio.

But our view is that we are in very good shape overall and most of the individual vehicle lines that we are in very good shape. And going forward don't be surprised if you see from time to time that we will have actions, to see actions that will take to take a crew off at a plant for a week or something to just manage a supply with demand. Something we have been doing consistently over the last number of years and we'll continue going forward.

Next when you look at incentives, since 2009 we have talked about this a lot. Incentives have been going up year by year by year, but a very gradual pace, we see that continuing this year. But so far as you can see when you look at the data here, we have been able to manage our incentives to a degree that is somewhat better than the industry. Although I think you can expect this year that you will continue to see an increase from us as well as the industry, but so far we have been able to manage it on a relative basis quite well.

Next, when you go to the average transaction prices, which obviously is inclusive of the incentives, you can see again that we did very well last year. And in fact for a number of years we have done very well in terms of the transaction prices that we have been able to deliver. A lot of that and particularly lately has been driven by mix and certainly that is the case right now.

You are seeing the effect of very strong, very positive reception to the Super Duty both in terms of just the amount of volume that we are putting out, but also the mix of the products within the Super Duty lineup. You have also got the impact of the Raptor, the F-150 Raptor, which we have launched which is having a positive effect, and the Continental and Lincoln are having a positive effect as well. As you can see in terms of ATP, so far through the year we are looking like we are in very good shape.

Let's turn now on slide 12 and we will talk about policy for a second. So in terms of policy, obviously nobody knows anything because nothing has gotten through Congress yet other than the executive orders that have come out. It is going to be a very important week this week, as we all know, looking at what is going on in Washington (technical difficulty) the Affordable Care Act.

That -- whatever comes out of that, first the House and then obviously later the Senate, could have a big impact in terms of all the other things that the administration wants to accomplish. So I think we are all going to be watching that very carefully and closely and see where all that comes out.

But based on what we know today and what the administration has said, what we have provided here is two views: one is in terms of tax reform, NAFTA, infrastructure, we can talk separately about the regulatory environment. We've shown a view in terms of what we think the changes would mean on us in an absolute sense and also how we think we would stack up in terms of that effect relative to our competitors, and that is the second column.

And if you look at tax first, we believe the tax reform in the aggregate is going to be a positive for us as well as for the overall industry. In fact, we think it will be a positive obviously for the country. We think we have a very positive position relative to our competition. Should a border adjustable tax be part of that tax reform, obviously everybody is out both pro and con against that particular aspect of that. So no one knows what gets through if anything on that front.

Should it get through, and we have modeled the blueprint tax proposal -- I think I mentioned that on the January call -- our tax team has been working closely with the staff of the House Ways and Means actually for quite a number of years as they have been working on various forms of corporate and total tax reform.

So I think they have a pretty good understanding of what is intended and what the team is thinking about in Washington at a more granular level around the blueprint tax proposal. We have modeled that out through the mid-2030s. In the next five years or so it probably would have a pretty neutral effect on us in terms of cash taxes if it were enacted as they hope. And then probably after that period through the mid-2030s it would have a positive cash effect in terms of our taxes.

So, on us in an absolute sense -- obviously that one impacted border adjustable, even though we think we are very well positioned vis-a-vis the competition just because of the more balanced position that we see versus our peer set, in an absolute sense it would be a negative for us.

But that is more than offset by the lower tax rate, it is more than offset by the effect of the impact of tax deductibility of CapEx as well as what would happen on interest expense. So the net of all of that is a positive and on a relative basis we think we are very well positioned.

In terms of NAFTA, that is one obviously we are all looking at very carefully. Anything that is done that puts some sort of wall or barrier or incremental cost of bringing in vehicles either from Canada or Mexico into the United States would obviously be a drag on our business, it would affect all of the players in the sector.

But again, on a relative basis, if you think about what we have in Mexico because that seems to be the focus primarily relative to Canada, we bring -- we don't -- we are not one of the biggest players in terms of bringing vehicles in. And the vehicles that we build in Mexico are basically the Fiesta, the Fusion as well as the MKZ.

So in terms of impact those are that lower margin products, lower price point margins or lower-priced vehicles, certainly not trucks, not utilities. So we believe that we are in a better position relatively speaking. But again, it is not something that in an absolute sense would be a plus for us. But it depends on what the overall agreement, to the extent that it is revised, what the outcome of that is.

In terms of infrastructure, all positives for us both in an absolute sense and versus competition just given the position we have in full-sized trucks. But importantly in many of the sectors that you would think would be most affected by big infrastructure projects. And so, to the extent the government were able to put some initiatives in place that would be incremental to infrastructure plans already in place that would be a positive for our business.

We don't have anything there for the regulatory front. You guys know that the president went out to Willow Run I think last week and has agreed to put back in place what was called the mid-term review, which was what was envisioned all along with the one national standard, which was a data-driven approach to look at the key assumptions that had been assumed back in 2011 when that was put in place, understand how those assumptions have changed and then have a conversation around what that means in terms of going forward. Really I think around the 2022 to 2025 period.

We are not asking for or seeking any kind of rollback in terms of the direction that we want to head. We are not asking for California to be treated differently one way or the other. We do hope that we have one national standard; that was a big plus for I think the whole sector in terms of that part of the agreement.

But we just want to have a conversation around how one gets to the levels that we want to achieve and the improvements we want to see in terms of the environment given what we think is a very different set of assumptions and factors in the real world today versus what had been assumed at this point in time back in 2011. So I think that is just work and a conversation that is ahead of us.

Next on slide 14 what I want to do is just -- I'm sorry, 13, is talk about something that you guys have asked about a number of times relative to what do higher interest rates mean for the business. Well, the answer is it is mixed, and it also depends on how fast the interest rates change and over what period of time.

I think fortunately we believe that we are still on a track and I believe that Chair Yellen confirmed that when they announced the rate, the last rate increase during the last 15 months. That we are on a path of very gradual rate increases towards a more normalized level, let's say 3% over a number of years.

Obviously if that were to change because of an overheating of the economy or something there would be a different effect on the business. But I think that if there were a gradual increase in rates over that period of time, it's something that we would as an industry be able to manage reasonably well, but recognizing there is going to be an impact ultimately on affordability.

So all that we have laid out here are the effects on the business. Ford Credit tends to be neutral although it can be some timing differences that Marion can touch on. In terms of auto, obviously it creates an added expense for them. In fact, there is already a factor of that in our outlook for this year for auto in terms of the effect of higher rates from Ford Credit (multiple speakers) Credit to auto to the extent that they want to [subvene].

Pension expense is probably going to be a slight positive to us, but we are now so well-funded and de-risked, particularly in the United States, that it is designed to not move much when there is a change in interest rates. So there will probably be a small positive but not a big effect.

Interest income will be better. Our debt is fixed, so no impact there but we would get higher interest income on the cash that we have. And then in terms of interest expense, as I mentioned, it is basically locked in.

If we go to the following slide, I wanted to put a few things in on Europe particularly given what General Motors and PSA announced very recently. So our view about Europe is it is a place that we want to be. The transformation plan that we announced back in 2012 has been effective. You can see just some comparisons here using the usual key metrics slide that we provide in the quarterly earnings.

The amount of improvement that we delivered in 2012 versus last year, substantial improvement in wholesales and revenue. We actually have seen market share growth and it's been a healthy market share improvement. The operating margin has improved by 10 points and we've seen a $3 billion turnaround in pretax results.

We generated a 4.3% margin last year that would be a margin that would generate a positive return on invested capital. This year we know we have the effects of Brexit along with some investments to support both emerging opportunities but also the launch of the Fiesta, which is a big product for Europe. So their results will be positive this year but they will not be as strong as last year, therefore the margin will be lower.

So I guess that message that we want to leave with you is it is a good market, it is an important market for a number of different reasons. The restructuring we have in place has been effective. We have more work to do and we recognize that. It is around many of the same things that we have been working on, the brand, product, cost.

Russia is going to be a factor. I have talked for the last number of quarters about how the year-over-year improvements of Russia have been a factor -- a significant factor actually in Europe's improvement. It is on its way to profitability and we see a very clear path to profitability.

And we also see down the road if the cycle that we are in now with oil prices is sustained for a period of time where that industry once again, perhaps at some point over the next five years, could challenge to be the largest single market in Europe. But we will see how that pans out. I guess the message is we think that our strategy has worked and we have more work to do, but we are all in and we think it is a good place to be.

On slide 15 you can see just some proof points around what we have delivered and particularly around the qualitative improvement in the mix, the qualitative improvement in the business channels that we have been able to deliver that share improvement. The big improvement in mix, and that is product mix as well as derivative mix. We think there is more there to go.

And of course commercial vehicles for us in Europe has also been a very important factor. We are the number one brand, not the number one Company in Europe, but we are the number one brand in Europe. And we think we have got some plans where we can actually strengthen that position going forward.

Let's go to the next slide on slide 16, kind building on the actions that we have taken in Europe. Just wanted to remind you the things that we have done elsewhere in the business. And again, remember going back to what I said earlier, we are still working on other parts of the business.

So the point of the European slide, the point of this slide is to just remind you that when we say we are transforming the business, when we say that we are going to be making choices about where to play, how to win we have done that, we will continue to do that and we have delivered good results in those areas. That is already visible to you in terms of the actions that we have taken.

So just a couple of the highlights. So in Asia-Pacific we were the first to announce that we were going to get out of production in Australia. We are out and the Australian business is now profitable.

In terms of ASEAN, we announced that we are going to remix our product lineup to focus on SUVs and importantly the Ranger. That is where we are now and our business there is profitable.

In South America we have a lot more work to do there, the business will improve there. But we are not satisfied with the results of South America. And so we have got the team working on a lot of different aspects of the business there.

And then of course in cars -- I want to talk about cars for a second because it goes back to that strategic pillar around transform small vehicles. Just want to remind -- today, today we have gotten our business to the point where cars, including Mustang, which is -- put that off to the side, already 73% of our business is trucks and utilities in the US. So we already have, if you will, diminished the role that I will call it just normal sedans, small, medium play in the business.

And if you think about the plans that we have already announced, we are moving the Focus from the US to Mexico. So we will have both the Focus and the Fusion, which are the only high-volume sedans that we have left in the lineup in North America into a low-cost location. And then a of course there is the Fiesta.

So we have already taken and we are continuing to look at what actions we should be taking in terms of capital allocation in the future and what we have to do to improve those businesses to make sure that we are on an appropriate path to profitability and positive returns -- not just in the US but also in Europe and in China. Although again, the role of those types of products in those markets is quite different; they are very mainstream and industry pricing in terms of structure is much higher. So it is a completely different business there than it is in the US.

As you go to slide 17, and Marion will talk about this a bit. I am going to be very brief on this one because he can explain it much better than I can. But the simple message is we called the change in auction values first in March, then in November as we kind of recognized -- we hadn't fully recognized the total industry effect of what was coming back into the auctions.

We did; we also recognized that the effect was spreading into utilities and also to some extent in trucks. We reset our portfolio, we've reset our outlook as well beyond, if you will, the portfolio that we had in place at that time. The effect of that is increase in accumulated depreciation, that was in effect in 2016. It is also the effect, if you will, in 2017 that's affecting the results of Ford Credit.

The $1.5 billion that we've guided this to is consistent with what we said back in November and is consistent with what you're reading about in the press in terms of auction values. There is nothing new to us in terms of what is coming through the last number of days whether it is NADA or whether it is JD Power, whether it is Mannheim, it is consistent with our outlook for the business.

The thing that is important about this slide, because it can be somewhat complicated relative to how one accounts for a change in auction values. The key message here is that when we reset the portfolio in place, 60% or so of that impact occurs in the following 12 months. So if you think about what we did in March and what we did back in November, just dial forward 12 months, 60% of that whole portfolio effect takes place in that period.

That is why we had the decline last year relative to the year before; that is why we had the decline this year. But once you get past that only 30% of that takes place in the subsequent 12 months and then only about 10% in the 12 months after that. So this will actually go all the way into I think part of 2019 I think.

But importantly, because the lion's share of this is taking place in -- or took place in both 2016 and 2017, when you get into 2018 we actually have lower accumulated supplemental depreciation in that year versus this year. So therefore the results of Ford Credit will improve. So that is one of the factors that will drive better results for the business in 2018 versus 2017.

And then very importantly, all the new business that we are writing today is based on these lower auction values. And in fact, our outlook assumes even lower auction values as we go forward. So we are very, very comfortable with where we are and this is taking into account all that volume that is coming back not only from us but most importantly from the industry where others have actually gone deeper than we have in terms of penetration and the use of the lease tool.

Let me go to the next slide which is somewhat related. We have heard and seen concerns around the risk profile of the portfolio. I think it is first of all important to understand when you look at the receivables that we have in place, what are those receivables, what consists of those receivables?

Well, you see $65 billion there is just normal sort of APR type receivables. We don't carry a residual risk associated with that. $38 billion of that is around non-consumer finance receivables, that is wholesale financing. That is short-term, we don't carry any risk associated with that too in terms of residual values.

So those parts of the portfolio which are the lion's share of that are not subject to all these issues and concerns that have been expressed around what is happening with auction values. And we have got a very robust origination practice around wholesale, around the retail and all the metrics tell us that we are in very, very good shape and still not at level in terms of LTRs, credit losses and so forth that would even be consistent with historical experience.

We are starting to get up towards those levels of historical experience but not quite there yet. You can see the lease portion that we have talked about and that is the effect that we have seen -- in the US, $26.9 billion.

We have seen some concerns expressed or written about Europe, particularly with what is going on with diesel there. You can see the green area on the slide -- we almost do no leasing in Europe. So there is almost no effect from what is happening in terms of residual values on the lease portfolio relative to what we've seen going on in Europe.

So our view is that Ford Credit is doing what it has always done, it is following the same practices it has always followed, which have been very healthy. The risk profile of the business is completely unchanged. And we have already called and are assuming even lower auction values in terms of the outlook going forward than what we are seeing today. So we are comfortable with where we are and the guide that we provided for the year and for next year is consistent with what you are seeing in the marketplace today.

On slide 19, this is just some of the metrics around those factors that I have just mentioned and you can see how it all stacks up. And again, very consistent with what we have been talking about and the type of portfolio and the risk profile that I just touched on.

To go to the next slide, which is slide 20, I just want to mention very briefly here autonomous vehicles. I think you guys are -- I know you guys are aware of what we have just done in terms of the virtual driving system.

I think we have established a very interesting and, as best I can tell, a unique structure in terms of how we can still play, if you will, a very involved, active, leading role in terms of development of that product, still taking the lead on the autonomous vehicle platform but partnering in a very innovative way with fantastic talent on the outside that provides opportunity for us to attract talent and to give them opportunities to participate in an equity option, if you will, around this part of our business as we move forward.

It is off to a very good start. We have moved our -- many of our software talent that had been working on the virtual driving system into this new business entity. And the guys that have joined us are bringing in some really fantastic talent that I think is going to give us a -- really a great position on the brain as we continue to work overall in terms of bringing to market by 2021 a Level 4 autonomous vehicle.

If you go to -- let's move to maybe slide 22. I think slide 21 just captures what I've said. In terms of guidance for the full year, this is unchanged from what we provided you in -- at the earnings call in January, you can see the ups and downs of the business.

If you go to the following slide, this is, again, the same slide that we provided by business unit. Again, unchanged, and to the extent that factors are maybe moving a bit, we will update that when we get to April. But right now it is pretty much on track for the -- other than the two factors I mentioned earlier.

And then the next slide is the same slide that we have had since November at Let's Chat and also at Deutsche Bank. As I said, we've just simply now, now that we are in the year, indicated that that stacked bar in 2017 is about $9 billion, again unchanged.

And then finally on slide 25, just for you to keep with you and understand these are the key takeaways of the conversation that we have just had. And now what we will do is we will open it for your questions. Matt.

QUESTIONS AND ANSWERS

Matt Stover - *Susquehanna - Analyst*

I had two questions. I was wondering if you could just sort of look at that first quarter and maybe flesh out some of what has changed to the worse. It sounds like it is mostly cost. Is that a fair characterization? And is there any sort of regional aspect to it that we should be aware of? And I have a question to follow on to that.

Sabrina McKee - *Ford Motor Company - Director of IR*

Just before you answer, Bob, I just want to remind everyone to un-mute when you are going to ask a question. And then if you could put it back on mute after you focus, that way the folks on the line can hear you. Thank you.

Bob Shanks - *Ford Motor Company - EVP & CFO*

Yes, so let me just say first of all, this is not an earnings call. So, I know you will want to get into that level of detail. I know you guys well. But we are not going to do that. So we provide the put and takes here. So what I will do I will just give you a higher level view of what we see happening in the quarter.

So the biggest impact that you will see in the quarter, based on what we know today, will be cost increase. The larger element of that will be product cost net of material cost efficiencies and that is around the Super Duty and all the other launches that we had last year post first quarter. So that will be the largest effect there.

The second effect that you will see will be around higher engineering expense and that is associated mainly with the emerging opportunities.

The third element will be a warranty expense, and we will talk more about that when we get to the quarterly call.

And then you will have commodity increases. So that is the largest.

You will see volume lower and it is around the issues that I mentioned earlier. You will see positive mix and you can see that on the slide. So we are still seeing positive mix. And I think we will still see a bit of positive pricing and there is a positive performance coming from our parts and service business. The last one I should mention is exchange, you will see some negative exchange pretty much across most parts of the business.

Matt Stover - *Susquehanna - Analyst*

Okay. The second question goes to the leasing portfolio and the slide that you provided.

Bob Shanks - *Ford Motor Company - EVP & CFO*

You mean the one on depreciation?

Matt Stover - *Susquehanna - Analyst*

Yes, that's right, exactly. So we've seen a negative trend in some of the used car prices that you guys have talked about. Who knows what the future holds, but NADA says that over the next couple years we will continue to see deteriorations in pricing. How have you factored in that sort of -- have you factored in that outlook into the thought process?

Bob Shanks - *Ford Motor Company - EVP & CFO*

Yes.

Matt Stover - *Susquehanna - Analyst*

And how much flexibility do you get in the accounting to sort of -- you would have to be prospectively adjusting lease expectations in the future if they are going to be going down.

Bob Shanks - *Ford Motor Company - EVP & CFO*

Let me ask Marion to answer that (multiple speakers).

Marion Harris - *Ford Motor Credit Company - CFO*

Yes, so we update quarterly all the assumptions in our lease book and change the accounting accordingly. So there is not a lot of flexibility and we have very robust rules of the road that ensure that we stay to the proper lease accounting guidelines. When we look at the lease portfolio, it is not just what is happening in the auction values today, it is over the entire portfolio.

What do we expect to come back and do we expect -- where do we expect it to come back and how is it going to manifest itself, what do we think is going to happen with early terminations and all kinds of things. It is a very complex analysis. But with that we look at all the factors, micro and macro around it, how much supply is coming back in the industry and so forth.

And that, as Bob talked about, last year we took the first step down in our auction value outlook as it related to smaller vehicles. Bob talked about the segmentation shift away from cars to SUVs. That was accelerating once we -- we had kind of concluded that fuel prices were going to stay lower for longer. And because of that we lowered our expectation of auction values on smaller vehicles.

Then later in the year we saw a real step down in auction values as it relates to the broader portfolio, trucks and SUVs. And at the same time we were getting a really good view, a better view. And I would have to say our models weren't fully incorporating the industry effect of leasing. I think they were very good at looking at what was happening in the Ford Credit portfolio, but we really began to understand what was happening in the broader industry.

And with that we lowered our outlook for auction values over the course of the remaining life of the portfolio, the next 39 months, so we do have some leases go out 39 months. And with that we look at it every quarter, make adjustments accordingly and change supplemental depreciation accordingly.

In that outlook it wasn't that we just lowered our auction value outlook for 2017; we lowered it for 2017, 2018, 2019. And we expect auction values to be lower year over year for the next several years reflecting the growth from supply coming back from lease. This is -- and it's an important point I went to make. The price -- the lower values that we've seen in auction are not a reflection of demand, they really are just of supply.

Rod Lache - *Deutsche Bank - Analyst*

Rod Lache with Deutsche Bank. A couple questions. One is the past several years we have had for Ford and for the whole industry some really strong pricing and mix improvement; you see that average transaction price growth. And now just at a high level we are all talking about trade-ins, the effect of falling used vehicle prices.

There have been on the margin broadly some changes in credit in terms of some companies maybe pulling back a little bit in terms of leasing and on the margin making some of these 84-month-long loans.

At what point do you think that actually starts to influence average transaction prices, mix and that sort of thing? Is that something that as you are looking out to 2018, is that a factor that you'd anticipate? Or can you give us some brackets around how that gets factored into your thinking and planning?

Bob Shanks - *Ford Motor Company - EVP & CFO*

Do you want to answer that, please?

Marion Harris - *Ford Motor Credit Company - CFO*

Yes, I will start on the finance company side and let Bob answer. We -- there are a number of factors that are affecting the affordability of vehicles related to the financing environment. You have lower auction values which tends to drive negative equity, you have a rising interest rate. You have rising incentives which are offsetting some of this for the consumer. And the natural tendency for consumers to want to buy on monthly payment.

And when a customer walks into a dealership, if they are upside down on their loan the dealer works very hard to ensure that the deal can happen, if you will. But if a contract -- if a contract gets submitted to Ford Credit we look at the contract, maybe the amount requested for financing is a little higher than we would want to buy. We try to work with the dealer to condition the loan to get it into the box, if you will. And it could be asking the customer to bring a higher down payment, it could be asking for guarantees, other types of things to get the contract to work.

What we have seen so far is no indication that it is driving any kind of mix shift or -- in fact, we are seeing quite the opposite, we are seeing mix improve in the business. So that financing environment has not yet affected what is happening, all the factors that you just talked about. But we are -- we look at it very closely and we do wonder about it.

And I also would point to what is happening in Canada. It is a market that is a number of years ahead of us in the United States in terms of financing trends. And they do 96-month financing like the US market does 84-month financing, and negative equity is a much bigger issue there. And to date it has not affected the market equation in Canada. So there is probably some room to run but it is not -- I mean these are not favorable trends for the industry.

Rod Lache - *Deutsche Bank - Analyst*

And just another question maybe, Bob, a few things that you mentioned in your prepared remarks. One is that --.

Bob Shanks - *Ford Motor Company - EVP & CFO*

They weren't very prepared.

Rod Lache - *Deutsche Bank - Analyst*

But addressing the slides. You talked about your expectations that core earnings would improve in 2018. If you can maybe just at a very high level talk about some of the big picture drivers. Is it things like -- obviously one would be the Kentucky truck plant being available for the full year. But what are some of the big things we should be looking forward to beyond that?

And you alluded to some changes to capital allocation and transforming the business (technical difficulty) when there are businesses that are challenged that are difficult to fix just through cost reduction or other things that you are considering. Can you give us a few examples of what is in the range of things that you might be considering there?

Bob Shanks - *Ford Motor Company - EVP & CFO*

Well, I think I am going to stay super high level on both of those. I think we will have opportunities later in the year to get into more detail about 2018 as we get a bit closer to it. But as we said even back at Investor Day, I do see the core business, we see the core business improving and 2018 versus this year. Credit is part of it, we just talked about why. Because the supplemental depreciation will be less next year than this year.

But we do see the core business improving. Some of that is just the timing in terms of where we are with what is happening with product launches and other things that we are doing. The efficiencies we are generating very big efficiencies year in and year out in terms of cost. Some more of that might flow through in terms of where we are from the work that we are doing at that point in time.

But I don't want to really get much more into that in terms of the specific puts and takes until we get a bit closer to the year. I will have to wait and see how this one comes out and then understand what might be changing that would affect next year. But we are still very comfortable with the fact that the overall core business, if you will, will improve including Ford Credit.

And again I will say that -- and you can see that on that bar -- that the effect of the cost and investments, profit impact of the [emerging] opportunities should be about the same next year. So we don't see that at this point as being better or worse in terms of the effect on the business, which allows those improvements to flow through. In terms of -- and I know you asked me something else, what was it?

Rod Lache - *Deutsche Bank - Analyst*

I asked about the -- you alluded to capital allocation changes or transforming businesses that are challenged.

Bob Shanks - *Ford Motor Company - EVP & CFO*

Yes. So the point of that slide and the conversation there, as well as that one slide that we had which talked about the decisions that we have already made, is that we've been transforming this business pretty dramatically all the way back since 2005 when we launched Way Forward with North America. And then we had the One Ford Plan.

And then we have had all these actions that we have talked about here, some relatively small in the scheme of Ford Motor Company, but moving businesses that weren't performing to businesses that should be performing. We have made decisions to get out of parts of our business when we just don't see a path to profitability.

So all that we are trying to communicate is this is how we do our business. And when you look at that transform part of the strategic framework around luxury, around small vehicles in developed markets, around emerging markets, I wouldn't run away and interpret oh, they are exiting all that part of their business.

But what I would say is that every single option in terms of what one could do in those parts of the business are on the table. We are working on different business models. We are looking at collaborations. We are looking at I will call it traditional restructurings. We are looking at rethinking the construct, if you will, of the business within some of those, where do we play, where do we not play.

We are thinking about products versus services and how we mix that out. And we are thinking about increases and/or decreases in terms of capital allocation. So everything, everything is on the table and it should be. We have not sorted out the answers. But I would say we have been working on this now for quite a number of months. I think we are starting to form some interesting points of view in terms of the direction that we might take.

And so -- and again, as I mentioned earlier, some of these things will take time to play out. There is not going to be a big bang, here is the answer. But as we reach appropriate decision points on those parts of the business, as well as the [Fortify] because we have got the same thing going on in Fortify, we will be sharing that with you, the growth as well.

So it is going to be sort of a running conversation I think in terms of this transformation of the business. I just want to communicate to you, demonstrate to you with actual things we have done over the last seven, eight years and more recently that we know how to transform the business and we will transform the business.

Justine Fisher - *Goldman Sachs - Analyst*

Justine Fisher from Goldman Sachs. I just have one follow up on Rod's question about used-car value. So one question we get all the time is how will the decline in used-car values affect new-car prices? And on the one hand new-car prices have been helped by new technology. And of course mix is helping the ASPs reported by the auto OEMs. But then over time there has been correlation between used-car prices and new-car prices.

So the question is for the motor company, do guys have an expectation that over the next few years we will see softening in ASPs as a result of the expectation that you -- on the credit side and I guess as an institution as a whole, you do expect used-car prices to go down 2017, 2018, 2019, 2020?

Bob Shanks - *Ford Motor Company - EVP & CFO*

Let me give a high level answer first and then Marion can add. The thing that is interesting, if you go all the way back to 2008 and 2009 when we were right in the depths of the downturn, when you would think like who would buy a vehicle. Volume did fall a lot, but it is because people that buy cars -- first of all, they have the money to do so, most of them. And what we actually saw back then was that people still bought -- they needed to and they also they could afford to.

Now that was a very extreme situation. We are not facing something like that right now. But I agree with you completely. There is a correlation between the two. And there are consumers who maybe in the past could afford a car because of interest rates, lease payments, the fact that we were able to manage extended terms, which probably still has more to play in the US based on what we are seeing in Canada. So I think that factor is still there, but maybe it is to a lesser extent than in the past.

But we do think that there will be people that will fall out and they won't be able to afford a new vehicle. And they'll -- particularly with all this supply of nearly new coming back into the market over the next several years. So the way that we have expressed that dynamic -- and it could be many different ways, it could be, as you are suggesting, mix or prices or whatever -- is through lower volume.

So our view is that industry volume will decline. So all the factors are still -- we still have a growing economy, we still have scrappage, but our view is that still from these levels that we have been at over the last couple of years, volumes will start to fall this year and next year. Now it may come out a little bit different in terms of all the various factors. But that is the way that we have expressed that impact is through that.

Justine Fisher - *Goldman Sachs - Analyst*

And then just on the --.

Bob Shanks - *Ford Motor Company - EVP & CFO*

Maybe he could just --.

Marion Harris - *Ford Motor Credit Company - CFO*

I'm not sure that I can (multiple speakers).

Bob Shanks - *Ford Motor Company - EVP & CFO*

Extended terms, you might want to talk about that.

Marion Harris - *Ford Motor Credit Company - CFO*

Yes, it just is it also -- we need as an industry to make sure we stay focused on margin as well because that way the volume would fall out as opposed to chasing price. Some of this has been -- over time has been dealt with with extending loan terms and the average term of loans and things going longer and longer and longer. And that is not a new phenomenon, it is been like that for 25 years and we are going from 36 to 48 to 60, 72, 84 months.

And we expect that trend to continue because customers like to buy a car based on monthly payment. And sometimes they will go a little bit longer to get into a vehicle. As long as the credit makes sense and it is consistent with the overall risk of the portfolio it is something that the industry will do.

We don't see -- there was a question earlier, a statement earlier about backing off in the industry on 84-month financing and so forth. I think what has happened, I do find it kind of funny because the banks are the ones that push the 84-month financing, not the captives, banks and credit unions. But that is, I will say we have seen it -- I wouldn't -- back off is probably not the right word, it just maintain these levels. And so we have seen just a plateauing of this range recently.

Justine Fisher - *Goldman Sachs - Analyst*

Okay and just a quick follow up. What percent decline in residuals are you guys now expecting for 2017 over last year? I know Hertz has said 2% to 3%, Mannheim 2% to 3%, Ally is 5% but they are obviously watching the data. So where do Ford's expectations lie?

Marion Harris - *Ford Motor Credit Company - CFO*

Well, we are not giving a specific number, but let me see if I can put it in context for you. Last year in 2016 we were -- full year, year over year, we were down about 4% on 36-month auction values. And if you looked at our data in the fourth quarter, if you looked at fourth quarter over fourth quarter we were down about 6% year over year.

In total for the year our lease residual performance, if you look at our waterfall chart, we were down about $250 million from lease residual performance and all reflected from supplemental depreciation. This year we've guided that we are going to be about $1 billion -- of about $1.5 billion in profits primarily because of higher accumulated supplemental depreciation.

If you do the math it would tell you that we are looking for auction values to be down same or more, without giving a specific number. But to reemphasize what Bob said earlier, what we have seen in the market recently is completely consistent with our outlook.

Bob Shanks - *Ford Motor Company - EVP & CFO*

Now we have seen -- I think I said it earlier but in case I didn't, I think I said it -- but since October when -- September/October there was a big decline. Our auction values have been relatively flat to slightly down. So we haven't seen like a sequential decline of the magnitude we are talking about. But for the full year that is our expectation.

Marion Harris - *Ford Motor Credit Company - CFO*

And some of this is the comp because last year, if you look at just the market, what happened in auction values, January and February were pretty strong. It was March when things really started to go down. And through the course of the year you had the comps versus 2015. This year you are taking -- as Bob said, sequentially they have been flat. But if you look at the year over year you are comparing to a very strong print in February from last year.

And I think as you go through the year, the year-over-year comps will probably look a little bit better. But in total year over year you would expect to see auction values down a similar amount or so or more than what we saw last year.

Colin Langan - *UBS - Analyst*

Colin Langan, UBS. Should we consider Q1 an important inflection point because numbers have been drifting down for the last couple of years? And it looks like, I didn't do the math, but I think you already said in your comments the rest of the year is at least flat or up. And so, and then you are guiding to 2018 better.

So I mean is this sort of the end of sort of the investment sort of headwind? And then what gives you confidence for the rest of the year? Because you mentioned upfront that commodities are worse than you expected. What are those things that are going to make it less of a drag through the rest of the year and how are you managing those costs?

Bob Shanks - *Ford Motor Company - EVP & CFO*

So I would say, yes, based on the guidance we have given. I have to say yes because that is how we are seeing the business. We did a record year two years ago, second best last year, this year at 9, and we expect to improve next year. And we do think, as I said earlier in my comments, that this quarter effectively is the full-year decline. So we do think that this is the bottom and then at least through 2018 that is the direction we are heading. We haven't talked about 2019 and beyond at this point in time. So I think that is correct.

In terms of the fact -- at this point the factors that we were looking at when we talked to you in January, the two big ones are the ones I've talked about, which is the commodities have gotten worse and that has been essentially offset by the fact that we have actually had favorable market factors versus our expectations with when we set the plan out.

And that is around a bit more volume, better mix and a bit more pricing. And so, I think we are on track to what we had expected back in January for the full year with a slightly different way of getting there. It always moves and changes, so I'm sure that will continue to -- we will see ups and downs and we'll just share that with you as we go forward. But we feel comfortable with our outlook.

Colin Langan - *UBS - Analyst*

(Inaudible) question on China. Any update there? I don't think there was much comment on the slide (multiple speakers).

Bob Shanks - *Ford Motor Company - EVP & CFO*

Yes, I think in China in terms of year over year -- most parts of the business are down in the first quarter. But I think it will be down sharply because you have got a big pay back effect from the pull ahead of sales into the fourth quarter last year because of the purchase tax reduction. We are seeing a big reduction in those types of vehicles, the ones that at I think 1.5L or 1.6L liter and below.

So there is a big slow down in those sales. We are still seeing strong sales of the Edge and some of the bigger displacement products, those are continuing as they had in the fourth quarter. So there is a big pay back that will take place in the quarter. But our view is that the industry will essentially get back on track once that is behind us and deliver the same level of sales as we did last year for the industry.

We do continue to see negative industry pricing in China continuing, but maybe -- at least so far it is more moderate perhaps than what we have seen in the last couple of years. Sequentially it has been relatively flat so far this year.

David Tamberrino - *Goldman Sachs - Analyst*

David Tamberrino from Goldman Sachs. Just want to revisit your comments on residuals. When you are talking about continued declines year over year it's not just passenger cars, right, I think you made this point clear. But I just want to make sure because we have heard other comments from some of your competitors. You are seeing it on the SUVs and the pickup trucks across your lease portfolio. Is it the same magnitude or is it to a lesser extent than what you are seeing in the passenger cars, sedans?

Marion Harris - *Ford Motor Credit Company - CFO*

No, it varies by segment. And again, we look at it by segment. And to be clear, when we took down our outlook the second time last year, as we said earlier, it wasn't necessarily because of what we were seeing in our portfolio; it was rather a broader view of what was happening in the industry.

And at that time I think we got a better understanding of how much leasing was happening in full-size pickups away from Ford. And no matter how great our truck is, higher volume is going to result in a lower price. And so, we factored that into our outlook.

David Tamberrino - *Goldman Sachs - Analyst*

And is that at a similar magnitude of kind of the mid-single-digits that you are effectively thinking about for 2017?

Marion Harris - *Ford Motor Credit Company - CFO*

I don't want to get that technical. But it's (multiple speakers).

Bob Shanks - *Ford Motor Company - EVP & CFO*

It is actually different by nameplate.

Marion Harris - *Ford Motor Credit Company - CFO*

Yes.

David Tamberrino - *Goldman Sachs - Analyst*

And then secondly for me, just on the used ecosystem as we think about your comments from earlier. As those used off lease supply comes back in the market that probably steals a little share from new because that vehicle is a little bit more affordable for that consumer.

Is there any offset from the new technology that you are having come in where you are stealing away a potential used customer because of incremental infotainment, incremental electronics, incremental active safety that you may be having within your vehicles?

Bob Shanks - *Ford Motor Company - EVP & CFO*

No, I know there has been a lot of things that have been hypothesized around that point. I mean the reality is that over a long period of time there's been all sorts of new technologies that are brought into products, a lot of it is safety-related. I am old enough to remember when airbags came in and we thought the world was ending because they were so expensive and they were going to have a massive margin effect, which of course they did initially and then over time we've got 10, 12, 14 in cars. So things change.

But -- that doesn't happen, what you are talking -- it just doesn't happen. It didn't happen then, it's not happening now because the reason people buy used vehicles is basically affordability. If they could afford a new vehicle they would buy a new vehicle for the most part.

I mean some people are, well, we'll just buy the nearly new because they believe they are avoiding the big depreciation. But essentially the people that buy new can afford it and they want it. And the people that buy used, that is what they can afford to buy.

So, throughout the whole, my career anyway, as vehicles have become more technologically advanced, safer and it is all relative to whatever the prior generation is, there has been no effect of that migration in the new in terms of the adoption of new technologies or new features and so forth including safety that has changed the dynamic between those who buy used and those who buy new, none, zero, no fact.

Joe Spak - *RBC Capital Markets - Analyst*

It's Joe Spak from RBC. The first one is just hammer home the point on the residual declines. We have seen the declines move from 4 -- down 4% to down 6% to 7%, that is what caused the --.

Bob Shanks - *Ford Motor Company - EVP & CFO*

No, those are two different metrics. One is an average year, so the 4% is an average year. So within the year you have peaks and valleys. So that is an average year versus average year. The 6% was a point in time. The 6% December, 6% December.

Joe Spak - *RBC Capital Markets - Analyst*

Right, but then I thought you said that more recent rate is sort of in line with what you were thinking?

Bob Shanks - *Ford Motor Company - EVP & CFO*

Yes, it is about 7%, but then it is point to point. So the 4 and the 6 are actually the same data set, it is just one is an average, one is just point to point. So, we haven't really seen, at least in our portfolio as you come into this year, February (inaudible) [January to February], we haven't seen any sequential changes.

Joe Spak - *RBC Capital Markets - Analyst*

So, then to see a decline order of magnitude is just sort of what you indicated in November you would need to see that point decline move closer to 8% or 9%?

Bob Shanks - *Ford Motor Company - EVP & CFO*

No, it will be different by month, Joe, because it just -- it is not flat, it is not linear, it kind of goes like this. So it depends on what point -- if you look at July it might be a difference and if you look at September point to point. But average year I think what Marion is saying is that that 4% that we saw last year, it's going to be something like that if not more.

Joe Spak - *RBC Capital Markets - Analyst*

Okay, and then on the new --.

Bob Shanks - *Ford Motor Company - EVP & CFO*

Is that right?

Marion Harris - *Ford Motor Credit Company - CFO*

Yes, part of this is just the comp, just picking February.

Joe Spak - *RBC Capital Markets - Analyst*

So then on the new leases, those assume a similar degradation in used vehicle prices as you are assuming on your book? Because I thought there were more takers of ALG on that data point when you write the new leases.

Marion Harris - *Ford Motor Credit Company - CFO*

The new leases are written at a lower residual.

Joe Spak - *RBC Capital Markets - Analyst*

At that decline that is -- it implies used vehicles decline at the same rate that you just mark them up?

Marion Harris - *Ford Motor Credit Company - CFO*

Take the example, we are going to write a new lease tomorrow, we have an outlook of what we think the auction value is going to be in three years from now. We are going to write the auction -- we are going to write the lease at the auction value we think it is going to be, which reflects all of the industry factors we just discussed. So it is at the lower auction value.

Joe Spak - *RBC Capital Markets - Analyst*

Okay and then just on the new side, I mean you said you were expressing this view of high affordability and lower volume. It is just a level of confidence that everyone can remain here rational more on the price side, especially since you have seen some data points with higher incentives, some select players with higher inventories. How do you see that playing out? Because clearly if there is sort of more of a chaser volume than your assumption that profitability reins here sort of begins to not hold water.

Bob Shanks - *Ford Motor Company - EVP & CFO*

Yes, it's something obviously that we are all looking at very closely. You looking at it, we are looking at it in terms of our competitive set. We are very focused on margins. In fact, when we develop our monthly sales program our team -- our data and analytics team develops an optimum frontier in terms of what is the best mix of margin versus mix versus price versus volume. So we really are focused on optimizing profitability and margin.

I believe that our competitive set have the same point of view, I don't know how they -- what mechanics they use to do this, but I believe that everyone is very focused on creating value on driving for positive margins and the strongest margin you can possibly get.

And any given -- I mentioned this to a couple of you before the meeting started, in any given month, and we have seen this now for a number of years, and frankly we have done it from time to time ourselves. In any given month if you've missed sales you may have to do a bit more the following month to try to get back on track as opposed to just cut production if it is just that type of issue.

You may have like for example a truck month. We always have truck month a couple times a year. So there is a bit more there to just kind of have a focus on trucks. So I think you will see -- you will continue to see, I would expect, everyone to do tactical things like that. But it is not sustained, it is not -- beyond the fact we have seen since 2009 a continuous increase in incentives, but it is gradual and it is relative to higher and higher prices.

So it is not a net reduction, it is just recognizing that you go for that price and there is still a bit of that you have to give back through the incentives to make the deal happen along the lines that Marion talked about.

So, I believe that that is the mindset of all the manufacturers. At any particular point in time I think at least we will look at what a company is doing and wonder if they might be skating right at the edge of have they started to think differently. But I don't see any evidence that that is actually happening on a going basis. But it is something that, like you, that we look at very closely because clearly that would be an impact.

I think the other thing here in the US in particular to just bear in mind again is some of the dynamics that created those really unhealthy conditions in the past were driven by the fact that we had completely inflexible labor agreements. So when you were looking at choices to make you kind of did it based on a different mindset around your cost structure.

That is simply not the case today. We have flexible labor agreements, we are able to manage that aspect of our cost structure as an industry in a way that we couldn't -- particularly those of us that are partnered with UAW, that we could not do in the past, which has affected the thinking, that is not the case today. Yes.

Jamie Albertine - *Consumer Edge Research - Analyst*

Jamie Albertine, Consumer Edge. Going back to some of the relatively high-profile announcements you have had with the Trump administration and discussions and his going out to Michigan talking about fuel economy. Can you help us sort of dimension what is on the table? Thinking about next year's mid-cycle review, what are the spectrum of options that we should consider as realistic? Is it an extension of the potential 2025 target? Is it something more significant than that in terms of a reduction of the target? So sort of point 1.

And then related, how do we think about -- I think broadly we look at the targets as pressures on your business as you are trying to get that level over time and invest in alternative powertrains, some of which are maybe a little bit earlier on the profitability spectrum relative to trucks and so forth. How good can this be or how should we think about factoring this into our longer-term expectations with respect to operating margins and so forth?

Bob Shanks - *Ford Motor Company - EVP & CFO*

So, Jamie, I know what you are asking me, I am not sure I can answer it, A, because I don't actually know. I think the good news is that the administration has agreed to go through the process that was part of the one national standard to begin with. So that is a big win I think for the industry.

Oh, by the way, just to remind you that in Michigan when President Trump was out there you had the entire industry represented; it wasn't just the domestic three, you had representatives from the Japanese as well. Because everyone is interested in having this discussion and dialogue because the assumptions, particularly around customer acceptance of higher tech solutions to solving and achieving better fuel efficiency just -- it hasn't occurred.

And the level of fuel prices that were assumed at this point in time back then, that also hasn't occurred. In fact it has gone backwards. So if we just want to have a conversation dialogue around, okay, we all want to go forward in a positive way in terms of addressing better fuel efficiency and CO_2 and the environmental effects of our products. So we want to do that but the conditions that we assumed are different.

So how do we do what we all collectively want to do but in a way that is more aligned to what customers at the moment are interested in buying as opposed to forcing certain types of products or solutions on them? I don't know where that is going to end up. But that is our mind set.

So it is not a rollback, it is not go backwards; I just want to be very clear on that. It is just can we together create a different construct that allows us to achieve what everybody wants to achieve? I don't know what the answer is, that is -- let's let the process start and have the dialogue begin and then we will see.

In terms of whatever it might be, I think we have to remember that first of all you have got California and CARB who are different entities and sort of sitting by the wayside and looking at what happens. We very much would like to keep to one national standard, so we are also not advocating that something be done in such a way that would cause them to go off on their own. We would like to keep everybody in the tent together in terms of how we address these issues in the US.

And then as we have said I think in past discussions on this, we are a global Company. We still have to meet -- effectively the same standards are different, you get there a different way and different measurements. But we have very rigorous requirements in Europe, we have essentially the same rigorous requirements that we have in China, even South America is getting on board although it lags.

So, whatever happens we still have to improve. And so, as a result we will still be investing in electrified propulsion. We will be investing in better and better internal combustion engines. We will be investing in light weighting, that is a reality of the business and it will be a feature of what all of us do. We all have our own ways of mixing all that together, but that will be something that will continue going forward.

Jamie Albertine - *Consumer Edge Research - Analyst*

If I may, if you don't achieve the targeted standard in 2025 nothing changes, let's just say, is there a penalty? What is the repercussion that you would assume logically?

Bob Shanks - *Ford Motor Company - EVP & CFO*

We have never assumed that we don't comply.

Jamie Albertine - *Consumer Edge Research - Analyst*

Okay.

Bob Shanks - *Ford Motor Company - EVP & CFO*

Nor have we.

Jairam Nathan - *Daiwa Securities - Analyst*

Jairam Nathan with Daiwa. So over the last two months we have seen a lot of action on the autonomous side with the suppliers, right, Intel, [Mobileye] and Nvidia. So as you spend money on autonomous vehicles do you bench -- how often do you benchmark with what the others are doing? And at some point do you think it is -- is everybody inventing the same wheel? Does it make sense? Or do you think there is more collaboration and you could maybe [cut the cost].

Bob Shanks - *Ford Motor Company - EVP & CFO*

Let me just make a couple of points there and then I want Ted to talk to it because he frankly has a better handle in terms of technology than I do.

So there is this perception, if you will, that somehow we'll go it alone. So, that is not true. We are working with many of the same people that other people are working on in terms of various aspects of the technology. So we are partnering in different ways with many of the same players. So we are not in isolation in some castle in the sky working on this. It is simply that is not the reality of what is going on.

And I think you can also see, as I talked about earlier, even in terms of the talent itself trying to take a different approach that still allows us to be very much involved, understand, learn, and also be the systems integrator in bringing all of this together whether it is developed inside or outside or whatever level of collaboration or partnership. So that is the approach that we are taking.

I think the other thing that we should bear in mind, and I mentioned this at a discussion that I had before this meeting, is that I think the technology is going to evolve and it may change and change quickly. So one of the things that we certainly do is our teams are very much aware of and trying to stay in touch with what is happening everywhere, what OEMs are doing, what the high techs are doing, what many of the key suppliers are doing or even the startups are doing.

Because what we think today in terms of what the technical solutions may be may not be what the technical solutions turn out to be or the suppliers may turn out to be by the time we get to the ultimate product. This is going to be a space I think where there will be pivots and changes and it's something that we need to stay really on top of very closely because this will be an ever evolving landscape.

And that is the mindset that we have. And I think we have got in place, if you will, the touch points to understand what folks are doing and also what key suppliers and the techs are doing. Ted, do you want to comment further?

Ted Cannis - *Ford Motor Company - Executive Director of IR*

I would only say that, as Bob alluded to, because we've been working on this for 10 years and we need the whole kit, we need the hardware side and all the redundant elements for the driving and non-driving activities that the vehicle has. And we need the [robo brain] and we have been working on it a long time. That requires the whole suite of sensors.

Mobileye is a supplier for us obviously on ADAS today, we work with them, we work with Nvidia, Intel. We have to have -- there has to be power on the software side. So a lot of these companies we work -- and we have done a lot of partnerships along the way that work with Civil Maps on the mapping stuff or with [Nuremberg] Networks on the sensor fusion for the sensing on camera side.

The thing is for us is that the selection of the suppliers for sensors over the board or anything else is a lot of like the systems integration we do with other suppliers. But we want to do the software integration ourselves. And much of our team, which was deep in R&D research which we didn't disclose publicly until more recently, a lot of that AI team moves over into the [Argo] business which is dedicated 100% on that software side of the business in a structure that really gives us a start up independent atmosphere to really focus on the software side.

But the whole collection of the rest of the fleet sensors, there are many suppliers involved. In our case, for example, we invested in Velodyne because they were the closest for production ready LiDAR sensors to meet the 2021 timing. There are other sensor technologies in LiDAR that are just as interesting, but they are not quite there yet. And we need to keep our options open to take the data, do the software integration ourselves so we can, like any supplier pool, make the timing as the technology cost improves over that time and plan them into our product programs.

And this is really no different as that big software integration role. And many of the guys -- these software guys we talk to as well on the external side, as well as you would imagine. So I think a lot of that is happening. We have stitched together some key partners through last year to aggregate these efforts. Our good friends from the DARPA challenge is now with Bryan and Pete and the team, that piece on software AI side.

So I think, and you're going to see continuing movement, as Bob said. The space is moving very fast is all its elements. I think we've got time for one more, Bob, so --.

Samik Chatterjee - *JPMorgan - Analyst*

(Inaudible). I just wanted to ask you on Europe, (inaudible) to the GM PSA transaction, what's your view in terms of how that helps the marketplace? Does it help you in terms of like pricing, etc., in the marketplace, the consolidation there? And when we look forward really does it change your expectations of where -- what sort of normalized margins and how quickly you can get there for the Europe business?

Bob Shanks - *Ford Motor Company - EVP & CFO*

Well, we don't know, but I would say the following. Carlos Tavares has been very successful in restructuring PSA. He had a lot of success also I think when he was in Renault, so I think his track record is a good track record. So my expectation -- our expectation is that he will take the Opel and the Vauxhall business and he will effectively restructure it over time.

I think we have to also recognize that he's been very careful in his commentary to be respectful of the existing labor agreements, but those labor agreements have end dates. So it will be interesting to see what he does once he has perhaps more flexibility around existing agreements. But as I mentioned earlier, we know from our own experience that that's a challenge. But he has been successful. So I think we should assume he will be successful.

If he is successful, then I think what that does is it creates obviously a stronger competitor with multiple brands and there are pros and cons of that, we know that from our own experience. But I do think what it does is it takes out a weaker player who certainly I think was a factor in some of maybe the more adverse aspects of the environment in Europe particularly relative to pricing and discounting.

That could be a positive, and yet, on the other hand, you'll be up against -- again, assuming successes from other competitors. So there's probably pros and cons, but I think in terms of perhaps the pricing environment, I think that would be longer-term once we can see the effects of the restructuring that should be perhaps a positive.

By the way, just to remind everybody too, we actually are partners with PSA in diesel powertrains in Europe. And that relationship has been very, very good and that relationship will continue in the future. They've been very good to work with.

Takuo Katayama - *Macquarie - Analyst*

This is (inaudible). I have a question in regards to India and China. India, as you know, is a growing market. I know Ford is taking part of that. What is your, I guess, medium-term strategy in terms of are you going to invest more into trying to expand your market share there? It is a difficult market, I understand. And also, how is -- I think [Mahindra Mahindra pact], I read in the news, I don't know if it's official. How is that going to be fitting into that strategy is the first question?

Bob Shanks - *Ford Motor Company - EVP & CFO*

On India -- so India is a very difficult market; it's more difficult than what we expected it to be. So when I was talking before about transformation, emerging markets is one of those and India is one of those markets that we need to have a different solution to. The approach that we are taking in India and have taken in India is not one that I think would have us on the track that we need to be on. So I won't say anything more than that, but what we've been doing needs to change. So that one is one that we're looking at closely.

We've not said anything about partnerships with anyone in India. And I don't know where it's coming from, but Mahindra Mahindra was our partner when we entered India actually. We had a joint venture with them back in the 1990s; I think it was 50/50 if I recall correctly. And then after a number of years we went our separate ways, but we still have a good relationship with them. They're very good people, but we've not talked about any particular solutions to the challenge that we're facing in India.

Takuo Katayama - *Macquarie - Analyst*

Thank you. And regarding China, I see that your expectation is the kind of wind down in terms of the expectation. But I believe Ford just recently --.

Bob Shanks - *Ford Motor Company - EVP & CFO*

Are you talking about the industry?

Takuo Katayama - *Macquarie - Analyst*

The industry, yes.

Bob Shanks - *Ford Motor Company - EVP & CFO*

Well, it's pretty flat, I mean it's (multiple speakers).

Takuo Katayama - *Macquarie - Analyst*

Right, now, but Ford I believe just launched a plan pretty recently. Now does that mean that you guys are going to try to take more market share in China going forward?

Bob Shanks - *Ford Motor Company - EVP & CFO*

I think you're talking about the [Harbin] facility. And that facility is -- it was an existing facility that was owned by our partner. And so, we've taken that within the joint venture structure, and that's up in the northeast of the country. And I think we've announced that we're going to put a derivative of -- a series, if you will, or a bodystyle of the Focus there. So it's nothing more than that.

It does give us opportunities in terms of capacity if we need that in the future. But I wouldn't interpret from that that -- I obviously want to grow in China. And we do think that after the period that we're showing here on the slides 18 that the industry will continue to grow. So I think that there is industry growth ahead. And obviously we're working to grow within that growing industry. But I wouldn't say anything more than that.

Takuo Katayama - *Macquarie - Analyst*

Okay, how does Lincoln fit into this? I think there was a --.

Bob Shanks - *Ford Motor Company - EVP & CFO*

Yes, Lincoln has actually -- that's a good question. Lincoln is off to a very good start in China. The brand there, even before we sold anything, the brand was known. The brand had a very positive and strong perception by consumers, it was seen as presidential, it clearly was seen as luxury. We've been able to come in with a clean sheet of paper in terms of how we go to market.

The network is fabulous in the types of experiences and service that it provides to consumers is number one in terms of third party ratings. And actually we're taking a lot of the things there, starting to bring them back into North America. So I think we're off to a very good start there.

The pricing has been good, the volume has been good, the growth has been good. And we recently announced that we would be localizing the first Lincoln product in China as well. We haven't said what that is, but that will be -- we think we'll have the volume and the scale necessary to do that and that would be done with Changan -- or Changan Ford which is the existing joint venture structure that we have there.

So I think it's a very positive step because we clearly wouldn't be doing that if we didn't think that the brand and the products, if you will, were off to a really good start, they are.

Takuo Katayama - *Macquarie - Analyst*

Right, so in other words, you're going to be able to tie in until (inaudible) I guess the localization of Lincoln, because it is a 25% tax (multiple speakers).

Bob Shanks - *Ford Motor Company - EVP & CFO*

Yes, it is, it is. And also, the exchange has gone in the wrong direction. It's now floating around CNY7 to the dollar, and that's weakened quite a bit from when we launched Lincoln in China. So localization is really necessary for the business case going forward.

Takuo Katayama - *Macquarie - Analyst*

Thank you.

Bob Shanks - *Ford Motor Company - EVP & CFO*

And in fact I would say it's become more compelling because of what's happened with the exchange. Exchange rates change and we look at volatilities around the dollar (technical difficulty) renminbi, but it's clearly the direction to go.

Takuo Katayama - *Macquarie - Analyst*

Thank you.

Ted Cannis - *Ford Motor Company - Executive Director of IR*

All right, well, thanks very much, everybody. And thanks everybody who are listening on line. See you all soon.

Operator

Thank you, ladies and gentlemen, that does conclude today's conference call. You may now disconnect.