BofA Securities Conference Call with Ford

APRIL: Good day, everyone, and welcome to the BofA Securities Fireside Chat with Ford. Today's call is being recorded. And now at this time, I'd like to turn the call over to John Murphy. Please go ahead.

JOHN MURPHY: Thanks April, and thanks, everybody, for joining us today. First and foremost, we hope everyone is well and safe during this global crisis that is, unfortunately, uniquely impacting all of us to varying degrees. Today, I am hosting today's call with Doug Carson, our partner and lead credit analyst here at Bank of America. Doug has a lot to add to today's calls, so we're happy to have him.

I'd also like to very much thank the Ford team for the opportunity to help get more information out to investors in this great time of uncertainty. But we'd also like to help everybody today really understand that this isn't just downside mitigation, but there are also opportunities to the upside for Ford. From Ford, we are very happy to have Jim Farley, chief operating officer, Tim Stone, chief financial officer, Marion Harris, chief executive officer of Ford Motor Credit Company, Cathy O'Callaghan, Ford's controller, Lynn Tyson, executive director investor relations, and Karen Rocoff, head of fixed income investor relations.

The format for the call will be a fireside chat, so Doug and I will pose a number of questions. We've organized these into three major topic areas. Really, the first being operations. The second being balanced sheet and cap allocation, and the third being Ford Motor Credit Corp., which is often really a misunderstood point of strength for Ford.

So really to kick it off here, maybe to you, Jim, first. At the moment, in post-first quarter, there doesn't appear that there was any real material major shift in strategy at Ford amidst the crisis around product restructuring or CapEx. There's certainly some honing and some small delays here and there.

And it seems like what you did in the last downturn, that you really are leveraging the balance sheet to really push the company forward and through the crisis. I was curious, as you hear that, do you think that's really a correct interpretation? Or is there anything else that's going on as you balance the near-term crisis with the long-term success of the company? And also, you have this mantra or strategy of fix, accelerate, and grow. And I wonder if you could, in the context of answering the question, really talk about that as well.

JIM FARLEY: Sure. Thanks, John, and hello to everyone. So Ford is in a very important period. And having gone through '08 and '09 on the leadership team, I would say this is quite a tremendous opportunity for us as well. We have a great portfolio of products that are just about to come out, especially in our most profitable market, North America.

Are there adjustments to be made there? Yes. But the products we've talked about, the product strategy we're following, has never been actually more important, especially our investment in commercial vehicles and iconic products, like Bronco.

Are there businesses that now with COVID hangover need to be refreshed, relooked at, remade? And the answer is everything's on the table, as we said in earnings. We want to be aggressive during the crisis. Let's just put it at that.

We have no news to share today. But you can imagine, as Jim Hackett said, we don't want to overlook the opportunity the crisis has for our businesses. And that's not just overseas business. It includes the changes we need to make in North America to get back to a 10% margin and potentially a lower industry next year.

We are really accelerating our work on launch fitness, as well as quality. And on the cost side, the two areas we're focused most on in fix-- these are all fix. Part of the fixed categorization would be material cost and warranty cost.

We see both areas, a lot of opportunity. And that's the reason why an experienced industrial leader, like Lisa Drake, is now the COO in North America. She, with her purchasing and engineering experience, is a terrific executive to lead our improvement in costs, not just to offset COVID, but to flow through into the years to come.

On the accelerate side, we made a big announcement with Ted taking over commercial vehicles. We've always had the strength as a company, especially in Europe, and Western Europe, and the US, and actually in China too, but it's always been treated, in a way, as a collection of nameplates, with the exception of maybe having a fleet sales group. And what we learned in Europe over the last two years, where we created a general manager position, where we created this commercial vehicles as a business, we really accelerated.

Our share's been growing for the last two years with a carryover product in Europe, and we've had a lot of new initiatives, like in our distribution area, our success in the camper business, et cetera. We're going to replicate that now in our biggest most profitable market, North America. And we see huge opportunity to accelerate immediately there, as well as new connectivity group bringing in a seasoned leader from John Deere, who's been on a 10-year journey on connectivity for both internal value creation and also external services.

I'd say, John, the piece that maybe isn't so clear to everyone, other than how are we going to get these businesses back on their feet, is the grow. It's just so critical that Ford has a compelling growth plan beyond the products that we're really excited to grow the business in the short-term. We see a lot of growth opportunities in commercial vehicles, especially pure digital ones, post-kind of Ice/Bev products, as well as growth in affordability.

And that's something that we really want to take people through in more detail at the appropriate time. So you can expect us to be doing everything you can imagine to recover the lost demand and production. And hopefully, we'll get the startup. But I hope that gives everyone an idea of what fix, grow, and accelerate really means, as well as the commitment that we will look at all of our businesses for sustained profitability.

JOHN MURPHY: That's very helpful. Jim, just one follow-up. The 10% North American margin, that is a run rate number that you're looking to get to, you said, potentially at lower volume than you may have been assuming before? I just want to make sure I got that right.

JIM FARLEY: It's always been our target for the North America business. And clearly, that target-- we're just dealing with the reality of COVID now and the flow through next year with all the headwinds. Now, we don't know-- I'm sure we'll get into the stimulus package in the US.

But we're not managing our business, assuming there's a stimulus package. We want to get to the cost level to get North America with these great new lineup of products that launch towards the end of this year. We want to be in a position to be that kind of profitability as a running rate, absolutely, even if the industry is slightly lower.

JOHN MURPHY: But that's very helpful.

TIM STONE: And this Is Tim.

JOHN MURPHY: I'm interested-- yes?

TIM STONE: I just want to clarify your run rate question. It's not run rate over time. Our target has been and remains 10% North America, 8% total company, and we're driving toward that.

JOHN MURPHY: So that's an absolute, not a run rate. That's the target, OK. That's very helpful, Tim.

And maybe as we think about the second quarter, you've outlined it as what presumably is the low point for the year. And for many years, I'm sure, at $5 billion plus in EBIT losses. I'm just curious if you can give us some rough idea of how you're thinking about that maybe by major market or really kind of-- obviously, there's a huge range around the stimulus.

I understand it's tough to pin you down to specifics. But is that kind of the assumption, that in your major markets, you'll at least be up and running sometime soon? And then also, as we're kind of thinking about that, maybe in as efficient a way as you can, maybe describe the restart process, which hopefully will come in the second quarter, but obviously, that's still TBD. So maybe just how you're thinking about that number for the second quarter, and then also how you're thinking about the restart process working as we go forward.

TIM STONE: Sure. So maybe I'll start with the second quarter, and then Jim can give some further color as he did earlier today on the return to work. So as it relates to the $5 billion, the $5 billion, more than $5 billion, EBIT loss reflects the output of what we're seeing from an input standpoint, which is that as of today, we still have all of our plants non-operational, except for China.

We're not yet in a position to be able to comment on when anything other than Europe will be getting back to production. But we're really happy with the fact that, as we announced on Tuesday, Europe will be starting to phase back in and do so over the next couple of months. And

we'll take a global approach to that and bring North America as soon as practical as well. And again, Jim can go into very, very thoughtful and deliberate process for that undertaking.

But again, $5 billion is the output and reflects the scale of our business and the volumes that we typically produce at wholesale around the world and having been down from a production standpoint. At the same time, we're doing everything we can across the business to thoroughly assess and address a full breadth and depth of our operations. We're looking for opportunities to preserve cash, to reduce, or to throw OpEx and CapEx.

That's why we're able to bring our CapEx guidance down, for example. Teams have done a really great job to thoroughly addressing cost reduction opportunities. As we've said, it's in the billions of dollars. In addition, of course, to, going back to your earlier question, identifying opportunities to redesign the business to amplify the long-term potential as we come to the other side of it.

JIM FARLEY: And just building off Tim's question about the return to work, in North America, we're ready. I'll just kind of quickly tick through all the considerations. First and foremost, is the safety of our employees.

We have our GDIA group modeling the virus' reality in all the 700 locations where we have facilities around the globe. Some of that data, we had to build. Others, we could use existing data. We've been modeling how the virus would change to have our own start date in mind.

But the safety protocols from air exchanges in our facilities, PPE-- thank goodness that we're making a lot of it ourselves so that we can source that ourselves-- all the job redesign for every job at Ford Motor Company, all the ingress of the team members, the temperature checks, the testing in case anyone feels uncomfortable and has an elevated temperature, all the way through our common spaces, redirect traffic flow in all of our facilities, and a lot of education of our team members. As Tim said, we've been up in China, and so we've been practicing and practicing.

AAT just went up in Thailand. We've had all of our after sales depots globally up and running. So we've been testing all of this. We feel really comfortable in the safety standards in our playbook and the execution of those.

On the supplier side, Hau and the team has surveyed over 1,500 suppliers. It's very important for our capability to come up and run. And for the US industrial system, obviously, the Mexican suppliers are really important, as is the Michigan suppliers.

In fact, I'd say for our Midwest plants, please think of it as a connected ecosystem, in that we will not move until all of the states are cleared and we can operate everywhere just because the interdependency of our supply base, and frankly, the internal stamping and powertrain work we do. So the dealers we feel like are in good shape, but there's always something out there. You know about BorgWarner. We were the first brand down there and making good progress.

On the dealers, 96% of our dealers in the US are open. Germany is now open. Southern Europe is opening as we speak.

So on the major markets, it looks like the dealer opening won't be a gating feature. And we moved online aggressively, thanks to China. About a third of our sales in China are now online, and about 25% in the US through our dealers. We're also doing large remote pickup and delivery for after sales.

We applied-- we encourage all of our dealers in the US to apply for SBA loans. About 80% have gotten the funding yet. So the dealers, we believe are in good shape.

We have put a wave zero into our facilities in Europe. That's a very important start up process, where we have team leaders, maintenance people, going in the facilities to start everything up. The government relations are really important, and not only obviously the decision in Michigan, but also in Mexico. Mexico is very important for our industrial system in North America, as well as our union partners, not just the UAW in uniform, but also IG Metall in Europe. We've been very supportive.

And we have pretty much daily calls with our union partners to make sure everyone feels comfortable with our safety standards, get feedback from them, make adjustments. And it's been very helpful to have such a regular dialogue with the UAW, for example. So net-net, John, we're ready in North America.

We have all the PPE, more than a million and a half masks, shields-- everything we need. All the processes are ready to go. It's just a question of a few of the other pieces to fall in place.

JOHN MURPHY: That's very helpful. And then maybe just one last operating question. There's a lot of discussion around a potential demand stimulus, a la a scrappage program in Europe or Cash for Clunkers, like we saw in 2010 here in the US.

I'm just curious what you're hearing about that, both in the US, China, Europe, and maybe even in South America, and how you think about that. Is that something that with your government partners you think would be a good strategy, and you're pushing that a little bit? It seems like your dealers are probably, at least just in the US, sitting on north of 500,000 units if I take inventory across the industry-- not Ford specific, but across the industry-- if we don't see a significant recovery and demand.

So that would be a good clear out mechanism. I'm just trying to understand what your thoughts are there, and if that's something that you would advocate for to some degree?

JIM FARLEY: We would absolutely advocate, and especially in the US, we insist on it. We think that the auto industry is a key part to our economy. Just the manufacturing alone is 6% of the GDP of the US. So the stimulus package for our industry is very important for the whole ecosystem.

Even put the OEM aside for a second-- the supply base, everyone. It's really critical. It's early days. There are lots of very healthy discussions. We're encouraged by the early discussions that we're having with the political leaders, our union partners, and state government leaders.

And obviously, from Ford's standpoint, we out produced in the US the second most pervasive producer of vehicles last year by 492,000 units. So for us, US-made will be critical. There's a lot of discussion around the duration of such a package, because obviously, we're just starting the manufacturing system up. It should last for enough time where there'd be upside to meet demand.

We would rather have something upfront for customers instead of something they would have to wait. But anyways, we're very experienced in this. It's early days. It'll be a bit of a moving feast, but really confident that there'll be something to help our industry, as well as maybe in the background infrastructure bill that would be great for the economy.

In Europe, things are a bit accelerated, I would say. Germany seems to be taking a lead working with the VDA. To our German team, it's clear that that's moving along nicely. And we're hearing both Spain and UK are also looking at a kind of scrappage type program, the specifics of which we just won't know for a little while. So John, I would say early days, but we're encouraged about the discussion and dialogue. And Ford, especially in the US, is really, really integrated in the process.

JOHN MURPHY: That's very helpful. And then I'm just going to turn it over to Doug to get into some of the balance sheet questions. Doug?

DOUG CARSON: Yeah. Thanks, John.

JOHN MURPHY: You on?

DOUG CARSON: Yeah, I'm on. Liquidity capital allocation I think is on everyone's mind. I guess this question is for Tim. Ford just completed a historic $8 billion bond deal pro forma. The deal, your cash balance reported $35 billion, well above the $20 billion target, and also above the $30 billion dollar liquidity target, but a lot's changed in the markets. How do you view this liquidity now in the new COVID environment?

TIM STONE: Yeah, thanks for the question. You're absolutely right. It's on everyone's mind, and certainly ours as well.

And besides our employee safety and our safety of all of our partners, it's the number one thing on our mind. But let me just start by saying that I feel good about where we're at from a liquidity perspective. As of last Friday, we were at $35 billion dollars in total cash and liquidity. And that's because we've been proactive, and taken a number of actions in the last month, and continue to stay out in front of the present crisis, which has created a lot of uncertainty for many industries and businesses globally, but also a great opportunity for us.

So just to recap some of the things we've done over the past, say, six weeks. In March, we suspended the regular dividend, and that's not a decision we deliberated as you would expect. And that's about $2.4 billion per year.

We also suspended our antidilutive share repurchase program. That's about $0.2 billion last year. And then we drew down the entirety of our corporate revolver and the supplemental credit

facilities. Again, not something on the corporate revolver front that you do you take lightly, but we thought it was important for us with that focus on cash and liquidity. So that brought $15 billion of cash onto the balance sheet and provided additional funding confidence.

And then just over a week ago, as you said, we issued $8 billion of incremental unsecured debt. This is opportunistic and further strengthened our liquidity, providing us with the added flexibility to continue to manage the crisis and also invest in our long-term opportunities. And then the team has-- we've talked about aggressively pursuing additional operating actions to bolster our cash position. And as I said, that's comprehensive across the entire business.

So yes, clearly these funding actions result in higher interest costs. But right now, our number one priority is making sure we have sufficient cash and liquidity, to ensure we have the flexibility to manage our business for the near-term and the long-term. So as I highlighted on call a few days ago, with the cash and liquidity we have today, even assuming no incremental production, which we do not believe to be the case, we're comfortable we have sufficient liquidity to last through the end of the year.

JOHN MURPHY: Very helpful-- thank you. And Tim, maybe if I could ask one question around the free cash flows you go through the course of the year and how you're thinking about it. Obviously, the second quarter is going to be a bit tough with the EBIT, the fundamental performance given what's going on in the market, and the working capital unwind. But as you think about the ramp back up and what at least I would think of as somewhat of a recovery in industry volumes as we get to the second half, how do you think about cash flow through the end of the year? And could, with the restart and the rewind of the working capital, could you actually see some potential positive free cash flow in the second half of the year as that work capital heads back in the right direction for you?

TIM STONE: Yeah, great. Thanks for the question. We did talk about this on the earnings call as well, because we think it's important for folks to understand how the working capital dynamics work for the industry, and certainly for us. And so we spent a lot of time on this for the past several months.

Regarding cash burn, it's also particularly unique, given the issue of this crisis, where the manufacturing is paused. And that's not something that anyone's experienced thus far for a duration, that no one's experienced besides holiday shutdowns and such. So what we discussed is, as you think about the cash burn, there are two phases.

The first is more severe, and that's driven by the roughly 45-day runoff of our supplier payables. And we talked about, at any point in time, that's roughly about $13 billion. And they remain in place as long as we continue to produce. But when production stops, as it did for us in the second half or latter half of March, the payables quickly run off. As you pay them down, it's important for us to pay our supplier payables and support our suppliers, and it makes the initial cash burn particularly acute.

So as I mentioned, we expect that to be completed on the supplier payables associated when we're producing by early May. And so then thereafter, what we have from an outflow standpoint

is the cash burn associated with our structural costs, with our warranty, our incentives, and those are relatively consistent over time. So that's a significant reduction in cash burn once you get past early May.

And then to your question, once you bring production back up, manufacturing is up and we're wholesaling, there's inherent leverage in our operating cycle. So the negative working capital cycle is a benefit when you're producing. And even with modest wholesales, our cash flow dynamics improve significantly, reflecting the restoration of those payables and the rebuild of working capital.

So we thought that was helpful to walk through it. I know it's a bit deliberate. But as you think about cash burn, that's how the business will work, not only during this crisis, but thereafter. And that's why we feel really good about the actions we've taken from a liquidity perspective, because it gives us the flexibility to weather the uncertainties associated COVID-19. If you have production come up or come down over time-- which we hope is not the case, we hope it comes back up, and phase up, and stay up-- but it's uncertain at this point. And we can weather the crisis and come out of this, as I said, even stronger than before.

JOHN MURPHY: Thanks, Tim. That's very helpful.

DOUG CARSON: I have a question regarding the kind of cash balance. If this crisis gets worse or it's prolonged-- and hopefully it's not, and let's say it's an unlikely scenario-- but you acquire additional capital, additional financing, how do you view internally your secured financing capabilities? And then kind of as a separate question, how's Ford viewing some of the Fed programs that were really unprecedented, such as a primary market corporate credit facility, the PMCCF, on the secondary market facility, that SMCCF, as potential options?

TIM STONE: Great. Well, let me start by just saying, we're really pleased with how responsive Washington has been. The Fed, the Treasury, has been so proactive in responding to the present crisis, and putting programs in place to provide certainty and confidence to the market, and the economy more broadly.

And regarding secured financing, we do have the ability to issue secured debt under our bank credit agreement and bond indenture. It's an option we've considered over time, but we're really happy with the fact that we're not in a position right now, or again, even with no production through the end of the year, that we need to raise additional liquidity or cash with $35 billion dollars we had as last Friday. So I wouldn't want to speculate on what we may or may not do in the future. But again, we're really pleased to the fact we're able to issue unsecured debt.

And also, similarly, I wouldn't want to really get too much into the detail of any specific programs or our intent to utilize with the federal programs that are in place. But we're clearly watching them, closely evaluating them as they're finalized and they become fully operational. Because it's really important, not just for Ford, but for the broader auto ecosystem, for our customers, our suppliers, and our dealers. And we're helping our suppliers and dealers navigate their way through those as well and be influential to the extent that we can. But again, we've

been really proactive in charting our own course, and I feel really good about the actions we've taken thus far to bolster our liquidity, and the position that we're in today.

DOUG CARSON: Thanks, Tim.

JOHN MURPHY: And Tim, as we think about your capital allocation priorities going forward-- and it seems like there's some drifting on CapEx in the near-term and some other stuff that's going on on the cost side. But as we kind of march through the crisis and get to the other side, how do you think about these cap allocation priorities? And maybe kind of selfishly, from an equity investor standpoint, what are the metrics, or the hurdles, or whatever the litmus test might be, that you're looking for for ultimately maybe reinstating the dividend?

TIM STONE: Sure. So I think one of the things that is interesting about the crisis is, it's really providing additional energy for us, additional momentum, to continue to do the things we've been doing. And we've talked about fitness and redesign not being initiatives over a certain time frame, but rather being the way we run the business. And I think it provides additional focus on making sure we have disciplined capital allocation, and more so than ever. But that's what we've been doing over the past few years.

We've also been focusing on making sure that we're having efficiency in our CapEx and our operating expenditures. But the capital allocation, in particular, is in the fundamental part of the portfolio refresh, for example, and the broader business redesign that restructuring, which in the portfolio, in particular, is a focus on our franchise strength. And so throughout this crisis, one of the principles we've been using is to make sure we're continuing to protect for product launches in our long-term investment opportunities.

Because at the end of the day, it all begins with the product portfolio, and it all begins, full stop, with the customer. And we have to do what's right for the customer for the long-term for our capital allocation, not just during the crisis, but always. So beyond that, we're continuing to focus on our balance sheet strength, ensuring we always have appropriate levels of cash. And liquidity, we have the target, as you know, of $20 billion in cash and $30 billion in liquidity.

Heading into an economic downturn-- one could argue that according to the papers, a speculation that may have started, we'll find out, I guess, next month-- make sure we get the appropriate cash liquidity to manage the business. And then once that's been established, we're confident the business is back online, operational, and we have sufficient visibility, we can look at other opportunities, including repayment of our corporate revolver, the bank facilities. And then once that's repaid, we can consider reinstating the dividend, as well antidilutive share repurchase program, and as soon as practical. Of course, that's always subject to board approval.

JOHN MURPHY: And maybe, Tim--

JIM FARLEY: I think we should just emphasize-- sorry, John. This is Jim. I just want to emphasize the importance of doubling down on our product range that we've already committed to, as Tim said. I just want to emphasize how important and how convinced we are of our new

product range that's coming out. And we really will do everything possible to protect those products as they make their way through the development system and in factory.

There may be more interesting choices to make around BEV, and ICE, and growth. I just want to emphasize the ambition for the management team to grow our business, especially in CV. When you look at the new F-150, what it could do to our company and our prospects in North America, as we completely transform the technology, the vehicle, add a new sub-brand, called Bronco, which we haven't had to compete and offer customers, a whole new lineup of Fords, and then the whole electrification line up, from the battery electric F-150 to Mach-E, these are really critical products for us. And there won't be any change to our commitment to them. But the growth will be key, and so will our capital allocation towards mobility, and our strategy.

JOHN MURPHY: And maybe if I just add just one follow-up on this. The punch line on all this capital that's being raised right now could almost be characterized as a working capital/bridge loan to get through this year to the other side to make sure the funding of the business is sufficient to keep pushing forward, and that we should think about it really in that context as opposed to any fundamental shift you think about the cash structure over time. Is that a fair way to put a punch line on it, Tim?

TIM STONE: I think that's an interesting way to put it. At the end of the day, we have to be mindful of exactly what you just said. We have to be mindful of fact that we don't have sufficient clarity, certainly not when we raise the capital. And even today, we're not in a position to be able to say definitively when our production will be back up.

We're also not in a position, given the nature of the virus, to be able to say how long it will stay up and to what degree. So we have to be prudent about making sure that not only do we have capital to fund working capital as we pay down from prior production, or as we ramp back up production again, and if it were to stop. But most importantly, to invest in our future, invest in the product portfolio, invest in all of the many, many long-term opportunities. Because again, we want to come out of this further down the path than we might have otherwise been, and down that path to achieving our long-term potential.

JOHN MURPHY: Great. And I think, Doug, you had some questions on FMCC you wanted to kick off?

DOUG CARSON: Yeah. Thanks, John. Ford Credit's certainly a meaningful partner. It's a lot of debt. It's where most of the debt of the company sits.

So I guess maybe this question is for Marion. If you could just outline the strategic importance of FMCC for Ford, given the crazy environment we're in, as a captive finance company, would you ever consider spinning off Ford credit? Just give us some thoughts around the relationship and how it stands now.

MARION HARRIS: Yeah. Thanks, Doug. It's a good question. And these questions are coming back up.

So I've been around the company for quite some time, and I've been in various parts of the company. So I have a perspective. But once I finish my answer, I'd like to ask Jim Farley for his perspective as well.

So from my view, I really believe that Ford Credit is a strategic asset. And I believe also that Ford's success is reliant upon Ford Credit. Ford Credit provides automotive financing to customers and dealers, and they do that through all economic cycles. That's why they're there, and that is critically important.

That's not always the case with banks. We also drive higher customer satisfaction, and we drive loyalty to Ford. We buy a full spread of credit risk, and we do it with industry leading cost and risk management.

And the results speak for themselves. Over the last 20 years, we've delivered $44 billion in profits, and we've paid $29 billion in distribution. And from my perspective, we have no intention of spinning off Ford Credit. Jim, do you have anything you'd like to share?

JIM FARLEY: Well, just to emphasize a couple of points from Marion. After being in the business 30 years, different brands, I can't emphasize any more than he has how critical the captive is for Ford Motor Company. Yes, continuity, I totally agree, but the loyalty.

It's just very clear that our industry is moving more and more towards a loyalty model. Especially for our B2B customers, this is really key. But also, to support our dealers,

When you look at the continuity, when you look at the stress the dealer has been under over the last couple months, Ford Credit has been indispensable. And you can't do that with a marketing agreement. It has to be a completely interwoven operations, like it is with Marion and the team.

And I guess, in a way, the only other thing I'd add is the incredible operational efficiency that Marion holds his team to. It's a benchmark for our automotive operations as well. And it's so critical that we have this incredibly fit team that we can benchmark ourselves against in a lot of areas. So, a heck no.

DOUG CARSON: Good answer. I guess, while we're on Ford Credit, it's great to have the businesses connected. But on the other hand, what levers can Ford pull to extract value from Ford Credit, which could be meaningful for Ford?

And I think bond holders for Ford Credit want to feel protected as well. Are you having any thoughts about Ford Credit dividending up to Ford? I guess expanding more would be-- if think about underwriting standards being changed, or the relationship agreement you have as of recently, I think Ford Credit waived its $3 billion allocation to the revolver. So kind of the connectivity there about protecting cash at Ford Credit.

MARION HARRIS: Yeah. I think-- well, first of all, Ford Credit provides tremendous value to Ford already, and not just directly to Ford, but also to customers and dealers, including

marketing programs, and dealer consulting. And there's so many different ways that Ford Credit supports Ford overall.

But on the financial side, the primary lever for getting, if you will, cash out of Ford Credit is distribution. And that's a function of the balance sheet size, our earnings, and leverage. And if the balance sheet shrinks, Ford Credit can distribute its excess equity. And the rule of thumb there is, for at a 9 to 1 leverage, for every $1 billion decline in receivables, we should be able to distribute about $100 million in distributions.

On the underwriting side, though, we already purchase a full spread of business, and that gives us the best mix of risk and enterprise profitability. And it's not something that we would look to change. Our underwriting practices have been very consistent for a long period of time, well predating the Great Recession. So if we were to buy deeper or not as deep, it just would not serve Ford well.

And then you mentioned the relationship agreement. I'm glad you did, because that's been quiet for some time. We haven't gotten many questions on it. It's an agreement that's been out there for a very long time, and it's an agreement between Ford and Ford Credit that governs our interactions.

And this agreement ensures that our intercompany transactions are done at an arm's length with arm's length of terms. But importantly, that our financing activities are prudent and commercially viable. And so years ago, when Ford Credit was growing, we modified that agreement to allocate $3 billion of the corporate revolver to Ford Credit. And in March of this year, we modified that agreement to return the $3 billion back to Ford.

We did this, because Ford Credit had significant excess liquidity, which we didn't need. And we particularly don't need it as the balance sheet is shrinking. It's best served back at the parent. Does that make sense?

DOUG CARSON: Yeah. I think it's very helpful. I guess the nature of Ford Credit has a self-liquidating balance sheet. And I think we've talked a lot about the liquidity of Ford.

If you could just maybe highlight the liquidity picture at Ford Credit. How do you stand relative to your minimum liquidity target? Maybe update us on that. I think it's $25 billion, but if you could just kind of share where Ford Credit stands in liquidity, that would be, I think, helpful to investors.

MARION HARRIS: Yeah. As a reminder for folks, we operate in Europe as a bank, and because of that, we have all the disciplines of a bank. We use those same bank risk frameworks within all of our credit for size, and liquidity, and capital, and so on.

So we make sure that our liquidity is sized to support Ford through all economic cycles, and we do that with the assumption that there would be no support coming from Ford. We plan for shocks and deep recessions, and because of that, our balance sheet, our asset quality, and liquidity profile are very strong. Liquidity for Ford Credit is predominantly in the form of

committed asset-backed securities capacity, ABS capacity, and cash. And we would expect to stay above our minimal liquidity throughout this year, even if we don't go the unsecured debt markets.

This is because our balance sheet is shrinking. And as it does shrink, we throw off liquidity. And so we don't have any issues meeting or liquidity target this year.

DOUG CARSON: That's great, comforting. Any questions around the ABS market? I think a lot of unsecured bondholders are familiar with the market, but don't have a lot of updated detail.

If you could just shed some light on how that market has been with this great test that we've had with COVID. And maybe if you could look at the mix of a future funding. And how much would come from ABS? And how much could potentially come from unsecured Ford Credit?

MARION HARRIS: Yeah. Well, as I said a little earlier, our balance sheet is shrinking right now. So we don't have any urgency or need to tap the unsecured debt markets. And we're going to continue to monitor those markets. But our view there is that our debt spreads are too high and don't reflect Ford Credit's underlying risk.

ABS spreads are also quite wide relative to where they've been over the last number of years. But at the same time, base rates have also dropped significantly, and the all in cost of securitization hasn't changed that much. We still would view it as reasonable for lending activities. It has been-- that market's been disrupted somewhat, but we would expect it to return to normal, particularly as the ABS markets begin to understand the virus' effects on the underlying collateral and the economy overall.

That being said, I would say that for Ford Credit, we have tremendous liquidity in the form of our assets. We have substantial committed asset-backed security facilities that are very robust. We proved that through the last-- the Great Recession. And we have ready access to that, and we don't foresee any issues funding ourselves. I think the capital markets appreciate the quality of our receivables and our assets, and I would expect that as we come to market that the market view on our assets hasn't changed.

DOUG CARSON: And maybe my final question here on the consumer health, the loan performance, residual value risk, and what that can mean Ford Credit and Ford Credit's dividend. I think it took a fairly meaningful increase in reserves, understandably so. But if you could just give us a picture of what you're looking at internally regarding COVID, and how it's going to affect your customer base, and the credit quality of those customers. I think you're in a great seat to share that with us.

MARION HARRIS: In the first quarter, we had about $700 million adverse impacts related to COVID-19. Overall, the quarter, the fundamentals in the quarter, were quite strong. The credit profile was good. Our credit loss metrics were all very good. But those charges really predominantly reflected forward-looking adjustments in credit loss reserves and as well as lease depreciation.

And I would just say, there's a lot of unknowns there. We use third party models as the foundation for our modeling for our critical accounting estimates. But it's a little bit like forecasting storm losses during the middle of a hurricane when you're sheltered in place. What I would say is that our first quarter credit loss reserve change is roughly aligned to our experience in the Great Recession. Time will tell on what the actual performance will be, and we'll make adjustments going forward accordingly, but as we see what's happening in the economy, where unemployment is, as well as our overall performance in our own portfolio.

On the residual value side, we did not take any forward charges in the quarter. The only charge that we took for residual in the quarter was related to vehicles that were off lease and awaiting sale at auction. As we change our outlook on what we think future auction values will be, that will actually flow through forward period earnings in accordance with lease accounting.

But the tricky part here is we're still assessing what we think that impact is going to be. The auctions, for the most part, are still closed. And as they open back up, we do expect auction prices to be dislocated for some period of time. And it's difficult for us to say how deeply or how long this disruption is going to last, but we are fully confident that the auction market will return to normal.

And so we're not giving any guidance. As I said earlier, distributions are going to be a function of balance sheet size, earnings, and leverage. So you can do your own modeling there. But we also said that we expect the balance sheet to continue to shrink throughout the year.

DOUG CARSON: That's good. That's good framework. John, do you have any follow-ups?

JOHN MURPHY: Yeah. If I could sneak two in here. Tim, we're getting a lot of questions, obviously, as well around the balance sheet. And kind of like we were talking about the punch line of this being bridge financing, as you think about the-- at least that's how I'm characterizing it.

As we think about the balance sheet two, three, four, or five years out, as far as the setup for the balance sheet, I would imagine your targets are relatively similar to what we were looking at prior to this crisis as far as how much debt you can carry, how much gross cash you need, and the goal is to head back in that direction. Is that a fair characterization?

TIM STONE: Yeah, I think that's a reasonable way to look at it. On the other side of this, as we'll do every step of the way, we'll continue to revisit and make sure we're the right targets for cash and liquidity. We'll do that.

But we believe the $20 billion in cash and $30 billion of liquidity is the right target. So we're going to drive back to that and sustain that. And we're committed to a strong balance sheet. And we have to make sure in all scenarios that we're able to always be in position to do the right things for the long-term, for customers to invest in the business, and never have any scenario where we're foreclosing any of our long-term opportunities.

JOHN MURPHY: That's helpful. One other just actually quick question for Marion on FMCC. As far as forbearance of some of the loans, or sort of loan payments, I should say-- it's not the whole loan on payments-- how is FMCC handling that?

Is that something it's kind of a wash, because it's a one- or two-month hiccup in one individual loan? What are you seeing there? And how does that get handled?

MARION HARRIS: Yeah. We've seen an unprecedented level of loan and lease payment extension requests. We've never seen anything like this in our history. And I'm sure all the banks and other finance companies would tell you the same thing.

In the US, we've extended about 10% of our portfolio since mid-March, and our goal is to make sure that our customers can stay in their vehicles. And our extension practice has really proven effective over the years to help reduce credit losses and improve customer loyalty. It's going to be really interesting over the coming months how that's going to work itself out.

And we are, I'll tell you, as a management team, hyper-focused on that on a day-to-day basis around managing through these extensions in the coming months. It's going to, frankly, depend on what the economic environment is like coming out of this and how high unemployment will be. And even if unemployment is high, how much stimulus is in the market, and how we work our way through this.

JOHN MURPHY: That's helpful. And maybe just a last question for you, Jim. We kind of talked about this a little bit on the earnings call.

But coming out of a crisis like this, there is a hyper-focus on cost, and execution, and efficiency tends to be very strong. And then also, the industry tends to have relatively solid mix. And given what you're looking at with your product portfolio on the F-150, the Bronco, what we saw last year with the Ranger, and what you have coming in the coming years, it seems like that really plays right your strength, not to mention low gas prices for the moment, which will help out trucks.

So as you look at the recovery-- and we see what we went through in '09, '10, '11, and then I think it was '11 and '12, your North American margins were in order of 11%-- it just seems like there's a lot of opportunity in front of you, presuming we don't get hit for this for the virus for an extended period of time. That when we get the other side, Ford would be really profitable, and really rebound in a way that would be similar to what we saw in the last cycle. How do you think about the other side? And given that everything you've got lined up here seems to be moving in the right direction-- obviously the market and execution are questions. But it seems like you got a lot lined up, and you got to go and knock it down. How do you think about coming out of this and where we'll be in two to three years sort of broad brush?

JIM FARLEY: Thanks, John. So right now, our focus is very much on controllable costs, as Tim mentioned-- warranty, material cost. These are really important. We can hold our breath on advertising and marketing. We can hold our breath on some facilities.

But at the end of the day, material and warranty costs, those are great for our business during the crisis and far beyond. So our team is laser focused. And our delivery is going to be our reputation. So we really focused on the cost.

We do believe that the Ford brand in the US is positioned very nicely for a number of reasons. We have a huge commitment to America as a leading manufacturer here, and we're launching these great new products. So we really believe our brand will get stronger irregardless of COVID. But we think that's a really important investment for us.

Back in '08, '09, I remember an F-150-- I just joined the company-- was $25,000, and it's way north of $40,000 now. So on the pricing for the industry and upside there, I think that will be really down to our execution of our launches and of our brand. If there's a tailwind on mix and things in the industry, that's great, but our team is really focused on the controllables, which are the cost areas I highlighted, as well as an incredible job on these launches.

And I have to really complement the team when you look at F-Series. We really learned a lot from Chicago. We now stagger the launches between Kansas City and-- sorry-- our two plants. F-150, we staggered the start up to dealers so that we can get one facility right and then the second.

We have moved out some of the new technology just a little bit beyond the launch, like the hybrid. The builds are going really well on the new F-150. And we have a lot of-- obviously, a lot of new software, because it's the first high-volume connected vehicle. So I think it's going to be the launches, our controllable costs, and the brand health itself. That'll be the big driver of our opportunity in the coming years.

JOHN MURPHY: Great. And with that, we'd like to thank you, Jim, Tim, Marion, and the rest of the Ford team for joining us today, and the opportunity to host this call. Thank you, everybody for joining us. And we're open, if anybody wants to catch up, to follow-up after this. Thank you very much for joining us. I hope everybody stays safe.

JIM FARLEY: Thank you very much.

AUDIENCE: Thank you.

MARION HARRIS: Thank you.

APRIL: That does conclude today's conference. Thank you all for your participation. You may now disconnect.

[MUSIC PLAYING]