RBCCM Fireside Chat with Ford Motor Company (F US) – August 3, 2020

JOSEPH SPAK: Good afternoon, everyone. I'm Joe Spak, the head of the automotive research effort here at RBC Capital Markets, and this afternoon we're very pleased to have with us a great roster of executives from the Ford Motor Company. Tim Stone, chief financial officer, Hau Thai-Tang, chief product development and purchasing officer, Gary Johnson, chief manufacturing and labor affairs officer, and Lynn Tyson, executive director of investor relations.

The format for today's call is fireside chat. I've prepared a number of questions that go into a bunch of different areas, including recent second quarter results, the redesign effort, the global redesign effort, some production, classification, and the balance sheet. But I do encourage investors to get involved in discussion as well and ask questions. To submit a question, you have to type it into the box on the webcast window. Only I will see the question, and I can ask it anonymously and integrate it into the conversation.

So, with that, Ford team, welcome. Thanks for joining us today. Tim, let's start off with diving back in a little bit to the second quarter results, particularly in North America, where we saw an $800 million cost benefit in the second quarter. But as you indicated, that consists of some structural savings as well as some lower costs related to volume. And that's obviously net of some issues as well, such as higher warranty, and it seems like commodities as well.

So, if we look at the company as a whole, I know you said structural was about $1.8 billion, the net cost savings I think was $1.1 billion. Given the importance of North America's region, it seems fair to assume a similar relationship holds. So what does that mean for the North America run rate going forward? It seems like it's at about that billion-dollar pace, but maybe you could help us understand how much austerity cost savings were in the quarter, when does some of that come back, how does it come back, and maybe some examples of some temporary cost savings that can become more permanent ones.

TIM STONE: Great. Well, thanks for having us today. I really appreciate it, and as it relates to the $1.8 billion you mentioned, over a billion of that is in cost, as you said. And that was from suspended production, one-time cost actions, like reduced marketing as an example. That was offset by higher material costs and the regulatory costs, as well as higher warranty, which we did say would be up for the year. But we have been and will continue to focus on all the different fitness initiatives you've been hearing us talk about, as well as the redesign as a priority.

How we've had to respond to COVID has forced us to even take a sharper look at our fitness and our redesign in how and where we work, the number of people working from home, or it's resulting in reduced travel, as it is for everyone. So we're looking at ways to plan definitely for the future, which we believe will have a favorable impact on cost. But relative to Q2 specifically, we certainly did accelerate our cost actions, and North America was no exception.

And some of this will follow through into the third and fourth quarter, and that's factoring into guidance. But for 2021, we really don't have at this point a better view of how things will develop. We'll sort of plan and processes as you expect later over the next several months. That will also depend to a large extent on what's happening with the virus, what's happening with

macro environment, as an example. As we've continued to say, I know at this point you want to see it, and we do, too. We'll continue to drive execution, but we believe our targets of 8% to the company, and 10% to North America, and 6% for Europe are achievable.

And there's a bunch of levers that are going to drive us toward that profitability-- the top line and improvements from a richer mix of products, certainly, as we have the SUVs, CVs, and trucks, many of them new coming up in the global redesign and the portfolio refresh. And then as you know, we have a lot of opportunity to improve and get better leverage from our material costs and our warranty costs, and in most areas of structural cost. So, we'll achieve those targets while we're still investing in long-term opportunities. So, you heard us mention that even with the de-consolidation of Argo, for example, we expect to still sustain a level of investment in autonomy. But also, our connectivity opportunities for customers and mobility services as well.

LYNN TYSON: And Joe, we did mention – we actually gave you a little bit more detail this quarter on some of the run rate benefits of the global redesign. So, for example, in South America they've taken out a significant number of heads. That will obviously carry forward. In Europe, they've reduced their facilities by six down to 17, they took out over 7,000 heads last year, more heads will be coming out this year. Those benefits obviously are sticky, and it will accrue into the future.

JOSEPH SPAK: Great. Maybe as you think a little bit about the back half here, Tim, you implied the hit from the F-150 launch which gets pushed to the fourth quarter was greater than the UAW ratification bonuses last year, which was about a $600 million hit. If we look at what IHS has in their forecasts and we understand that they're not always correct, they've got F-150 about 78,000 units lower, which if you assume a high variable profit assumption on those vehicles, would kind of be closer to that billion-dollar view. So, help us think about – is that sort of somewhere within that $600 to a billion dollars for the range you're thinking about?

And also, when you talk about the F-150 downtime, is it strictly a volume-related impact, or does it also consider some of the launch or marketing costs associated with it?

TIM STONE: OK, all that would be factored in certainly, but I'll tell you downtime as we ramp down and change over two plants, and then ramp back up, normal successful launches as we were accustomed to doing is meaningful for the F-150, our highest volume and most profitable product. So we're intently focused-- Gary and his team, Hau and his team, everybody across the company, frankly-- on ensuring we have very successful launches of the F-150, the Bronco Sport, and the Mustang Mach-E this fourth quarter, and then getting ready for the launch of the two-door and four-door Bronco in the first half of 2021.

These are great examples of us completely transforming the portfolio and will help us accelerate as we go into 2021, where there's a lot of work to do on the fitness and redesign side of the overall business, of course. So, it's a big cost for us, for sure. The F-150 changeover and $600 million. So, the UAW charges a year ago at Q4 were $600 million, and we're saying that the F-150 will be more than that. That's factored into the loss expectation for the fourth quarter. At this point, we're not saying anything more.

JOSEPH SPAK: OK. You mentioned the Bronco launch, and the program profitability, and how that's important to getting to 10% EBIT margins in North America over time. You've been showing a slide really for a while, I think, that shows about a $1.5 billion profit improvement from new products in Michigan assembly in Hermosillo. I think the Bronco is the last big piece of that, but the other thing that's happened, I think, since you first started showing that side is maybe industry volume expectations are a little bit different.

So, if you think the $1.5 billion is still valid-- and maybe you can give us a little bit of sense as to what type of volume assumptions were you planning for with Bronco to hit that number. And I guess a final question on that is Jim Hackett sort of talked about having this high-class problem that demand is off the charts, and I think it sort of signs you guys up for some higher production already. So how would you think about it if that high-class problem does occur – meeting higher volume? Would it still be in those facilities, or can you produce elsewhere?

TIM STONE: Great. So the $1.5 billion is still valid, but like the guidance we provided for the back half of the year, assuming no meaningful change in the economic environment, continuous, steady improvement in the global automotive supply base, and no further meaningful COVID-related disruptions. So beyond, I don't know. Gary, if you want to jump in on how we might we get more production capability.

GARY JOHNSON: Yeah, it's been an interesting couple of weeks, Joe, since we did the unveiling of the Bronco. We've already been asked to look at potential upsides, which would we could do internally in Michigan assembly with line speeds and what we may do from a different change in mix between that and the Ranger. It's early days and we're working through that, and also what can the supply base support with those mixed rates that we're doing, but we've already started that process.

The next morning after unveiling, the first phone call came in. Gary, what can we do more? So we're working through that as we get into the first quarter 2021 and work our way through the rest of the launch, and then stabilize the system.

LYNN TYSON: And Joe, when we first showed that slide, it was early in 2019 and it was just Michigan assembly, right? So it was just Bronco and Ranger, and on that slide we said basically a full run rate in 2021-- obviously, this is pre-COVID-- has about 200,000 units. So when we added the Hermosillo and Baby Bronco to that, we actually didn't refresh that number. But to Gary's point, I don't think a minute went by before he was being asked to say what could be done on volume.

JOSEPH SPAK: And just to be clear, the reason that number wasn't updated even though you added Hermosillo is just out of conservatism, or is there an offset to not change your numbers despite adding that facility?

LYNN TYSON: Well, we actually thought that the estimate of the change in EBIT--

JOSEPH SPAK: Yeah.

LYNN TYSON: --was going to be more relevant at this point in time than necessarily counting units. So it's the change in EBIT between the two manufacturing facilities, once you got rid of the passenger vehicles and then put the new products in.

JOSEPH SPAK: OK. Gary, while we're sort of piping around manufacturing, obviously this has been a very challenging quarter and I think still continues to be a sort of challenging time. Maybe you could give us a quick status update of where we are sort of globally from a production standpoint at Ford, and some of the changes you've had to make under COVID, and the impacts of productivity and costs. And again, back to Tim's comments earlier, how can or when do some of those fall in line?

GARY JOHNSON: Yeah, Joe. Great question. We started on the journey for the COVID in China in the first part of the year, and we put together our return-to-work playbook, and we've proven that out in Europe, proven it out in North America. We stabilized the volume when we came back after some plants had been down between six and eight weeks later in May, and we can see that it's making an impact with our union discussions, our ability to meet our volume. I think we've talked about we've exceeded the numbers with 95% of our schedule's been on track. The last two weeks it's in the 98% to 98.4%, and we're working through it. So, the really great thing about it is our people are being healthy and safe. If I look at the discussions Hau and I've had with some of the experts in the medical field, our plants are probably safer than most places outside the plants in how we protect our employees from what they're going through from a protocol standpoint. So we're on track, everything's back up running full bore, we're watching the supply base, and also making sure our safety protocols are on track. But every region across the world's back to running full production.

JOSEPH SPAK: Yeah, and from a supplier standpoint, have there been any shortages? And could you plan on keeping a little bit higher inventory than sort of normal just in time to compensate for that?

GARY JOHNSON: Yeah, the hot spot for us is Mexico.

JOSEPH SPAK: Yeah.

GARY JOHNSON: We just had some issues last week, so we're watching that day to day. We've stabilized in Europe, stabilized in China, but right now the high content area from Mexico and supporting the North America plants is critical for us. And we've got some exceptions to run more volume in Mexico, we have increased our inventory, but we're right about now about two weeks ahead of the schedule from an inventory standpoint minus a few critical suppliers who are hanging on. So it's 98.4% volume and we're going to continue to push that through the rest of the third and fourth quarter.

JOSEPH SPAK: All right. So maybe we could flip over to Europe. I'm seeing this came up on the call. You know, you have cost in pretty neutral for the year despite a billion dollars in structural savings. I know that's sort of being offset by some of the compliance costs. Is the net of those two really starting to be pretty flat and really the best way to sort of think about that? And how does that dynamic play out into '21, when you might have some incremental cost

savings from, as Lynn mentioned earlier, where you are in the run rate, but I think the other thing that happens in Europe next year is the compliance gets a little bit tougher because you can't omit some of the vehicles that are the worst offenders.

HAU THAI-TANG: Yeah. Joe, so I think, first and foremost-- Lynn touched on it-- the Ford of Europe team have done a fantastic job of restructuring their business since 2018, the end of 2018. They've taken out significant capacity, we've exited Russia, we've closed plants, and we've reduced the workforce dramatically, and that's the enabler for the $1 billion of savings. We're using that to not only offset the higher regulatory costs that you mentioned that's a function of the more stringent CO2 requirements as well as the change with the WLTP test procedure. But keep in mind, for all of the investors, that we're also reinvesting these efficiencies to transform our product portfolio and really improve the mix.

So we're playing to our strengths, we're investing in more commercial vehicles at the same time. On the passenger vehicles you are seeing a shift from the traditional, you know, I'll call it sedans and hatches to utilities, which have higher material costs versus the outgoing product, but they also significantly better margins. So the other thing I'll mention is we're investing heavily in technology, we're connecting all of our vehicles, we're putting in a new electrical architecture that gives us the ability to really transform the business model and deliver incremental value to our customers with connected services and over the year updates. So all of these actions will improve the business and supports our long-term EBIT margin objectives for the region.

JOSEPH SPAK: So you mentioned some of the actions you've taken. I think you reduced your footprint by about six facilities. Tim mentioned earlier that things are even under further review here, sort of evaluating the world post-COVID. I know you're sort of limited in what you can say in terms of announcements in Europe until all the proper constituents are notified. But is there scope for further footprint consolidation in Europe? Because you still have that $5 billion sort of cash number hanging out there on the redesign.

TIM STONE: Yeah. Joe, as I mentioned in the past, I know that our redesign approach is a bit different in that we didn't announce a bunch of initiatives and at one time. Rather, we're trying to take a more thoughtful approach to say we think our redesign initiatives would be about $11 billion in charges and about $7 billion in cash over a several-year period. As a result of that, we only share things as we've actually made the decision and therefore are taking a charge to be sure of downstream cash ramifications.

So based on the work we've done, which has been great work by the European team, the South American team, for example-- but in Europe in particular, we're on track based on the initiatives that have been underway and announced to reduce the workforce by another 2,500 people by the end of the year. And that's the total 12,000 in total, including Russia. 2,000 in Russia, and we expect the European personnel-related expenses to be down about 20% at the end of 2020 versus the end of 2018. And we've further reduced our structural costs including that and [INAUDIBLE] market equation in the first half of 2020.

So that all adds up to what we said on the call, which is we're on track to deliver by the end of this year roughly a billion dollars in structural cost actions since they were announced in the third

quarter 2018. But beyond that, and of course the facilities reduction, as you mentioned – you know, down six facilities just to 17, so beyond that there's not much more to share at this point. But we're as passionately focused on a redesign as ever, and Europe's no exception.

JOSEPH SPAK: Maybe this is a good place to squeeze in a question from an investor which relates to redesign but also South America, where you've done a lot of hard work. I think the loss narrowed this past quarter but still a loss, I think, as you pointed out on the call. You know, what else is sort of under consideration for that region? And is an exit even on the table?

TIM STONE: Yes. So, as I mentioned, we share these actions as we make the decisions. So I don't have anything more to share at this moment, but we have done a lot of redesign and restructuring work in South America already. We phased out unprofitable vehicles, the Focus production in Pacheco, heavy trucks business, discontinue the Fiesta production, ceased operations in Sao Paulo manufacturing plant, we phased out Sigma engine production and adjusted capacity and restructured the dealer network to better serve customers there and improve viability for the remaining dealers.

So, total head count has been reduced by about 44% over the past three years, including about a 20% reduction of the management team in 2019, so a lot of activity already in South America. We're looking at further opportunities, for sure. As I said, we're looking at Europe, South America, and around the world for redesign or restructuring opportunities to make sure the best design for the opportunities that are ahead of us. But again, nothing unfortunately additional to share in terms of announcements at this moment.

LYNN TYSON: Joe, this is in our disclosures. There are tax and incentive structures in South America that are different than we have in other regions. And obviously as you're considering footprint and timing, you have to take those things into consideration.

JOSEPH SPAK: Right. And any scope for the size of those tax considerations?

LYNN TYSON: No.

JOSEPH SPAK: We're getting a bunch of inbound questions I guess on balance sheet, capital priority, dividend for forecast. Let me try to sort of consolidate these here because I think they're all related, but I guess one – what's sort of the official dividend policy now? What type of cash levels and free cash flow outlook are sort of needed? And I guess as it relates to-- you know, and what is I guess the general sort of capital priority now for Ford? Is it really getting the balance sheet improved and potentially trying to get back to investment grade?

TIM STONE: Yeah. So, first of all, let me start with our balance sheet is strong. You know $39 billion in cash, $40 billion in liquidity. We repaid roughly half of our $15.4 billion revolvers we drew down in March. So the balance sheet is strong, and what we'll continue to do is focus on generating more cash and more free cash flow and then evaluate opportunities to pay down debt, as an example, pay down remaining revolver, as an example, and make investment decisions as well that are appropriate for the long-term success of the businesses as it relates to the dividend.

And we'll reinstate the dividend when it's appropriate to do so, of course with board approval, and similarly for the antidilutive share repurchases.

JOSEPH SPAK: OK. Well, maybe let's turn the conversation to products a little bit. So to start, I guess no one really knows if everyone sort of gets the volume assumptions wrong, but it does look like we're looking at a global volume over the coming years that's lower than maybe what we thought pre-COVID. How does that make you reassess your capital priorities, capex spend, or the timing of any of any product launch?

TIM STONE: I mean, prioritizing the allocation of capital toward the product portfolios is one of the most important things we do on behalf of customers and make sure we're building differentiated products and services. And the whole team, everyone on this call, works together to do that. I want to make sure we're investing in high return on capital investments and the differentiated products for customers. So that's not new. We certainly have a heightened focus on it, making sure that from a strategy standpoint you have the right fresh product set for our customers. And I think the F-150, the Mach-E, and the Bronco are great examples of that.

HAU THAI-TANG: Joe, specific to the vehicle portfolio itself, certainly we're scrutinizing where we allocate capital. We want to make sure that each of our vehicle lines where we choose to compete are going to have a compelling, I'll call it, where to play and how to win. We are stress testing the assumptions using our data analytics capabilities to look at a realistic market equation call, and we're also looking at our historical performance in that segment or region, as well as any political and economic risk as a result of post-COVID. So that's kind of the normal approach that we're using.

You'll see us continue to leverage partnerships to help us become more efficient with our capital spending as well as engineering expense. So a great example is what we're doing with VW around commercial vehicles and pickup trucks, as well as battery electric vehicles in Europe. In terms of mobility, we are looking at again trying to stretch our dollars there and partnering. So VW's investment in Argo AI is a great example of this to help us both co-fund that effort, and we know based on everything we're seeing that's probably going to be more capital intensive than we all anticipated initially.

And then the last thing I'll mention is the teams are really stepping back and looking at the future, and considering all of these disruptive forces, and really stress testing what's going to differentiate Ford and Lincoln going forward. And only in those areas will we choose to do that ourselves. In traditional attribute areas that are really basic expectations now and no longer brand-differentiating, we will outsource to the supply base and leverage their expertise and their resources. So that's essentially the approach we're taking around capital allocation for our product programs.

JOSEPH SPAK: Great. Maybe to follow on, like in conversations we've had in prior years, you really sort of talked about this idea to reduce some of the complexity on the models and the platforms and some of the savings associated with that. Now's maybe not sort of the best time to sort of bring that up given sort of a low volume quarter. But can you update us on sort of some of those initiatives – what's been done, and how much more can be done?

HAU THAI-TANG: Yeah. Well, we made tremendous progress. So just to sort of go back in time a little bit, when Mulally joined Ford, I think we had over 30 platforms all around the world, and under his leadership with One Ford, we reduced it by a factor of three, from 30 down to 10. Today, we're working towards five flexible architectures, so another 50% reduction, and that's a huge enabler for us to capitalize on the engineering efficiency and increased commonality and scale.

At the same time, we're looking beyond just the underpinning or the platform, and we're looking at the top hat parts, if you will, and trying to leverage that for more commonality as part of our modular catalogs that we're doing. And that is helping us not only reduce the engineering expenditure but also speed up time to market. The products that you see hitting the market this calendar year really are a reflection of that, so Bronco, Bronco Sport, Mach-E are all coming off these five common architectures. So it's allowing us to be fast to the market, be more engineering efficient, and then drive efficiencies from material cost not only with us but with our suppliers as well, so it's great.

In terms of monetizing it, we previously a couple of years ago, we did mention the fitness-related savings, and they were very significant. And I think my recollection is 80% of it was really enabled through material cost, engineering, and capital efficiencies, which are all really enabled by this flexible architecture and modular catalog approach.

JOSEPH SPAK: OK. You know, you mentioned the Mach-E and the Bronco, and it seems, taking a step back, that Ford's undergoing a little bit of a brand strategy shift here, right? You're leveraging the Mustang brand, leveraging the Bronco brand, almost start trying to have a family of Bronco underneath, it seems like, with the products you've announced and potentially future Bronco product. Is that accurate and, I guess, purposely done? And I guess the F Series is sort of already it's sort of on brand. Is there other sort of brand equity you see at Ford that you'll be able to leverage, and potentially Lincoln? What's the plan with that brand?

HAU THAI-TANG: Yeah, I think it's, as you noted, really an intentional choice by us. We have really strong iconic brands that probably we were guilty of being somewhat too purest with. In the case of Mustang, as an example, and I think we've seen from other folks up the street that they've done a really good job of leveraging their strong brands across multiple nameplates. And the reception we've gotten on both Mach-E and the Bronco family of vehicles has been phenomenal, and I think it really reinforces the equity that we have there.

So F-Series is another great example, Transit is a great example. We have multiple vehicles under the Transit brand umbrella, and then even across products you can series. Raptor is a fantastic example.

JOSEPH SPAK: I know.

HAU THAI-TANG: A great success with F-150. We've extended it to Ranger. It's been a big hit there, so certainly there's more that we can do there. So, yeah, it's something that we will continue to embrace, and we think it's a huge opportunity for us to play to our strengths.

[INTERPOSING VOICES]

With respect to Lincoln? Yeah.

JOSEPH SPAK: No, I'm sorry. Go ahead.

HAU THAI-TANG: Yeah, they're coming off a fantastic year, the new products. You know, Aviator, Corsair has been really well received, and even during COVID time we're seeing increases in market share. Just really rejuvenate the Lincoln brand, and we're very excited about how we can continue to leverage that and compete in a very lucrative, high-margin premium segment.

JOSEPH SPAK: Yeah, I was going to say I know a couple of people who are waiting for you to take their money for that Bronco Raptor, so-- [LAUGHS] So it's not--

[INTERPOSING VOICES]

HAU THAI-TANG: I know 170,000 people, as a matter of fact. Yeah.

JOSEPH SPAK: [LAUGHS] You mentioned Transit, and I think Ford has actually in the past shown some pretty interesting stuff with sort of clear commercial van opportunity. And I remember being down in Miami for the Argo AI day, and you sort of showed really sort of the convergence of everything that I think Ford is trying to do sort of, but centered around that commercial van opportunity.

It seems though to be a little bit underappreciated, maybe, the opportunity by the investor community. I think internally you seem very excited about, so maybe you could sort of spend a sort of quick second on it. Because, like I said, it does seem like it's really the convergence of everything you sort of talked about – connectivity, and electrification, and potentially elements of autonomy as well.

HAU THAI-TANG: Yeah, you're spot on, Joe. So it's a huge business for us. We're dominant globally with Transit, as you know, in the commercial van business but also with F Series in the commercial truck business and in North America. And as you stated, we think that the transformation that's going to be enabled by the combination of electrification, increasing levels of autonomy, as well as connectivity and I'll call it more broadly connected services is going to happen first with commercial vehicles, because those customers will be the first to benefit from those efficiencies and productivity improvements. So we're very excited.

We did a hybrid Transit in the UK, and we learned a lot from that engagement. We spent a lot of time with our commercial fleet customers, where Ford is by far the most dominant player in terms of market share, to really understand their business and how we can really make them more productive with the incremental capabilities enabled by connected vehicles as well as electrification. And we're super excited, so we want to build on that dominance. Transit is the number one full-sized bus and van segment leader, with 37% percent market share.

In North America, if you add in the E-Series van, our market share goes up to 47%. So it just shows you how dominant we are, and so it's not a surprise that among the first battery electric vehicles we're going to introduce will be an F-150 and a Transit. They also will have our new electrical architecture, which allows us to not only connect and provide access to the data for the customers, but also do over-the-year updates. So we can do things like flash in incremental features and attributes, do prognostics to keep them on the road, and increase their uptime, so we're super, super excited about the next phase.

JOSEPH SPAK: So maybe just to follow up there, and I guess we won't hold you to it, but by what year maybe first in Europe and then in the US do you think cities will only allow zero-emission vehicles inside cities?

HAU THAI-TANG: Well, we're starting to see that now, right? And even I mentioned the hybrid vehicle, the hybrid transit in the UK. But as many of your audience knows, inside the Ring Road in London there's a congestion charge. And so when we launched that product, we looked at between the fuel economy savings, the savings on the surcharge, the congestion charge surcharge daily, plus the incentives that the government was giving for zero-emissions vehicle. The payback of buying one of those products was less than two years, and that's before in incremental productivity from connected services and those types of things.

So we're seeing it in places like Norway, a lot of cities in the Netherlands, other places in Europe are already announcing very draconian restrictions into city centers. And we believe that that trend will expand into the green states in the US, and then certainly in places like China as well.

JOSEPH SPAK: OK. Since we're on the topic of electrification, I think-- and leave this open to you or Tim-- but one of the things you mentioned in the earnings call was that you're sort of halfway through your, I think, $11.5 billion electrification effort, which was targeted through 2022. So that implies about $3 billion over the next two years. I'm not sure that's exactly the split, but if you just sort of straight line it, that's about the number. Is that really just the beginning? Because you've talked about some of your electrified product. Maybe you haven't sort of shown us all of it, but it seems like you're still in the earlier innings of electrifying the portfolio. So how do we think about what that spend needs to be as you sort of move through the rest of the portfolio? Is it about $2 or $3 billion a year, or do you start to gain some efficiencies on that spend as well?

HAU THAI-TANG: Yeah, when we announced it, I think the time horizon was through 2022, which seems like-- you know, it's only a couple of years away, right? So we are about halfway on that journey of that original $11.5 billion dollars. We've announced products like Mach-E, F-150, Transit that we've talked about. We also included as part of that all of our hybrids, full hybrids as well as plug-in hybrids, which we believe are going to play a key role during this transition phase to help people migrate towards eventually full battery electric vehicles.

And then beyond that, certainly we will do more products that we're not ready to announce yet. But we don't want to get ahead of our skis, over our skis. We have a lot of work to do to launch these products, and we think the market-- we're targeting the segments where we know we're

going to be strong-- commercial vehicles, pickup trucks, performance vehicles with the Mustang Mach-E, and we'll see where the market proceeds in terms of acceptance and demand.

LYNN TYSON: We also have territory in China, right?

HAU THAI-TANG: Yep. Yeah, territory in China is also in the marketplace today. Yeah.

JOSEPH SPAK: And then is the-- any update on the Mach-E orders?

HAU THAI-TANG: Yeah, it's been going really well, and obviously we took a different approach. With the Mach-E we had a higher reservation amount, but so far it's been-- the first edition models have been sold out. They were, in fact, sold out the first week of availability here as well as in Europe. I think at the end of June, we asked customers to basically convert their reservations into orders, and we've seen a really good conversion rate. We think we have sufficient reservations to basically fill our 20 calendar year production.

We were conservative with our estimates in terms of capacitizing the supply base especially with batteries. So very confident on that first year will be fully subscribed, and then we'll see where we go from there.

JOSEPH SPAK: On the topic of batteries, which has a little bit more focus of late. Other than the capital efficiency, which I think Jim Hackett eluded to on the call, is there a strategic reason for not having tighter control over the sales and sort of just being a taker there?

HAU THAI-TANG: Yeah, there are. I mean, so the capital intensity is clearly a key component, and everybody knows Tesla I think has gone on record to say they've spent about $5 billion on their Gigafactory. We know the GM-LG spending is about $2.5 billion for the new facility that's going into Lordstown. For me, as both running product development as well as purchasing, that's something we think very deeply about. This is an intentional choice on our part.

If you study the supply base and you look at what it takes to have an optimum loading in a battery plant that's very capital-intensive, you need somewhere between 100,000 to 150,000 vehicle volume to load up that factory efficiently. Now, a lot of that depends on what sort of kilowatt-hours and range you're targeting, but on average 200 to 300 miles of range. That's about the volume you need. We don't have that volume initially to justify that capital expenditure.

The substandard scale in the initial phase is further exacerbated by the fact that you're supplying these products globally, and in many markets there are local content requirements. In China, the licensing agreements you have to basically partner with a Chinese battery supplier. In the US now with USMCA, it has to be localized in North America. So there's insufficient scale for any one OEM, other than somebody who's a full line battery electric manufacturer like Tesla, to justify that spending. Working with our suppliers, we can leverage cross OEM scale to allow them to operate very efficiently.

It gives us the ability to access the latest technology and innovation across multiple suppliers. So I know exactly what the state of the art is from the Korean suppliers, the Japanese suppliers, the

Chinese suppliers, and I'm able to compare notes across them maybe better than they can. So we don't believe we're disadvantaged in terms of access the technology, battery chemistry, and in power density based on all of the competitive intelligence we have. And then, of course, we have the competitive tension with dealing with multiple suppliers, which allows us to drive the cost down. And in fact, I know from what I've read and what's been announced that we have the same pricing forecast in terms of material cost improvements as GM and Tesla would measured as dollars per kilowatt-hour.

The last one, and this is a really important part, is the battery chemistry will change over time. We know there's a lot of money being invested in solid state. So the question you have to ask yourself is, if you have access to all of the batteries you need, you're not disadvantaged by technology, function, nor cost, why would you sink billions of dollars when you know that battery landscape is going to change in terms of chemistry?

I'll use Toyota as an example. They've invested to vertically integrate nickel-metal hydride batteries for their hybrids. And after spending over a billion dollars to do that, the technology shifted to lithium-ion, and they were among the last to switch over. I don't want to put Ford in that position, so, yes, the capital intensity is a big consideration, but there are many other very legitimate strategic regions now. As our portfolio of battery electric vehicles increase and we have more volume and scale, would we go revisit? Absolutely. But right now, we think this is the right choice for us.

JOSEPH SPAK: Are your vehicles, your e-vehicles, being built flexible enough such that if chemistry does change mid-product cycle it will be able to accept new or different batteries?

HAU THAI-TANG: Yeah. I mean, to an extent. So if it goes to solid state, maybe not, but certainly we work with all of our suppliers to project changes in battery chemistry. We try to understand what that means to the physical shape of the battery arrays and then other interactions with the power electronics and cooling. And that's in our business plan assumptions in terms of how much more energy and power density we would expect there to get over the cycle of the vehicle life, as well as cost improvements.

JOSEPH SPAK: Yeah. Tim, I may be going back to the balance sheet here. So you have your $20 billion in cash, $30 billion liquidity target. A question coming in is what's-- the balance sheet, like you mentioned, still has a lot of cash, and I think after you repaid the revolver even the net debt looks like it's back down to-- or closer to sort of prior levels. But what is really the plan for the balance sheet going forward? Because it seems like investors are concerned that there can be some calls on the free cash you might be able to sort of generate here going forward, including the redesign and maybe some other items as well.

TIM STONE: I just want to emphasize again because it’s something we've been proactively doing is managing the balance sheet well so we feel comfortable with our cash position and confident enough to repay half the revolver after being proactive and pulling it down in March. So $39 billion and $40 billion liquidity, as you said, roughly zero net debt. We're going to continue, primarily focusing on the strategy to the vehicle portfolio, the fitness global redesign to

bolster free cash flow. That's primarily what we're going to be focused thereafter from a balance sheet standpoint.

As it came up earlier, we'll definitely look at opportunities to continue to pay down debt, certainly pay it obviously when do. But, you know, the line of credit, pay those down to zero. We'll consider that over time. We'll also look at other opportunities to ensure we feel very confident in our cash liquidity position. As you said, we have over time about $5.6 billion, if you go up to the $7 billion in total, of future cash for redesign, for example. That will be over the next several years, so it's not necessarily a 2021 focus, but over the next several years.

And we have investments we want to make in autonomy, and connectivity, and commercial, and the product portfolio in general. And we're going to be focusing on generating free cash flow to not only have a strong balance sheet to put us in a position over time to reinstate the dividend but be feeling very confident on each step of the way in the balance sheet that we have. The only guidance we're giving short-term is for free cash flow to be higher than EBIT in the third quarter given the working capital dynamics. We have reached near full production at the end of the second quarter, but we're not all the way. And then similarly in the fourth quarter, because of the launches, the launch primarily of the F-150, working capital playoffs such that free cash would be less than EBIT. So as I said, negative free cash essentially since EBIT was guided to be a loss.

JOSEPH SPAK: Meaning free cash burn greater than the EBIT loss?

TIM STONE: Correct.

JOSEPH SPAK: OK. We got another question. Maybe one clarification, I think. On the call or the slide you sort of mentioned de-consolidated Argo, but I think you said the spend won't change. Is what you mean by that that the dollar amount that you will incur is basically the same even though you're only taking half the loss? And I guess implicit in that is that the spending at Argo increases, which makes sense I guess. But is that what you mean?

TIM STONE: Yes, essentially that's right. And so the second quarter recall we had already de-consolidated Argo as of June 1st, so one third of the quarter was already reflecting the, say, roughly 40% ownership stake in Argo. And thereafter, that will be the case for all of Q3, and we're saying if an absolute dollar investment level standpoint, despite the de-consolidation, would be a similar level. So similar absolute dollar level investment in autonomy. That's because it's not just Argo, it's not just the self-driving solution. It's software, it's the full go-to-market activities, and so forth we talked about on the earnings call.

JOSEPH SPAK: OK.

LYNN TYSON: Yeah. And Joe, we believe we have the largest urban testing footprint right now on autonomous vehicles, right? So we have the engineering, all the additional product design that's going into it, all the additional technologies aside from the self-driving system. That all sets in a mobility LLC, which is fully consolidated.

JOSEPH SPAK: Right. So is it possible to sort of break out how much of a spend Argo was versus the entire autonomous offer?

LYNN TYSON: So, if you go back and look at the mobility line, over the last two years AV LLC was roughly half of that, and Argo was less than half of that number. It was less than half of the AV LLC number.

JOSEPH SPAK: OK. Maybe some questions on Ford Credit. You know, I think in the beginning of the year we talked about auction values down about 5%, then in the first quarter there was an indication that it could be worse than that. Auction values have thus fare held in. I think you're still saying down about 5%. It might even be actually a bit better than that.

But can you talk us through? Because I guess, one, did further write down never really happen in the second quarter? And then, two, can you just walk us through the profitability trends and targets and loss divisions as we think about the remainder of 2020?

TIM STONE: Sure. So let me start out with just stating that Ford Credit I think demonstrated itself throughout this crisis and certainly over course of time. What a differentiated value it is for customers and for our business. And to your questions on the business profitability, for example, it was profitable in the second quarter. We are seeing a lower profitability than in third quarter of '19 and fourth quarter of '19, as was the case in second quarter, but nonetheless profitable. And I think that reflects the way the team has been managing through the current circumstances.

And our auction values came back well. It was down 2% year over year. As you said, for the for the full year, we're still expecting about 5% decline in auction values. That's based on third party estimates, informed by third party estimates, but the prudent actions that we took in the first quarter helped that we had adequate reserves, for example, as we navigate through the second quarter, and all the macro uncertainty that we have, and the portfolio was strong.

JOSEPH SPAK: OK. A couple of investor questions coming in, and I think we sort of touched on some of this. But maybe you could address more directly how will Ford's Powertrain makes shift? Meaning hybrids, plug-in, electric vehicles, and battery electric vehicle going forward. And what is the cost inflation with doing this initiative?

HAU THAI-TANG: Yeah, I mean, that's a hard one to guess. I think everyone's seen a lot of external projections around the inflection point, and I think most of the times those forecasts are basically talking about the number of new product offering. So it's a supply side look rather than a demand side. So if I can predict demand, I'd probably have a different job, but I think certainly we are reducing our capital expenditure on internal combustion engines. We're driving for more commonality and reducing the complexity, and then we're shifting our focus, as we talked about earlier, to doing more battery electric vehicles and electrified vehicles.

So that's certainly our intention. We talked about the $11.5 billion, and we will increase that as we go beyond 2022. The actual demand, I think, is going to be a function of government policy, both on the demand as well as supply side in terms of what incentives and things like tax rebates, those types of things, or even access to HOV lanes.

It's going to be a function of customer education and acceptance and awareness. I think range right now is something that people are still struggling with. They're over-buying more than they actually need because it's just a comfort level to help with the anxiety of switching over, but I think we'll settle on a more optimum position there that will help the cost, and then certainly the costs will continue to improve as we build up scale and technology advances. So all of those things will play a key part, but we are certainly going to help drive and accelerate that transition over time. That's our strategy.

JOSEPH SPAK: So Elon Musk recently said that the goalpost on battery electric vehicle range are moving, and he thinks 300 is sort of the right level. What's sort of Ford's 300 miles range? What is sort of Ford's view on the optimal mile of range for consumers to be comfortable with battery electric vehicles? Maybe not--

HAU THAI-TANG: I would tend to agree with him, Joe. I think 300 is quickly becoming kind of the target, the bogey that everyone's targeting. The one thing I would say is I mentioned we have a lot of-- our vehicles are connected, among the first where all of our hybrid vehicles and we know from just monitoring driver behavior that on average our customers drive about 17 miles a day round trip. So if we deliver 100 miles of range, we probably satisfy the 90th percentile customer, but people are preparing for that worst case scenario, I'm going to drive to visit my grandmother in Chicago for Thanksgiving.

The thing that the customers have to understand-- and they will with time-- is unlike an internal combustion vehicle with a large fuel tank, as you drive and burn off that fuel, the vehicle becomes lighter and more efficient. If I give you a big battery, you're carrying that cost, that space that it's occupying, plus that mass, that weight, around with you all the time. And if you're only driving 17 miles a day, you're preparing for a worst case scenario. It would be like Apple making this phone last a week. They could technically do it. We just wouldn't want to carry it around.

They've landed on a form factor that they will get us through the day, and you can charge it up overnight, and your good to go the next day. I think the same thing will happen, and I suspect the answer will probably be around that 300 mile range.

JOSEPH SPAK: We didn't really touch on China very much, but I'd be remiss if I didn't sort of mention it seems to be some good progress there. Pre-COVID I think there were some comments about a 50% improvement in the loss this year, further in 2021. The environment has changed, but are those still valid targets? And really what are the biggest drivers towards the improvement in China? I know a lot of the low hanging fruit and just organizational stuff I think was done. So is it really more mix and volume from here?

TIM STONE: Yeah, given the current environment, we're not going to be updating any forecasts on China. But as you said, China team has made great progress. You know, it's the result of a number of different actions being taken throughout this year and leading up to this year. Production localization, the Corsair and the aviator, and the cost discipline focus.

You know, China was the only region to have a gain in whole sales this last quarter, up double digits, and they've benefited from the launch of Escape and Corsair, strong commercial vehicle sales. And then Corsair's the first locally-produced product, and Aviator is launching now, as I said. But that contributed to 12% net increase in sales in the quarter, so that's a great progress. Lincoln is a highly attractive brand for customers, and then China had a second consecutive quarter share gain, up to 20 base points to 2.5%, and that's the highest market share it's had since the third quarter 2018.

It seems clearly some early signs of momentum, with the test run making great operational execution progress. And structural vehicle strength was based on a 34% increase in sales at JMC, our JV partner, out of the 40 base point share gain. So, as with other regions, China's going to continue to focus on cost discipline, and it's done a really great job navigating delivery for customers and employees in a safe manner throughout COVID.

The cash flow, by the way, it's important to note that with the localization, you get a step function change on working capital improvement and of course Capex efficiency. So, again, we're not providing any specific color or forward-looking commentary on the profitability profile or cash flow profile for China, but the team is making really strong progress.

JOSEPH SPAK: OK. Gary, I know you're in charge of labor affairs as well. There's been reports of some higher levels of absenteeism in the plant, so I was wondering, A, what you're seeing from a Ford perspective, whether that sort of caused any constraints or impact to the cost of production. And, B, just maybe in general if you could sort of comment on dealing with the labor union during such a time of distress.

GARY JOHNSON: Yeah, Joe, great question. Us, and the other OEMs, and even our supply base have been struggling with the absenteeism as we came back up in May here in the US. Part of that's also heat-related. You've got the CARES Act. Our union partners have been fantastic with the UAW and bringing more temporary employees in to help us cover that absenteeism.

But I'd like to explain to a lot of people who aren't used to working in a plant, it's like working 10 hours a day on a treadmill, going three and a half miles with a mask on in 95-degree weather, and you get 90 minutes of breaks. So what they're doing to provide product for our customers is incredible. And like I said, we're about 98.4% of the volume the last four weeks. We came out of the gate in May pretty good, and the union relationship is really good. Roy Gamble heads the UAW International Union. We talked every couple of days, we're working on what we can do to improve it, how do we support our employees, and protect our employees for being safe.

And we had a task force committee with GM and Chrysler every two weeks now. We were doing it every day during the period, and make sure we're helping each other from a consistency standpoint in protecting the UAW employees. So we're on the right track. We have enough temporary employees now to help us get through that peak. So we see it stabilizing going the rest of the summer going into the fall.

JOSEPH SPAK: Great. Well, a couple of weeks ago, there was an announcement that Ford had with Intel, and I thought it had a couple interesting elements. One, it mentioned this the first time

Ford's committed to, I guess, active safety technology from them for the entire lifecycle of your next generation vehicle. So I'd be curious to know what sort of changed internally that caused you to go that route. And the second is that the Mobileye logo sounds like it's going to be displayed on the center screen kind of like an Intel inside branding, if you will. So can you just walk us through that decision process to give a supplier, a tier-2 such recognition? And do you deal directly with the tier two here-- you know, should we read anything into that in terms of how you are dealing differently with suppliers? Because historically you've dealt with the tier ones.

HAU THAI-TANG: Hey. Joe, I'm sorry. You cut out in the first part of your question for me. Can you just repeat? I heard the second part.

JOSEPH SPAK: Yeah, sorry. So it related to that the Ford Intel announced. And so first question was that it said you committed to the tech for the entire lifecycle of the vehicle, which I think it was said it was the first time you've done that. So the first part the question was, what changed that caused you to do that, to commit to that technology for the entire platform life?

HAU THAI-TANG: Yeah, so I'd say that the engineering spending to develop a driver assist system is quite high. So when we do it, our intention is not to change it for the life of the vehicle. We just wouldn't be able to make the business case to switch. The phenomenon of us, I'll call it, disintermediating the supply base and working directly with select tier two is something we've been doing. Especially as we shift towards new technology where, whether it's a computer vision system in the case of Mobileye, or CPUs in the case of a Sync infotainment system or computer platform, is we're finding that oftentimes the tier two suppliers are the ones that really are driving the state of the art in terms of technology.

By working directly with them, we can understand the competitive landscape, and what the state of the art is, and how future-proof it is. The tier one suppliers are basically playing the role of the integrator. So by us working directly with select tier twos, we can oftentimes not only understand the technology landscape better, but achieve better cost and value. And then we basically direct that tier two to the tier one, if you will, who plays the role of the integrator.

Mobileye is the recognized leader for computer vision system. This co-branding strategy is probably not dissimilar to what we've done in the past in terms of partnering with Sony, or B&O, Harman Kardon for audio system, or even Microsoft, which--

[INTERPOSING VOICES]

--the first generation sync.

JOSEPH SPAK: Yeah.

HAU THAI-TANG: It gives us an opportunity to create value for both companies as well as form a long-term strategic partnership.

JOSEPH SPAK: Yeah. Great. Well, with that, everyone, I think we're at the half hour. So Tim, Gary, Hau, and Lynn, I want to thank you very much for joining us today. I really appreciate your time and insightful answers. I think with that, operator we are ready to close the call, but thanks again to the Ford team.

TIM STONE: And thank you very much.

LYNN TYSON: Thank, Joe. I really appreciate it.

GARY JOHNSON: [INAUDIBLE]

[MUSIC PLAYING]