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Ford Motor Co. (F)

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MANAGEMENT DISCUSSION SECTION

Joseph Spak
Analyst, RBC Capital Markets LLC

Good morning, everyone. I'm Joe Spak, lead auto analyst here at RBC Capital Markets. Very pleased to have with us today Ford Motor Company. From Ford, we have Lisa Drake. She's the COO of North America, a newly created role where she's focused on returning North America back to the 10% margin. We're also joined by Lynn Antipas Tyson, Executive Director of Investor Relations.

Lisa, I think you have some opening comments and a brief presentation, so we'll go through that and we'll head into Q&A. I highly encourage investors on the line today to participate, and you can ask a question in the Q&A box and we'll ask those questions when we get into the conversation.

Lisa Drake
Chief Operating Officer-North America & Vice President-Global Purchasing, Ford Motor Co.

Great. Thank you, Joe. So I wanted to start with a first slide, if we could advance that, please, which is our value creation framework because it's the foundation of everything we do at Ford, and I wanted to highlight a few examples of this framework in action. First, at a high level, when we say we're becoming fit, it means that we're addressing the underperforming parts of our business. And this isn't a one-and-done exercise; we'll be at this for quite some time. It's a perpetual undertaking across all the teams throughout our company to continually improve our fitness. And some great examples of this include our decision to exit the traditional sedan silhouette in North America at our Michigan assembly plant which is right here down the street from Dearborn. For example, the Bronco and the Ranger are replacing the Focus and the C-MAX. And with overwhelming reception we have had for the new Bronco, it's evident that this will be a very powerful transformation for us in North America.

To deliver quickly on a winning portfolio, we've also reduced our flexible architectures down to five, and that will help us drive speed and efficiency in our product development process and essentially will bring newer products faster to the market. And in the US, we're targeting to reduce the age of our showroom by over 40% to a more competitive three years by 2023.

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So in the next slide, I want to talk a little bit in this presentation about fix, accelerate and grow, and that's really what underpins the value creation drivers for us. First, fixing some of the gaps in execution that we have around three key aspects of our business, and that's around material, cost, quality and warranty. Accelerating our actions where there's even greater opportunity and then growing some of our nascent businesses that will become more significant over time, and I'll touch on the highlighted areas in the next few slides.

So let's talk about North America. We see it as a growth business. Improvement in the overall North America business represent a huge opportunity for us to increase our margin. And as Joe mentioned, my role as the Chief Operating Officer of North America is to focus the organization on identifying and implementing fitness action throughout the operational side of the business. That can be everything from efficiency of our product development and material cost work, it's our launch robustness especially with the four launches coming up this year, and our ongoing quality and warranty performance.

And we have the winning portfolio locked in, and now we need to sharpen our focus on the cost side to achieve the 10% margin. And as we continue to bring to market high-demand products like the Mach-E, like the F-150 and Bronco, we'll not only continue to decrease the average age of our portfolio which drives pricing and share but then we'll use those new program opportunities to deliver our year-over-year cost improvement. And to put this in context, our business in North America generates roughly $100 billion of revenue per year, so a 10% margin is worth $10 billion of EBIT which is a sizable opportunity for us compared to our recent performance. And again, that's why we think the North America business is a growth opportunity for us.

So as I mentioned, this is a big launch year for us, and I can tell you that we tightened our focus on launch execution. We said previously that our major launches in North America has shifted to the fourth quarter, and that's in line with our COVID-related production disruption. Launches of the new F-150, the Mach-E and the Bronco Sport are already underway and they remain on track. To be honest, the COVID shutdown provided us an opportunity for us to go even deeper on our readiness, and we took some time needed to button things up with our suppliers and we came out more ready than before the pandemic hit.

First, our Bronco Sport which is being built in our Hermosillo assembly plant. In this plant, production of the prior sedans has balanced out which allows us a singular focus on launching the new vehicle. And I'm pleased to say we've hit our job one on time and now we're on track to start accelerating production of that model. Our two F-150 plant launches are staggered at Dearborn Trucking Kansas City Assembly Plant, and that allows us to learn from the first plant and implement any changes when we bring the second plant online. And those two plants are stalwarts of truck production for us; we're very excited about the launch status on F-150.

And then as we learn from past launches, we'll also be staggering some of the future rollout during the launches to reduce the complexity and enhance the focus on the high-quality early build. And it's really important to note that with the exception of the Mach-E, all of the vehicles we're launching this year are based off of existing platforms which are in production today and in some cases have been for many years, and this further de-risks the launch. And finally, most important, we're leveraging our connected vehicle data through the launch process to accelerate some of our testing and feedback, and I'll show you some examples of that in a few slides.

If we can turn to quality on the next slide, there's three building blocks that underpin quality performance of a product. It's the design and the engineering of the product, it's the manufacturing and assembly and how well we build that design and the quality of the parts coming from our supply base. And we've taken incremental actions in all three areas and not just for our new launches but for our entire lineup. As part of the prior fitness changes, our product development team enhanced their focus on systems engineering under the leadership of Hau Thai-Tang

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to take us to the next level of design robustness and customer [indiscernible] (00:06:39). Our manufacturing plants are implementing increased inspection and testing, and early indications are that these are holding even through the stress of COVID.

And we've increased data transparency with our supply base. Again, it was accelerated by the need for alignment through the COVID shutdown and then the bring up of the supply base. But now, we use it routinely to stay on top of performance and to cut issues off before they get to Ford and then, more importantly, to our customers. I'm very grateful to the supply base in how they stepped up and how the work that we've done so well together through the industry has allowed us a quality restart.

On the next slide, we'll talk a little bit about our material cost initiatives. And as I mentioned in my role, my primary objective is to bring the skill teams together to target material cost opportunities. These are things like eliminating spending on parts of a vehicle that matters the least to the customer experience. As an example, reducing costly hard buttons on items that are [indiscernible] (00:07:39) like head restraint heights or adjustable pedal positions moving to touch screen control or delivering the same level of discernible wind noise or interior performance but with far fewer steel and patches through more human-centered product decisions. And finally, we're really leveraging our analytical modeling and connected vehicle data to make sure we're investing in the features the customers want and being smart about how we engineer the vehicle, and I have a great example to share before we wrap up.

On the next slide, almost without argument, material cost is one of the single largest levers an OEM seeks to control. And we've been working on more efficient design solutions for several years as part of the modular catalog work where the most efficient designs are on a shelf and then future programs use those building blocks as they build up their program content. And with the new launches, we're now starting to see the results of this as we bring our newer products to market with those best cost designs. And this is the intersection of growth for us in North America. As we introduce these new products and the product refreshes and we lower the age of our product showroom, we're simultaneously delivering continued cost savings which results in the improved profitability we talked about.

On the next slide, as I've mentioned, we're accelerating our efforts around leveraging our connected vehicle. Today, all of our new vehicles in the US are connected through an embedded modem, and here are a couple examples of how we're using connectivity inside at Ford. The first example is from the Mach-E where an engineer 30 miles away from the vehicle was actually able to remotely diagnose a low voltage battery issue, isolate the root cause to the exact fuse that was in the vehicle and then recommend the repair all without having to have access to the vehicle. And the second one is on our F-150 launch. We did have a power running board failure that was detected on a launch vehicle. And during COVID, when it was difficult to travel, the engineer was able to pull the vehicle data log and the error log remotely through our connectivity with the F-150. They replicated the failure in a test vehicle and they were able to identify it there. So it's all about speed and the quality of launch execution.

And then the next slide is an example how we've used connected data to reduce our material cost. Rather than surveying users about how often they lock or unlock their vehicle through a rear door, and that's our passive entry – when you have the key fob on you and a truck recognizes it and the door unlocks automatically – we actually just analyzed the connected vehicle data across multiple vehicle lines and we found that our new F-150 that we're launching, the early development users weren't utilizing the feature on the rear door, so we removed the cost before the launch. And on a high-volume vehicle like F-150, this material cost reduction adds up to millions of dollars in savings. And we're pursuing many more opportunities like this passive rear entry example where we're listening with better fidelity to how customers are using their vehicles.

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The final slide is just some key takeaways, and hopefully this has given you some insight into the improvements we're making in our North America business and our approach to delivering a 10% margin as a business unit. We have a refreshed portfolio, laser-focused on the launch execution which we're well into as we sit here at mid-September. We have a relentless focus on material cost and delivering what matters most to our customers while delivering material cost efficiencies around what matters least. We have a rising use of our investment in connectivity to help us with material cost, quality and launch.

So with that, Joe, I'll turn it back over to you and Lynn and I are happy to take any questions.

QUESTION AND ANSWER SECTION

Joseph Spak
Analyst, RBC Capital Markets LLC

Q

Thanks very much, Lisa. Maybe just to kick off the conversation, Ford recently announced that Jim Farley will take over as CEO in October. Can you just talk a little bit from your perspective some of the differences between the two Jims and how do you expect Jim Farley to act on taking Ford forward with some of the initiatives you laid out in your presentation?

Lisa Drake
Chief Operating Officer-North America & Vice President-Global Purchasing, Ford Motor Co.

A

Yeah. Thanks, Joe. I love both Jims. It's great. The transition has been very seamless so far. Jim Farley is starting to move into his new position. But one of the things that Jim Farley did early on even before the announcement was the appointment of my position as the COO in North America, and he did that when he took over the auto business back in February. And I really appreciate his focus on the North America business. I think it has great growth potential and he understood that.

And it goes back to that slide that I showed with those key levers, the profit from the portfolio freshness that we now have with those three incremental products, the Bronco, the Bronco Sport, the Mach-E, again all white space for us plus the brand-new F-150 this year. And when you couple that with the cost efficiencies that we're working on, that's where we feel like we'll really unlock the potential for the North America business. So with Jim Farley, I appreciated his focus right away on this sizable opportunity for us, and he's put a lot of time and energy into the resources that we need to go ahead and deliver that. So I'm really looking forward to his continued leadership as the CEO.

Joseph Spak
Analyst, RBC Capital Markets LLC

Q

Thanks for that insider's insight. Maybe just to turn to the here and now. Can you just update us on the status of production globally here or really North America I guess in the third quarter? There's been off and on reports about some stuff going on in Mexico. I know that's maybe a little bit less relevant for you, but how sort of the rebuild or the restart of production trended from the severe downtime in the second quarter?

Lisa Drake
Chief Operating Officer-North America & Vice President-Global Purchasing, Ford Motor Co.

A

Yeah. It's, I mean, this has been unprecedented as you know. But it's amazing what this industry has been able to do, and we're very happy with our plant performance in North America. All of our plants are now at or near our

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pre-COVID levels of production. In fact, we're at 97% of pre-COVID levels. And when you think about what the industry in general, the supply base, the auto workers, the OEMs are going through to get to those levels, it's pretty fascinating. I have to say our supplier partners are key, super-critical. And the good news is we started to see a stabilization across the supply base now. Things aren't as sporadic as they were when we first started out back in May. But they're pretty fluid as you can imagine and we're monitoring everything very, very closely, especially in Mexico. Good improvements in Mexico we're seeing but it's still a location that we pay a lot of attention to.

Joseph Spak
Analyst, RBC Capital Markets LLC

Q

Okay. And maybe to follow-on, obviously an unprecedented situation in North America. Going through this experience and as you begin to do some of your work and analysis as COO of North America, have your views on the breakeven levels in North America changed at all given this experience?

Lisa Drake
Chief Operating Officer-North America & Vice President-Global Purchasing, Ford Motor Co.

A

Yeah. I think breakeven is a rather static measure. And what we've been doing given how dynamic not only the volumes have been but just our outlook on pricing ability, we've really just been looking at it from a stress test standpoint with multiple variables including pricing. From a SAAR perspective, we were just under 13.5 million units through the first half of the year, and we do see this improving a bit in the second half. And the first half was the lower boundary of the full year; we stated that prior. And as I mentioned, we do expect some modest recovery in the second half.

Joseph Spak
Analyst, RBC Capital Markets LLC

Q

Okay. You mention the F-150 launch and the Bronco launch which is more white space to your point. But on the F-150 launch, there's been some reports in the media that the units could be about 100,000 lower year-over-year. To us, that would seem to suggest about $1 billion profit hit. But maybe if you can sort of help us a little bit more about some of the impact you expect here in the back half. And then has the slight delay in the F-150 changeover at all really sort of changed your view on when you could reach sort of more normalized levels of production?

Lisa Drake
Chief Operating Officer-North America & Vice President-Global Purchasing, Ford Motor Co.

A

Yeah. Thanks, Joe. We haven't shared a volume estimate, of course. And there are a few really important things to note about this particular launch. First of all, it was a – it's a two-plant staggered launch which is a really big advantage for us. It's always an advantage more so in this space with COVID. It just allows us better ability and better predictability of the quality of the launch. One plant comes down to change over and then the second plant continues to produce, and we used the input from the first plant into the second launch. The impact to production, it was planned and expected. It always is when you have to change over the assembly plant, so that's built into our plan for this year and it really didn't change with the shift of the launch.

We have a lot of carryover powertrains on F-150, and that helps us with our acceleration. You don't have as many bumps through the acceleration process the more carryover the product it is. We don't have a new body shop like we had in prior years when we went aluminum, and Kentucky and Dearborn or, sorry, Kansas City and Dearborn are some of our strongest plants. So I can only reiterate what we said in July which was that F-150 impact to the changeover will more than offset the non-recurrence of our 2019 UAW contract ratification which was about $600

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million, but we're not going to comment on volumes at this point. But as I've stated, we feel confident that we're on track to the plan of our F-150 changeover.

Joseph Spak
Analyst, RBC Capital Markets LLC

Q

Okay. Lisa, you mentioned that sort of part of your role is getting back to that 10% margin, and we're getting a bunch of inbound questions from investors, sort of some combination of 2021 potential and 10% margin so I'll try to combine these two. But as we sort of think about it, right? You look at 2019 North America margins and there were a lot of one-off factors there including, as you mentioned, UAW but also an Explorer launch that probably didn't go exactly to plan. You also had a bigger warranty headwind and then 2020 we had a global pandemic. But as you start thinking about 2021, you got the F-150 launch coming up, you got the Bronco and the Bronco Sport launch coming up. So if it – I guess the question is are there other factors we should think about for 2021 and is it possible to see a quarter or so of that 10% margin goal in 2021 even if it's not for the full year?

Lisa Drake
Chief Operating Officer-North America & Vice President-Global Purchasing, Ford Motor Co.

A

Yeah. So we're not giving any guidance today for 2021, but you hit on some of the things where we know we need to focus. To hit that 10% that you're talking about, it goes back to that slide with the key levers on the product portfolio freshness. We'll be in one of the freshest lineups that we've had in quite some time, close to just three years. The cost efficiency metrics are starting to bear fruition. We've been working on material cost for several years but we've been doing it with the intent of launching those inside of behemoth product programs when we were retooling each part and each plant anyway. So that's starting to show up.

Again, I can't comment on the timeline for the 10%. But fundamentally, the North America business does have the ability to achieve a 10% margin. We've done it in the past, so we have to have laser focus including the product launches that you mentioned. And we have the new Explorer, the Escape and Super Duty last year, three major products for us in the US, some of our higher margin-generating products. We have the new F-150 and then we have these three incremental products that we mentioned before, the Mach-E, the Bronco and the Bronco Sport. And then we didn't talk about it much, but there's another white space product coming next year which is also again incremental for us.

So when you couple all of that product freshness, and these again are on the non-sedan silhouette type of vehicles where we do quite well in this market, and you couple that with the material cost progress and then you add in the growth, we didn't talk about connectivity and the CV business which has now been stood up more aggressively in the United States with Ted Cannis as the CV lead, we see a path to 10%.

Joseph Spak
Analyst, RBC Capital Markets LLC

Q

Okay. I want to dive a little into something you brought up a couple times now which is the freshness of the lineup and also the material and sort of content cost, and I think it was your slide 8, it might have been, that sort of showed the two curves of material costs and I guess age. Is the implication that material costs really don't start to become a bigger tailwind for you until that average fleet age starts to mature a little bit because you mentioned you're really sort of refreshing the lineup going from I think sort of five to three years but then it's probably going to be until I would say 2023 or 2024 where that age starts to level off and maybe you get some of the material cost benefits? Is that fair?

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Lisa Drake
Chief Operating Officer-North America & Vice President-Global Purchasing, Ford Motor Co.

A

It's a little bit of both, Joe. Obviously, every year we have year-over-year productivity gains both with design changes that we make to the current production model as well as our commercial work that we do with our supply base, and we continue that every year. But when you want to make a fundamental step change in that material cost performance, it's best to do it when you're re-engineering full systems in the product, and that usually happens when you change over or introduce a new model. So we continue on our material cost glidepath year-over-year as any OEM would but you get to see a bigger, more step function improvement, again, when you're retooling not only the product but also the assembly plant which it's built. Labor efficiencies go hand-in-hand though with process efficiencies, so that's why when I'm talking about that intersection of that curve, it hits more in the sweet spot during those bigger product launches. But by no means, and make no mistake, every year we are working on material cost improvements on the current production lineup.

Joseph Spak
Analyst, RBC Capital Markets LLC

Q

Great. Another inbound question from investors. You mentioned some of the actions you're doing on the F-150 in terms of removing content. We also noticed that it looked like the 2021 model year Ford Explorer price was coming down. And so maybe if you could talk a little bit about that. Are you reducing content cost on the Explorer as well and what's the rationale there? Is it something you're seeing from a competitive or value proposition perspective?

Lisa Drake
Chief Operating Officer-North America & Vice President-Global Purchasing, Ford Motor Co.

A

Well, that price reduction was planned and it's largely because we launched with such a rich mix when we launched the Explorer right out of the gate. So we had – that was built into the strategy. Typically, when we take year-over-year price reduction, they're not typically related to the cost reduction. We try and take our material cost reductions in places where the customer doesn't see it, in which case it wouldn't be influenced – the pricing wouldn't be influenced. In the case of Explorer, it was a new launch. There was complexity in the plant. We added labor into the facility to help us with the launch and we're doing what we typically would do after any launch, is work on national productivity levels. So I wouldn't associate that price strategy with any de-contenting on the Explorer.

Joseph Spak
Analyst, RBC Capital Markets LLC

Q

Okay. Moving on, maybe we can move over to some of the new products you showed. And I don't think you showed it today, but in the past Ford has sort of shown this slide which showed how over $1.5 billion of profit improvement from new product in Michigan Assembly and Hermosillo, and I think the Bronco is certainly a piece of that, the Ranger was a piece of that. When you first started showing those slides though, I think industry volume expectations were a little bit different. But since then, I think you also had probably a better than expected response to the Bronco, so maybe you're looking to increase capacity there if possible. I guess given all the puts and takes that we've seen in the industry, do you think that $1.5 billion number of profit improvement is still valid?

Lisa Drake
Chief Operating Officer-North America & Vice President-Global Purchasing, Ford Motor Co.

A

Well, we should – so first of all, I want to make sure that the $1.5 billion is understood. That was a delta between the footprint that was there prior, right? Focus and the C-MAX which were two sedan silhouette types of products and then the new footprint which is the Ranger and the Bronco, so that was the delta between the two. The

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Bronco demand and the excitement, it's hard for me to even talk about Bronco without smiling too much. We have over 165,000 reservations now with the Bronco, so Michigan Assembly Plant will be fully utilized and that is going to help us even if overall industry volumes are lower. The fact that we have a very efficiently, fully-utilized facility is what will underpin a good part of that $1.5 billion between the two products.

Also part of that savings is in the fact that we're going to reuse existing lines at Michigan Assembly Plant where the Ranger is today for that Bronco production. Again, being as efficient as possible and filling up the plant with high-margin products, and all of that contributes to that $1.5 billion improvement. Certainly, we will be looking at will we get more Bronco capacity but nothing to announce today. But again, that $1.5 billion was a delta and I think it is probably still a good estimate.

Joseph Spak
Analyst, RBC Capital Markets LLC

Q

Okay. Great. Maybe since you sort of gave us an update on Bronco orders, just wondering if you're willing to update us on Mach-E orders and then maybe to follow-on, since we're going to get some questions about your electrification strategy there, just any inkling of where you can go next on electrification within North America. And as you start seeing some of these competitor vehicles, electric vehicles coming out in North America, are there plans to compete directly there or how you think about approaching electrification in North America?

Lisa Drake
Chief Operating Officer-North America & Vice President-Global Purchasing, Ford Motor Co.

A

Yeah. I'll take the Mach-E question first. So the first edition model, reservations sold out in the first week of availability here in North America which was great and are also sold out in Europe by the way. Customers were invited, so we put the reservations but now they have decided to convert those at the end of June into new like online reservations. And we'll fill the 2020 calendar year production so our production schedule right now is already full for the balance of the year and we're expecting orders right now to fill 2021 calendar year. It's really important to note that the $7,500 Federal tax incentive still applies for new orders, and we're hopeful that with that competitive advantage that we'll fill the order bank for the 2021 calendar year quite well. And those – as you may know, we'll start delivery of Mach-E late this year in the US and then early next year in Europe.

In terms of a more broad discussion on electrification, and I'm going to stay somewhat North America-centric here. But in general, we're about halfway through. We had announced that we were going to invest $11.5 billion. We're about halfway through that plan at this point. We have some major programs that we've already announced, the Mustang Mach-E. We also have our all-electric F-150, and then Transit EV will also be coming in the next two years. Nearly 10% of our fourth quarter [indiscernible] (00:30:38) will have some sort of electrification this year to give you an idea of where we stand. And those nameplates globally, we have an all-electric Territory in China. We have our Escape and the Kuga in Europe, a plug-in hybrid that we're just launching in addition to the HEV that we already have. We also have the F-150 hybrid which we call the F-150 PowerBoost to great reception when we unveiled it earlier this summer and then also our Mustang Mach-E BEV. And then we also, as I mentioned, we have the F-150 EV and then the Transit EV that follows.

So we have a fairly large suite of electrification with hybrids, plug-in hybrids and pure electric. And again, about halfway through that electrification plan that we announced prior. We have the alliance with Volkswagen, and that is working out quite well for us. We'll accelerate some of our commercial vehicle and EV strategy in Europe. And we still have our investment and our partnership with Rivian and that'll play a key part of our electrification strategy moving forward as well.

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Joseph Spak

Analyst, RBC Capital Markets LLC

Great. Certainly a topic we could spend a lot more time on, and hope to in the future. So – but we are out of time. Lisa, I really want to thank you for joining us today. Really appreciate your insight and color. Thank you.

Lisa Drake

Chief Operating Officer-North America & Vice President-Global Purchasing, Ford Motor Co.

Thanks, Joe. I appreciate it.

Lynn Antipas Tyson

Executive Director-Investor Relations, Ford Motor Co.

Thanks, Joe.

Joseph Spak

Analyst, RBC Capital Markets LLC

Take care.

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