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# Ford Motor Co. (F)

Analyst Meeting - Credit Suisse

## CORPORATE PARTICIPANTS

**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

**Kumar Galhotra**

*President-Americas & International Markets Group, Ford Motor Co.*

**Marion B. Harris**

*President & Chief Executive Officer, Ford Motor Credit Company, Ford Motor Co.*

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## OTHER PARTICIPANTS

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

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## MANAGEMENT DISCUSSION SECTION

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Okay. Good afternoon. I think we are live and I apologize for the technical difficulties and the delay in starting here. Thank you. Thank you, everyone, for joining. I'm Dan Levy. I lead equity research coverage of the US auto sector at Credit Suisse. I'm very pleased to have with me on the line key members of the Ford management team, John Lawler, CFO; Kumar Galhotra, President of Americas and the International Markets Group; Marion Harris, President and CEO of Ford Motor Credit; and Lynn Tyson, Executive Director of Investor Relations.

Should be very timely conversation as we'll discuss a number of key topics from 3Q call as well as a number of broader strategic topics. I'm going to run through a series of prepared questions on the business units, the strategic initiatives, including commercial vehicle and EV. And then, we'll open it up for questions. Please feel free to e-mail me at dan.levy@credit-suisse.com, and I can ask your question anonymously. Our conversation sets last until 2:30. And please be advised we have investment disclosures for discussion today. Please reach out if you'd like a copy

And with that, John, Kumar, Marion, Lynn, welcome and thank you. Very much appreciate having you.

[indiscernible] (00:01:25)

## QUESTION AND ANSWER SECTION

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Great. Well, why don't we dive right in? And I think the best place to start is, given there's a new regime in place – Jim Farley is now CEO, I know a number of you are Ford veterans, but a new management team in place. I think that it's probably a good place to start to get a sense of the priorities under the new team. And I want to start with a cultural question. We've heard about the importance of accountability and urgency at Ford in the past, but it seems like under Jim Farley this theme is really accelerating. So, if you could just talk to what specifically is changing under Jim Farley's regime to really drive acceleration of urgency and accountability?

**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

A

Yeah. Well, thanks, Dan. It's John. Let me take that one. I would say that one of the things that's happened now, as Jim came in and we as a team worked with him leading up to his transition into the CEO role, was: one, he wanted to make sure he got his team in place and that team was of like-mind with him and very focused on the fact that there is a couple of things we need to do. And the first thing is, is we need to be laser focused on fixing our automotive operations, right, fixing the issues that we have so that we can generate and deliver in the automotive business the types of returns and cash flow we need to fund our growth initiatives. And then, once we've done this transformation, this double transformation as we're working both avenues of it, fix our issues, improve our automotive operations, raise our level of execution and then really start to invest in growth opportunities that'll be accretive and value creating for everyone, and for our shareholders and all our stakeholders. And so that's what we're laser focused on. We have a plan, we've got a great team, we know that we need to fix the automotive side of the shop, improve our performance there and then invest to grow.

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

And how do I balance – one of the things that we heard under Jim Hackett's tenure was this notion of managing multiple clocks. And I think this theme is obviously very relevant today. So, you're talking about the near-term automotive operations, but also the longer-term growth. So, how does the management of these two clocks – the near and the far, the near-term auto biz and the longer-term growth, how does that balance change if at all? I mean, is it arguably the case that without near-term execution, the longer-term growth is just evolving, you need to fund that longer-term growth with the near-term execution?

**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

A

Yeah. They're not mutually exclusive. I mean, we need to do both, execution in the near term and growth for the long term. That's exactly what – we need to deliver the complementary. So, we need to improve what we're doing today, including launches. We need to improve our cost. We need to improve our warranty cost. And those – better results, those will help us deliver, as I said earlier, the profitability, the EBIT margins and the cash flow so that we can invest. And we're laser focused on getting to that 8% EBIT margin, 10% in North America, 6% in Europe, and that will give us that consistent generation of free cash flow, right, that we will invest in, as I said earlier, in high-return businesses. And the nice thing about it is not only can we do that on the auto side, but we can also do that around products and services as we expand our bandwidth of what we can do as we lean into electrification, as we lean into connectivity and connected services.

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*



Great. Let's pivot to the business units because I think this is where a lot of the investor questions are lying, and obviously North America. So, at the core of your 8% company margin target is 10% in North America. And I think you've talked about there's a number of components [indiscernible] (00:05:31) the winning portfolio, cost, growth in adjacency. So, let's just start with 3Q. You've put up a 12.5% EBIT margin, and that's your best margin in the segment in roughly four years. And that was without any benefit from new product, that's without any of your cost initiatives. So, how do we look at that 3Q [indiscernible] (00:05:52)?

What can be extrapolated to future quarters, what can be viewed as unique one-time benefit? And specific to the pricing side, \$900 million tailwind in the third quarter, how much of that was a unique function of the market reflecting [ph] tight supply whereas (00:06:08) the potential for that to be extrapolated to future quarters?

**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*



Yeah, why don't I start and then maybe Kumar jump in as well. So, when you look at it, this year is a difficult year, Dan, as you know, because we have COVID and that's disrupted the business in the second quarter, we took the factories down and then we came back up. And it's really difficult to get a run rate of the business. As we go into the fourth quarter, we're launching three new products. And when you look at what happened in the second quarter, I think there were a couple of things that came together, both internal factors and external factors that drove that: One, the SAAR came back much stronger than we had expected. And that came on the top of having inventory that was constrained given that the plants were down in the second quarter. And so, the teams did a really good job as that demand came back executing in a difficult environment, making sure that our team was safe and protected as we ramped the plants back up. But we also had to do a lot of work with our supply base and work very closely with our supplier partners to make sure that the supply chain continued to deliver parts into the plant. And we had over 300 suppliers that were on premium freight and different forms of expedited freight. And so, the team did an incredible job. Many of our plants worked overtime, worked weekends to keep up with demand and keeping that running in. But that was pulled with a tailwind from incremental demand versus what we expected with low supply. And so, that led to some pricing power. And the team did a nice job of managing that pricing power in that strong market. So, a couple of those things came together. And as you look at the quarter, we gave – we've put up very good numbers, we've put up good results, but it was really a couple of things coming together that allowed us to do that.

Kumar, anything you want to add?

**Kumar Galhotra**

*President-Americas & International Markets Group, Ford Motor Co.*



Thanks, John. The only thing I would add is, we remain very focused on getting North America to 10%, which obviously supports the 8% margin for the company. And as you mentioned, it's been a very – unique here. In third quarter, the SAAR was substantially stronger than expected, but that's just the demand side, right? If we don't perform from the supply side, you can't capitalize on that opportunity. So, really proud of the manufacturing teams who were able to, first, stop the production as quickly as we did, and then to come up with a playbook for our manufacturing operations where we can keep our employees safe, bring in thousands of people for every shift, have very, very clear protocol on how to manage the risks and run our factories, and they did an pretty amazing job. And also, we reduced our structural cost to some extent. The pricing tailwind was good because the inventories were down, not just for us, for the entire industry as well, that really helped as well.

So, we're taking all these factors into account and obviously working on making sure that – that the efficiencies that we gained during third quarter as much of that as possible. The reason I say as much as possible is because next quarter is going to be very different. We're going to have – we're in the middle of the F-150 launch and we're going to lose substantial amount of – part of units during that launch. So, the underlying improvements, we're working on flowing them through to the future quarters as much as possible.

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**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

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Great. And that's helpful commentary because that tells me on one hand you obviously had some unique pricing benefits, but at the same time we need to consider that you were – achieved that even in the face of incremental inefficiencies, so that, I think, bodes well. Let's talk about cost because I think that that's really top of mind and I think that sort of gets to what you're talking about, you mentioning on the structural side. So, [indiscernible] (00:10:39) start broadly, listen, the last, call it, three-and-half-years or so, 3Q 2016 to 1Q 2020, cost was a headwind in North America and basically every quarter. Sharp tailwind, however, in the second quarter, flat in the third quarter, but really reversing a trend. So, just help us understand what's happened on costs in the last couple of quarters that's helped flip the trend, how much cost relief – last couple of quarters was temporary versus more structural benefits, and then we can go into the warranty and materials side?

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**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

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Yeah. Sure, Dan. It's John. I'll start out there. If you look at the second quarter, clearly that was affected by the fact that we took our factories down with COVID. And so, with that there's going to be a cost input impact to that. And then, as we brought production back up, we resumed some costs that came in with that. And then in the fourth quarter, we're going to see incremental costs coming through, as Kumar had identified, that is associated with the launches.

But as Kumar said, one of the things that we're doing is we're looking at the efficiencies that we gained and the improvements that we had as we went down in the second, came back up in the third, and how do we understand what happened there and leverage that to bring that through following quarters. And so, we're laser focused on improving our costs in a couple of areas, in particular around warranty and then in material costs. But when you look at second quarter to the third quarter, I think you've got the impact there of going down with production, coming back up with production in the third quarter. In the fourth quarter, we've got some incremental costs coming in for launching the vehicles and launching the brand, but we're very focused on making sure that efficiencies that were gained that we can maintain and retain and flow those through.

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**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Great. Let's talk about the warranty side. Let's zoom out for a bit, maybe you can help us understand. Well, we've heard about warranty for a while, but it seems like the issue has lingered. So, really could you give us a sense what's the root cause of all of these quality issues, is it an engineering issue, is it manufacturing problem, just on legacy issues? You're still having quality issues on the new vehicles. And as we frame the opportunity – I think you've had in excess of \$3 billion of warranty headwinds the last few years, how much of that can you recover?

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**Kumar Galhotra**

*President-Americas & International Markets Group, Ford Motor Co.*

A

So, Dan, this is Kumar. We're obviously fully committed to very high-quality vehicles. Unfortunately, our warranty costs are up about \$1 billion to \$2 billion, as you mentioned, since 2017. We are working all levers to improve this

as quickly as possible. We've invested very significant resources, for example, in our craftsmanship of our products, and we're starting to see results.

So, we look at quality through two or three different ways, right? There is the, what I would say, things gone right where we're surprising and delighting our customers [indiscernible] (00:14:01) industry-standard metric, there is appeal by J.D. Power. So, we're starting to see improvements there. So, we're gaining traction. Another is where it actually is a warranty claim where something is wrong with the vehicle and the customer has to bring it into our dealership. As you alluded to, those error states occur in one of three areas, either the – there was a design that wasn't robust enough or there was a manufacturing issue where it wasn't put together correctly, or it was [ph] – is (00:14:41) issue in our supply base where the parts that were supplied weren't robust enough or to spec.

So, we've taken all of our quality issues and are very clear on where those error states lie. And we're dedicating resources to fixing each one of those error states, including a much higher engagement with our suppliers. We're putting measures in place where the suppliers have more skin in the game. This will make us more consistent with the rest of the industry which we weren't in the past.

In terms of speed of resolution, we now have a very visible, transparent clock on every one of our issues, every one of the significant issues that is visible to me, to Jim, to the entire leadership team and to people who have to fix it, so a much higher level of focus on speed and accuracy. We've gone back and done an audit of where we may not have proper resources. For example, our last redesign of the business that we did, we found, not a lot, but some areas where we had taken out resources such as a group that looks at the supplier quality of inbound parts into our plants. And as we're finding those holes, we're fixing them very, very quickly. So, we've put those back – resources back in the plants where they belong so that we have a feedback loop that directly ties our plant operations to our supply base operations.

And finally, we are really leveraging connectivity. 100% of the vehicles we are building in US now are connected. That presents a really significant opportunity for us to diagnose errors states, sometimes even before they happen. And we're using that both in development of the vehicle, we're using that in launching process – launch process of the vehicle, and we're also using them for vehicles that are in the field where we can access data over the air from the vehicles both for early detection, as well as investigation of the problem. So, there are several examples where the teams are already doing that. So, I think a combination of all those very specific ideas is going to help us bring that warranty down substantially.

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### Dan Levy

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Great. That's helpful color, again. Sounds like the initiatives have stepped up incrementally versus what you've – versus your focus, your efforts in the past. Let's ask a similar question with material costs, same deal, we've seen that. I think that's been a drag of – in excess of \$2 billion over the last handful of years. Again, how much of that is recoverable, what's the low-hanging fruit in that, what's the underlying root cause, and again, what's [ph] different (00:18:17)? We've heard about complexity reduction in the past. What makes the opportunity for complexity reduction or other initiatives different or more achievable this time around?

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### John T. Lawler

*Chief Financial Officer, Ford Motor Co.*

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Yeah, Dan. It's John. I'll start off. It is a significant focus of ours to continue to drive down the cost. And as you said earlier, getting to the 8% margin for the company really does require us to improve our cost structure. And there's a few areas that we're really focused in on. One of those is around looking at every opportunity we can to optimize the content and features in the vehicle. So, really focusing in on what our customers use on a regular

basis and what they value, and so, looking at reductive design possibilities, opportunities there. Reducing complexity is another lever we can pull that will allow us to take cost out. And then, designing upfront – almost end-to-end or greater cost efficiency. In looking at those three areas, we're looking at that from an end-to-end process throughout the whole development cycle. We're also using benchmarking and looking at the competition.

In fact, there's the ability now to take a like-for-like vehicle and do an X-ray of that product to really understand what the comparable costs are with competition and to understand where you might be overdesigned relative to others in the industry. And there's a couple of good examples that have come through as we do that from both the X-ray or the reductive design. And I think Jim touched upon those – couple of those when we had our earnings call, but one of those is the F-150 rear-door proximity sensors. And through connectivity and being able to understand what the customers use, we understand that you don't need proximity sensors on all four doors. But if you look at our F-150 jack, it's overdesigned relative to what others provide consumers. So, we're looking at everything. But one of the areas that's really exciting for me is the work the team is doing on connectivity and being able to understand exactly what the customers use and what they find valuable and then leveraging that to provide a better product, but one that could be at lower cost.

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**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

All right. Excellent. So, I think that's a good overview on the cost opportunities in North America. Why don't we pivot to Europe, also obviously, a very topical business segment and let's just start with something more near term? Obviously, we saw on the CO2 front – you initially said you were going to achieve the 2020 and 2021 CO2 targets without credits or penalties. Obviously, the Kuga PHEV recall changed that and you took some incremental charges in 3Q, and some in 4Q. Does the recall impact your ability to hit the 2021 CO2 targets, or do you also need to pull targets for 2021 and pull credits for 2021 and what's the incremental cost on 2021 pulling if relevant?

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**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

A

Yeah. So, first let me start with 2020 and then come back to more directly answer 2021 as best I can at this point. Yes, we would have met our CO2 requirements in Europe for passenger vehicles had we not had the stop-sale, stop-ship on the Kuga. But we did, and we had the component issue with the quality issue from a supplier. And we did take a charge of \$400 million in the quarter related to the cost to comply with the emission standards as well as the warranty and the manufacturing costs to deal with the issue and customer satisfaction initiatives that we've put in place. And we have identified that it will be about \$100 million to \$200 million in the fourth quarter of cost. But outside of that, we would have met that CO2 target. And the cost that we've put in do include the cost for us to now join a pool with Volvo on passenger vehicles, but we haven't announced or we haven't disclosed what that cost is for pooling. And that's something that we haven't – we don't think is appropriate to put out there at this point.

Now, we have also exceeded our CO2 requirements on commercial vehicles, and so we are creating a pool for commercial vehicles where others can join us and take advantage of the fact that we are above the CO2 targets for commercial vehicles. And so, I think holistically as we look at it, we always intend to meet the emissions targets, we have always and we will continue to meet those emission targets. And so, specifically for 2021, I'm not going to comment on how we're going to do that, but it's always our intent that we do that through our product plans.

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*



Great. Let's talk about the path to 6% margin in Europe, and I guess let's just start with a quick one. How much of that 6% margin target is dependent on material industry recovery, or what's – what industry recovery do you need to see to get that 6%?

**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*



Yeah. Well, the 6% that we've put out there is really a sustainable target. We expect to achieve that year-in and year-out, not just in the best market conditions. But I guess conversely, I have to say that it doesn't apply if we're seeing a severe market downturn, but we expect that to be at a run rate of the business. And so, that's sustainable. I guess when you look at the path to 6%, a big part of that is going to be covered in: one, the businesses that we're focused on; two, fixing our cost issues, addressing cost issues, right; And then three, what we're going to do with our footprint. And so, when you look at what the team in Europe has done, they've done a really nice job over the last couple of years taking their structural costs down. They've identified \$1 billion of efficiencies in their structural cost that they will achieve by the end of this year which is starting to show up in the results. And in the third quarter, had it not been for the quality issue on Kuga, Europe would have been profitable.

The other thing I have to say is that focusing on our strengths and shifting our attention as we've been doing the last couple of years, the European team has been doing into commercial vehicles and into more profitable SUVs, is also part of the recovery plan. And we grew our share of commercial vehicles again this quarter. And that's very profitable business in Europe for us. And then, we're also growing our SUV share which has much better margins than the traditional passenger vehicles.

And then, looking at our footprint, the team has done a nice job so far of reducing our manufacturing footprint by six facilities and next year we'll see the full impact of that and the benefit of those actions that we've taken so far. So, there's quite a few areas that the European team is focused on. We're starting to see the results of that flow through. And the team is going to continue to work that as we move forward as we drive to get to that 6% sustainable EBIT margin.

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*



And as we layer in increased electrification, does the cost of CO2 compliance – and presumably that only increases in subsequent years, do all those other actions mitigate those incremental CO2 compliance costs?

**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*



So, I think we've identified the 6% understanding that there's going to be a shift into battery electric vehicles and a shift into meeting the compliance. And we've taken a holistic approach where not only do we have BEVs, but we have full hybrids and PHEVs as well. But when we identified the target of 6%, that was full well knowing that there were going to be CO2 requirements that we had to meet.

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*



Great. Let's wrap up with sort of one quick one on Europe and maybe an incremental risk, Brexit to the extent there – different developments on the Brexit front, does that pose any incremental risk for you?

**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

A

Yeah. I mean, we're encouraged by what we're seeing in that both sides are committed to a tariff-free, quota-free deal, and that's really what's crucial for and critical for our business in Europe. As you know, our footprint, we have very [ph] large (00:27:27) footprint in the UK. And we're encouraged by what we're seeing. And I would have to say though that if there is a failure to reach an agreement and there are tariffs that come into place on vehicles and components, it would have a significant negative impact on our business in Europe and particularly in the United Kingdom.

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Great. That's good color. Okay, why don't we pivot to China? And China, I think, is an interesting region where you're really seeing the benefits of your initiatives there, and the growth on your units in second and third quarter were pretty robust, up something like 40-plus percent in the second quarter, up 20-plus percent in the third quarter. Give us a sense of the underlying dynamic in China? Is this industry – is this recovery in volume, is this just simply easy comps or is it the benefits of the new products? And going forward, obviously, your goal is to not only hit breakeven to be profitable, how much does the push to NEV impact the roadmap of China profitability?

**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

A

Yeah. Yeah. China has – did have a good quarter with shipments up – wholesale shipments up 22%. And that, I believe, was the second consecutive quarter of year-over-year growth. So, sales are improving there. I guess if you unpack that a bit, there's two things that are helping drive that: one is vehicles and the mix of what we're focused on. So, we had our strongest sales of SUVs and commercial vehicles in quite a while. SUVs in the quarter were up 13 percentage points. And now, they're 36% of our sales, and what we've seen in the last quarter is we launched quite a bit – quite a few new vehicles over the first part of the year. First is the Explorer. And what's key about that is the Explorer is now locally produced. And then we have the Lincoln Aviator and the Corsair which are – the Lincoln Corsair which is also locally produced. And so consumers are receiving them well. They're produced in market, so there's a much lower cost. And so the combination of having new products, locally produced, lower cost structure you're starting to see that come through the results in China.

And what's interesting is Lincoln – now 65% of the Lincoln vehicles are produced locally. And that's up from zero last year. So we didn't have anything locally produced. And we're really seeing a favorable reception of both the Corsair and the Aviator. The other thing – the other strength we have in China is and I don't think a lot of people know this but our commercial vehicles are very strong in China through JMC. Their sales were up 38% versus last year. And that's a strong business for us. And we're continuing to see strength in demand for light trucks, vans, and pickups. And so with JMC, we're seeing growth there as well. So I'd say that it's localization, it's new product, it's new product in the right segments, it's a product that's being well received, and then it's the strength of our truck business with JMC.

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

And then just a question of clarification, you said you're at 65% [ph] timing (00:30:50) to get to full localization of Lincoln?

**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

A

Yeah. That's going to come in over time. We haven't announced the exact timing of that. And then there will be some products that we continue to import that are very low-volume, high-margin products that wouldn't make sense to localize.

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Great. Let's move on. Same spirit of questions onto Ford Credit. And again same deal as North America, really strong quarter. I think \$1.1 billion in EBIT in the quarter and that was your best quarter since 2005. And I know there were some benefits on residuals on the lease book. But could you help us understand same question as North America, what parts of the third quarter results can be viewed as one-time versus what we can maybe extrapolate to future quarters?

**Marion B. Harris**

*President & Chief Executive Officer, Ford Motor Credit Company, Ford Motor Co.*

A

Hey, Dan. This is Marion Harris. A lot of that lease performance in the third quarter was, I would say, unusual. It's not often in your career you find yourself with excess supply and then demand all of a sudden shoots up dramatically and that's what happened to us. And not only did the demand shoot up dramatically in the third quarter alone with prices, these are units. We found ourselves with excess supply going into the third quarter and we had taken a lot of depreciation on those units in the first and second quarters [ph] in anticipation (00:32:18) of significantly lower auction values [ph] not only were (00:32:24) they not lower, they were significantly higher, so a lot of that – a lot of the financials came out in the third quarter. So that's what I'd say.

But if you look at the business and try to find the signal through the noise for the run rate of the business, in total, auction values are better. They're certainly running better today than we would have expected them at this time. Our actual credit losses are performing better than we anticipated at the beginning of the year. That being said, we're prepared for escalating losses in an upcoming recession. So if and when those losses occur, it's not necessarily a profit issue as we are appropriately reserved for that. That would be offset by somewhat smaller receivables. But the business itself is continuing to operate very, very well.

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Okay. So – that's helpful, Marion. So as we distance ourselves from COVID and obviously I think you took some conservatism earlier on and now you benefit because of the market's a bit better, as we distance ourselves from the depths of COVID, are there any lingering issues that would challenge Ford Credit whether it's – what's the timing to get the lease mix back to the pre-virus level or the cost of funding given you're now high yield, just trying to parse through the different puts and takes as it seems like the industry has recovered really nicely, but there're still maybe, I guess, some lingering impacts as far as the cost of funding. Just trying to understand when we can get back to a full run rate like we saw in 2019 profit, if possible.

**Marion B. Harris**

*President & Chief Executive Officer, Ford Motor Credit Company, Ford Motor Co.*

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Yeah. It's a good question. I think from lingering issues, I don't really see that many the – I think at least mix will head back to where it was just as the marketing programs run out and we get back to more normal volume and so on. So I don't really see that. We also see auction values normalizing over the coming months, not dramatically fast or dramatically slow, but we think that the run-up in auction values largely reflected the production disruptions

we had from COVID, particularly in pickup trucks and as production normalizes launch for a new F-150. We'd expect auction values to return to a more normal level, but that should be a mild positive for a while, although we don't have the units to sell at auction because we sold so many in the third quarter.

On borrowing costs because of – following the COVID, the pandemic, we're now [indiscernible] (00:35:17) investment grade credit rating. Our unsecured borrowing costs are a bit higher, but our securitization costs were still very, very competitive. And that's why our balance sheet structured the way it is with our liquidity and so we feel really good about that. All in all, we feel really good about where we are.

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**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Great. I think that's helpful color. Let's go to the growth side and let's talk about commercial vehicle because I know that that's something that's been highlighted quite a bit. So maybe John, Kumar, you can help us understand. Let's just start by framing the size of the commercial vehicle business today. And I know a couple of years ago you put out a slide that said that your truck/van business was 2.4 million units and \$10 billion of EBIT, what part of that business. Just if we can start with sort of the size of the commercial vehicle business, what part of that is the CV business that you're focusing on now? Maybe you could give us a financial snapshot of where that business stands today, so we know what the starting point is.

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**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

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Sure. Well, I guess the one thing I'd have to say is, we haven't really disclosed the size of the commercial vehicle business since we laid that out a couple of years ago. But with that said, it's very substantial, it remains to be very strong and it's very profitable. So what we had laid out previously, we continue to see a very good business there. And that's both in North America and in Europe. And as I said earlier, in China, we're seeing strength as well in our commercial vehicles with the mix increasing and the strength we saw there coming through with JMC. There are significant growth opportunities we see in the commercial business particularly here in North America. And I'll let Kumar go ahead and talk about what he sees there.

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**Kumar Galhotra**

*President-Americas & International Markets Group, Ford Motor Co.*

A

Yeah. Thanks, John. We have really, really strong presence especially with the work segment of commercial vehicles. So internally we talk about it as we own work, and we're going to continue to capitalize on that strength both as a brand and with the capability of the vehicles. But with connectivity, that's going to offer us a whole set of opportunities that didn't exist before. So we won't be selling just the vehicle itself, but we can help our customers with the running of their businesses making their businesses more efficient. I can give you a few examples of this.

We can – we have already started providing services where they can monitor their fleet much better. They can have – they can geo-fence their fleet. We can provide driver training, we can provide them fuel economy training so that how many harsh starts or how many harsh stops they had. We can use one of our technology platforms to provide them electronic keys. So if you go to medium to large size fleets, we notice that they have employees whose job it is to manage the keys full time. Those resources could be used elsewhere. So there's just unlimited amount of opportunity in leveraging our know-how of these fleets and using connectivity to provide much broader suite of software services and other experiences for our customers and for us, as John mentioned, that can generate annuity-like revenue streams.

Secondly, for a lot of these businesses, reducing their CO2 footprint is very important. And we've already announced that we're building the F-150 battery electric vehicle, we've also announced the Transit battery electric, so those two vehicles are incredibly important in the commercial side of our business. They are the highest volume commercial vehicles in the industry. So there is a very large addressable profit pool for electrification in those types of vehicle. So we're going to reveal the electric Transit on November 12. That will have a lot of the key attributes that I just talked about and a combination of both investment in electrification and investment in connectivity leveraging our brand, leveraging our built-for-tough strengths, we see substantial opportunity here. And that's one of the key reasons we've stood up a unique commercial vehicle organization with its own general manager, his name is Ted Cannis, to start capitalizing on a lot of these opportunities.

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**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Great. Let's – just one follow-up on that. You've talked about connected services, but I guess how much of this opportunity to use the connected services to create these recurring revenue streams would you view as low-hanging fruit versus more difficult and what's the timing to really see a material contribution from that hitting the financials? Is this more of a longer term five-plus years or is this something that within the next couple of years we could see a material uptick?

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**Kumar Galhotra**

*President-Americas & International Markets Group, Ford Motor Co.*

A

So let me answer first. And John, after that, if you have any more color to add. I would say it isn't as binary as low-hanging fruit or a longer term, clearly a very long-term play, but there's a bit of a continuum. As I mentioned earlier, every vehicle we're selling now is connected. And several of the services that I mentioned, we are already offering those or starting to offer those. So there is already a subset of our commercial customers who are buying those services from us, but we believe that this is just the start as the over-the-air capability increases, as the connectivity speeds increase over time, let's say once we go to 5G, for example, the opportunities that present themselves are going to be much bigger. So it's going to be a continuous evolving journey between now and, I would argue, forever because the software capability, the tech stack capability, the connectivity speeds capabilities are going to continue to increase very substantially between now and then, but we're not waiting for that as I mentioned. We have the organization now. We are offering commercial services now and it is growing literally every month. John, is there anything else you'd like to add?

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**Lynn Antipas Tyson**

*Executive Director, Investor Relations, Ford Motor Co.*

A

John, you're on mute.

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**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

A

Thank you. I think you covered it, Kumar. I think nothing to add. Thanks.

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**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Great. Why do we – you gave us a helpful date for marking the calendar, November 12. Why don't we pivot to EV and this, I think, was a very popular question from folks. So, look, your approach on battery electric has been one where you choose not to go with dedicated platforms, but I think presumably a non-dedicated BEV platform has more inefficiencies than a dedicated platform. So what's the rationale to using non-dedicated EV platforms, even

though they're more inefficient? Is it just that matter of scale and does a non-dedicated EV platform make it harder for you to compete in EV than players with dedicated platforms?

**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

A

Thanks, Dan. Let me start out and then Kumar can add on top of that. I guess I would say that our goal was to build a profitable electric vehicle portfolio, right? And so to do that, we need to leverage our strengths in the scale that we have. And so we're being very strategic about the platforms we choose, really first looking at what the customers need and starting with the customer and understanding what it takes to provide them with the products that they need. So if you look at our lineup of electrified vehicles, if you look at the Mach-E, for example, it is on its own dedicated BEV platform designed. It's from the ground up, it's designed to be a BEV and it gets all the benefits of that, greater interior space, the driving characteristics are what you would expect from not only a BEV but from a Mach-E Mustang BEV, the electrical architecture, the OTA capability, it's the interior human machine interface I guess which you'd say the digital experience in the vehicle, all a unique BEV platform.

But then when it comes to our trucks and commercial vehicles, as Kumar said, where we own work a substantial part of those segments with the all-new F-150 and the E-Transit, those are going to be built on platforms that will share with their ICE models. And so you get the benefit of some scale there. But if you think about that, those vehicles are much larger. And so with those larger vehicles, the engineers have less constraints on packaging of components and batteries, et cetera, than you would see in a smaller platform or a smaller packet side. So we're really looking at it from a standpoint of how do we give customers what they need, how do we leverage the scale, how do we leverage where we have our strengths.

And then when you look at Europe, we are leaning into that with – from commercial vehicles, right, as we said the Transit platform, but we're also going to leverage the MEV platform which is a dedicated platform and it will be leveraging our strategic alliance with Volkswagen and we will benefit from their scale, right, then what will be what we see as a sweet spot for a BEV in Europe for that size and the capabilities that the European market needs. So I think the way we're looking at it is what's best for the consumer, start with the consumer, where can we get the best scale and then what are the opportunities we have with the strategy we've laid out for battery electric vehicles.

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Great. It seems like a very tailored approach. Why don't we ask one last one on balance sheet and then we will pivot to some of the audience questions. And I think just more near term, John, you noted that your working capital recovery is now complete, the dealer allowances are still a couple of billion dollars below the 2019 year-end level. So is it fair to say that you have an additional, call it, \$2 billion cash opportunity over the coming year as you replenish those dealer allowances and you can rebuild stock?

**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

A

Well, we're going to continue to focus on improving our balance sheet, improving cash flow as best we can and driving – a lot of that's going to be driven through EBIT. But we're looking at every element of the business to increase our free cash flow and drive that into our cash position which will give us the flexibility and make sure we maintain a very strong balance sheet.

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Great. Okay. Thank you. This is great. Why don't we move to the audience questions and I know some of you've been sending questions, so I'll try to get through as much as we can here and I'll just read these off. So on CV, results and outlook for commercial vehicles in Europe and China basically very bright. Wondering if Ford sees an opportunity to grow in CV beyond light commercial to more heavy commercial; if not, why. I know you have a little bit of Class 8, but not much, so what's the opportunity in CV, call it, medium duty versus heavy duty?

**Kumar Galhotra**

*President-Americas & International Markets Group, Ford Motor Co.*

A

Yeah, I would say – this is Kumar – there is obviously substantial opportunity in very work truck execution of the F-150 and the Transit, and those are the two that are immediate – that we're working on immediately. At the moment, we do not have any plans to go into heavy duty with battery electric vehicles.

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Okay. So no, Class 8. Okay. Question for you, John. What is the timing or the zone to return to IG?

**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

A

Yeah. I think that's a great question and I wish I could answer that with a definitive answer and say exactly at this point. But we have work to do. We know that our plan of getting to an 8% margin, generating free cash flow that will come from that 8% margin with a good cash conversion rate is going to be the first step in what we need to do to get back to investment grade. So we're laser focused on improving the business and then identifying the growth areas as we talked about throughout this call. And as we do that, then we'll continue to work with the rating agencies and one foot in front of the other and we keep improving the business and keep delivering on what we say we're going to deliver, then it'll be up to the rating agencies to decide when they're going to bring us back to investment grade.

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Okay. Great. As far as the structural cost saves, how quickly do you expect to see the structural cost saves drop to the bottom line now that you have aligned business leaders with their own P&L, so for instance, Head of Europe can make all decisions that affect his business? How long does it take to see the benefits of those actions come to fruition? And I think we'll note – we've seen in Europe structural benefits. We haven't seen sort of [ph] a net (00:51:13) improvement. So just some comments of [indiscernible] (00:51:16) incentives and when we see net benefits on the cost side?

**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

A

Yeah. So as you said, in the Europe, we're starting to see that restructuring in those costs – structural cost reductions flow through. We would have been profitable in the quarter had it not been for the Kuga issue. And so we're going to continue to push those, and as they come through, the goal is they're going to be required, right, to drive us to the 6% margin in Europe as well as continuing to find those efficiencies elsewhere around the world to drive us to the 10% in North America and the 8% globally. And so I think they're going to come in over time and what we will do is in the spring when we get together and have a bit more time, we'll lay out that bridge to the 8%

margin and what the cost structure will be and how that's going to come through and frame that up in a little bit more detail.

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

And the management structure, does that change now that business leaders have their own P&L? Does that accelerate it?

**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

A

Yeah. I'll start there, and I'll let Kumar. Kumar and I as we were working with Jim, we were very likeminded in that having run China in my past life and now Kumar running the Americas and International Markets Group, it's really an important step forward to make sure that those that are closest to the customer also have end-to-end capability to pull the levers they need to drive their bottom line. And I'm really excited about this opportunity and change that we have. Some might think that it's simple or subtle change in how we're approaching the way we run the business, but it's fundamentally important for us. Kumar, anything you want to add to that?

**Kumar Galhotra**

*President-Americas & International Markets Group, Ford Motor Co.*

A

Yeah. The only thing I would add, John, is the people who are in these positions including myself have been part of a skilled team or a function for big parts of their career. So myself in PD, [indiscernible] (00:53:25) Americas and finance for several years, Stuart's been in finance and strategy. So all of us understand both sides of the business well. We understand how the skill teams function and we understand that those skill teams have to come together to deliver the business and the accountability for P&L lies with us. And we're very conscientious of the fact that we need to have strong and modern skill teams. So it is a very thoughtful approach that Jim and all of his leadership team are taking in providing clear accountability for P&L. But within that clarity that we can't just be short-term focus that we need to make sure that those functions stay modern. Those functions stay strong functions like manufacturing, product development, IT, et cetera. So I'm – like John, I am very excited about the opportunity to serve in a way where we have both the responsibility and the resources to do what needs to be done for the business to be healthy and to grow and to be more profitable while bringing all of our skill teams along so that they stay modern and efficient.

**Dan Levy**

*Analyst, Credit Suisse Securities (USA) LLC*

Q

Great. And then we'll ask one last question because I know we are at time. The uptick in COVID cases in Europe, could you give us a sense, do you see factory closure as part of the government mobility restrictions combat COVID or do you think new procedures can help keep your factories in place, basically just a question on how do we see what's the risk to Europe around COVID?

**John T. Lawler**

*Chief Financial Officer, Ford Motor Co.*

A

I guess I would say it's really too early to really know to what extent the resurgence is going to impact the business. I really don't want to speculate on potential scenarios. What we can do and what we do control is our protocols. And we've developed very extensive protocols around prioritizing the safety of our team. And we're going to continue to be very vigilant about that and monitor the situation. We'll continue to prioritize the safety of the team, and then we'll manage the situation as it unfolds. But I don't want to speculate on potential scenarios on what might happen.

## Dan Levy

*Analyst, Credit Suisse Securities (USA) LLC*

Great. Okay. Thank you. I think we're at time. So, John, Kumar, Marion, thank you. This has been incredibly helpful and better understanding the Ford narrative, very much appreciate your time. And look forward to seeing the story unfold. I guess sounds like next spring is – we have a lot more to learn then. So, thank you. Really appreciate it.

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## Lynn Antipas Tyson

*Executive Director, Investor Relations, Ford Motor Co.*

Thanks, Dan.

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## John T. Lawler

*Chief Financial Officer, Ford Motor Co.*

Thanks, Dan.

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## Marion B. Harris

*President & Chief Executive Officer, Ford Motor Credit Company, Ford Motor Co.*

Thanks, Dan.

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## Kumar Galhotra

*President-Americas & International Markets Group, Ford Motor Co.*

Thanks, Dan.

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## Dan Levy

*Analyst, Credit Suisse Securities (USA) LLC*

Great. Thanks. Okay. Operator, you can now disconnect. Thank you.

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