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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to Ford Motor Company's briefing on 2016 second-quarter financial results. (Operator Instructions)

Thank you. I would like to turn the conference over to Mr. Ted Cannis, Executive Director of Ford Investor Relations. Please go ahead, sir.

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

Thanks very much, Kayla. Good morning and welcome, everybody, for our second-quarter 2016 financial results. As a reminder, copies of the press release and the presentation slides are available on Ford's investor and media websites.

The results discussed today include some non-GAAP references and these are reconciled to the most comparable US GAAP measures in the appendix to the slides. Today's discussion include some forward-looking statements about our expectations for future performance. Actual results may vary and the most significant factors are included in our presentation.

As a reminder, Ford Credit will be holding a call at 11 today to review its second-quarter results and later today we will be filing our 10-Q.

As discussed in our July 15 Ford University presentation, we are no longer providing sector financial statements. Instead, as you'll see in the presentation and our 10-Q as well, we are reporting segments focusing on automotive, financial services, and other business activities. Prior period amounts have been revised to reflect our reportable segment change.

Presenting today are Mark Fields, our President and CEO, and Bob Shanks, our Chief Financial Officer. Also participating are John Lawler, Vice President and Controller; Neil Schloss, Vice President and Corporate Treasurer; Paul Andonian, Director of Accounting; and Marion Harris, our Ford Credit CFO.

Mark, over to you.

Mark Fields - *Ford Motor Company - President & CEO*

Thanks, Ted, and good morning, everyone. You can read our numbers and our comparisons with last year on slide 3, so what I would like to do is provide some context for the quarter.

Overall it was a strong quarter. In fact, it was one of our best second quarters ever. And while pretax profits are down compared with last year's record second quarter, revenue was up 6%, so we grew the top line.

Global market share declined outside of North America, but share was up in the US and Canada. Our automotive operating cash flow was an all-time quarterly record. Europe's pretax profit almost tripled from last year and North America and Ford Credit remained strong.

Now combined with our first-quarter record, we achieved record first-half pretax profit and operating margins for both the Company and for North America. Now we continue to expect another strong year and we are committed to our full-year guidance of company pretax profit and operating margin equal to or better than last year. But at the same time, we now see a number of risks that the entire Ford team is working hard to mitigate to achieve our guidance and we will explain more as we go through the information this morning.

Now turning to slide 4, we remain absolutely focused on the four drivers of shareholder value and I'm pleased to say we made progress on each. As I mentioned, we grew our top line and we announced actions to continue to grow our core business, including new global SUVs and also positive sales momentum at Lincoln.

We also continued to pursue emerging opportunities such as our investment in Pivotal, which will further strengthen our cloud-based software capabilities. Our returns were strong, as I just reviewed.

Now in terms of risk, we received a rating upgrade by Fitch. Our business units outside of North America, collectively, were profitable for the third consecutive quarter and we achieved $1.6 billion of cost performance in the first half versus our plan. And in terms of rewards, we distributed regular dividends of $600 million to our shareholders.

Now slide 5 shows some of the other highlights in the quarter, and I won't go through each of these, but as you can see, they span everything from awards for new products and engines to progress in our quality efforts to launches of products and connected services.

But I will just point out in quality, the J.D. Power IQS survey. Lincoln came in at number seven and Ford came in at number 11; both improved. And really puts an exclamation point on the efforts that our team has around continuously improving our quality for our customers.

Now let's turn to our view of the global business environment and how we see it on slide 6. At the macro level, we are seeing higher levels of economic uncertainty. Financial markets and the sterling and euro are affected by Brexit and global interest rates have been reverting to recent lows.

Now, US growth is improving after a weak start that we saw at the beginning of the year, but we are seeing signs of a maturing US recovery. We do expect continued growth in China, albeit that is supported by government stimulus measures, but we are also seeing increased pressures on margins. And while conditions in Brazil remain difficult, Russia is actually showing some signs of stabilization.

Now for Ford specifically, our risks are around lower pricing and higher incentives than we expected in the US and China; a softer, although still strong, US retail industry and the effects of Brexit on our operations in Europe; a more difficult external environment across many of our markets in Middle East and Africa; a weaker Chinese RMB; and lower-than-expected auction values for smaller vehicles leased in the US.

So with that I would like to have Bob take us through our performance and I will come back at the end and cover our outlook. Bob?

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

Thank you, Mark. We'll start on slide 8, which is our key financial summary, and what I would like to do is just highlight a few of the key metrics in the first column on the second quarter. And then I will do the same for the first-half period, which is the third column.

As Mark said, it was a strong quarter for us. And to demonstrate that, if we look at the company-adjusted pretax results, you can see $3 billion, which was down 9% from a year ago, but it was, as Mark said, one of the strongest second quarters that we've had. If you go down further to net income attributable to Ford at $2 billion, that was also down 9% and adjusted earnings per share down 4%.

If you go to the bottom of the chart, you can see the liquidity metrics. I will come back to those later, so I won't go through them individually at this point, but you can see they were very, very strong.

If you look at the year-to-date column, let's hit the same lines on the chart. Company-adjusted pretax results of $6.8 billion. Remember we had the best-ever first quarter, so when we combined that with this strong second quarter we ended up with a record for the first half, $6.8 billion; that was up 35%.

And net income of $4.4 billion, that was up 33%. Then the adjusted earnings per share for the first half of $1.20, up 45%.

Let's go on to the next slide, slide 9, and here what I want to focus on are the absolutes before we get into some of the details within both the Automotive segment and Ford Credit.

Looking at the Automotive segment you can see the strong result at North America, $2.7 billion. It was down about 5%. Europe was, clearly, a highlight among all the business units in the quarter. It was up 3 times from where we were last year, the best second-quarter result ever, and that included some impact from Brexit, which I will talk about in just a minute. But really a great result in Europe.

And if you look at Financial Services, that includes a $400 million profit from Ford Credit. It was down and I will explain what was behind that. If you look at the other business units, they were all in losses. South America at $265 million, down a little bit; Middle East and Africa down also at $65 million loss; and then we had our first loss in Asia Pacific in 13 quarters at $8 million. That decline was driven largely by China and we will talk about that later in the presentation as well.

I will highlight here All Other; that's one of our new segments. That is primarily in this quarter net interest expense.

Okay, let's go on to slide 10. And, as usual, we will look at the key metrics for the Automotive sector. Very strong absolutes across the board, but when you look at the comparisons versus last year some mixed results.

Wholesales flat. Revenue up 5%. Market share, Mark explained that, was down everywhere but in North America. And the operating margin was a strong 7.7% and the results at $2.8 billion. Then if you look at the very bottom of the page, we've provided you with the same metrics on the year-over-year changes for the first half and you can see very strong performance right across the board, with the exception of market share, where we were down just a touch.

Okay, let's go on to the next slide, slide 11, and we will start breaking the Automotive segment down. This is a view of what happened on a year-over-year basis that resulted in the decline of $130 million.

When you look at it overall you can see that market factors, which is volume, mix, and net pricing, was down and that was driven by higher incentives. And that was mainly in the US. We will talk about that when we get to the North American slides.

You can see exchange was an issue of $269 million. We did have some favorable cost performance and that was largely driven by commodities. And then in Other to the far right, that was largely the gain on sale of an equity investment I will touch on a bit when we get to North America.

Okay, let's go into North America on slide 12 and look at the key metrics. Again, very strong quarter for North America. The top line was essentially flat to very slightly up in the case of revenue.

Market share flat, but as was already mentioned, within that the US was up. And that was higher fleet performance, but also we had very strong retail share improvement for F-Series. Canada was up, Mexico was down; that's how we ended up with sort of flat on a year-over-year basis.

When you look at margin, 11.3%. That was down 0.9% but obviously it was over 11%. That's an outstanding level of efficiency and performance for the North American operations. And then $2.7 billion.

If you look down at the bottom of the slide, really strong results in the first half, best-ever for North America. We had very strong growth; we grew the share, 12.1% margin, and $5.8 billion in profit, up 31%. So really strong performance in the first half for North America.

All right, let's go to the next slide and look at what happened in the quarter.

On a year-over-year basis here, the story is largely around incentives. If you look at the market factors, you can see that they were down on a net basis driven by the incentives. Essentially what we are seeing is, over time and particularly as the US industry has started to plateau and we are starting to get to a more mature part of the economic cycle in the US, we've seen sort of a very gradual rising, very modestly rising level of incentives for the industry. And we have been increasing along with that.

Now, what you also have happening on a year-over-year basis, which is maybe a little unique to us, is the fact that a year ago we had very low incentives for the F-150. Because if you remember, we were coming out of the launch of Kansas City -- I think it was around May when we got to full production -- so we had very tight incentives, very high ATPs on F-150. We've become more normal, if you will.

We're still in a good position relative to our peer set within the -- particularly our domestic peers in terms of ATPs for F-150, as well as incentives, but there was a factor of that in our incentives as well. But there's no question that we've seen an increase and that is more than what we had expected when we developed our plan at the beginning of the year.

When you look at costs, we were favorable on costs overall. That was, again, driven by incentives -- rather commodities. Most of the good news on commodities in the Company occurred in North America. Then, to the far right, you can see the good news from that equity sale, which was the OEConnection sale that occurred in the quarter, and that benefited North America.

Before we leave the slide I just want to go back to mix. Mix is a very important part of the story across many of the business units, but certainly North America was one of the stronger stories. That's product mix in the case of North America. When I get to Europe, you're going to see the same thing along with good news on series mix and options.

A very important part of what's happening as we are seeing sort of the car recession, but this has actually been part of our strategy to focus on higher margin, more profitable vehicles, but also where the consumers are going.

The other thing I would just note on this slide is that we have picked up in warranty costs. You can see that in the callout box, the Takata recall. That was about $100 million.

And I just want to digress for just a moment to say our approach inside Ford is, unfortunately, recalls are a normal part of business. So we do not put recalls in special items or exclude them from margins or exclude them from operating results as some of our other competitors do. It is, again, unfortunately a normal part of business.

We will report them in operating results. We always have; we always will. And if there's something of consequence that occurs we will just call it out and you can make your own judgments in terms of whether that's a run rate or not. Certainly, they are lumpy.

Mark Fields - *Ford Motor Company - President & CEO*

Just a little bit more color on the US industry. Obviously, as Bob mentioned, is it still remains at fairly healthy levels overall. The competitive environment has increased as growth has slowed and the retail industry demand has weakened, as we saw in the second quarter. This has resulted in higher industry incentives with -- if you look at the retail industry sales rate, it actually declined three out of the last four months.

So the bottom line is that we've seen a tougher pricing environment this quarter and we will face one going forward. As Bob mentioned with the car segment, the most impact as various competitors look to protect their share.

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

Okay, let's move on to slide 14 and we will talk about South America.

In South America, this is a story that is very much what it has been the last number of quarters. External conditions, particularly in Brazil, continue to be pretty challenging. We saw a decline in the top line; you can see double digits.

In the case of revenue, you can see it was down 17%. That decline is entirely due to the weaker currencies. Market share was down as we focused on the most profitable parts of our portfolio amid increasing discounts across the industry. And then you can see the results in terms of margin and pretax results. This is largely what you are also seeing in the first half.

I will say that the team has done -- continues to do a good job of focusing on the things that it can manage, particularly on cost. And if you go to the next slide on slide 15, you can see the results of that. We, once again, delivered very strong cost performance.

If you think about last year we delivered over $400 million of good news on cost performance. We had good news in the first quarter, another good tranche of performance during the second quarter. But as you can see just to the left of that, we continued to see difficulties in pricing enough to be able to offset the effects of high local inflation and the weaker local currencies.

Industry still an issue, as you can see, in the volume and mix. Then the balance sheet actually helped us this time. This was the strengthening of the Argentinean peso. We are seeing good things in Argentina. The new government is really getting traction in terms of turning that economy in a better direction and so that gave us some good news in the quarter.

Okay, let's go on to Europe, which as I mentioned earlier, was a bright spot for us. If you looked at wholesales and revenue, up double digits. Share actually declined a little bit; that was market mix. The Southern European markets grew, if you will, disproportionately.

Our share performance there is a little below the average of what it is in Europe and so that affected us. Margin was 5.8%, which is very, very good performance, and the profit that I touched on earlier.

Then, if you look at the first half, we made $900 million in the quarter, a margin of 6%, and you can see very strong growth at the top line as well. And share was flat. So this was a really great story.

The other thing I want to highlight, we were committed to Russia. We stayed in Russia. We've been working to make sure that we are responding to the environment in Russia and it's paying off. Within the good news that we saw in the quarter, Russia was actually a good part of that.

And on that note, let's turn to the year over year on slide 17. You can see the improvement of $300 million. It was market performance; it was favorable cost performance.

And then, in the case of exchange -- this is the first time that you will see us talking about Brexit. We had bad news of about $60 million on the balance sheet related to the weak sterling.

One of the things that is important to note is that our strategy on hedging for the Company is to go in to a year with certain of our key currencies completely hedged from an operational exposure point of view. So we came into the year with the sterling and the euro completely hedged, so we don't see any issues relative to the weakness of the sterling on an operating basis for the balance of the year. We have about 60% of next year's exposure already covered and there's a little bit that also covered all the way out into 2018.

When we talk about Brexit effect later, you have to remember the $60 million because there is an impact in the second half that we will talk about that's related to a weaker industry.

Mark Fields - *Ford Motor Company - President & CEO*

Just a little more on the Brexit. Obviously, it's important because 30% of our sales in Europe are in the UK, so we are closely monitoring the situation and, of course, engaging with key stakeholders. That includes, as you can imagine, looking at consumer confidence levels, amongst other indicators.

And if you reflect, the industry back in the first quarter in the UK was at a record, but we saw that growth starting to decline in the second quarter ahead of the Brexit. So far as we look at July, by our reckoning, the industry is actually up in the UK, but on a retail basis it's down. So as we look going forward, the industry could be down 5% to 10% for the rest of the year depending on which outside forecast you look at.

But even within that, we will continue to work to deliver consistent market performance, including obviously continuing our strong growth in commercial vehicles.

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

This is probably the best place to talk about the ongoing effect of Brexit. We will talk about second half a little bit later in the presentation, but we are expecting to have headwinds of about $200 million this year associated with Brexit. It's a $60 million with another $140 million, $150 million related to a weaker UK industry.

When you get into 2017 and 2018, we see the impact on Ford as being somewhere in the range of $400 million to $500 million in each year. And that is related, again, to weak industry or weaker industry in the UK. And then also you start to pick up a little bit of bad news on exchange, because of the fact that the hedging is only 60% in place for next year and less than that in 2018.

So that's what we're looking at. We are not going beyond that in terms of what happens once they actually leave, because there's just too much uncertainty, particularly around what will happen with tariff barriers.

Okay? All right, let's go on and we will talk about the Middle East and Africa on slide 18.

This is a story of just a bad business environment. If anything can go wrong, it seems like it has. It's low oil. It's weak currency. It's just political strife. In South Africa we've seen labor disruptions. I mean it's just, you name it, it's happening.

And the results have been really weak industries. We're seeing declines of 30%, 40% in some of our markets. In some of the countries access to currency and so forth it's pretty difficult, but you can see the effect of that has only been a modest increase in the loss.

The team has actually done a great job of working on the costs it can control, because it does import most of the vehicles that it sells from other business units. But they've actually done a great job on cost and they have done a good job on pricing.

If you look at the market share, while it looks like it's down -- and in fact it is -- that is driven by the growth of the Iranian industry, which we don't participate in. The overall region is down 300,000 units. Within that, Iran is up [300,000].

So if we take Iran out, the team has actually increased our share by 0.6 points. So they are really doing a great job on share, on cost, but the headwinds across the region are just so large that we are kind of swimming in place at the moment.

Okay, let's go on to Asia Pacific. Asia Pacific is an interesting story. We saw a decline in wholesales. Some of that was expected because we did have a planned eight-week shutdown of our Chongqing 1 assembly plant that was for a complete overhaul of the paint booth there. So that was expected, but, frankly, there were performance issues at Ford as well. There were also issues in terms of industry segmentation that we will touch on.

If you look at revenue, revenue was up 17%. We did see a decline in market share -- that was China -- and if you look at the margins, obviously we were just below breakeven in margins and pretax results. And as I mentioned earlier, the first loss we've had in quite a number of quarters.

If you look at the year-to-date results, we've seen the top line grow with share as well, but again our operating margin and pretax results down from a year ago. I would highlight on the far right of the slide our China joint ventures, on an equity after-tax basis, contributed about $300 million of profit. That was down about 28%. We still had very healthy margins there at 16.1%. I think that was down about 1.2 points from where we were this time a year ago.

What we have on slide 20 is a bit of what happened in terms of market share in China in the period, which really drove what happened in the region. If you look at the far left, last year we did 5.3% China. We're down about 0.9 points and you can see the factors that drove that.

Half of it was basically external. Industry mix, what that means the mix of the industry was stronger in passenger vehicles; it was weaker on commercial vehicles. We have joint ventures that participate -- two different ones that participate in each one of those.

The segmentation issue is that within commercial vehicles it was down, but it was actually up in the very low margin mini commercial segment, which we don't participate in. So if you think about the part we participate in, it was even lower and so that was the effect that it had on our share from both the industry mix change and then the segmentation within commercial vehicles.

And then on performance, we were off 0.4 points and that was largely around weakness in the C segment and small utilities, where we are seeing a lot of competition from the domestics that are really coming up strongly and with really better products. And so it was a difficult situation for us.

We also had some go-to-market strategies, frankly, and the team immediately saw these issues there. They actually started to occur in March. Immediate action was taken to address these issues and you can see, looking at the share in April, May, and June, we started to get back on track. And we feel like the second half of the year is going to be better for us and supported in part by a number of new product launches that are important that will help us.

Mark Fields *- Ford Motor Company - President & CEO*

Just, again, a little bit more texture on that as we looked at the movement during the quarter. In terms of our performance, we have also focused on the quality of our market share. Our mix of more profitable vehicles, such as medium and large cars and SUVs and premium cars, now account for about 40% of our sales in China and that's up 5 points versus last year.

As Bob mentioned, we've taken actions to improve our market performance and we have a number of important launches: the Taurus with the 1.5-liter engine. It will be the only large car eligible for the purchase tax incentive. The new Kuga, the new Mondeo, Lincoln MKZ and Continental. And the majority of these launches will benefit us in the fourth quarter, not so much the third quarter.

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

Okay, let's go to slide 21 and we will see what happened in terms of the year-over-year results.

So I'm going to explain what you can see; I'm going to explain to you what we had expected, because it's relevant to what we just talked about. You can see market factors were slightly negative, both pricing and then you can see volume mix pretty flat.

Within that there actually was quite good news on mix, so with that mix and other it was more like around $60 million, $70 million of favorable mix. And that's along the lines of what Mark talked about.

When you look at the cost performance, it was up. We expected it to be up. It actually isn't up as much as what we had expected.

Then exchange, this is a story of a weaker renminbi. As Brexit has occurred and it affected the sterling and the euro, the Chinese are now targeting their currency against a basket of currencies, not just the dollar. As those weakened, we saw the Chinese start to push down the renminbi and the response to that, and that had an effect on us.

What we had expected to see in the quarter -- we didn't expect the loss obviously -- was the fact that we'd have stronger market factors. The net pricing in China has been worse than what we thought. We thought 5% to 6%; actually year-to-date it's approaching 7% or high 6%s. We are at about 7% or so.

We think this will mitigate in the balance of the year, because if you look at last year, the decline was largely from this point through the rest of the year. So we think it will mitigate and we will end up at the high end of that range. And when you look at the volume and mix, that was the share issue that we talked about.

So team is all over it; we're working on it. But that's really what happened to us in Asia Pacific in the quarter.

Let's go on to slide 22 and we will turn to Ford Credit. Ford Credit grew -- that's the first two metrics -- double digits and that was really around the world. If you look at the pretax results, the $400 million, that was down 21%. I'll show you why in just a minute.

If you look at the portfolio performance, very healthy. FICO scores in a good place. Delinquencies up a bit, although I will say something about that in just a minute in terms of credit losses.

And the loss receivables up 15 basis points, actually about where it has been the last two or three quarters. It's just up a bit from the last two or three, up more from a year ago, and starting to approach the level of LTR that we saw before the Great Recession. So this is just getting back to sort of normal levels; it's not an issue, per se.

Let's go on to the next slide and look at the year over year. The decline was largely around lease residuals and credit losses.

In terms of lease residuals, it's really two things and it's in the callout box. If you look at the residual gains and losses, you can see on the year-over-year basis the declines.

So these are vehicles that come back; do we lose money or do we gain money? We actually gained money on the returned vehicles in the quarter. We just didn't gain as much as we did a year ago, so that's how we ended up with the negative number.

And then in terms of supplemental depreciation, this is a reflection of lower auction values and a projection of lower lease-end values, particularly for smaller vehicles. We have adjusted our depreciation glide path to those new lower endpoints and that's what's reflected there.

When you look at the credit losses, this is largely around a couple of things. You can see the charge-offs. Those are the vehicles that we actually repossessed and then we took back to market and resold. You can see there was a decline there of $34 million and we had to increase the reserve by $31 million.

But the thing I wanted to mention on this is a number of things going on in here, but while the delinquencies are up a little bit, what we are seeing happen is that the number of people who actually default once they are delinquent, if you will, is increasing versus where it has been. It's not at a level that is of concern. It's actually just coming back again to a level that's more normal. I think there's been a number of articles from banks and others around that, but that's one of the factors.

The other thing is that the severity -- so when we do take them back to the auction market, the severities are greater. In part because of what I mentioned in terms of the lease-end values of the vehicles are lower overall, but also because of the longer terms, people are -- the portfolio, people are turning the vehicles a bit earlier and so the severities are greater. Because of all of those factors we also have had to increase the reserve, in addition to the fact the business is just bigger and so we have increase the reserve in line with just a larger business.

Okay, let's go to the next slide and this is looking at trends. I'm just going to talk to the two on the right. I think I have already covered -- two on the left. The two on the right I've covered.

We said in the first quarter that our lease penetration would decline. It did by 3 points in the second quarter. We think again for the full year it will be lower than it was in the first quarter, and you can see that we dropped a bit more than what the overall industry did.

Then the lower left, this around what we talked about, the auction values. This is a constant mix, so it's mix the same as the second quarter. You can see that we are pretty flat in terms of our values in the second quarter compared to the first, but down from where we were a year ago. And that's largely around the smaller vehicles.

Okay, let's turn now to cash flow. Cash flow a very, very good story for us in the quarter. It was the best ever in the quarter and the half, $4.2 billion operating the quarter, $6.9 billion in the half. It was driven by the profit, but also you can see that we had favorable working capital and we had favorable timing differences.

When we look at the full year, we do expect that the $6.9 billion will come down, so what we achieved in the first half will come down because we do see negative cash flow in the second quarter, largely driven by the third quarter. And we will come back to that just a minute. But we think largely this is around the fact that working capital and the favorable timing differences will reverse by the time we get to the end of the year.

I will note on this slide we're taking our capital spending projection down. The guidance had been $7.7 billion; we're taking that down to $7 billion. It's largely around efficiencies on programs that are coming to a conclusion and we're seeing we delivered them more efficiently. Also, lower non-product spending.

Okay, let's go to the balance sheet summary. This is a new slide we have developed just to capture all the balance sheet metrics.

The only thing I will say here is the automotive balance sheet is very, very strong. Ford Credit continues to be well-capitalized and strong, as well. And then finally, in terms of pensions, we're still on track to have the pensions largely funded and derisked by the end of the year.

Okay, now let's switch gears and let's talk more now about what lies ahead -- not only in the second half, but for the full year -- and we will touch very briefly on 2017. Of course, talk more about that at investor day in the middle of September.

What this slide basically says is, compared with our prior expectations, our prior guidance, when you look at GDP we now expect global US and Europe GDP to be somewhat softer than what we had expected. Brazil and China pretty much in line with what we've expected since the beginning of the year.

When we look industry volume, we do think the global industry volume is likely to be a bit higher than we had expected. That is driven by primarily China, but also Europe is doing a bit better than we had expected; at the high end of the range that we guided to earlier in the year.

The softness is in the US. That is largely on the retail side of the business and also in Brazil.

Now let's go on to two special attention slides that we provided to help you understand the second half, but also our view of the full-year. The first thing I want to highlight is when you look at the far left that's the $6.8 billion company profit in the first half. Record results, fantastic.

What is in there, though, is important to understand. A lot of the issues and risks that we will talk about for the full-year, they were there in the first half. They started to appear at the first quarter and then the second quarter unfolded. We offset those risks with $1.6 billion of favorable cost performance versus what we had expected at the beginning of the year.

It wasn't an easy quarter or easy half. We had to work to get there, but the important message of this is that those risks flow into the second half. So for us to deliver the guidance that we are committed to deliver for the full year, we have to do that all over again.

We're going to have to deliver stronger actions on cost. We're going to have to go back and look at the top line as well and find every dollar of revenue that we can get. That's what that next-to-last bar represents, the profit improvement actions. So we do that and we are committed to doing that; then we are able to deliver the guidance, which again we are committed to do. And that's what the right-hand bar reflects.

What we're highlighting in between there with the red bars are the factors that are going to drive to a lower second half than is normal. Second half is normally lower; that's what the first red bar represents. But there's some other actions in there that I won't go through individually, other than I will touch on Super Duty, that will give us a lower second half than what would be normal.

Super Duty is a very, very important product. It's high volume, it's very high margin. It's a big changeover because we have not had a complete redesign of this product for 19, 20 years. It's going into a big plant. It's aluminum. It's a new frame. It's powertrain upgrades. It's new features. It's new technologies.

We really haven't touched a lot of this product for 19 years, so when we make this change, obviously, it's going to have an impact in the quarter from the launch affect and so forth, the cost, but even as we go through the quarter, we expect to have some impact because we do think we will have lower contribution margins coming out of this than what we had going in. Still very high contribution margins, among the best in the portfolio.

But the new product, which will be far superior than the one that we have today and certainly position the product to be a winner and a leader over the next decade and meet the regulatory requirements that we have to meet -- there will be lower contribution margins when we come out of the launch and that will flow through into the fourth quarter and the full years. Now what will happen over time is we will start to get the cost reductions which we normally get, which is what benefited the older F-Series over the course of that 19 year cycle. But it will also drive a weaker-than-normal third quarter, along with some of these other factors.

So to put that into context, usually the third quarter is about a quarter of our full-year results. It's likely to be half of that or lower and that's largely around the F-Series effect.

Let's go to the next slide. Some of those risks that we talked about that were in the first quarter largely -- or first half and that flow through into the year are shown here. It's around higher Ford and industry incentives. We've talked about that. They are up; we're up in line with that. The weakness or the softness in the US retail industry; we see the second half actually being softer than the first half on an absolute basis. Again, that is retail.

These are absolutely strong levels. They're just not as strong as what we had expected. In fact, looking into 2017 we think that we will see further softness as the cycle matures.

If you go down the page, Middle East and Africa, I've already talked about it. That's going to continue, the situation that we are facing. We are responding to that.

In Asia Pacific the higher -- the lower net pricing, the weaker exchange. We saw that; we're still dealing with it. And then Ford Credit, we have addressed the US auction values, but it will give us a lower second half, in line with what we saw in the first half when we earned over $900 million.

The opportunity is Europe. We made a lot of money in Europe in the first half. Clearly have opportunity versus what we had expected at the beginning of the year, but we have to deal with Brexit. And we talked about that already.

So we see these risks. We have seen them since the beginning of the year. We've been dealing with them very successfully. We will do so in the second half, but that is work that is still yet ahead of us.

Mark will talk to that in his comments, which I will turn over to him now.

Mark Fields - *Ford Motor Company - President & CEO*

Great. Thanks, Bob. As you can see on slide 30, we remain committed to our 2016 guidance. As we mentioned, we are facing risks to achieving that.

Now I would like to talk about what we're going to do about it. If you go to slide 31, it shows you the improvement actions that we already have underway in the Company.

To start, as we match production to demand and be very consistent around that, that will help reduce manufacturing costs. We have implemented an aggressive company-wide attack plan on costs and, as Bob mentioned, it builds on the considerable cost progress that we achieved in the first half of the year with that $1.6 billion in cost improvements we delivered versus our plan. As you can imagine, it looks at everything from material costs to marketing and selling efficiencies to freight and admin reductions.

Now, at the same time, we have to put special attention on our go-to-market plans in the US and China to deliver even more revenue and cost opportunities. In addition, we are also utilizing our expanded data and analytics team to really pinpoint immediate areas of improvement in our market factors, including better volume and mix and pricing, which will in turn drive revenue.

And then, finally, we have a number of significant vehicle launches around the world this year. And we are challenging our team to deliver even more revenue and cost opportunities as we launch those vehicles and take advantage of those launches. So we are aggressively executing on all these actions and, of course, we will provide an update on our progress during our investor day on September 14.

In summary, and in turning to slide 32, again I would like to put the quarter in context for you. We had a strong second quarter. We had record cash flow and we had a record start to this year. At the same time, we are seeing more pressure throughout the business for the remainder of the year.

Now some of it, as we discussed, is expected, such as the launch of the Super Duty in North America, and some of it is not expected, such as the higher Ford and industry incentives in North America, a softening of the US retail industry, and uncertainty in Europe due to the Brexit effects. As a result, we are calling the second half of this year, and particularly the third quarter, to be much weaker than normal.

Now I just want to caution you against using the second half of the year as an indicative run rate for 2017. It isn't. We expect 2017 to be another solid year for Ford, despite the likely absence of growth in the US industry volume and Brexit effects in Europe.

Now I think you know us very well. The Ford team remains committed to delivering our plan for this year but we also have a long track record of calling risks as soon as we see them and acting decisively to deal with them. And that is exactly what we are doing today.

So with that we would love to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Brian Johnson, Barclays.

Brian Johnson - *Barclays Capital - Analyst*

Good morning. Want to talk a little bit about North America. A couple of related questions.

First, we talk about the inventory situation at the end of 1Q. Certainly we tracked how it's developing during 2Q and, even backing out Super Duty safety stocks, it looked like coming into the quarter there was a fair amount of inventory. How much of the incentive activity has been related to working that down and perhaps versus sort of broader trends? Then what's your thinking on the trajectory of industry sales, particularly retail sales, through the second half and into 2017?

Mark Fields - *Ford Motor Company - President & CEO*

Brian, let me take the second half of your question. Bob will take the first one on industry sales.

Here's how I think we'd characterize the market. If you recall, vehicle sales for the industry grew at a really good pace in the early stages of the economic recovery. And if you recall, it actually outpaced the overall economic growth at the time.

So while the industry remains at fairly healthy levels, the competitive environment has intensified as that growth has moderated and as we've seen some of the softness in the retail demand. In that environment, you have seen, as we said, incentives creep up and we have been about in line with that.

But also I think what it will result in probably for the remainder of this year, Brian, is a fairly volatile kind of SAAR factor from month-to-month, because that will be influenced by any particular OEM or brand that wants to increase their incentives to maybe juice their market share or whatever.

As we get in -- the bottom line is we expect in the second half of this year the retail industry to be lower than the year ago. As we get into 2017, obviously we will talk more about that in the future, but as Bob mentioned, we do expect the industry to be probably slightly down in 2017.

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

Brian, on your question around the inventory and our incentives related to that, I go back to what we talked about at first quarter and also the Let's Chat that we had in March. We knew that we would be at higher levels of inventory as we were -- particularly in the early part of the year because of two factors. One, we had to prepare for the Super Duty launch, which we touched on, and also because of the fact that many of our plants are running at three crews.

And so, as a result, there will be periods where it's low absolute volume months where the inventory will be, from a days' supply level, high, but it's to support the higher-volume months of the year, particularly in the spring and the end of the year, end of the summer, and so forth. So we are comfortable with the levels that we have been at.

The things that's kind of interesting in terms of responding to the softness, it has not been around incentives. It has been making production adjustments. Because if you look in the first half at -- you wouldn't see this, but I'm telling you this. If you looked at the wholesales that we had planned, they are higher or were higher than what we actually delivered.

Because even as we saw some of the softness that we've talked about occur in the first half of the year, Joe Hinrichs and the team were making production adjustments along the way, so we ended up with lower wholesales in the half than what we had expected. That's how we primarily deal with that is just adjusting production to demand and that's what we will do in the second half, which is what Mark talked about in his comments.

So the incentives I think are different. The incentives are really sort of an environmental issue, if you will, across the industry. And then, for us, I think there's a piece of what I talked about earlier around the normalization in this period versus a year ago of F-150.

Brian Johnson - *Barclays Capital - Analyst*

Okay, just a quick follow-up. When you talk about incentives, I guess a housekeeping. Are the incentives adjustment you made here just based purely on what happened in the quarter? Are you at all forward-looking into the amount of incentives that would have been either anticipated for 3Q or booked or in place on June 30, continuing into July?

Then second, just broadly, are you seeing the SUV -- I actually mean CV market beginning to see greater incentive activity, not just the sedan market?

Mark Fields - *Ford Motor Company - President & CEO*

When you look at it overall going forward, as we said, Brian, one of the risks that we are calling out is lower pricing and higher incentives here in the US. And that's based on the softness that we are seeing in the retail market.

As you look at the data across the industry, cars, utilities, and trucks, you can see, as a percent of the transaction price, all of them are going up. Cars the most because of what's happening with the segmentation. In terms of commercial vehicles, not so much. That's still relatively balanced.

Brian Johnson - *Barclays Capital - Analyst*

Okay, thanks.

Operator

Joseph Spak, RBC Capital Markets.

Joseph Spak - *RBC Capital Markets - Analyst*

Thanks for taking a question. First one is, Bob, you made a comment about looking for every dollar on the revenue side. So in light of a higher incentive environment, I guess one way is to just move a little bit more volume. Can you just talk about the go-forward sort of discipline on incentives in the US environment?

Mark Fields - *Ford Motor Company - President & CEO*

Thanks, Joe. We're going to stay very disciplined in matching production to demand. When you look at our approach going forward, as we mentioned, you will see some production adjustments in the second half and in the third quarter. And that's based on the fact -- our view of what we see as the retail industry going forward.

So we are just going to stay very disciplined around that, Joe.

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

Joe, I would just add: there are a lot of ways to get an extra dollar out of revenue and mix is a really, really important one. If you look at the Automotive segment and the year-over-year change, we picked up over $700 million of good news just from product mix with a little bit of good news in series mix and options. That's something that we are very focused on. It's been part of our strategy in North America, in Europe, in Asia Pacific; Mark touched on it.

The other thing I don't want to leave unsaid, the great work that our global data insight and analytics team is doing. We are bringing new analytical tools to the table to help the marketing sales teams be really focused and targeted in terms of where to find that extra dollar that's sitting there but maybe we are not capturing it because of lack of insight in terms of the specificity with which we can put all the tools together to get it and bring it back home. And that's exactly what that team has been helping us do, particularly in the US, but now starting to do so in Europe and China as well.

Joseph Spak - *RBC Capital Markets - Analyst*

I guess just following on that conversation, you're talking about the US environment that's a little bit tougher, maybe slightly down, but the guidance in the back half in North America implies something about 6.5%, as you mentioned, sort of pricing and incentive way a little bit. So I guess given what you are seeing from an industry perspective in just a little bit of a tougher environment, does that give you any pause for your breakeven analysis longer term? Or are we maybe -- am I underestimating the impact of Super Duty in the back half?

Maybe you could give a better sense of what you think margins would be in the back half if you didn't have the Super Duty changeover.

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

I'm not going to go there in terms of giving you a view on margins. I think, clearly, they will be lower. There's no question about that, because the second half will be lower; they usually are lower in the second half. This will be a weaker-than-normal second half, so that is what's going to happen.

I would just go back to 2014. If you think about 2014, North America had lower margins than it had been running at because of the launch of F-150 and they bounced back up in 2015, particularly the second half, and then early this year.

So what we are seeing is a really big launch. It's not going to take as much volume out as those launches did because we've learned so much from them, but it's a really big launch and it's going to have an effect. It's really around all these other issues and the softening of the industry, the higher incentives. Those are the things that we are working on.

And I would actually call them early signs of the maturation of the cycle. The structure that we have put in place in North America was designed to give us good results and good performance when things get tough and it is getting a little bit tougher. That's what we are seeing.

But I think the structure of the business is good and, oh, by the way, remember that $1.6 billion of cost performance we talked about? A lot of that was delivered in North America. So we are keeping up, if you will, in terms of the structure of the business with what we are seeing happen. So I think we're in good shape in terms of the robustness of their structure and prepared for that eventual downturn.

Joseph Spak - *RBC Capital Markets - Analyst*

Okay, thanks.

Operator

Adam Jonas, Morgan Stanley.

Adam Jonas - *Morgan Stanley - Analyst*

Thanks and good morning, everyone. You probably saw Fiat Chrysler is ending the production of all cars in the US by Q1 2017 on the grounds that they couldn't justify the use of capital for products they don't make any money on.

Now, while recognizing that Ford is on a completely different level of scale of passenger cars in the US vis-a-vis Sergio's house, are you at least somewhat sympathetic to what Mr. Marcchione is saying? How much money do you actually make in small and midsize cars in the US and can one make the case that, over time, Ford, too, could be carless in your US plants?

Mark Fields - *Ford Motor Company - President & CEO*

I think overall, as you can expect, Adam, we look at how we spend our capital very, very carefully to make sure that we are earning a good return on it. When it comes to our portfolio, we have said very clearly it's important to have a full portfolio. And cars -- in particular to adjust to any changes we see in consumer demand, in terms of the economy, in terms of the regulatory environment.

So those are just a few of the things that we look at as we are making investment decisions across our portfolios, including small vehicles.

Adam Jonas - *Morgan Stanley - Analyst*

The second question is on Ford's strategic position in small downsized engine and fuel-efficient vehicles. The emphasis on smaller, lighter, and more fuel-efficient vehicles, we know that all good auto companies with an eye on the long term have to do this type of thing. It's certainly existential, but thinking near term is this strategy -- it seems to work a lot better when oil is $100 a gallon -- or oil is $100 a barrel or gas is $4 a gallon.

I'm just curious if you see any link between fuel prices and consumer buying preferences that could be creating some near-term headwinds to that strategy, even recognizing it's the right one longer term. Thanks.

Mark Fields - *Ford Motor Company - President & CEO*

Thanks, Adam. As usual, we have to live in today and we have to take a long-term view. But overall what we are seeing is, literally, across every segment, whether gas is $4 a gallon or whether it's $1.50 a gallon, fuel economy is still an important purchase criteria for folks because they have long memories.

And so what we are seeing in terms of the take-up of our EcoBoost engines and the take-up of our smaller displacement engines, like our 1-liter which has won international engine of the year for like five years in a row, we are seeing very, very good take-up of that. And we think going forward that is exactly the right strategy.

Yes, you could have some customers on the margin that say, well, gas is low so I will purchase a bigger engine. For the most part, whatever they purchase they want good fuel economy here in the US and globally.

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

Adam, I just would add that we are a global enterprise; almost half of our volume is outside the United States. Due to taxation approaches outside the United States, the fact that oil prices are low has not really changed gas prices. So it is an extremely important consideration outside. It's an important part of what we have to do, not only here, but also in serving customer demands elsewhere in the world.

Adam Jonas - *Morgan Stanley - Analyst*

Thank you, Mark and Bob. One quick one, a third one; sorry. Do you guys think autonomous cars are a little bit overhyped in the market here? That's it, thanks very much.

Mark Fields - *Ford Motor Company - President & CEO*

Do I think they are overhyped in terms of the level?

Adam Jonas - *Morgan Stanley - Analyst*

In terms of media perception and the type of activities you are seeing from your competitors in acquiring assets and building them and the amount of press releases and CNBC time devoted to the topic. Just more of a market commentary. Just curious of your opinion, thank you.

Mark Fields - *Ford Motor Company - President & CEO*

As you know, we are working very hard on autonomous vehicles. Listen, whenever there is something new and shiny and sexy I think sometimes the media does tend to write about things maybe in flourishing ways.

We're just going to stay very focused on our plan. And as you know, as a company -- there's a lot of announcements going on right now by a lot of competitors and I just want to be really clear, we are not in a race to make announcements. We are in a race to do what is right and best for our customers and best for our business, period.

Adam Jonas - *Morgan Stanley - Analyst*

Thank you.

Operator

Colin Langan, UBS.

Colin Langan - *UBS - Analyst*

Great, thanks for taking my question. It's very helpful to see the first-half versus second-half walk, but when we think about it year over year, mentioned earlier it seems like a pretty massive year-over-year deterioration. I think almost like $2 billion and I remember last year you had UAW signing bonuses in Q4.

Can you help maybe bucket on a year-over-year basis the big items that are dragging things down? Obviously, Super Duty would be one. I mean it doesn't -- you actually did take-up full-year production. I don't know how that is looking into H2.

And then commodities that you mentioned getting [worse in] the first half, is that actually going to be a drag year over year? What are the big items that are causing this?

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

I guess the first thing I just want to correct you on, there's no down, because if there was a down we're not baking it in our guidance. Our guidance is equal to or improved on what we did last year, so our expectation and our commitment is that is not what's going to happen.

Now we have risks that we have to mitigate, which is what we talked about throughout the call, but our commitment is that we will, as we did in the first half, we will find ways to improve. So that is not the plan; that's not where we would expect to end up or hope to end up.

But to your question, Colin, what you will see overall, particularly in the second half, you will see a bigger-than-normal cost increase. And that will also be something that you will see for the full year.

We had great performance on a year-over-year basis in the first half. Some of that is because it was a relatively quiet product period for us, if you will, overall globally. But when we get into the second half we have the Super Duty, we've got the Continental. We have some of the launches in North America that will take place in China.

But very importantly, and we will talk more about this when we get to investor day, that was one of the bars on that waterfall chart which was around product investment. We have been seeing an increase in product investment from Ford over the last number of years actually. As we got bigger, we expanded the portfolio, invested more in technologies. We went into new markets. We added capacity, particularly in emerging markets.

Going forward, we're going to be completely replacing the C platform. We're going to be completely replacing the C/D platform. We are investing heavily in electrification. Adam's point around autonomous vehicles, that's underway as we speak. There's regulatory requirements that we have to meet, which bring with it added investment as well.

So you will see an increase in both capital spending and engineering, and you see some of that even in the second half relative to the first half because what we're showing you is an increase that is higher than normal. Normally if we see that happen, it's even higher than normal, and as we go into next year that will be a factor. So you will see higher cost overall in the year versus a year ago that will largely occur in the second half of the year.

But we don't expect to be down by the time we get to the end of the year. That's the risk, but our commitment is to offset that.

Mark Fields - *Ford Motor Company - President & CEO*

Just one other thing. The other thing that is affecting us half to half is, as I mentioned earlier in the year from some of our fleet sales, particularly rental car sales, they were very frontloaded because the rental companies wanted to buy at the beginning of the model year. So I think it's about -- half to half, it's about 170,000-ish less wholesales, if you will, because of the fleet.

Colin Langan - *UBS - Analyst*

Got it. Kind of related, you mentioned in the first half there was $1.6 billion in costs to offset headwinds. What are the major headwinds, just so I'm clear? Is it really pricing and FX issues? Are those the issues? It seemed like they actually came in better in the first half. (multiple speakers)

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

If you look at that slide that shows the full-year outlook and then shows the arrows up and down by region, most of those -- slide 29 -- most of those issues were actually in the first half as well. The incentives in the US; the industry in the US on the retail side was weaker than what we had expected; the external issues in Middle East and Africa; the pricing in Asia Pacific in China, we talked about that specifically in the quarter; the weaker exchange; the auction values -- all of that was in the first half. It will flow through into the second half.

We offset it in the first. We are committed to offsetting it in the second along with Brexit issues, which are unique to the second half. So that's what we were talking about and conveying.

Colin Langan - *UBS - Analyst*

Got it, and just one last question. On slide 13 there's that $1 billion-ish of incentive. I remember last quarter there was a big chunk related to the F-150 sort of catch up and it was around I think $500 million. Is that an issue again in that big number? And is that (multiple speakers)?

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

No, that was more of a stock accrual effect in the first quarter. I think there is maybe a little bit of that in the second quarter, but nothing like what it was in the first quarter. It's more normal, if you will.

Colin Langan - *UBS - Analyst*

Okay. All right, thank you so much.

Operator

John Murphy, Bank of America Merrill Lynch.

John Murphy - *BofA Merrill Lynch - Analyst*

Good morning, guys. Just a follow-up sort of on the pricing and incentive discussion in the US. It sounds like the environment is getting a bit tougher, but I was just wondering if you could demarcate or parse it out via cars and trucks.

And given the Cap Ute (capacity utilization) levels on CUVs and trucks are very high in the plant level and inventory is, in particularly, high, it just seems curious that there would be real pressure on pricing there. I can understand the car side, but just trying to understand where you're seeing this in the model mix as well as why you think this is coming in at this time.

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

Well, we've seen it across all the sectors. It hasn't been unique to any particular sector. As Mark mentioned, it has been particularly prevalent in cars because -- I can't remember who used the term, but car recession. I think that's a good way of thinking about it actually. We have seen that and that has had an impact in that segment.

But, frankly, it's been across the board. It's just been a slow, very modest, increasing level of incentives across the industry that's affecting the industry. So I wouldn't call out any particular segment, frankly.

John Murphy - *BofA Merrill Lynch - Analyst*

Okay. Then just a second question, Bob. You alluded to the Super Duty having a lower contribution margin. Is that really just around the launch and the early days and, as you get a few years in, you think it might have a similar contribution margin as the old Super Duty? Or is there something structural that's going on with the truck and the content in it that would provide --?

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

No, it's not structural. Your question is spot on. We have cost reduced the Super Duty for 19 years, if you will. Obviously, we did some things. There were some moderate changes along the way, powertrains and so forth. It's not like we didn't do anything, but we did -- but we haven't done a ground-up and this is what this is.

If you think about it, almost all the parts are going to be new or carry across from the F-150, so we're going to get a scale benefit because of the strategy that we are deploying. But you're right; what will happen once we get into production, we will start to benefit from cost reductions on the new parts. But not only will Super Duty benefit, so will F-150 because of the carry-across commonality between the two.

Mark Fields - *Ford Motor Company - President & CEO*

Just the flipside of that, John, just speaking about the revenue for a moment. In this segment, in the full-sized pickup segment, people pay -- our customers pay for capability. We talked about that when we launched the F-150 and we've seen that across the board in terms of our ATPs, in terms of our lowest levels of incentives versus the competition. People pay for capability.

And when you look at the investments that we've made in the new Super Duty, because it is going to be the most capable, we think that is going to pay benefits on the revenue side of it. And as Bob mentioned earlier, we invested in this platform for a cycle, not just a freshening, in terms of capability, meeting fuel economy requirements, etc.

We took the long view on this. We've made the investment and I think it will pay benefits for us over the next good number of years.

John Murphy - *BofA Merrill Lynch - Analyst*

That's incredibly helpful. Then just lastly, and I know you guys very much do care about shareholder returns and the stock price, so I don't mean to -- this is an interesting question.

As you look at all the things that you have to deal with fundamentally in the business and all the issues that you are facing -- and opportunities, which there's a lot of good stuff out there -- do you table your view on what's happening with the stock in the short term and just look at this and say, we've got to execute through the cycle and on the other side of the cycle we will ultimately get paid for this? And you kind of put that view of the volatility in the stock aside for now?

I'm just curious, because the stock is having some wild swings here and I'm just curious how you are thinking about it. Do you react to that or you just say we've got to keep executing; we will get through the other side of the cycle after we go through a downturn and the stock will be rewarded at that point for it?

Mark Fields - *Ford Motor Company - President & CEO*

I think it's kind of like when you're having a bad golf game, you just kind of play through it. And I think in our case we are going to stay really focused on just delivering the business and, of course, the stock price is very important to us.

But, again, I get back to those four elements that we showed in one of the charts. We review that with our team every single week: how are we doing on growth, on returns, on derisking the business, and on providing rewards for our shareholders.

John Murphy - *BofA Merrill Lynch - Analyst*

That's very good to hear. Thank you very much.

Operator

Itay Michaeli, Citi.

Itay Michaeli - *Citigroup - Analyst*

Great, thanks. Good morning, everyone. Just on North America, as we look at the changing business climate that you described, I'm curious on a normalized year basis, clearly after you get through Super Duty and seasonality in the second half of the year, how you're thinking about margins there relative -- I think the prior communication was that 8% to 10% range in North America. Just curious on the latest thoughts on that range.

Mark Fields - *Ford Motor Company - President & CEO*

That has not changed, Itay. That continues to remain our goal is 8% to 10%.

Itay Michaeli - *Citigroup - Analyst*

Okay. And then if we think about the competitive environment, does it all change your plans or potentially could change your plans to increase capacity in North America around 2018 or is that plan still intact?

Mark Fields - *Ford Motor Company - President & CEO*

Well, our plans remain intact, as we've talked about. Part of -- as we look forward and as we've talked about, we're going to be introducing four new SUVs into segments that we don't compete in today. And as you know, we've made the announcement to build a plant down in Mexico for small vehicles. So we are pretty comfortable with the plans that we have laid out and we've talked about before.

Itay Michaeli - *Citigroup - Analyst*

Great. Then just lastly, are most of the second-half mitigating factors in North America? And if so, what are the puts and takes in the Asia Pacific outlook for the Company in the second half of the year?

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

Again, if you look at the slide, I'd say in terms of magnitude, yes, North America, but we also highlighted the risk in Middle East and Africa. Although a small region for us, we had expected a profit. We're a loss for the first half, so if you think about that for the full year, that's an offset that we have to create.

Asia Pacific we think that we have got a plan to get us moving in a more positive direction than certainly we were for the first half. But in terms of magnitude, it's really North America. And when I say North America, I think you put Ford Credit with it because this is around US -- auction values in the US, so it's largely around the US actually.

Mark Fields - *Ford Motor Company - President & CEO*

Just, again, a little bit more color on what we are doing in China in terms of what you asked. Clearly, as Bob mentioned, we had some sales operation issues which the team has gotten a hold of. But as you look at the launches, the product launches in the second half of the year -- and as I said, most of these will benefit fully in the fourth quarter -- it's not only the launches that I mentioned, the Taurus with the 1.5-liter engine and Mondeo and Kuga -- but we are going to have improved availability of our 2-liter version of the Edge.

The Edge has done extremely well in China. People are really clamoring for the 2-liter engine. We've broken through some capacity constraints recently, so we will have better availability of that that plays into the growing segment. We'll have better availability of Explorer.

But also, on the cost side, Bob mentioned we faced competitive pressure in the C segment and that -- a lot of that is from the domestic competitors. We have had an intensive focus on our Escort and our EcoSport in terms of attacking material costs. And you will see that play out during the second half of this year.

Itay Michaeli - *Citigroup - Analyst*

That's very helpful. Thanks, Mark and Bob.

Operator

Ryan Brinkman, JPMorgan.

Ryan Brinkman - *JPMorgan - Analyst*

Good morning, thanks for taking my question. So question is on Asia Pacific outside of China. If you look at slide 19, still extremely strong margin in China. I think the implication here is that the consolidated operations outside of China lost maybe a little over $300 million in 2Q or upwards of $1.2 billion annualized.

Firstly, what drove that softer performance? And then how should we think about it moving forward? Should the losses start to mitigate as Australia manufacturing winds down?

Then I can't imagine all of that relates to Australia obviously, so are there additional actions that you need to be taking or are already starting to take, maybe in India or Thailand, for example?

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

Let me take that one. When you look at the loss for the quarter, the JVs generated the $295 million, but there are other -- I've mentioned this every quarter. There are other parts of total China. You've got Lincoln, you've got the Ford imports, you've also got engineering that Ford is incurring that the JVs payback through royalties once the vehicles are in production. So those sort of sit in a central pot, if you will, in Ford of China.

Actually, when you look at overall what happened on a year-over-year basis, most of the decline actually was in China. Some of that was at the JVs. We talked about the 28% decline, but it was the other factors as well.

When you look at the balance of Asia Pacific, on a year-over-year basis it was largely -- the Indian operations was a factor, but that was very much in line with our plan. In fact, when you think about what happened versus what we expected, the operations outside of China in the second quarter did a bit better than what we had expected. It really was around China.

Ryan Brinkman - *JPMorgan - Analyst*

Okay, that's very helpful.

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

Bigger China; not just the JVs, but bigger China.

Ryan Brinkman - *JPMorgan - Analyst*

Then just last question on Brexit again, thanks for the color that you did provide. I think might be a little harder, likely too soon to say, but at this point is there any reason to reevaluate or need to reevaluate the 3% to 5% pretax margin that was indicated by I think 2020 at the 2014 analyst day, or more recently, some of the discussion about 6% to 8% margin longer term in the region?

Mark Fields - *Ford Motor Company - President & CEO*

We are still shooting for those, Ryan. Clearly, as I said, as a team you know us; we're going to look at what the world throws at us and we're going to act decisively on it. So we are going to have to see how Brexit plays out, but it will just provide more motivation for the team in terms of keeping us competitive and also at the same time putting us on that path to sustained profitability as we think about Brexit.

This is going to play out. It's not only an issue of seeing how this plays out and what the trading relationships are going to -- how they are going to play out, but it's also the timing. Because clearly, once they start the clock on the Brexit negotiations, it's about two years so we have to look at all that.

We are scenario planning, but we are accounting for Brexit in the results that we have shown here in the outlook and we will talk about that at the investor day as well. We will put that all in there.

Ryan Brinkman - *JPMorgan - Analyst*

Okay, thanks a lot.

Operator

Pat Archambault, Goldman Sachs.

Pat Archambault - *Goldman Sachs - Analyst*

Thanks for squeezing me in. Just I guess a follow-up on China. It sounds like you are expecting a sequential improvement and let's just go through that. Is that both year on year as well as sequentially from first half to second half?

Then, as we think about the list of items, there has to be a pretty big impact from the non-recurrence of that downtime at that one large plant. You talked about product. And then on slide 20 it does seem like while pricing is still negative from April to June, your slide makes the point that it has moderated. Just wanted to see if we were tabulating all the items and thinking about that correctly.

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

I think what you should expect to see in the second half I think we will have a very strong fourth quarter, as we did last year, in China. Some of that is just seasonal as you start to build to prepare for the Chinese New Year the following -- early in the year, but also it's timed to the product launches.

So I think when you think about the profitability in the second half from Asia Pacific, which -- and of course, China still drives much of that, I would think it to be concentrated largely in the fourth quarter.

Pat Archambault - *Goldman Sachs - Analyst*

And the items that we listed off, those are the ones, right? Basically product, pricing being bad but not as bad, and the lack of downtime I guess?

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

We do think that the negative pricing we have seen year to date will start to moderate. And that's in part because of the comp from last year is a bit different in the second half than it was in the first half.

Pat Archambault - *Goldman Sachs - Analyst*

Got you. Then just my last question is Brazil and South America, specifically. It is an unusual thing to ask a question about upside risk and potential improvement, but you cited improving fundamentals in Argentina. And then also Brazil, strangely enough, has seen a second derivative improvement across most of its macro metrics and currency has started to appreciate.

So maybe just your perspective on how that plays into your outlook there. Maybe it's a little bit too early to think about changing things.

Mark Fields - *Ford Motor Company - President & CEO*

I think it's a little bit too early because, despite some of the things that you mentioned, we have not seen the improvement in the SAAR factors and in the sales, as you saw from the data. That really has to ultimately start playing itself out in consumer confidence and into industry sales, and we're not seeing that yet.

Pat Archambault - *Goldman Sachs - Analyst*

Got it. Even from a currency side you are -- I guess it's just too nascent I suppose?

Mark Fields - *Ford Motor Company - President & CEO*

Yes.

Pat Archambault - *Goldman Sachs - Analyst*

Okay, all right. That's all I had for you guys, thanks.

Operator

Rod Lache, Deutsche Bank.

Rod Lache - *Deutsche Bank - Analyst*

A couple things on North America and one on China. Just first, at a very high level, could you just give us what your perspective is on what is driving the moderation in the North American retail market versus the run rate we were seeing in the back half?

And then, more generally, there was a thematic view that automakers would be more price disciplined as demand moderates given all the capacity changes and structural changes in the market. But obviously here we are looking at a 3% price decline year over year with very slight moderation in volume and I know part of that for you was the F-Series.

But how should we be thinking about the trajectory of price deflation that you would be expecting in a North American plateau? And can you give us a little bit more color on what you expect for pricing in the back half?

Mark Fields - *Ford Motor Company - President & CEO*

Let me take the first half of the question on what's driving the moderation. I think it's a number of different things. Obviously, Rod, you've seen, as I mentioned earlier, that pent-up demand go away so now it's really about replacement value. In addition, you've seen used-car prices go down and when used car prices go down obviously there's an impact on the new car market.

Then when you look at some of the elements that are driving the retail business: there's been extended payments, there's been higher leasing, the low interest rates. That plays itself out over time and you can see our strategy around that, particularly in some of the leasing numbers that Bob showed earlier. So I think those are some of the factors.

Probably there might be a factor of the noise that's going on right now around -- here in the US around elections and what that means, because there's lots of things being said that could impact it as well.

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

Rod, on the question of price discipline, that's a very, very good question. I actually think the industry continues to be quite disciplined, so I think we need to put in context what's happened.

I think we are in transition. If you go back and think about what's happened since 2009, the industry has grown way in excess of GDP over that period of time and so we've all benefited from very, very robust growth of the industry. It is now plateauing and I think the industry and all the players in the industry, we have to kind of pivot. We have to transition and I think that's what's occurring.

The reason I'm encouraged by -- encouraged to think that that will occur successfully is the fact that not only us, but everyone, all the big players, are very, very focused on margins. They know that's important. They know that's what counts. They are focused on that and I really believe that, ultimately, that will be the driver of decisions around how aggressively people go after a pie that isn't growing, frankly, anymore.

The other thing that's probably different than it has been over the last two or three years is the yen. The yen has started to strengthen from the levels it had reached. I think it to about a [JPY120] level. It's been JPY100, JPY103, JPY105. That certainly puts some constraints on the Japanese participants in the market in terms of maybe some of the benefits and the windfalls of the weaker yen that they were deploying that just isn't there anymore.

So I think it will probably take some time, but I think that the discipline that we have seen will stick and we will get used to the new environment.

Rod Lache - *Deutsche Bank - Analyst*

That will play out over time?

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

It will play out, yes. It's not going to happen overnight, obviously, here.

Rod Lache - *Deutsche Bank - Analyst*

Can you give us any color on expectations for pricing in the back half? And then on China, the pricing was effectively down 6%, even with the 500 basis point decline in the taxes, which is effectively another price cut for consumers. I know the comps get easier in the back half of 2016 versus the back half of 2015, but is there any concern on your part that as you look out to 2017, if some of the tax -- the temporary tax benefits moderate that actually, for automakers, the pricing environment becomes more challenging?

Mark Fields - *Ford Motor Company - President & CEO*

When you look at on the moderation, clearly at the end of the year the purchase tax reduction is expected to expire. It's an interesting question because if you look at the Chinese SAAR in the second quarter -- I think it was like 26.5 million units. It's incredibly strong.

Part of it is could you argue are people rushing to buy cars with six months to go on the purchase tax incentive reduction? I think at a SAAR at that level -- and I couch that because the official Chinese numbers coming out from the government are not available. This is based on the manufacturers getting together and sharing their data. But based on that we do think that it's a sign of the strength of the market.

What that will mean for pricing next year? I don't have a hard and fast thought on that, but I am encouraged by the level of sales that we are seeing well before the purchase tax incentive ends.

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

Rod, on your question about what are we expecting for the balance of the year here, I would just say we are expecting the continued trend that we've seen, which has been very slow, modest increase. And so we are kind of baking that in to our outlook, but we will see what happens.

Rod Lache - *Deutsche Bank - Analyst*

Okay, thank you.

Operator

James Albertine, Consumer Edge Research.

James Albertine - *Consumer Edge Research - Analyst*

Thank you and good morning. Two quick ones: one on the credit side of the business and the other just to go back to the UK for a moment.

First, on credit. Looking at your average FICO score, you are not in the business it seems of focusing too much on subprime. But from an observational perspective and to tie together with what you said about retail sales earlier being somewhat softer, what are you seeing, if anything, that would suggest some weakness coming from the subprime side of the market? And is that a leading indicator that could suggest further tightening as we think about credit for the back half of this year and into next year?

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

Let me just give a high-level response and then I will ask Marion Harris, our CFO, to add any color or texture.

As we show on slide 24, and I think this is our point of view from just looking across the industry, there continue to be articles about subprime problems or a big increase in subprime. We just don't see that. It certainly hasn't been the case for us in terms of our high-risk mix. As you can see on slide 24, it's been absolutely constant, over quite a number of years actually; not just the periods that we are showing here.

So that certainly has not been something that is a factor in terms of our own results and our own business. And I think it's fair to say that we haven't seen a particular boomlet or problem across the industry, but maybe you could add some texture on that.

Marion Harris - *Ford Motor Credit Company - CFO*

That's right, Bob. We're not seeing any leading indicators that suggest that there's any kind of particular problem emerging. And you said it earlier: the increased credit losses we are seeing are coming from some of the delinquencies that are moving towards default. But, again, it's off of a very, very low base that still remains around historic lows on the delinquency side.

As the subprime goes. We have seen subprime mix within new vehicle sales be very constant for a long period time. In fact, it was down just a bit in the second quarter, but not anything meaningful. We are not seeing anything troubling from our portfolio; we buy a full credit spectrum.

James Albertine - *Consumer Edge Research - Analyst*

Okay, I appreciate that. Thank you so much.

Then on the UK, understanding that July and August are somewhat lower seasonal months when you look at unit sales every year and then September there tends to be a big registration changeover period that drives unit sales in that respect, I'm wondering are there any indicators this far into the third quarter that would allow us to take a view on September. In other words, are maybe orders up or down or flat? How should we think about that, if at all? Maybe it's just a false indicator.

Mark Fields - *Ford Motor Company - President & CEO*

I think you're right; obviously, because of the plate change, September is an important month. But, clearly, we got to be cautious about looking at a specific month, even if it is a plate change month, to understand what's going on in the marketplace.

I think maybe it's still too early to tell. As we mentioned, we are seeing some less footfall traffic in our dealers, for example, in the London area or in Scotland, but in other parts of the country it's a little bit different. So I think it's going to play out over the next number of months, but our view is that the industry is going to come down to a certain degree.

James Albertine - *Consumer Edge Research - Analyst*

Understood. Thank you again for taking the questions and best of luck.

Operator

Emmanuel Rosner, CLSA.

Emmanuel Rosner - *CLSA Limited - Analyst*

Good morning, everybody. So just one additional question on China and it's regarding your strategy. Obviously a lot of big shifts in industry dynamics going on there. And then if we look at your performance in the quarter, it seems like this amount of -- share loss and you explained that well, but the margins are still obviously incredibly high, at least by global automaking standards.

So is part of your strategy there or even your whole strategy, to essentially refocus on the profitable part of the market in the context of very deep competition and pricing pressure on other parts? And, therefore, basically maximizing margin, even if that means some -- losing some share?

Mark Fields - *Ford Motor Company - President & CEO*

As you know, Emmanuel, our first and foremost focus is on our operating margins and not necessarily just market share. But I think in China we have worked hard in putting out a full family of vehicles across the spectrum there.

Our opportunity going forward is in the areas where we underperformed this past quarter, like in the C segment and the small SUVs, is to work on our cost, work on the product appeal, and really leverage, as you mentioned, the strength that we see in midsized cars, large cars, and SUVs, and as I mentioned earlier, some of the better availability of some of those vehicles. So it's really working both of those elements.

Emmanuel Rosner - *CLSA Limited - Analyst*

Okay, that's helpful. Then I guess just more broadly, looking at 2017, you were, importantly, cautioning against using the second half as sort of your new run rate, which obviously makes a lot of sense with what you have going on with the Super Duty. But then looking just -- beyond just the Super Duty factor, you are essentially talking about potentially larger risks or downside from Brexit, as well as a US auto industry that may be modestly down, pricing pressure both in China and sort of in the US.

What are the big pieces or big factors that looking into next year should be more positive and essentially argue that 2017 would be a better year?

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

I will just mention a number of them and Mark can chime in, and we will talk obviously more about 2017 and beyond in the middle of September. But, first of all, we will get out of some of the one-time, unique issues that we saw in the second half, and maybe to some extent in the first half.

But you will also see -- I think it does appear, and there's articles that are being written about it, that the emerging market downturn perhaps globally is beginning to bottom out. I talked about the fact that Russia is already improving in terms of our own portfolio. There was a question earlier around South America.

Our view -- early view anyway -- is that there could be very, very, very small levels of growth there next year. Nothing to write home about, but it would be great to see a positive number with no brackets around it. And so that would be perhaps the beginning of the turn there and decline of the increased losses. So that's going to help.

We're going to have, again, as we always do, a lot of product launches. And I think going back to the earlier question around the portfolio, we really are focusing our investments very specifically to where we can make money. I think that will be a phenomenon that will be even in sharper focus going ahead and I think that will benefit, for example, the four new SUVs that we talked about globally. Those are in the sweet spot of where consumers are going. Those are higher-margin products that will start to help us as we move ahead.

And the cost, we're going to really be -- we will see cost increases, I will call them that are healthy to support the growing business and certainly to be a leader in all these emerging opportunities ahead. But, other than that, we are going to be, as we have been, very focused on efficiencies and driving nonessential costs out of the business. We did that very successfully in the first half; we need to do that in the second and we're going to do that going forward as well.

Mark Fields - *Ford Motor Company - President & CEO*

The only other thing I will add is to Bob's point on focusing on where we make money and taking appropriate actions. Next year we are closing our facility, our assembly facility in Australia at the end of this year and that will pay benefits for Australia's performance next year.

We are exiting -- it's not big, but we are exiting the markets of China and Indonesia. I'm sorry, Indonesia and Japan. And that will pay benefits, so we are really starting to get very focused on this.

Emmanuel Rosner - *CLSA Limited - Analyst*

Perfect, thank you.

Operator

There are no more questions at this time. I hand the call back over to Ted Cannis for any closing remarks.

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

Thank you very much, everybody. You can find our information on the website as described before. Thanks very much.

Operator

This is the end of today's call. You may now disconnect.
