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Q2 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Dorothy and I will be your conference operator today. At this time, I would like to welcome everyone to the Ford Motor Company Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

I would now like to turn the conference over to Ted Cannis, Director of Investor Relations with Ford Motor Company. Please go ahead, sir.

Ted Cannis

Executive Director, Investor Relations, Ford Motor Co.

Thanks very much, Dorothy. Good morning and welcome everybody to Ford Motor Company's second quarter 2017 earnings review. Presenting today are Jim Hackett, our President and CEO; and Bob Shanks, our Chief Financial Officer. Also participating are John Lawler, Vice President and Controller; Neil Schloss, Vice President, Corporate Treasurer and CFO of Ford Smart Mobility; and Paul Andonian, Director of Accounting; and Marion Harris, Ford Credit CFO.

The results discussed today include some non-GAAP references. These are reconciled to the most comparable U.S. GAAP measures in the appendix. Today's discussion also includes some forward-looking statements about our expectations for future performance. As you know, actual results may vary. As a reminder, copies of the Ford and Ford Credit's second quarter earnings presentations and press releases are available on Ford's investor and media websites.

With that, I'd like to turn it over to Jim.

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

Thank you, Ted, and thank you for joining our call today. You know, success for me today is to start my first call as CEO of Ford Motor Company to assert two important points as a baseline. The first; Ford is a fantastic company with not only an incredible history, but I think a very bright future. And you know, I've had time leading another business in another industry, and during that time, I often traveled to Silicon Valley. It was so frequent that I did learn and understand the culture there. In fact, it's steeped into my thinking, optimism, innovation and questioning the status quo.

Out there, being a young company is cool. And in this realm, a company that is 114 days old is a hot item. But what I also learned from all these experiences is that a company that has lasted 114 years is rare, and it doesn't get there by luck, decree, or sticking with the status quo, rather in the face of the facts that fewer than one in five startups succeed, a company that has persisted 114 years, what if had to remake itself many times.

When war engulfed the world or when gasoline was 100 times more expensive than when the industry started or when a pickup truck was reimagined to yield one of the largest collective gasoline savings in the car inventory park today. In this way, Ford Motor Company is a jewel in the eyes of those who study long-lived businesses. In the eyes of our customers, who've seen us evolve, trust us and they love the Ford brand.

The second point starts with the humble underpinning that Ford can be a much better company. We have an opportunity to be extraordinary in the way we relate to and deliver value to our customers. And in this way, we can deliver much more value of course to our shareholders.

And I'd like to briefly update you on how we're approaching the work in the first 100 days. In some of the earliest thinking, as we develop our compelling strategy and plan, and you'll hear a reference that we're going to be coming back to you in the fall with more details on that strategy and plan.

Now with the slides, you'll see graphics here that support my comments, and I'm sure you're familiar with the fortify, transform, and grow strategic framework that was articulated over the past 12 months or so, and that's on the right side of the slide.

What we're doing as a team in my first 100 days is unpacking that on the right with fresh eyes, and we focused on a few early priorities. Let me identify those for you. Initially, we evaluated how to maximize revenue opportunities. As you hear, there is a leveling in the business. So by utilizing data modeling, we identified sweet spots between volume, mix, and price to help deliver higher transaction prices in an increasingly competitive market.

We're also evaluating and improving the fitness of the company. And I've been talking about this concept of fitness, and of course, it includes cost, but it really involves taking a much deeper system or holistic view of all parts of the business to ensure that we're really as fit as we need to be to compete and win, and win, I want to emphasize that. We're also evaluating capital deployment opportunities, something I've heard from many of you, and we know, we're going to be quicker and more purposeful with our decisions on where to play, and how to win and that will affect the capital decisions.

We're also renewing our focus on innovation. This is something that I humbly bring in this job. This is something I care a great deal about. One of the things that I did subtly was I elevated the Chief Technology Officer position reporting to me. This was to reassert our leadership in critical technologies. And we're building a more robust mobility business under Marcy Klevern, who also has responsibility for as Chief Information Officer, the computing in our business and we have a unique opportunity to merge the mobility and computing for future digital services.

We're transforming the culture and we're creating an environment to win. This is going to be hard to describe without you following me around every day. But it starts with the renewed recognition that we're in an incredibly competitive industry. And the competition just doesn't relax because we're thinking through a problem, opportunity or because we had a management change, it's relentless.

We have a talented team here at Ford and we believe we can be really competitive, a team that we're working on empowering and re-energizing to grow our business. So, that work in those five points is well underway in that 100 days, and I look forward to sharing more, as I said with you later this year about detailed plans to make Ford even stronger and more innovative, not only built to weather the business cycles, but to win in future growth areas.

Okay. Well, turning to the second quarter. I do believe we delivered a solid performance. I'm really proud of our team with all the change we went through, they did it. But it needs to be said no one here is satisfied. We know and I want to emphasize this, we all know we have a lot of work to do. And our entire team is focused on these areas of growing revenue, improving fitness, optimizing the capital deployment and innovation in all parts of the business, and having the spirit of an environment to win. In order to improve the top and bottom lines, we're going to be focusing on these things in the quarters ahead.

On the next slide, I'll share a few highlights from the quarter, if you happened just to be gone during the last quarter and you didn't know what was going on at Ford. Some exciting things here are F-Series, including the Super Duty continue to perform extremely well, and we look forward to refresh F-150 going on sale this fall. This is our product that is so successful. We're going to be building on momentum here.

The quarter, we also had sales success in China in a number of areas, including the best ever June sales for Ford Motor Company and the best ever June and quarterly sales for the Lincoln brand. This quarter in Europe, where we launched the All-New Fiesta, this is an important model for us in the region, a very popular vehicle. All the early reviews have been great.

We're also making important strides in quality. We improved significantly to become, listen to this, the number 2 ranked non-premium brand in this year's J.D. Power Initial Quality Study. It's our best result in the 31-year history of the company. I was really proud to hear about that, receive that as I walked into my job and credit is due to all the hardworking folks at Ford for that accomplishment.

This quarter, we also made a decision. It was in the news that we would source the next-gen Ford Focus for the North American market from China initially. This decision meets the preservation of capital and it's going to deliver significant savings.

At the same time, we were proud to announce further investment in the Kentucky Truck Plant. This is going to build the new Expedition and Lincoln Navigator later this year, both very important new entries for us in large SUV segment, would urge all of you to take a ride in those. I think you're going to be really surprised.

But now, I'd like to turn it over to our Chief Financial Officer, Bob Shanks. He is going to take you through the second quarter financials and then, of course, we'll be happy to take your questions today. Thank you again.

Bob?

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

Thanks, Jim, and good morning, everyone. Thank you for joining us today. We're going to start on slide 6 and I'll just cover very briefly other headlines and then we're going to start diving through the results for the balance of the presentation. So as you can see here, the company did grow in the quarter. Our adjusted pre-tax profit combined with a low effective tax rate generated an adjusted earnings per share that was \$0.56, that was up 8% from a year ago. We did generate another quarter of Automotive operating cash flow on the positive side, and we did generate a margin of 5.9% on the Automotive business.

Let's turn now to slide 7 and look at the key financial summary and I just want to highlight several things here, to bring out a bit more texture in terms of what happened. So, starting and focusing only on the second quarter at the top in terms of wholesales, we generated 1.7 million units in the quarter. That was down 43,000 units. 55,000 of that was Europe and within that, almost all of that was the Fiesta and we'll talk about the impact of that when we get to the European section.

The revenue increase was four-tenths, only one-tenth of that was on the Automotive side of the business, the balance was in Financial Services. Going down further to special items pre-tax, \$248 million charge. That was related to write-offs that we took associated with the decision to deploy capital away from small cars and specifically the next-generation Focus in both North and South America and as you know, we have announced

that we're going to put the next-generation Focus for North America primarily in China with some derivatives also to come later from Europe.

Further down from there, you can see the provision from income taxes, \$209 million. You can see that's nearly \$700 million better than the prior year. Within that, there is \$421 million of good news that comes from distributions that was taken from overseas that bring with them foreign tax credits that we've realized on the balance sheet.

And what I'll say right now is that for the full year, we expect to have additional actions that we'll be taking in the same space, different types of actions, in the different parts of the business, but with the same effect that will generate a tax rate for the full year of about 15%. This result was a 10.2% effective tax rate in the quarter.

Because of that, and then combined with the company pre-tax result of \$2.5 billion, which was down about 16%, we were still able to generate an improvement on net, you can see the \$2 billion that was up \$72 million from a year ago. Adjusted EPS, I touched on, and then further down the page you see liquidity, which is continuing to be strong, and we'll talk more about that later.

Okay, let's go to the next slide, slide 8, and here what I'd like to do is, just briefly talk about where the profits were earned. So, on the far left, you can see the total company adjusted pre-tax profit of \$2.5 billion. \$2.2 billion of that was generated by the Automotive segment. We had very strong results in Financial Services, \$600 million, and then in All Other that's primarily our treasury-related activities, think of that as net interest expense and portfolio gains and losses, and then there is a very small piece of that that's related to the Ford Smart Mobility LLC.

When you look below the chart, you can see that the decline in the Automotive segment drove the decline in the overall business. We had a very nice improvement in the Financial Services, and a small decline in All Other that was largely around the treasury-related activities.

Let's move on to slide 9, and here what we're going to do is start looking at the Automotive segment only. So, on the far left is the \$2.2 billion of profit that we generated in that segment, and then you can see right beside that the North American result. So, effectively every dollar that we earned in the Automotive segment was earned in North America.

When you look to the right of that, you can see the ups and downs of the other regions. They all net to breakeven. But I would highlight within that we did generate our ninth consecutive quarterly profit in Europe and we had a good result in Asia Pacific. If you look below the chart, declines in North America and Europe on a year-over-year basis is what drove the decline in the segment. All the other regions improved.

Now, let's move further into the Automotive segment and focus on our key metrics and we'll just go right across the page. You can see the top line and the first two metrics there, the wholesales I've touched on, down 3%, the revenue, basically flat as I mentioned. SAAR is not shown on the page, but the SAAR for the global industry is estimated at about 93.2 million units, that was up 4% and that was driven by increases in the industries of Asia Pacific, Europe and South America.

Market share, 7.4%, was down a tenth and that was driven by declines in North America, Europe and Middle East and Africa with the other regions going in the positive direction. And then, you can see the margin was down and the pre-tax results was down as well.

Let's go to the next slide and let's look at what was behind the decline in profitability, \$641 million. Basically, it was three factors; it was higher commodity cost and we talked about that in the first quarter call. You can see here in the second quarter, an impact of \$387 million with that mainly being steel, although we did have increases across the other commodities.

If you take that combined with the first quarter we're at a roughly \$600 million of increase, we're looking at about \$1.2 billion for the full year. So, we expect to have about the same amount of headwind in the second half on a year-over-year basis that we've seen here in the first quarter.

Second factor is exchange. You can see \$154 million, most of that around Europe. That is more than explained by weakness in the pound sterling and then also weakness in Asia Pacific related to the Chinese renminbi. And then the third factor, just to refresh your memory, this time a year ago, we were telling you about a gain on the sale of an entity called OEConnection, that generated a profit improvement of \$150 million, obviously this year on a year-over-year basis is not occurring.

So, those three factors explain what happened. Don't want to leave the page though without highlighting the fact that our market factors were positive over \$200 million and within that, when you look at the callout box on volume and mix, look at the very, very strong mix that we generated. Most of that being mix among in terms of products, but also some very good performance in terms of series mix and options, which is the strategy that the team has been deploying for some time now to drive the mixes of each of our individual products into the higher series and it's proving to be quite successful. And we did generate an improvement in net pricing for the segment and the year as well.

Let's move on now to the regions, and we'll start, first, as always with North America and these are the key factors. Starting from the left, wholesales were down, just a little bit above 8,000 units, 1%. The revenue up 3%, that was driven by the mix. If we look at the SAAR, the SAAR for the region at 21 million units was down 0.5 million units. That was fully explained by a decline in the U.S. The U.S. came in at 17 million SAAR and again that was down 500,000 units. Market share was down one-tenth. That was explained by the U.S., and that was explained by lower fleet and that was explained by cars. If we move over to margin, you can see we had a strong margin of 9%, but that was down from last year and then a profit of \$2.2 billion, down 19%.

If we move to the next slide and look at what was behind the \$0.5 billion decline in profitability, very similar to the Automotive segment, but I would call out just the two factors; one, the higher commodity cost. Most of the company's commodity cost decline occurred here. And then, of course, the non-repeat of the gain on the sale of the OEConnection LLC majority stake that we had. I do want to highlight the engineering. You can see the engineering here is up \$126 million. That was the increase for the segment as well and that was largely explained by the investments that we're making in strengthening our utility lineup and also a bit of the investment in our AVs.

Again, I want to highlight the market factors. We had favorable mix, 217 million units, most of that was driven by Super Duty, so that was both the mix among effect as well as very strong derivatives performance within the Super Duty. And then, you can see we did have higher pricing as well in the quarter.

Okay. Let's go on to slide 14. Here what I'd like to underscore, again, some of the metrics we've been sharing with you that demonstrate the disciplined approach we're taking to the business here in the United States, but I just want to note that this is the same approach we take to our business everywhere in the world, not just the U.S., but we'll use the U.S. to highlight the effect of that.

So, you can see around transaction prices, our transaction prices in the quarter driven by strong mix, particularly Super Duty, F-Series, Raptor is in that as well, five times what the industry saw in terms of an increase. If you look to the right, incentive as a percent of vehicle price over the last number of months. You can see that we've been around no increase and in fact two of the three months it was a decline, which drove a small decline for the quarter and that compares with an increase for the industry. And on the lower left, we ended the quarter at 79 days of gross supply for the U.S. That was only up one day, but for the full year, our take on our stock levels are that they're in very, very good shape overall.

Okay. Let's move now to South America. And here again, third quarter in a row, we're seeing improvement on a year-over-year basis in the key metrics in right across the board. And I think the thing that was very encouraging here is the SAAR for the region at 4.2 million units was up six-tenths. Half of that was Brazil. Finally, we've gotten to a quarter, where Brazil is up on a year-over-year basis. Now, a lot of that was direct sales, but the other economic metrics we're looking at in terms of PMI, inflation, exchange is stabilizing.

All of that is looking more favorable, although, of course, all of us are watching very closely the political developments there. Looking at wholesales, wholesales were up 12%, revenue up 18%. We had very strong performance by the Ka. And that was evidenced in the market share, which was up by five-tenths of a point, and again completely driven by the Ka. Margin improved and you can see the pre-tax loss reduced by \$80 million.

Go to the next slide, which is slide 16, and look at what was behind that improvement in the loss. And you can see it's entirely driven by favorable market factors, both the volume. And you can see that a lot of it was around the pricing. The good news for me was around the cost. Because we're starting to see a much mitigated level of inflation, the efforts that the team have been making in terms of reducing cost is now more clearly flowing through.

And you can see here that despite the fact that we still have some inflationary pressures, our costs were flat in the quarter, a little bit of bad news on exchange, but even that was much less than what it has been. So, feeling much, much better about the direction of the business now in South America, and certainly the work the team has done over the last several years to really thrift out, reduce, lean the business, I think, with the top line now starting to come back, a lot of that's going to flow right through.

If you go to the following slide in terms of Europe, in Europe, all the key metrics are lower and I'll explain what's behind that. I've already talked to the wholesales. The revenue is down largely because of the volume. The SAAR was actually up, 20.7 million, across the region. That was up nine-tenths. Within that, the UK was down, so we are now finally seeing what we had expected to see from the effect of pricing and other effects across the economy, a slowdown in the UK industry. So, that was down two-tenths of a point of SAAR.

On the other hand, in Russia, similar to Brazil, really excited to see this market starting to come back now in terms of some of the external metrics. The SAAR was up two-tenths as well on a year-over-year basis. When we look at share, the share was down two-tenths of a point that was more than explained by Fiesta. So that's another one of these Fiesta launch effects that I'll talk about shortly.

Within that, our commercial vehicles performed very, very well. We once again on a brand basis were the number one selling commercial vehicle brand and we grew share in the quarter in addition. When you look at margin and pre-tax results, both of them down sharply. And if you go to the next page, we'll talk about what's behind that.

So this – I'm on slide 18. So we were down about \$380 million. Almost literally half of that is related across a number of these factors due to Brexit. The biggest impact is exchange, so a much bigger effect than actually what's shown in the singular bar there, directly related to Brexit. We also saw the industry decline, which is buried

within the – in fact the industry – as I mentioned to you, the industry was up, but you can see the industry dollars is down. That's the effect of the UK, because it's a high margin market.

Then we had, of course, an offset in terms of pricing. So, that's buried within that small improvement of net pricing. We did also see launch effects of the all-new Fiesta and that's spread across a number of these factors. So again, for those of you that don't know, Fiesta is our biggest selling product in Europe. This is an all-new product. We are just in the launch phase. The initial reaction from the media has been extremely strong on the product. So, very excited to get this to the market and give the customers the opportunity to enjoy it.

The third factor is commodity cost. And you can see that in the callout box for contribution cost of about \$70 million. So, those three factors fully explain the decline. When you look at the rest of the business, the other item I'd like to highlight is, once again, we had the year-over-year improvement in Russia.

In terms of what we expect for the rest of the year, we expect Europe to remain profitable, although, it's going to be below the levels of 2016. And it's basically the same story we've been talking about. We think that the profits will be down about \$500 million, \$600 million – about \$600 million related to Brexit. That probably is about the decline that we'll see in total for the business. In addition, you will see some headwinds from higher commodity cost, which will offset probably in other parts of the business.

Okay. Let's go to the following slide, which is slide 19 and now we turn to Middle East and Africa. And just to refresh your memory, we've been talking here about declining industries, declining performance for us in the Middle East. A lot of this due to external factors related to geopolitical issues and lower price of oil. That is continuing, although maybe some signs of it starting to mitigate when we look at some of the external economic factors.

When you look at wholesales, down pretty sharply, 37%. Revenue was down because of the volume. The industry was down about 12% in the markets where we participate. You can see that our share was down 1.2 points. That was almost fully explained by the Middle East, where we are still working through some performance issues. And go to the right of that, you can see the margin down. Yet for the first time now for a while, we're starting to see the loss reduce and it improved from \$65 million a year ago to \$53 million this quarter.

When we turn to the following slide, it's a small improvement, but to me the thing that's interesting and exciting about this is how we got there. When you look at the cost factors, the team continues to do a really good job in the face of a lot of difficulties on the top line to generate cost savings. The exchanges moving in our direction as well, that's around South Africa and euro. If you go to the far left though, you'll see the impact of volume and it's across all elements in the business, industry, share, stock adjustments, in line with that.

So, a lot of work ahead of us on that, but we still continue to expect the Middle East and Africa to improve this year compared to 2016 due to lower cost, favorable exchange and lower volume. And a lot of that – in fact, all of that improvement is going to take place in the second half of the year. So, I expect to see better results on a year-over-year basis in the second half of the year than what we've seen in the first half.

When you get to the following slide on Asia Pacific, the last of our Automotive business units, a lot of positive stories here. Wholesales up 24,000 units or 7%. That's all explained by China. Circling back to the first quarter, we talked about some issues that we had in China in the first quarter and we were down.

We talked about improving in the quarter in China and the team succeeded in that regard. They've revised the go-to-market strategy. I think we still have more work ahead of us, frankly, but we did generate an improvement year-

over-year in terms of sales in China in the quarter, but more work ahead of us. And you can see some of that here in the wholesales to support that.

Revenue was up in our consolidated activities. Interestingly that includes some of the activities inside China, including Lincoln because those are consolidated. In terms of SAAR, the SAAR was at 43.7 million units. That was up 2.3 million. Of that, China was 1.9 million. So the industry's recovered from the first quarter and is growing quite nicely now. When we look at market share, we were up one-tenth, and that was driven by JMC along with Lincoln in China. It was all China that drove the market share.

Margin recovered nicely to about 4% and pre-tax results at \$143 million, an improvement of \$150 million from a year ago. On the lower right of the slide, I'll spend a second on this. So, this is, as we usually report, our China JV net income. So it's equity after tax, what we get, was \$195 million. The margin was 10.7%. Both of those were down, so let's talk about the profit. I'll explain it through the profits. The profits were down, that we get, about \$100 million.

The majority of that is due to lower investment incentives that we received in China. Most of that is due to just the timing of incentives this year versus the timing of incentives last year. For the full year, we expect incentives to be a bit lower, but much less than what we're seeing in the quarter. So you need to think about this as not something that you multiply four times. We also had some headwinds related to the exchange that I mentioned earlier.

Go to the following slide and we'll look at the improvement of \$150 million and what was behind that. So you can see it was driven by favorable volume. We also had favorable mix in the quarter. It was offset in part by the negative net pricing in China that we continue to see. But then we had favorable cost performance. I've talked about the exchange, and then within the other, that is more than explained by the timing and the lower level of investment incentives in the quarter that I referenced just a bit earlier.

If we think about the full year, we expect Asia Pacific to improve. That's no change from prior guidance, and that will be driven by favorable volume and mix and lower cost. We still expect, on a full year basis, industry pricing to be negative and we also expect to see unfavorable exchange due to the renminbi flow-through as well.

Okay, that's it for Automotive. Let's move now to Ford Credit. Where – we've got some really great performance to talk about and you can see it here on this slide, the business grew \$8 billion in terms of managed receivables and that was driven largely by retail financing globally. And then, the pre-tax result was up 55% at \$619 million. We'll talk in a second about what was behind that, but it was pretty broad-based, when you look at what drove the improvement.

If you look at some of the portfolio metrics on this particular slide, very strong. Average placement FICO over 740, consistent more or less where it had been. The delinquencies remain in a very, very good place and the loss/receivables ratio, while it's up, is certainly well within our expectations from where we are at this point in the cycle. So, overall, very robust portfolio performance combined with great bottom line performance and growth.

If you turn to the next slide, on slide 24, this is what's behind it. You can see most of the factors are green and positive. We had favorable volume and mix, that's the growth that we talked about, the margin was favorable. Credit loss reserve was good. We actually did increase the reserve for credit losses in the quarter. We just increased it much less so than last year.

Lease residuals are flat. I think that's a victory. That's been one of the biggest headwinds of the business now for quite a number of quarters, but as it has been written about by many of you and others in the media, we are

seeing less of a downward draft on auction values than what we had expected, and so that's reflected here. We still expect our auction values or residual values to fall on an average basis by about 6%. But if you go back to what I said in the first quarter, I said about 6%, that was around down to 6%. This quarter, it's around up to 6%. So even within that number, we're seeing some improvement.

Then we go to the far right, you can see other and we had a \$90 million improvement in our derivatives and this was based on favorable interest rate movements.

If you go to the following slide and look at some of our financing trends. Again this continues, I think a similar story what we've talked about in the quarter, we're seeing leasing pull back a bit and you can see that we came down, as did the industry. To the far right, on the upper part of the chart, you can see what I was talking about. In the quarter, we had a seasonal – seasonally or a sequential increase for the second quarter in a row in terms of average auction values. And on a year-over-year basis down only about 4.5%; again that is less than what we had expected or more than what – less than what we had expected.

If you go to the lower left, in terms of severity, that's looking very healthy and we talked about the LTR. So, overall, what we're seeing is strong credit quality, strong business environment and healthy consumer credit conditions and that's reflected in really great results for Ford Credit.

Let's move on now to cash flow. Looking at the Automotive segment. So, in the middle of the page, you can see the \$1.3 billion that we generated. The one thing I'd highlight is the negative impact of changes in working capital that was primarily in payables, a lot of that associated with the launch of the Fiesta in Europe. So we had much lower production in the last 45 days of the quarter related to that. We also had some inventory holds in other parts of our business for various reasons, which have subsequently unwound. But, at the end of the quarter, that had an impact. The only other things I would highlight is that we're still on track to our guidance for capital spending, pension contributions and also full year shareholder distributions.

Moving on to slide 27, the balance sheet metrics, the only thing I'd comment here, we can take questions later, is everything is in great shape, the balance sheet remains strong, Ford Credit well capitalized, a lot of good liquidity there. And in terms of pensions, we still expect by the time we get to the end of the year, it's not reflected here, but based on what we're seeing in terms of the key metrics that drive our pension funding obligation status, we expect it to improve from where it had been at the end of 2016.

Moving on to more of an outlook discussion, looking at GDP and industry planning assumptions, GDP is unchanged in the second column from what we guided previously, but on the right hand side, industry is up a bit on the global basis. We have taken the U.S. down, a couple of 100,000 units from prior guidance to 17.5 million. That's really driven primarily by lower fleet sales. Brazil up a tenth, Europe up a couple of tenths, and China down a couple of tenths. So, some small movements up or down, but probably the one that's most noteworthy to you is the U.S., a little bit softer than we had expected, but that's driven by fleet sales.

Now, let's spend a little bit of time on guidance, because we're making a couple of changes here. So, as you guys all know that we have historically provided an adjusted pre-tax profit outlook for the company, we've then separately provided a tax rate. So, we're going to be moving from this point forward to a methodology, which is used by others and it's understood very well by you and the Street to use an adjusted EPS and so you see that in the first column.

So, our guidance for the year is of \$1.65 to \$1.85. To the right of that, importantly, is the tax rate that I referred to earlier. Now, to help you understand how to think about the guidance, if you take the last quarter guidance and

you put it on the same basis, it would be \$1.58, that was the about \$9 billion, 30% tax rate. So, clearly the range is higher, but it's driven by the tax rate. So to help you further, if you were to take the top end of that range, that's effectively about the \$9 billion, it's a little bit less than in absolutes since the \$9 billion, but that's effectively about the \$9 billion.

And then beneath that, think about that as our view of potential risks, as we think about market factors or cost performance over the balance of the year. So it's not necessarily something that we see happening, but as we look at history from this point forward, and we think about the environment that we're in, we're providing for various outcomes on both market factors and cost performance that takes us to the lower end of the range.

The other thing I would highlight is the tax rate. And then the other thing that may be helpful to you, as we think about the second half of the year, we do expect the second half of the year to be lower than the first half, that's based on seasonal factors, historical experience, but this year also related to the launch of the Expedition and the Navigator. Those will be going through effectively launch the entire quarter, don't expect to see any wholesales until the beginning of the fourth quarter.

And then in terms of 2018, we've provided a view on 2018. Ever since Investor Day back in September, we've continued to share that with you at other events. We're not doing that today, because of the reassessment that Jim has us working on, and we'll share more on the business later this year as he said earlier.

And then on slide 30, this is our full year guidance puts and takes. It's been updated and reflects our latest thinking. So if you have any questions on that, we can take that later. And then finally, on slide 31, our view of the key takeaways. So a solid quarter, certainly a lot of excitement here as we progress our 100-day review. The second one is around all the metrics we've shared, Ford Credit, strong results, the balance sheet in great shape, continuing to run the business in a very healthy way and then of course the guidance update that we just talked about.

So with that, Ted, I think we're ready to move into Q&A.

Ted Cannis

Executive Director, Investor Relations, Ford Motor Co.

So with that, we'd like to turn it over to questions for the team here.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Ryan Brinkman with JPMorgan.

Ryan Brinkman
Analyst, JPMorgan Securities LLC

Q

Great. Thanks for taking my question. First question is really on tax. You touched on the drivers of the significant reduction in tax rate this year. Firstly, is there anything you can say more about the change from 30% to 15%, which is pretty big? And secondly, does the lower tax rate this year have the potential to impact future years? And thirdly, is the change more to book taxes, or will there also be an improvement to cash taxes and if so, how material could that benefit be?

Robert L. Shanks
Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

Yes. Thanks, Ryan. It's a good question. So, in terms of tax, think about the effect that we're talking about is being 2017, I would think when we get into 2018 we'll move back to a more normal tax rate of around 30%. Obviously, we'll update you on that when we provide the guidance for next year. But, I would see that as something that we're doing this year.

So, the other way to think about what's happening, the tax team, who as I said, has just done a great job, they had line of sight to the actions that we're talking about affecting 2017 that we'd be taking in some of the years ahead of us. But, frankly, in anticipation of potential corporate tax reform and again no idea when that happens, but also not knowing what it is, the team recommended that we take these actions that we had planned to do perhaps later in our planning period and pull them into this year, which is what we are doing.

And I'm not going to get into specifics of the one action that we took in the quarter, as I said there will be others in the second half of the year, but effectively they're bringing distributions back to the U.S. Those distributions are bringing with them foreign tax credits which we're then recognizing on the balance sheet.

So, in terms of the impact on cash taxes, this is a book tax effect, would not expect it to have any near-term impact on cash taxes, but certainly at some point in the future it will, so this is real in terms of both profit and cash, but the cash impact will be later.

Ryan Brinkman
Analyst, JPMorgan Securities LLC

Q

Okay, thank you. And then just lastly for me, I thought to ask on Ford Credit, obviously very strong in the quarter. When you first got it to \$1.5 billion for full year 2017 in November last year in the absence of knowing anything better, I just sort of assumed \$750 million in the first half, \$750 million in the back half, you've done \$1.1 billion to-date. Can you say anything about the cadence of Ford Credit profits this year in order to help us maybe gauge, how much better than \$1.5 billion could the division be tracking for the full year?

And then just sticking with Ford Credit, the lease residuals, those tracking better, does that do anything to change your previously communicated outlook that prices would continue to fall through 2019 or some of the actions you're doing on rental cars or something else maybe helping you rethink that?

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

Yes. So in terms of cadence, we're not providing a specific number in terms of profit for the year. It will be better. Second half will be lower than the first half. So, I certainly wouldn't take \$1.1 billion times 2. That is not happening. But it will be better than the \$1.5 billion. And to the question that you had around, how are we thinking about – and let's not talk about auction values but more residual values as a percent of sales price, because we actually expect over time that those will rise and we want to kind of focus on the percentage, if you will, residual values as a percent of that. But we are still expecting, as I said, it's about 6% year-over-year, which would suggest a pretty sharper decline later this year in order to land in that spot. So, we'll have to wait and see if that happens. Frankly, the team just gave me a report yesterday, the latest weekly report, and things are still holding up well.

So, we haven't seen the signs yet of anything happening. We've certainly heard that we can expect to see some declines coming from the next ALG update. So we'll have to work our way through that. But that's what we're kind of providing for in that guidance. In terms of looking at 2018 and 2019, nothing has changed in terms of our expectations. We're still expecting that residual values as a percent of vehicle price will be declining and we're building that into all of the new business that we're writing.

Ryan Brinkman

Analyst, JPMorgan Securities LLC

Q

Very helpful. Thank you.

Operator: Your next question comes from the line of Brian Johnson with Barclays.

Brian A. Johnson

Analyst, Barclays Capital, Inc.

Q

Yes. Just want to get underneath the kind of puts and takes and revisions to the outlook. It looks like with the tax credit benefit, you will be taking that it appears that the midpoint of pre-tax seems to be as mentioned coming down from the roughly \$9 billion that you talked about. Can you, A, confirm that and, B, with the regions performing a little bit better this quarter, where is that up and with certainly Ford Credit now poised to contribute more? Where do you sense that operating weakness is likely to come from?

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

Yes. So, first of all, you shouldn't assume that our own point of view in terms of where the business is at the midpoint. But you are right. I mean you can calculate and figure out what the midpoint is and it would be further below the prior guidance of \$9 billion and just a bit below which is where the top end is. But, please don't assume that's necessarily where we are in terms of our own single point estimate.

But to the point you are raising, we are looking at the business both in terms of market factors and cost performance. We are trying to provide some recognition of the fact that we don't have control over everything and so there's two-eyed highlight. One is the commodity cost, which as I said, will be up based on what we think right now about \$1.2 billion on a year-over-year basis. By the way, they were favorable last year by \$900 million, so you can see how they can swing. The exchange is another factor that obviously will be what it's going to be and then frankly, the other one is around warranty expense and the potential for recalls.

We don't forecast recalls. In fact we don't know, I personally don't know about the recalls or others until the team has done the work and the data supports an action and then we move and we move very, very quickly. But as you are very well aware of what you've seen, some recalls that have had material financial impact over the last number of quarters, and so this provides us a little bit of space for that as well.

But I would add, Brian, that a couple of things since the first quarter guidance that has taken place, actually three things, very specifically that we've accommodated in this range, one is higher incentives across all regions of the world, not really large in any one region, but when you add them up, it's a factor. The second is higher warranty expense already in North America and that's related to coverages. So, not recalls, but coverages, normal 36 months, 36,000 miles that sort of thing. Also something, sum up related to our extended warranty that we provide on some of our components.

And then the last, which is an offset, which is what you raised is a favorable view of what Ford Credit is going to bring to the business. So those three together, in an absolute sense, will take you a bit lower than \$9 billion, but contained within the upper end of the guidance. The rest of it is really a risk assessment.

Brian A. Johnson

Analyst, Barclays Capital, Inc.

Q

And now a question for Jim. I know you're still in the midst of this 600-day fitness assessment, but one thing that jumps out at us is the gap in North American margins between Ford and GM, which is now running around 300 basis points. What's your observations of that? Ford still historically has traded at premium to GM, primarily thinking that the brand equity was stronger, that brands were better positioned. But to the extent that is, it's certainly not showing up in the margins in North America. So wondering, if you have some points of view on that and how just preliminary that might be addressed at the end of the 100 days?

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Well, I think, Brian, it fits the early comments I made about fitness that, that notion means, you're scanning for competitive improvements. People coming at you that you don't expect, as we start talking about the future, we'll be talking about competitors that are outside of industry. So that kind of thing gets my attention. I can understand that in ways with the SUV segment being so strong and our franchise being really strong in that same area, and this kind of perspective that you're bringing up is something that we talk about. So I can just confirm it's the kind of thing that doesn't go over the top of our head.

It's not something at all that I'm worried about addressing and I also have great optimism that when we talk to you about how we're going to address that, there is big opportunity there. Just for all the listeners and in regard here, we changed the organization on May 22. So, there were 19 direct reports in the last administration, I have 8 and I've an executive team that, the speed in which they can address something like what you just talked about, there's a big improvement. You wouldn't know that based on the data which you are looking at right now, but that's the promise that hope to prove to you.

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

Hey, Brian, it's Bob. The only thing that I would add and again it's not to denigrate GM's performance because I think what they're doing is quite impressive I think. But we do have to and you guys recognize this as well and they do as well, there has been a lot of stock build. So, I think when you want to compare margins and that type of thing, you really have got to neutralize that effect on both sides.

And if you look at our business in the quarter, we actually had a stock decline in the quarter in the U.S., and in North America, we had a very small stock – favorable stock change. That was not the U.S. which is where high margins are. So that's the only caveat I would put as, on an apples to apples basis probably gap isn't quite as large as what you said.

Brian A. Johnson

Analyst, Barclays Capital, Inc.

Q

Okay. And just final question around capital, are you open to sort of bold moves around capital consumption ranging, whether it's from investing in product lines all the way to spinning out or joint venturing major parts of the business that consume big chunks of cash?

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Yeah, I mean you called it bold, I think it's just part of the fitness cadence and discipline that I'm really trying to stress. I mean this is one of the most important things the leadership can do, is making choices in a way that really preserves capital, gets the kind of returns that you would expect, so of course all of that is in the air up for grabs.

Brian A. Johnson

Analyst, Barclays Capital, Inc.

Q

Okay. Thanks.

Operator: Your next question comes from the line of Rod Lache with Deutsche Bank.

Rod Lache

Analyst, Deutsche Bank Securities, Inc.

Q

Good morning, everybody. Jim, I'd like to just ask a couple more questions about the things that you are assessing in the first 100 days. First of all, just on this innovation question, what do you think can change to accelerate the pace of innovation and the clock speed at a company like Ford and to make the company more competitive in terms of speed and risk-taking with some of the tech companies that you've had quite a bit of exposure to?

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Rod, this is the area that I probably have the most confidence and I'm humble about what I'm about to say to you, because I have to prove it here. But surprisingly in a company like Ford, all the talent's here, all the capability is here, so I got to confirm that with you. It's what happened in business history, there was a little bit of a shift in terms of the way that you understand the nature of the way people use products. You marry that with really rigorous development processes and you have success.

And so, the inference is that that frontend part, the way we understand use, think about that as building more value in products, but there is also a reductive opportunity, there's stuff that people don't care about in vehicles that we shouldn't have there. And in the course of doing that, I want to confirm that this is one of the pleasant surprises I've had when I got closer to Ford from just being on the board, is they have mastery in key systems like

the financial systems as an example. They have mastery in the ability to engineer product to market. The quality metrics that you're hearing about and there is an ongoing report of quality. There is definitely change there.

So, I want to leverage what got better over the last, say, seven or eight years in those areas and marry them with some of the innovation techniques that I won't go on about today, I want to share all of that, that I understand. And the way you walk away from that discussion is you realize that the people all of a sudden are saying, I like the Ford products better and they like them a lot now. They are really popular, Mustang and F-150, but I see opportunity in every area where we can be better.

Rod Lache

Analyst, Deutsche Bank Securities, Inc.

Q

So, just to understand that a little bit better, is the management team and you specifically dissatisfied with what you see at this point in terms of the clock speed or the changes that you're seeing from an innovation perspective?

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Well, this is a kind of question that could come up a few times a day. So, let me step back and tell you one of the first things we did going from 19 to 8, is we addressed the, what I call, the point of view ownership. Think of that as when you have a lot of things that are triangulating for attention and clarity. These are big decisions. But the simple notion that somebody owns that point of view is an empowering and freeing stance. So, we went through exercises together as a team to clear that up and we're already seeing the effect. So, we're speeding up decision-making. We're speeding up the way that choices are clarified. A neat consequence from that, that was a word that Alan used to use, wasn't it, neat.

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

Neat and cool.

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Neat and cool. So, a neat consequence of that is we've been able to free up time on the executives' calendars. I just did the math last night. It's about 30 minutes a day that was taken off of their calendars that were corporate kind of requirements. So, when you work the hours these folks do and how hard they are working all over the world, that's found money. And then that translates in ways. The body language is now translating down to the teams that work for these folks.

So, again, if you're following me around, we got some early momentum here. It's too early to report in this quarterly call to you, but you asked the question, how do I see that infiltrating? And that is what you pick up in startup companies, in tech companies. They haven't grown to the size of Ford. So, they didn't have that kind of hierarchy that I inherited. So, they have some advantages in that regard that we don't have to cede that to anybody else. We can bring those in and that's what we've begun to do.

Rod Lache

Analyst, Deutsche Bank Securities, Inc.

Q

Great. Thank you. And just, lastly, a question on how you're thinking about capital allocation and the portfolio of businesses and products. One of the biggest paybacks that we've seen over time in the industry is actually when

the industry exits segments that have been – the companies have been involved with maybe just – maybe based on tradition more than anything else. But they're obviously challenging segments and you can think about regions that have been challenging for many years and maybe so for a long time. Is this reassessment that you're looking at also that broad that you're questioning regions or segments, markets that Ford is currently in?

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Yes. And I don't want to dismiss your question with this response. I mean you've got to believe the capability of the folks running the company, including myself. Don't fall asleep on that question. I mean there's other forces that tend to put that in a vice and hold it. And that's what you are accurate about. You have to break that hold to say, what's causing us to hang in there. And every time, if you look back with me that we hung in a market was because we actually took actions to improve and maybe it didn't work.

So I think the new reality that I can kind of confirm to you is that we really have to ask ourselves what do we have to believe to get to the kind of returns that we expect and you expect. And if we can't answer that, then we can't be there. That's making the choice when you hear us talk about playing to win and where to play, that is what that code means, is that you are clarifying where you're going to put capital.

You've seen decisions from us already in the short 60-plus days that the new teams come together and the decision to put the Focus in China as an example. That would save a bunch of money doing that and there is other things like that that will be forthcoming.

Rod Lache

Analyst, Deutsche Bank Securities, Inc.

Q

Great. Thank you.

Operator: Your next question comes from the line of John Murphy with Bank of America.

John Murphy

Analyst, Bank of America Merrill Lynch

Q

Good morning, guys.

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Good morning, John.

John Murphy

Analyst, Bank of America Merrill Lynch

Q

Maybe just a first question here, Bob, on the guidance, and just doing some real dumb guy's math here. I mean it looks like, at the high end of the range which you're relatively more endorsing than the low end, you do about \$4 billion in pre-tax in the second half of the year roughly. And your guidance range though does kind of imply a pre-tax range of almost \$1 billion. So, that \$1 billion is against that \$4 billion in the second half of the year. I am just curious, I mean you kind of highlighted these three factors, but I mean is there something else going on or is it just a big recall maybe around Takata that you think might create incremental expense in the second half of the year because it's just a big relative range to that remainder of the year?

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

Yeah. I agree with you. I think it is in part around some of the – if I go back and look at the last year-and-a-half in particular, we've had a number of material recalls that, again, for the reasons that I mentioned, don't know about them and then they happened, and not in the guidance because we didn't know about them. So, what we're trying to protect for is the possibility of something like that.

Again, nothing that obviously has been acted upon because otherwise by definition we'd have done it. Takata is actually not relevant in that conversation, I think, at least from our point of view, because we actually have gone back to the government and indicated that there's no facts or circumstances that would support us in doing something. So, we are having that conversation with them. But it's really more around risk assessment of that, if something like that happening.

Also, just looking at a historical experience in terms of market factors, what could happen in terms of market factors in this point forward, commodities out there. They've started to actually get a little bit better from the first quarter, but that's a concern, exchange and other. So it's really more around risk assessment. That's the way I would think about it and not that there's something going on. There's something that we have in mind. I think it is fair to say that at the moment we're more towards the upper part of that range, but we're just trying to protect for the potentiality of something along the lines that you talked about occurring. That's it.

John Murphy

Analyst, Bank of America Merrill Lynch

Q

Okay. That's very helpful.

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

What I would expect when we get to the third quarter obviously the range will be a lot less. And we'll narrow it down and have a better feel for ultimately where we're coming out for obvious reasons, but this is where we are today.

John Murphy

Analyst, Bank of America Merrill Lynch

Q

Okay. That's very helpful. And then just a second question on your mix being positive \$310 million in the quarter, I think you highlighted, goes far beyond just segment shift, but there is also a shift we see in vehicle lines as you are selling – up-selling the consumer. I'm just curious how much of that do you think is sticky over time, how much of that is very Ford specific? And are you getting into a higher set of customers that are willing to pay you sort of mass market, luxury sort of premium kind of prices that will stick around for a while?

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

Well, this is something that we've had a lot of success in North America. It's a big part of the story here both around product mix, but also the derivative mix. Stephen Odell and then Jim Farley in Europe made that a central part of the transformation plan there and that's been extremely successful. And Jim's still pushing the team there, but everywhere around the world for the dollars to be mined from that approach.

So, I wouldn't say – and I should mention also China. We've also picked up over time a lot of good news there from bringing in the Edge, the Taurus. We're taking the same derivative strategy in China too. So, it's not just a single market that we're taking that approach because we know it works and successful and customers actually love those types of products.

What I would say though just to condition you, when we look at the first half, we've picked up quite a bit of good news on mix on a year-over-year basis, about \$700 million. I don't see that happening in the second half. And the second half is probably a bit flat to even maybe slightly negative. And that's because on some of the big contributors of the more recent improvements and particularly Super Duty we started lapping ourselves, in terms of when the product came in and the derivatives in the high – the high derivatives at the beginning of the launch, et cetera.

I think Fiesta will give us an opportunity in Europe. So I think that's one that we should look out for, because I would expect that to follow. But I do believe if we take it out longer than just the half, certainly Jim's view is that, there is gold to be mined and there are hills and he is going to keep pushing us.

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

And I would add, Bob, that coming in new, when I was on the board, we got to tour that plant, that was building the new F-150 with the aluminum underpinnings. And when you drive that vehicle and you know, it's handling characteristics, and I made reference to its contribution in this last year to MPG improvement.

It is the significant factor that's improved our goal, our march towards a cycle plan more than any other vehicle in anybody's inventory. But where I want to go is, when I drove that car, that vehicle for the first time, and the kind of feeling I had, I believe the word spreads in this kind of industry, and here we have a product that's now starting to be understood and very popular. And then, as I mentioned in my comments, the refresh is coming, and as Bob's conditioning you, we know we've sold a lot of these vehicles, but we believe there's still a lot to be had, and that's what's helping that transaction price go up.

John Murphy

Analyst, Bank of America Merrill Lynch

Q

And maybe just – I apologize, maybe just a follow-up on that. I mean the Expedition and Navigator launching next year. I mean, if you make up some ground on GM and Ford, that might be a \$1 billion or \$2 billion opportunity. I mean, is that also – I mean off the back of the F-150 platform, and similarly fuel efficient, is there a real big opportunity here when the Expedition and Navigator launch next year or actually really hit dealerships next year?

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

Yes, we definitely see the Expedition and Navigator as an opportunity both in terms of volume and certainly in terms of price, transaction price, mix and so forth. That's a really big opportunity. That's why I wanted to make sure that you understood. Even the old one was quite profitable, right?

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Yes.

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

So, I wanted to make sure that when I was talking about the third quarter, you understood, we're basically not wholesaling hardly any of those old or new in the quarter, and then we'll start filling the pipeline in the fourth quarter and then of course it really will pick off and take off in 2018.

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

And this is why I talk about the handling of those vehicles in my early comments. You're going to have to drive one to feel what I'm talking about, but there's a definite marked improvement, I think competitively. It's going to be really interesting how they react to that.

John Murphy

Analyst, Bank of America Merrill Lynch

Q

Looking forward to it. Thank you very much.

Operator: Your next question comes from the line of David Tamberrino from Goldman Sachs.

David Tamberrino

Analyst, Goldman Sachs & Co.

Q

Good morning and thank you for taking our questions. First, I want to just stick with the U.S. market. I think you brought down your assumptions from around 17.8 million to 17.5 million total SAAR, so about 17.2 million light. Wondering how you feel about the market going forward from 2017 into 2018 and 2019? Are we in a plateau mode in the 17 million, should it grind lower into the 16 million? That's kind of point one.

And then on the back of that, Jim, as you think about North America cycle peaking and coming down, what type of levers do you expect to pull to maintain profitability? Are you going to be quick to pull out production, is it incentives, do you drive back more sales to the daily rental channel? How are you thinking about navigating what looks like a cycle peak and decline from there last year and at least in North America?

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

Okay, Dave. Well, let me take those and see if then Jim would like to comment. So in terms of industry, we don't have it in this deck, but we had indicated in our prior guidance, and I think it was 17.7 million, the prior guidance, that we would see a further decline in 2018. So I think the way to think about it – I know we're all kind of struggling with this to figure it out, because I see what you guys are forecasting too.

Our view is that what, however, you wanted to describe it, an eroding plateau, I've seen that, or however you want to characterize it, very strong sales, we don't see anything in terms of the economy, the health of the consumer, housing, oil, the oil production is back up and that's had an impact on trucks for example, that would suggest that over the next two – let's say two years, that there's any kind of significant collapse or dramatic change. We do think it's going to decline. We think it will be a soft gradual decline.

What we're seeing this year seem to be more on the retail side, probably our fleet side related to what's happening with auction values, a lot of that with rental, but that seems to be the effect this year, we'll have to just wait and see when we go into the next two years or so, what does happen.

That's our view and what we'll do is, as we always do, we update this monthly and we'll share it with you kind of real time, as we have the chance to get together. But that's our view, it's declining, but it's still going to be very strong.

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

In North America, Bob, the belief is, David, that all the work we're doing for new products, these are going to be forthcoming, so there's an improvement in the mix of products because of what we're inventing. We see opportunities, as I mentioned a minute ago, in the F-Series with the refresh. You've already acknowledged the Expedition and the Navigator, Transit as well. This is a product that has very high share and has a big advantage in terms of people love what it can do and so we're investing there as well, so think of the North American product mix isn't sitting still.

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

The other thing that I would add in terms of things that we would think about as the industry softens a bit. To me, there is no better time than to follow the principles of a disciplined approach to the business. You have got to be even more disciplined. You've got to be anticipating a bit more where the industry is going, where you see changes. You got to act superfast. And if anything what, and I know this is Jim Farley's mindset and Joe as well.

The other thing that we should do, you don't wait for it to happen. You've got to start kind of lean yourself down in the areas that you know will be affected by the downturn on the way towards what will be downturn, so for example stocks. We do have targets on stocks. But can we grind that a little bit lower than the target stocks, and can we kind of glide our way down a bit, so that when the sharper downturn occurs that we're in better shape once it starts.

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

And in earlier calls, Bob, I remember you were establishing that we were managing the days in inventory. Let's be candid, the world thought, oh, there's something I miss here, but as this quarter now and the industry plays out, we're real happy with our position right now in the inventories. We were managing that very well.

David Tamberrino

Analyst, Goldman Sachs & Co.

Q

Understood. I think that was clear. And on the go-forward, as we think about new company kind of three pillars of autos that's changing; mobility, electric vehicles, autonomous vehicles, should we be expecting or naturally do we expect spend to continue to increase from here on all three of those? I mean is that the way that we're – or you're going to be approaching the business and somewhat expediting, some of the things that were going on at Ford Smart Mobility at a total company level and getting further into that electric vehicle platforms that were going to come out for 2020, further into the autonomous vehicle development, further into mobility?

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Yes, are you – when you are asking the question, Joe, are you thinking about incremental, are you asking me the question, can we get our total fitness to absorb – oh, excuse me, David, sorry.

David Tamberrino

Analyst, Goldman Sachs & Co.

Q

Well, it's a mixture of both, right, because the spend, seems like it should increase to bring forward the clock speed if you will or pull forward some of this...

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Yes.

David Tamberrino

Analyst, Goldman Sachs & Co.

Q

But then against the backdrop of a declining North America market, how should we think about overall spend?

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Yes, so, I'm going to let Bob tell you the way we're planning that in the current numbers. But I'll just give you the way my body language is. I want to question that you have to sit here and hear us say that, the core business as we knew it, all the spending there is as fit as it needed to be and everything new has to be incremental. I haven't bought that yet.

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

And the only thing I would add, David, is that, this year, we expect in terms of CapEx, and we use that as the surrogate for what do you spend, because there is engineering and other things, but CapEx of about \$7 billion. When you look at our 10-Q, which will come out later today, we had guided over the next five years to – previously to \$8 billion to \$9 billion. I think we're going to take that down to about \$8 billion.

So, I at the moment, would see us kind of moving up to that level, after this year, not necessarily all the next year, but we'll have to wait and see where that pans out, but it's certainly, that's about the level that we see the business running in terms of CapEx. And one other thing that's kind of interesting in that regard, lot of the things that we'll do in some of the mobility spaces, digital services are not capital intensive, so we have to remember that. Also, if you think about the actions that we took around the Focus for North America, we freed up \$1 billion, so part of this is finding smarter ways, which is what Jim was talking on to deploy and allocate our capital, not just spend more.

David Tamberrino

Analyst, Goldman Sachs & Co.

Q

Okay. And finally just in China, can you just talk to what you're seeing from a price down perspective, has it accelerated since the first quarter update? And exiting the second quarter, how do you feel your inventories are, given slower sales pace that we saw at least in the second quarter?

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

The overall industry pricing accelerated in the second quarter, which I think we had expected. I think we're still on track towards, I want to say, 5% for the full year. And that seems to be pretty much in line with what we're experiencing ourselves. So, I think that's – that seems to be the path that we are on.

We took a lot of actions in the second quarter to get our stocks in shape, because of the issues – the sales performance issues and also the lower industry that we talked about in the first quarter of the year. So, I think we are in pretty good shape right now. And then going back to the earlier question that we had – that you gave us around what you'd do, I mean, Jim has been really fast with Joe as soon as we see sales miss or anything in the external environment that suggests that we need to take out stock we're doing it ASAP.

David Tamberrino

Analyst, Goldman Sachs & Co.

Q

Understood. Thank you for the time.

Operator: Your next question comes from the line of Joseph Spak with RBC.

Joseph Spak

Analyst, RBC Capital Markets LLC

Q

Thanks for the time. A question for Jim. So one of the things you've mentioned is looking at capital. It's come up a couple of times, and making sure that's used efficiently. So along those lines, and as the industry migrates more towards xEV technology, well, first, do you have a sense of how much of your current PP&E is related to internal combustion engines? And I guess more importantly, what percent of that equipment do you think is flexible enough to be repurposed? And as you make new capital decisions, are those purchases being made with a certain level of flexibility in mind?

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

I would say yes, yes, yes. I mean, I don't know that I'm going to tell you some of the internal strategic things about that, but remember, Ford's ability to produce an ICE engine and the kind of engineering to bring that to the level of quality that I think is world class is the same kind of talent that will allow us to bring these new Powertrains. And they themselves can carry the day I believe in the future with robust designs and better business models and better digital services. I mean, there is more to the quest for profit than just what's it cost us to build the vehicle.

As we can stare at other competitors that are doing this and I am not worried about the embedded cost, let me just state this for the record, I am not worried about the sunk cost or the fixed cost we have in the old historical technologies, frustrating us about thinking of the future. It really doesn't matter. I mean, we're going to do what we got to do to make the company really successful and meet the kind of requirements that we have to meet and win the way you hear me talking about. And I don't think about how many factories I have building gasoline engines. Now, I know that if I flip that, that you can ask – you're asking a really smart question, which is, can you leverage capabilities at Ford? And absolutely, we can. That's something that you will expect.

And you'll go what's an example right now? Just think of the early investment we made in Chariot, that's a Transit platform that we know a lot about, as we build the ride-hailing and ride-sharing service ideas, and we're learning about users in those kinds of experiences that can backward integrate in the way people just experience the Transit when they're not sharing it. So, there's lots of synergies in the future back to what we've already understood about our business.

Joseph Spak

Analyst, RBC Capital Markets LLC

Q

Okay. Thanks. Look forward to hearing more about those opportunities.

Operator: Your next question comes from the line of Itay Michaeli with Citi. Your line is open.

Itay Michaeli

Analyst, Citigroup Global Markets, Inc.

Q

Thanks. Good morning. Just maybe shifting gears to South America, it does look, it looked like you've narrowed your losses a bit year-to-date on plan with your guidance. But I was hoping you could give us a little bit of a better view of how you are thinking about the second half in South America. Where your breakeven levels there are? And what the path there is to get back to profitability for Ford in that region?

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

Thanks, Itay. Good morning. The path is really going to be around what I touched on, when we were going through the section, which is the recovery of the industry firstly and the consumers. So, when we look at the second half of the year, we expect to see substantially better results on a year-over-year basis than what we saw in the first half of the year. And much of that's going to be driven on the back of the industry, a little bit of mix, but also some pricing without too much impact of exchange based on how we see the market right now. And cost being very, very well controlled with some inflation getting through, but very well controlled.

As we move forward, I think and as momentum continues in the economic recovery, again the leverage effect, I think it's going to really flow through quite quickly. And then what the team also is working on of course is product. We need to make sure that we've got a very robust and exciting product portfolio and that later this year, we're going to be launching the EcoSport, the mid-cycle change on that which has been a very successful product there. And we'll also have coming a mid-cycle change on the Ka, which is in the highest volume segment in the region. So, those are the things that I think we're going to have to build on for product portfolio and bring more customers into the showrooms from that point of view and our team is working on that.

Itay Michaeli

Analyst, Citigroup Global Markets, Inc.

Q

That's very helpful. And then maybe a follow-up for Jim. As you go through your 100-day review, can you talk a little bit more about the revenue opportunities that you are looking at? And also, maybe how Ford's investments in Big Data kind of play into some of the opportunities both within revenue and fitness that you described on slide 3?

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Well, you led me to that answer in the knowledgeable way that our GDIA helps us – this is an important thing that was invested in that's really been worth its value. So it helps us understand demand in a lot more granular way, it helps us understand pricing, it's going to help us understand pricing even better. So, right now, we're looking as I mentioned in my comments, the relationship between mix and pricing is where the revenue opportunities are. That's probably as much as I want to share about it, because it's competitive, but there is opportunity there.

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

And maybe I can just give you an example of what Jim was talking about, Itay. For example, GDIA for quite some time – we're probably most progressed in the U.S. in terms of their ability to help guide us in terms of how we play volume versus mix versus incentives versus types of incentives, the effectiveness of the marketing, the fixed

marketing, the advertising sales promotion, so we've got tremendously strong data and starting to move to the point where we can actually understand individual customers, not just the broader market, but individual customers.

But one of the good examples and this plays a bit to what we've seen unfold across the industry, but perhaps more so at Ford, which is around the cars. As we've looked at the data, and we've looked at our own data and we've looked at the competitors, there's just not much elasticity on the cars. So, we can put more variable on that. It's not going to do anything other than we spend more variable. So, that has enabled us to kind of pull back a bit. And in fact I think in the second quarter, we pulled back on our incentives in an absolute sense, much less than increase for the industry on cars, if I remember correctly.

And we've been able to take those funds, and we may be able to allocate to other segments and specific vehicle lines combined with an aligned advertising sales promotion approach, but also Tier 2 marketing by the dealers and Tier 3, to be very aligned and very powerful around where we know the most elasticity is, and really drive hard. So, that I think has saved us incentives and it's probably given us some off the mix effect that we've had, it's also I think given us a clear view about the real underlying strength of the car business in general, but ours specifically.

Itay Michaeli

Analyst, Citigroup Global Markets, Inc.

Q

That's very helpful. Thanks so much for all that detail.

Operator: Thank you. We will take one more analyst and then we will switch to the news media. [Operator Instructions] Your next question comes from the line of James Albertine from Consumer Edge Research.

Derek J. Glynn

Analyst, Consumer Edge Research LLC

Q

Hi. Thanks for taking my question. This is Derek Glynn on for Jamie. Jim, in your view, can the success of emerging opportunities be complementary to the success of the core business or is this inversely related? And similarly, recognizing it's still early days since the investment in Argo AI, what are your views on the strategic vision for that entity and the role it could play going forward? Thanks.

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Well, the important secret in this, Derek, is that humans are in both of those models. People use the products in the historic understanding of our industry and that's our target obviously in the future. Even though and I am being a little facetious, but even though there is robots in the future, right, as you're targeting about with Argo AI, so the robots are only going to be as effective as how they serve the humans. This is a distinct position that I am taking and I think there's going to be a difference in the way Ford thinks about it.

So, Bill Ford and I had a really intimate discussion about this when I started in the board. Then later, which is – the history of the company is evolving itself over this long-lived life and not thinking about that it's in a regressive way unable to leave the last phase to the new. I mean, we just got to do what we have to do to win and be successful in the future.

What tends to happen, you are hearing me preach here a little bit, is we over-romanticize that future. We over-dramatize. Bill Gates used to say you overestimate the arrival and you underestimate the impact of these

technologies. So, we have to get ready for how disruptive they are, but they probably aren't as soon as everybody is writing about them. We're ready though, we're going to be ready.

And so, Argo was an investment in that area. John Casesa, our Head of Strategy, helped put this together and it was a really innovative idea, because to get that kind of talent inside Ford, the configuration of the entity in Pittsburgh allows us to have them be us and then be them. They can be both together. It probably wasn't known as deeply as you can read about today, is the deep learning, is a phase of artificial intelligence that's recent. It's only three years really in its awareness. And deep learning is kind of the special pixie dust the way these things are going to really perform. The ability to do that is what we're targeting with Argo AI to bring that capability into Ford. There's very few firms in the world creating what we're talking about that have this capability.

And so, that promise is something that we have to come and show you, but it's situating us really well to be ahead in that game eventually. We're not there yet. I wouldn't say we're number one, but we're at the top of the people working on this technology. As we go into the media discussions, someone is going to ask me to calibrate that, but you just – you got to trust the way machine learning has evolved. There are differences. There is kind of elite kind of players in it and then others that are kind of good at it. We're going to be in that elite level with this capability.

Derek J. Glynn

Analyst, Consumer Edge Research LLC

Q

Okay. Thanks very much. That's very helpful.

Operator: We will now take questions from the news media. Your first question comes from the line of Dee-Ann Durbin with The Associated Press.

Dee-Ann Durbin

Auto Writer, The Associated Press

Q

Thank you for taking the call. Bob, a quick one. What's the update on the buyout offers? Are you getting what you need and if you don't get what you need, do you then consider layoffs? And, Jim, another quick one. Just your take on Ford stock price and what it's going to take to move the needle to kind of get past the cycle fears that investors just can't seem to get over? Thanks.

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

Okay. Thanks, Dee-Ann. So, on the first one, based on the latest that I have seen, it's progressing well. I think they have until sometime later this month, someone's saying today. Today? To select. You'll have to see what the final numbers are, but I've been told it's going well. Just for the analysts on the call, we will reflect any separation cost associated with that in the third quarter as a special item. Don't know what that number is, but we'll report it in the third quarter.

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

And regarding, Dee-Ann, the share price, there is no CEO in the world that doesn't understand that that currency is not only how they are compensated, their teams are compensated, but is the scorecard for how well things are going. But the way I think about that, it's a consequence. It's not a leading indicator. So this share price today does not reflect the team's activities that I believe we're going to embrace and deliver to you. So that has to happen with dispatch and more importantly what Bob and I talk about, Bill and I talk about is reliability where you

expect things from us and that we build trust in the way we create value. I've been in the business, been around CEOs that have that kind of command and so I long for that and that's my pitch that the share price over time is going to reflect what we're able to get done and we plan on getting a lot done.

Dee-Ann Durbin

Auto Writer, The Associated Press

Q

Thank you.

Operator: Your next question comes from the line of Brent Snavelly with Detroit Free Press.

Brent Snavelly

Automotive Reporter, Detroit Free Press, Inc.

Q

Hi. Thanks for taking the question here. I'm wondering, as the industry goes through this very big trend of car sales declining, as SUV, crossover, and pickup sales increase, if your review of capital allocation – I mean, if you're looking at car lines and if there are cars in the U.S. get risk of being eliminated as you add SUV models?

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Well, I'm looking to Bob because – and as I came into the job, I knew we were in the middle of that. So I want to confirm we do. That is one of the leadership responsibilities. And there's been some decisions that have been in the air, so to speak, but I'm going to let you...

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

Yes. I think, Brent, what you're talking about is consumers are moving away from passenger cars into utilities and trucks. They've been doing that for quite a long time. They've been doing that not just here, but in all the major markets of the world. And there is no sign that trend is going to continue. So we will be responding to what the customers want. That's around the – the guidance we have already provided is around investing more in utilities and investing more in trucks.

But in some markets and for some reasons, cars will continue to be important. We're just going to be very thoughtful about the amount of investment that we make there and make sure that it gives us an appropriate return. So I think two examples that demonstrate that is the decision around the Focus, so we will still provide a Focus to customers in North America. But we're going to do that in a way that's very capital efficient and saved us \$1 billion versus what we had expected. And we'll do so in a way that gives us a better return than what we would have done if we've just continued on the path that we had been on.

And we're going to look at all the individual vehicle lines with a very critical lens as we go forward, because we've got to make a return on that investment. Another example is in Europe, the B-MAX. The B-MAX is a small multi-utility vehicle in a segment that's declining and we're going to be discontinuing that. That's going to be replaced by the EcoSport to be built in the Craiova plant, which is going to be much higher volume and it's exactly what consumers want. It's a very big growing segment. So we're going to do that type of activity right across the portfolio everywhere in the world in response to what consumers want and our desire to get an appropriate return.

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

And, Brent, to add, you know the utility mix in the company is high. That continues and we're adding, of course, the Ranger and the Bronco coming. There is other ideas that are coming in that category. For those who wonder, are you worried about over time that as fuel, let's say, starts to shift again or there is a different conscience about utilities, that's why Ford's investment in these aluminum understructures was so prescient. That's why our ability to put hybrid and other kind of Powertrains is going to be really important. And so let's just make an investment in this category that's been very profitable for us and future proof it a little bit because of the way we're thinking about their performance over time.

Brent Snavely

Automotive Reporter, Detroit Free Press, Inc.

Q

Is there any way you can speed up getting Ranger and Bronco to the market and EcoSport or is that schedule sort of baked in at this point?

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Well, you've to come and help me twist arms. I'd take it as soon as I can. But the rigor of getting this done right, I think, is the thing I'll lean into. We got to do it the right way. So it's getting all the attention that it deserves to get here at the right price, right time kind of equation.

Brent Snavely

Automotive Reporter, Detroit Free Press, Inc.

Q

Okay. Thanks.

Operator: Your next question comes from the line of Christiaan Hetzner with Automotive News.

Christiaan Hetzner

Correspondent-Automotive News Europe, Automotive News

Q

Yes. Many thanks for taking my question. I need just one to ask really quickly. What your views were about Europe in particular, in terms of the number of brands competing, the complexity in the market, the role of diesel, upcoming CO2 emissions targets and, of course, Brexit. How do you view the region? Is it something that over the long-term remains attractive for you? And, secondly, very quickly about the Fiesta launch. How important is the Brexit effect in that, given that that is the most important market – the most important car in that market for Ford? Thank you.

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Well, let me start and then I'll give it to Bob to add precision, because this is something I think about a lot. I think, every – by the way, every CEO that competes in Europe in all industries have stepped back. The industry that I was in before this had similar kinds of challenge to compete there. What's top of mind for me is how strong the Ford brand is there. So when you witness other things that have happened in our industry, the Ford brand is highly regarded. I've learned the Mustang, for example, I think, last year, Joe was number one sales in Europe, I mean – and that was a decision by us to take that to market and look how well it did.

So, there is reinforcement over and over again. Jim Farley, who just came to head up all the markets for us, was just in-charge of that for the last three years. And we're able to make that profitable. And we can – now Brexit was a twist in that. I don't think any of us saw that. I mean, if you were thinking of predictive kind of exercises, the kind

of things we're going right now. We did not sit as a management team and say, hey, Brexit's going to happen and therefore your footprint's going to be under pressure.

But we're business people. So, we're accepting that and we're deliberately now thinking about how to play to win there. But I want you to know, we're in Europe. I mean, Ford can be really successful there. We've got great response to the Fiesta. I'll let Bob tell you about that. And so, I'm bullish on it, but that we've got to address the issues that come from Brexit. And the mobility play, as it had all this promise, and it means lots of things to different people has a real attraction in Europe. There's some things there that we see them as early adopters of that we're trying to leverage. So, I want to leave the message that Europe is a place we're going to be.

Robert L. Shanks

Chief Financial Officer & Executive Vice President, Ford Motor Co.

A

So, the only thing I would add is that we do see opportunity for the Fiesta as I touched on earlier. It's our highest volume product. It's the fabulous product that we're bringing to the market. And clearly, it's going to give us an opportunity in 2018 and in the latter part of this year. I think a couple of other points think about, I mean PSA and even our own performance has demonstrated that one can make profits in Europe, now always to do is make better returns in Europe and certainly we're very focused on that, although to be frank, probably the type of return that you get in Europe, won't be what it is in the United States because of the structure of the market and competitiveness, the products and so forth. But we do believe that we can get an appropriate return in Europe. The other point I would make is around Russia. There is Europe and there is Russia, and Russia clearly, we believe has the opportunity to first grow, which seems to be the largest individual market within Europe but also to give us very good returns. Although recognizing that will be more cyclical than probably the underlying European business itself. So we still feel a lot of excitement about Europe. We're very committed to Europe. We think we can get the appropriate returns in Europe. We are all in and we are working to improve the business in response to curveball that Jim just mentioned around Brexit.

Christiaan Hetzner

Correspondent-Automotive News Europe, Automotive News

Q

Thank you very much.

Operator: Your next question comes from the line of Matthew DeBord with Business Insider.

Matthew DeBord

Senior Correspondent, Business Insider

Q

Good morning. Two quick questions for Jim. First is Jim, if you could just give us possibly a specific example the Ford product in which you're applying some of the systemic design thinking that you spoke of earlier in the call?

And then second question is about Silicon Valley, if you think Silicon Valley is in trouble, as far as the transportation and mobility initiatives go and might need victory at this point, might need the traditional car business to show at the way to bring some kind of value monetize some of these opportunities?

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

A

Yes. And, Matthew, let me take the first one first. The AV is a perfect candidate for the techniques that you hear me talk about and for all kinds of reasons, just a highlight for you because we can look back the perfect hindsight and say, who were the leaders in the computer industry Commodore, Atari, Digital, at the time when I was young and PCs were starting to come out, IBM came later. And all four of them going to win and most of what the history

will show us was the use evolution of the science happened too late. So I'm trying to bring the discipline that says this technology is coming really fast and we've got to make it people centered very early if it's not a way of winning, so.

So let's use that, the leverage of that is as I look at your second question, I don't – I would never -- it would be arrogant for me to say the valley is in trouble in any kind of regard, kind of work that's created out there and value for shareholders. But I think you've heard me say a few times, I don't think we have to cede the future of the transportation to them, in ways that Ford is in here. I just don't believe that. And I've been saying this in meetings I have had with analyst and press that they may need us more than we need them, because the export of software is not as difficult as the export of the vehicle constructs that we've learned.

These vehicles have to protect people, save lives and have to perform in extreme conditions. And so, that stuff, we have a lot of awareness about. The concern that anyone would have is we, are we, were we asleep at the switch that we didn't understand them coming; of course, we do. In fact, there is Ford people that have been recruited into some of those businesses. So I'd like the – I'd like the challenge of trying to prove to everybody that this technique I'm talking about our capabilities married together, make us a really good player in the future.

Matthew DeBord

Senior Correspondent, Business Insider



All right. Sure. Thank you.

Operator: This concludes the question-and-answer session. I will turn the call back to Jim Hackett for closing remarks.

James P. Hackett

President, Chief Executive Officer & Director, Ford Motor Co.

Yes. So I just want to thank everyone for joining us today. I appreciate you being patient with me as I start the 100 days, I want you to know, every day I get up, I think about clarity and focus in delivering, understanding about where we are going and so we look forward to meeting you in the fall with more information.

Operator: This concludes the Ford Motor Company earnings conference call. Thank you for your participation. You may now disconnect.

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