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CORPORATE PARTICIPANTS

Lynn Antipas Tyson
Executive Director, Investor Relations, Ford Motor Co.

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.

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

James D. Farley, Jr.
Executive Vice President & President-Global Markets, Ford Motor Co.

Marcy Klevorn
Executive Vice President & President-Mobility, Ford Motor Co.

OTHER PARTICIPANTS

David Tamberrino
Analyst, Goldman Sachs & Co. LLC

John Murphy
Analyst, Bank of America Merrill Lynch

Rod Lache
Analyst, Wolfe Research LLC

Ryan Brinkman
Analyst, JPMorgan Securities LLC

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day. My name is Deirdra and I will be your conference operator today. At this time, I would like to welcome you to the Ford Motor Company Fourth Quarter 2018 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] After the question-and-answer session, there will be closing remarks.

At this time, I would now like to turn the call over to Lynn Antipas Tyson, Executive Director of Investor Relations.

Lynn Antipas Tyson
Executive Director, Investor Relations, Ford Motor Co.

Thank you, Deirdra. Welcome, everyone, to Ford Motor Company's Fourth Quarter 2018 Earnings Call. Presenting today are Jim Hackett, our President and CEO; Bob Shanks, our Chief Financial Officer; and Jim Farley, President of Global Markets. Also joining us today are Marcy Klevorn, President Mobility; Joe Hinrichs, President Global Operations; and Brian Schaaf, CFO of Ford Credit.

Jim Hackett will begin with a brief review of our progress relative to the value creation framework. Bob will then review our quarter results in more detail, and then Jim Farley will talk about the actions we're taking to improve our performance in China and Europe.

After Jim's comments we'll open the call up for questions. Following Q&A, Jim Hackett will have a few closing remarks. Our results discussed today include some non-GAAP references. These are reconciled to the most comparable U.S. GAAP measure in the appendix of our earnings deck which can be found, along with the rest of our earnings materials, at shareholder.ford.com.

Today's discussions include forward-looking statements about our expectations for future performance. Actual results may differ from those stated, and the most significant factors that could cause actual results to differ are included on slide 47. In addition, unless otherwise noted, all comparisons are year-over-year, company EBIT, EPS and operating cash flow are on an adjusted basis, and product mix is on a volume-weighted basis.

Now, let me turn the call over to Jim Hackett.

James P. Hackett

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

Thank you, Lynn, and thanks to all of you for joining us today. If you would turn to slide 2, as we recap 2018 and look ahead to 2019, I would like to make a couple of points to start our discussion this evening. For Ford, 2018 will be known as the year between the business that wasn't designed right and the business that we know will win.

Certainly, it was a challenging year, in that we were hit by some headwinds outside of our control and frankly, poor performance in some parts of the business which we have now taken action to address. Importantly through 2018, was a year of progress where we laid the foundation for a much stronger, more resilient and more dynamic business, a business that we want to tell you can thrive now and in the future. So, I am really optimistic as we enter 2019. We have a clear vision, we have a solid plan, and we are in execution mode.

We're fortifying and building on our strengths to start and taking decisive action to address underperforming parts of the business. Some that you know about, for example, were our decision last April to phase out sedans in the U.S. and our restructuring in Europe that we announced recently. And Jim Farley will touch on this later, along with the action we are taking in China to restore profitable growth.

We are reorganizing and resizing our global salaried workforce, and we're retooling product development to bring more unique, customer-focused product to market more efficiently. We're leveraging relationship where it makes sense to be more cost and capital efficiency, hence, as our alliances with VW and Mahindra. Our work on AVs and Mobility is advancing quickly. We're connecting every new Ford vehicle in the U.S. to the cloud. And soon, these vehicles will talk to the world around them through the technology known as C-V2X. Through this, we will help usher in a new transportation system that reduces traffic congestion, accidents, and improves CO2.

Now let's turn to slide 3. I will cover our full financial metrics here. For the year, revenue grew 2%. We generated $7 billion in EBIT with a margin of 4.4%, and we delivered $1.30 in EPS. Now led by North America, Auto EBIT benefited from the largest improvement in market factors in seven years. This benefit was more than offset by commodity and currency headwinds and higher net product costs as we entered a major product refresh cycle. We also incurred higher warranty costs and the Ford-specific challenges in China and Europe, again confirming that we are addressing all of those. Importantly, in the face of all that, we generated $2.8 billion in company cash flow and we ended the year with $23.1 billion in cash and $34.2 billion in liquidity, both well above our targets.

I'd ask you to turn to slide 4. This is the strategic highlight slide. Now on every market, this team is focused on introducing a fresher, more targeted and appealing lineup that can compete and win in the marketplace. For example, in the U.S., over the next 24 months, we are refreshing 75% of the lineup. In that we're bolstering our strong pickup in commercial vehicle business, [ph] note a (05:52) $72 billion global franchise with 14% EBIT margin. In 2018, our F-Series outsold the nearest competitor by the widest margin ever. And our transaction prices were about $2,000 above segment average.

In the U.S., we recently started selling the new Ranger and early customer interest has been very strong. In Europe, we are expanding our profitable Transit Commercial Vehicle franchise that includes new services and revenue streams in that strategy. Now, given our brand strength and capability, we have the opportunity to create a similar stronghold in SUVs globally and we are moving quickly in this area. The new Explorer we revealed last week in Detroit at the Auto Show is but one in a series of world-class SUV that we're bringing to market. The Lincoln Aviator is another example. And I have to say we've been really pleased to see the experts note how superior the Aviator is to other brands that it competes against. We also launched the all-new Focus and Escort in China, and this is the first of many new products for China. Jim will hit on this area as well.

In terms of advancing our propulsion strategy, we introduced the new Explorer Hybrid, the first of our next-generation of advanced hybrids that provide no compromised blend of capability and efficiency. We will reveal a new fully electric utility later this year with, if I say so myself, stunning design, performance and technology. And we've confirmed that we have started early work on a zero-emissions version of the F-150.

In November, shifting to the press review of self-driving technology, we demonstrated how that technology will propel self-driving fleets in partnerships with cities and businesses to deliver people and goods in new ways with new business models. I was very happy with the reviews that that generated.

As we build out our Mobility business, note that we acquired the e-scooter company, SPIN. And this is to deliver first-mile and last-mile mobility solutions.

Lastly, the bottom-line impacts of our fitness initiatives on operating leverage will continue in 2019. I get asked about this all the time. Let me tell you that from 2013 through 2017, our Automotive structural cost increased by $1.7 billion per year on average. We've arrested this trend in 2018. We kept cost flat year over year, and we expect our structural cost to be flat again in 2019.

Before I turn it over to Bob, let me say in the coming months that of course you can expect us to share more specific initiatives related to the redesign of our global business. There's nothing more important than having you understand what's happening there. I want to confirm that plans are in place and that we're taking action. These announcements, though, have to come in a coordinated way as we work respectfully and constructively with our stakeholders.

Now, let me turn it over to Bob Shanks, our Chief Financial Officer. Bob?

Robert L. Shanks

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

Thanks, Jim, and good evening, everyone. Before going through the details, I'd like to provide some context on the quarter and the year, and to keep it simple, I'll just focus on the full year, although my comments generally apply to both periods.

First off, let me reiterate what Jim said about our market factors. It's been a year of no global growth in industry volume and of relatively light new product action at Ford, we delivered very strong market factors, specifically strong mix and higher net pricing. We delivered 45% of this in the fourth quarter alone. It's probably fair to say that most folks didn't expect this from Ford, given our product refresh plan for the year. And you should note that in 2019, we have planned a more active year of significant product actions in growing segments.

Secondly, in 2018, we incurred headwinds of about $3.3 billion in four areas. These impacts are not indicative, for the most part, of the ongoing run rate of the business. The first, roughly $750 million in tariff-related effects. The second, $1.1 billion of increased commodity cost unrelated to tariff effects. The third, about $750 million of unfavorable exchange net of pricing were taken to partially recover some of this impact. And fourth, about $775 million related to the Takata recalls announced last year in North America.

Now, this $3 billion impact, we incurred a bit more than $1.9 billion in North America. North America's EBIT, however, declined year over year by only $450 million. This suggests to us that Kumar Galhotra and his team delivered strong improvements elsewhere in the business as they continue their aggressive work to return the region to a 10% margin.

South America absorbed about $400 million of these headwinds, yet it delivered a $75 million EBIT improvement from 2017. Again, this demonstrates to us that the efforts of Lyle Watters and his team to successfully pushback against these adverse trends, not to mention other inflationary effects not counted in the $400 million [audio gap] (11:37), as they approach the fundamental redesign of the business in the region.

The two regions that essentially drove the year-over-year decline in Automotive and company EBIT, both for the full year and in the fourth quarter, were Asia Pacific, specifically China, and Europe. Asia Pacific took on about $400 million of the company headwinds, yet delivered a much deeper decline in results from 2017, $1.8 billion in fact. And Europe, Europe absorbed about $600 million of the headwinds yet saw a year-over-year decline of $765 million, and that was with the strongest product refresh among all our regions in 2018. These results underscore the urgency we have in addressing Ford's specific performance issues and executing fundamental redesigns of our business models in these regions to generate appropriate returns on future capital that we may allocate to them.

Finally, I'd be remiss if I didn't highlight, both for the full year and the quarter, the continued strong and stable results from Ford Credit.

So with that, let's turn to slide 6, the summary of our company key metrics. There's three things I want to highlight here. First, in the quarter, all key metrics were lower from a year ago with the exception of revenue, which benefited from strong mix in North America and higher net pricing across all regions, except China. Performance in China and Europe drove the year-over-year decline in most of the other metrics.

Second, company-adjusted EPS in the quarter was $0.30 per share, and this includes an adjusted effective tax rate of negative 4% driven by the favorable impact of U.S. tax planning and tax reform. Finally, company GAAP net income was a negative $116 million. This includes adverse special items of $1.2 billion. Two major items drove this. First, we incurred a negative non-cash pre-tax mark-to-market adjustment for our pension and OPEB plans that totaled $877 million. This was due to adverse financial market conditions that occurred late in the year. The second was personnel separation charges of $262 million.

Now, turning to slide 8, favorable results in Automotive and Ford Credit more than accounted for the company-adjusted EBIT of $1.5 billion. This result was nearly $600 million lower than the year-ago period, explained mainly by a lower Automotive EBIT. In Mobility, we incurred a loss, as planned, driven by investments to develop our mobility services and autonomous technology businesses.

Next, looking at taxes, while total company taxes were low in the quarter, this compares to a positive absolute total tax effect a year ago, resulting in a large unfavorable increase in the impact of taxes. This largely reflects the non-repeat of favorable U.S. tax reform and tax planning effects a year ago.

Slide 9 shows that North America generated $2 billion of the $1.1 billion Automotive EBIT. Operations outside North America were individually and collectively at a loss, which increased from a year ago. China and Europe drove the increase in the combined loss outside of North America.

Slide 10 highlights Ford Credit. In the quarter, Ford Credit delivered earnings before taxes of $663 million, up 9%. The full year EBT of $2.6 billion was the best in eight years. Ford Credit continues to operate very well and support Automotive effectively. U.S. consumer metrics remain healthy.

As shown on slide 11, we ended the year achieving positive company-adjusted operating cash flow in the quarter and the full year. We also ended the year with a cash balance of about $23 billion, with liquidity at more than $34 billion, both above our targets. Cash net of debt was $8.9 billion. Our global funded pension plans at year-end continued to be fully funded taken together and de-risked.

Turning to the full year for a moment, slide 12 shows that Automotive and Ford Credit results more than accounted for company-adjusted EBIT of $7 billion. Mobility and Corporate Other, as expected, were losses. Compared to a year ago, the lower Automotive EBIT fully explains the decline in company EBIT.

Bridging to our GAAP net income results, special items for the full year were driven by the fourth quarter pension and OPEB remeasurement adjustment and personnel separations across North and South America and Europe.

Slide 13 focuses on the regional results of our full year Automotive EBIT. Like the fourth quarter, North America more than explained the profitability while we incurred losses outside of North America. Compared to the prior year, and like the fourth quarter, the decline in Automotive EBIT was essentially due to China and Europe. Unlike in the fourth quarter, North America was down in the full year as well, due to the headwinds that I mentioned earlier.

Turning to our outlook for 2019, as shown on slide 14, we see the potential for year-over-year improvement in key company metrics including revenue, EBIT margin, ROIC, cash conversion and adjusted debt to EBITDA. This is based on what we control and the specific assumptions we've made for key external factors as we shared last week in Detroit at the Deutsche Bank conference.

From a business unit perspective, we expect North America, China and Europe, where results were lower in 2018, to lead the potential EBIT improvement. Drivers of this would be the favorable effects of new products, fitness initiatives as they gain greater traction, and a turnaround, at least in part, of the major factors that led to our lower China performance in 2018. Offsetting these positive effects in part will be higher investments in Mobility, both for our autonomous vehicle business and mobility services development, as well as lower, though still strong, earnings before taxes at Ford Credit. This reflects lower volume and margin, and higher operating costs.

Now, before going to Q&A, Jim Farley is going to provide his insights on the actions that we're taking in China and Europe to improve our near-term performance in both regions. Jim?

James D. Farley, Jr.

Executive Vice President & President-Global Markets, Ford Motor Co.

Thank you, Bob, and good evening. Let's turn to slide 15. Before I dive into the actions we're taking in China and Europe, I would be remiss if I didn't put a finer point on the opportunity in North America this year and our 10% EBIT margin target.

Last year, North America delivered $2 billion in favorable market factors, as was mentioned, supported by positive mix and pricing from a largely carryover product lineup like F-Series and modest new product launches like the new Expedition, Edge and Navigator. This year, we're beginning our complete refresh of our North America lineup. As Jim mentioned, we're adding Ranger, which is off to a great start, to our truck lineup. We have the new reengineered rear wheel drive Explorer, America's all-time best-selling SUV. We have brand new hybrid and performance models of Explorer. We have a wonderful new three-row Aviator, which is a new nameplate for Lincoln. And later in the year, we have the all new Escape and Escape Hybrid, which will be a new product in the largest U.S. segment in our industry. We even have, at the end of the year, another all new Lincoln utility.

So let's turn to China. Obviously, China is the largest automotive market in the world. And we think it could be twice the size of the U.S. by 2025. So getting our business back on track is essential, given our plan to grow both brands in China.

Last year, as we discussed with you, we identified a number of operating shortfalls including inadequate dealer profitability. We had excess stock, especially of our high volume C-cars. These deficits were exacerbated by the fact that we had not maintained a fresh lineup. In fact, all of our volume cars were in sell down last year. Also, our structural costs were not aligned with our volume, and we lacked a strong bench of local leadership. Well, we've been working tirelessly and urgently to address each of these issues with a focus to restoring profitable growth immediately. At the core is having an engaged and profitable dealer network. For example, by the end of last year, just about a third of our dealers are now profitable. And we expect this positive trend to steadily increase this year with our new lineup.

Relative to inventories, in the fourth quarter, we've reduced our aged inventories by roughly 60% quarter-over-quarter. And as we prepare to clear the decks for all new product lineup, this is critical. This includes as well the launch of the all new Escape and Focus, both of which produced a double-digit increase in transaction prices last quarter. Well, these are really encouraging results. We're also on top of these products, adding more than 10 new Ford and Lincoln products to China through our distribution network. We're also aggressively tackling costs in China. Simply by sourcing from true local Chinese supply base, we will cut our material costs and we are targeting significant reductions in structural cost for our consolidated operations.

Lastly, to ensure China receives the proper focus, we've broken it out as a separate business unit reporting to me, and we have local China talent in key management positions such as Anning Chen, our new CEO, as well as new marketing and sales leads for both Ford and Lincoln.

Let's turn to Europe. I've said in the past, to deliver on our long-term target of 6% EBIT, we are now redesigning our European operations. The core of this is to leverage our profitable light commercial van and pickup business and aggressively attack costs and drive improved capital efficiencies. Earlier this month on January 10, we announced our plan to achieve this, including much more targeted vehicle lineup with three customer-centered business units. And most importantly, we're standing up a dedicated light commercial vehicle group with its own general manager. We're also addressing our cost structure head-on. We've already begun the formal consultation process with our key union partners in Europe.

Turning to the core of our portfolio in Europe, last year marked our fifth consecutive year of growth in share in the light commercial vehicle business. And we plan to extend that lead as Europe's number one light commercial vehicle brand this year, including key product improvements on Ranger and Transit later this year.

With passenger cars, we will reduce our lineup while focusing in higher margin series mix such as our new Fiesta and Focus ST and Active derivatives. Now, relative to profitability, we are prioritizing our higher margin markets like Germany, and we will improve or exit unprofitable products and markets. In addition, we're also targeting a significant reduction in personnel and structural costs. You are going to hear more about specifics this year after the consultation process is completed. Assuming a steady macroeconomic for our business units around the world, we believe all the actions I've just shared with you will drive favorable mix this year with a fairly flat cost structure, as investments in our all-new utility products across the globe are offset by our specific cost actions.

With that, I'd like to turn it over to the operator for Q&A.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of David Tamberrino with Goldman Sachs.

David Tamberrino
Analyst, Goldman Sachs & Co. LLC

Q

Oh, great. Yeah, thanks for taking my questions here. Jim, the way you kind of communicated how you think about 2018 as a year and 2017 as a year of kind of planning from a redesign perspective, if we're to fast-forward to the end of 2019 and maybe into the middle of 2020, will 2019 be known as an action year for Ford?

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.

A

Oh, unquestionably, David. And it's worth pointing this out that the time in – I'm going to say in 2017, when we had our first investor conference to the beginning of 2018, we worked on this strategy. We addressed the product portfolio from stem to stern. You've just heard from Jim how important that was. We were constipated in product development. And when we did that, we updated the way we thought about car architectures and propulsion. So we addressed three big issues all at the same time. Got our cycle plan in shape and taking cost out to boot.

The second thing we did is, we – I was really pleased with the AV work with Argo. They really started at the same time in June 2017. So they've only been in real action in 20 months. So in that time that we were planning, we put a lot of work towards thinking about the evolution of the AV. I can just share that, independently, lots of people looking at this business and looking at all the competitors have rated Argo very high. It's not surprising given the talent that we've got there. Then we started to tackle Mobility. And you've heard me talk about, David, that the idea of building a cloud structure and connectivity, we had none of the vehicles really connected back when the call-to-action was being asked for. So we had to get that through product development and now the plan to monetize that. All those things are in shape.

And then, as I tour with you, if you look at North America, it's exemplary for me the way the management team gathering to work and make all this stuff happen with Kumar has really gone very well. They ran into some headwinds that they, frankly, offset a lot of it and then some they couldn't. And then we had a foot fault with warranty this year that Joe can explain in more detail, if that helps everyone understand, that we've arrested, we think, a lot of the issues, and some of them were caused from the past that you just have to deal with.

When I think about, then, in October of 2017, the call from very smart people following the industry saying, hey, what are you going to do about these markets that are underperforming? Every one of them are being addressed.

I also just want to confirm, in China, that I'm not happy with the way we performed there. But the lessons also showing the market moved on everybody, and it's changed. So we just got to be world-class at dealing with that. And you heard from Jim tonight. And we can talk more about that, what's going on in China. So that's my quick tour for you that, from that thinking phase to the doing phase, all those things I just said, just from top of mind – I'm not reading from a list – we're all over that.

David Tamberrino
Analyst, Goldman Sachs & Co. LLC
Q

Understood. But my question's a little bit more around the restructuring side. If we kind of think about...

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.
A

Okay. So...

David Tamberrino
Analyst, Goldman Sachs & Co. LLC
Q

...Ford's footprint today and Ford's footprint – or what it's going to start to look like by the end of this year...

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.
A

Yeah.

David Tamberrino
Analyst, Goldman Sachs & Co. LLC
Q

...will there be – you're expecting material changes is what you're implying?

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.
A

Yeah, so let's cover that. So on the white collar work, hard to explain but going very well, is an attempt, I think it's a modern attempt, I said this at Deutsche Bank, to involve the leadership in architecting a new version of Ford that doesn't have as many levels and layers, less bureaucratic, more team-oriented. We believe we'll have that work behind us by April of this year. We started that last October. So it would have taken us five months. The Europe redesign is a little longer, and we're going to start seeing benefits later this year.

You know, anyone of you that follow industrial companies, paybacks in those parts of the world, because of strong social plans, are four to five years on average. But there's going to be some quick wins and I think the confidence I can just cite is in our management team. We have a plan that's starting to come together. I'm very, very excited about that turning out very well.

There's more news coming on South America. It's not a lack of planning or consideration. It's managing the constituencies and all the different interest. But you don't have to wait long on that, David, so you'll know more about the year there.

The Russian alliance is under review. When I sat in the boardroom that was done and we just did it again, and want to come back with – given all these markets that Jim Farley has led the review of, we will be done with that, and you'll expect – then as you are looking at our forecast, going forward it'll be cleaner. A lot of this will be behind us.

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

Hey, David. It's Bob. Another way of thinking about it that will help you, I think, with what you're trying get at, is that our EBIT charges that we've talked about, $11 billion effectively, they're almost nearly spent by the time we get to the end of 2020. And when you think about the cash effects of $7 billion done largely by the time we get to the end of 2021 because there's a little bit of a lag, as there often is, between the recognition of the charge and the cash going out the door. So you can read from that that we've accelerated the plans from what we've shared with you earlier in the year.

David Tamberrino
Analyst, Goldman Sachs & Co. LLC
Q

Yeah. I think I would agree with that. Thanks for the additional color, Bob. I guess my second question's really, quarter-related it didn't kind of go forward for China. Can you walk us through the headwinds for that JV income which took another sequential step down to pretty seriously negative for 4Q 2018, and how you think about the cadence to improvement, if that's the level that we should probably start out in 1Q and as you launch new products and fill out that wholesales and dealer pipeline, if that's going to turn around the business?

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.
A

I'm going to ask Bob and Jim to tag-team on that. Bob?

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

Yeah, I mean, it was volume. We also had negative net pricing as that's been a feature in China for quite a number of years, but it was pretty simple and straightforward and the team actually delivered some cost improvements, but not nearly enough to offset what we saw on volume. The volume was largely, I call it, us although as we all saw in the fourth quarter in particular, the industry really fell off very, very sharply, and Jim can...

James D. Farley, Jr.
Executive Vice President & President-Global Markets, Ford Motor Co.
A

Sure.

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

...maybe add to that.

James D. Farley, Jr.
Executive Vice President & President-Global Markets, Ford Motor Co.
A

So we certainly have line of sight for improvement narrowing over losses this year. And as we localize several key models this year, next year and coming years, we see a great line of sight for very [ph] solidable (32:03) profitable business in China.

This year, to give you a flavor, we have those more than 10 new products. Our dealer network, as you mentioned, has stabilized now and starting to grow in terms of profitability and engagement, and a lot of those products come in the second half of the year. I mentioned the localization. Those are really key. We have Explorer, three new Lincolns in three years. So the localizations will really drive our profitability in the next few years. Anning and the team have already started on a very serious effort on material cost as well as structural cost as well. We expect that to take hold in the second half of this year and next year.

David Tamberrino
Analyst, Goldman Sachs & Co. LLC

Q

Understood. And if I could just sneak one last one in, are there any type of legacy costs outside of employment contracts that would impede Ford from fully exiting any particular region?

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.

A

I would like to look at the riddle that there's a lot of variables in that consideration, and legacy costs would be one, David. But it's not the only thing that we've thought about.

Operator: And your next question comes from John Murphy with Bank of America Merrill Lynch.

John Murphy
Analyst, Bank of America Merrill Lynch

Q

Good evening, guys. I just like to focus on one thing first on the big positive being mix and price. I mean the industry has been more disciplined and things have been a bit better, particularly in North America as you kind of highlighted. Just curious, when we look at your aged product on a relative basis, what do you think the key driver was that gave you just such significant strong price and mix through 2018 in North America specifically and even in the fourth quarter? The stuff going on in SVT or other things, and what was the big driver there?

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.

A

I'm going to ask Jim to address that.

James D. Farley, Jr.
Executive Vice President & President-Global Markets, Ford Motor Co.

A

Yeah, it's a great question. So relatively speaking, the F-Series is a carryover vehicle but it's still relatively new. One of the big drivers was the impact of the Super Duty on North America. It was really an important positive, and I would say as well, the team is really laser-focused on yield management. We got a lot of really positive news on the controllables for series mix, product mix, through different allocations, different kind of go-to-market strategies, and those are being worked in these vehicle line rooms that we're now institutionalizing. But I would say a lot of it was truck because that was still relatively new and is still, and a lot of it was controllable by the team.

John Murphy
Analyst, Bank of America Merrill Lynch

Q

Okay. That's incredibly helpful. Then as a second question, I mean as we look at the cash flow in the year, it was not the greatest this year and as we look at what we – the funding of the dividend, it was largely off the cash on the balance sheet. I think there was some concern in the rating agencies that if you don't get your plan worked out and really turn the cash flow around, that you're going to continue to pay the dividend off the balance sheet and then fund the restructuring from the cash on the balance sheet.

I mean, from where you stand right now, the balance sheet looks like it's in great shape. So it doesn't seem like there's really significant risk, but the rating agencies seem to be a little bit concerned about this. I'm just curious how fast you think you can get the cash flow turned so you can fund the restructuring and the dividend out of operating cash flow as opposed to the cash in the balance sheet and really solve the riddle for the rating agencies.

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

A

Yeah, that's getting a lot of attention obviously, and I won't pretend to speak on behalf of the rating agencies, but my interpretation of their concerns is that it's really the operating performance. The balance sheet as you noted, John, is very strong. And we deliberately are running the cash and the liquidity at levels that are above our targets in part because we saw this period of lower cash generation on the horizon, and so we've been planning for that. But at the end of the day, what we, as a team, have to do is we've got to deliver stronger operating performance, and that operating performance includes stronger cash flow.

As we've mentioned both at Deutsche Bank and today, we certainly see the opportunity for us to deliver on our plan this year and that includes stronger cash generation. But, again, it's an interesting – it's not so binary. As I mentioned to someone the other day if we didn't pay the dividend right, we've got $25 billion of cash. It's really a question – it's not that cash level. It's the ability of the business to generate, as we look ahead, positive cash flow, and we think that we're going to be able to do that to a degree that is above and beyond what we delivered in 2018.

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.

A

And I'm going to rift with you on this, Bob, because David Tamberrino's question and John's question are linked here. Because when Bob points the simple approach that's saying, you've got to improve the operating performance to build confidence, David, your question about all those things that we were doing is totally intended to do that. And that's why the team started with we've got to get new product in the system. The new product has been observed, can do better. But we had to fund all the development in that that's in some of our higher costs. But we're happy that a lot of this is through the system and the new stuff is going to be coming. So it's the intersection of all that hard work giving us a chance now to win with all these things in front of us coordinated and happening now.

So that's why I would give us higher probability of improving operating performance because of the mix and the kinds of things that we're bringing to bear here.

John Murphy
Analyst, Bank of America Merrill Lynch

Q

Jim, one just maybe big picture question, as you look at this – and I mean and you've kind of been in this job and there's been some frustration of – that the plan and there's a lot going on in the industry on AVs and EVs, and what's going on in China. As you look at sort of the North Star of where you need to go going forward, is it ultimately really just product cadence that is 90% of the game and the rest is 10%? And we just went through a pretty tough period for Ford on the product cadence, and now we're staring at down the barrel at least in North

America, and China had some big stuff coming at us. I mean is it really – I mean that's very complicated stuff but I mean is it really that simple, though?

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.

A

Well, I would – I get to look backwards, right, with hindsight just like I feel I have to be studied that way. When I look in hindsight, I wouldn't have traded some of the product deferral that happened that caused some of the delays that we now are righting. So as I go forward, I have to look in the mirror and say, I'm going be faced with moments of truth. I'm not going to starve product, so I want to confirm what you said.

But I think the challenges of competing in China and the challenges of competing in Europe, the challenges of competing in South America are also about design of business issues that we've addressed. They have to do with the underlying car architectures, how complex the organizations can get, how big they can get. We don't have the F-Series profitability in all those markets. And in a way, that might have misled us about some of the potential. So it's the combination of product and what I would say model design that we've addressed.

Operator: And your next question comes from Rod Lache with Wolfe Research.

Rod Lache
Analyst, Wolfe Research LLC

Q

Hi, everybody. Can you hear me?

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.

A

Rod, I get to tell them that your real name's Rod Lache every time. You know that.

Rod Lache
Analyst, Wolfe Research LLC

Q

I know who I am and you know who I am so that's all that counts.

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.

A

Yeah, thank you.

Rod Lache
Analyst, Wolfe Research LLC

Q

So thanks for taking my questions. First, just a housekeeping item, I presume that the $700 million warranty item in the quarter was Takata and that the underlying North American performance excluding that was closer to 10%? Is that right?

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

A

Yeah, the $700 million that I referred to was for the full year. There was a big chunk of it that was in the fourth quarter, but there was actually a couple of recalls. There were some other costs associated with it that were spread through the year. So that was a full year. All those numbers I gave you, Rod, were all full year numbers.

But it's true that, that alone, if you think about the revenue, it's maybe 0.7 point of full year margin in the case of North America. So they would have been up in the mid-8s...

Rod Lache
Analyst, Wolfe Research LLC
Q

Yeah, the fourth quarter looked like it had a big number in it though, on a year-over-year basis, but.

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

Yeah. Just a chunk of that was Takata.

Rod Lache
Analyst, Wolfe Research LLC
Q

Yeah, just at a higher level, you're talking about an 8% margin, presumably at some point beyond 2020. On your revenue base today, that'd be $13 billion of EBIT. You're doing $10 billion in trucks and $3 billion in the finco, so that kind of makes sense. But to get from here to there, you need to improve by $5 billion or $6 billion. Obviously, people have been a bit frustrated by how long it takes to get some of these things together; the savings that you're working on. But I was hoping you can maybe flesh out a little bit more on this and on how we should be thinking about the cadence of improvement.

So it sounds like the first thing that comes through is product; not so much cost savings. Can you maybe talk a little bit more about that and how that plays out in 2019? Because it seems like there's some big products like Ranger that come in. And then as we look out to 2020, could those other elements, the savings and the exits from certain markets, do those really start to move the needle materially in just a year from now or does that take longer?

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.
A

Well, Rod, it's Jim. I want to help shape this question and tee this up for Bob because no doubt, you heard me talk about the structural costs for five years kept accelerating. And we arrested that. That didn't take us long. And we've actually turned it now to the second year. The structural improvements that we're making in the white-collar area, the way I've described the car architecture and what that's going do to product development, is coupled with the inference that you make about, once you get Europe restructured, yeah, you start to see a big improvement.

And, Bob, I know there's more to that that we're doing in addition to the things I just mentioned. But I want you to see that we are counting that as we talk to you. The frustration that I feel is felt is why does it take long to get that done and through the system, and I respect that. But it is what it takes to build an industrial model that we're talking about, to do it the right way and not have it fall apart, not to have big disruptions and so on.

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

Yeah, so if you think about 2019, I think clearly we've got a lot that's going to be going on, the top line including mix, pricing, all the product stuff, building on very strong performance in that part of the business in 2018 actually. So that would be something that you should expect to see from us in 2019. Coming with that will be some degree of net product cost investment. That's always the case with new products. But we do have in the year, a continued improvement in the level of – I forgot the words that we used – the fitness initiatives. We said when we first started talking about that, that that would gain traction a little bit in 2018 or start to grow in 2019. That certainly is the case. That is included in our assumptions and then that continues to progress as we go forward because a good portion of that was related to material costs that we believe that we'll realize as we go into new models. So that certainly is something that you'll see featured as we go forward.

But I think your overall premise about there being a – put aside external things that could come against us, yeah, we should be accelerating as we come out of 2019, because we will have gone through a big step forward in Europe. There'll be other parts of the business that we will have been taking actions on. There'll be more that comes in 2020.

Going back to the comment that I made earlier around the acceleration of the redesign and the restructuring affecting some of our key regions, all of that should bear fruit. And then very importantly, the improvement in China, because we had a very large loss in 2018, we expect that to reduce in 2019 and we're moving very aggressively to get it back into a profit.

So that will really, really help, and don't forget the localization of some key imports into China which – I mean, the effect of that is pretty amazing when you look at each of the Lincoln products and the Explorer in terms of going from what now are quite substantial losses for those imports to very attractive, locally built business cases. There'll be a number of different things, Rod, but your overall premise of the business gaining traction, whether it's restructuring, redesign, fitness initiatives, localization, fixing things like in the case of China, all that starts to gain momentum as we move forward on this.

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.
A

And let me sneak in, that something like a simple metric, we don't want to spend beyond our depreciation rates today in capital. So I mean, we've got to wash through some things that were already in the system, but we're designing the business so that its capital appetite drops in the future.

Operator: And your next question comes from Ryan Brinkman with JPMorgan.

Ryan Brinkman
Analyst, JPMorgan Securities LLC
Q

Hi. Thanks for taking my questions. Firstly, following your autonomous vehicle demonstration in Miami during the quarter, I'm curious where you think you are in terms of your autonomous capabilities, both in relation to your 2021 targeted commercial rollout, and relative to key competitors such as Waymo or Cruise. Do you think you are number one, number two, number three in autonomous, et cetera? And then, Jim, following on your comment in Detroit last week that you are open to investors in this area and have lots of interest, I thought to ask what you would look for in a partner, as it sounds like you might have some options?

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.
A

Yeah, and I mentioned in my comments that I've been very proud of, because of the interest in investors, how Argo has been graded. So it's a strong, strong enterprise. You all saw that when you went down to Miami. And Marcy has worked really hard at this question of, what kind of partners make sense, how do we get one plus one equals three. I want to remark that you know, last week we told you that we signed an MOU to have discussions – that's not coming from here, we're having somebody's phone – that we started discussions with VW. I have nothing to report tonight. But Marcy, what else would you add to this effort?

Marcy Klevorn
Executive Vice President & President-Mobility, Ford Motor Co.

A

Sure. Thank you for the question. First of all, I'll answer the first part of your question about how we're feeling overall. Our message has not changed and our confidence level remains the same, which is we are on track to have a purpose-built vehicle at scale by 2021. And we, I think, maybe somewhat uniquely have said all along this is a very difficult problem and we'll be ready in 2021. And we are also uniquely building the technology, along with building a business. And as Jim referenced, the Miami experience, we demonstrated how we are building the tech and the business side by side. It's very important when you see vehicles become available, we have already figured out how we want to monetize them and establish key partnerships like Walmart whom we announced in November, and already partnering with Postmates, Domino's and others.

And as far as the partnership and building on Jim's comment, we believe, and I know many in the industry do as well, that there'll probably be maybe two, three-ish kind of winners left standing at the end of all this. We're confident we will be one of those. We will pick partners that help build that dominance and so building scale, continuing to learn how to build businesses, et cetera, will be something that we would look for in selecting a partner.

Operator: And your last question comes from Adam Jonas with Morgan Stanley.

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

Q

Hi, everybody. It's Adam. Thanks for taking my question. First, to go back to the balance sheet, and investment grade priorities that you communicated in Detroit, what is a higher priority, sustaining the current dividend or maintaining investment grade?

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

A

I don't usually get to answer my questions to a beat but...

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.

A

[ph] Yeah, we're having some problems (50:03).

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

Q

You can rap it if you want, Bob.

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.

A

Is that your background, Adam?

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

A

I'm looking for the silver disco ball. So on a serious note Adam, I think I was very clear at Deutsche Bank in terms of our overall financial strategy. It starts with a strong balance sheet, an investment grade rating, maintaining our debt capacity, and ensuring that our global funded pension plan stays funded and de-risked. So to me that is sort of like ground zero, and then what you have to do, and it kind of goes back to the earlier question that I think Dave asked, which is – then the business has got to generate the cash flow that enables us to fund everything else. Everything else includes the traditional business, the new business opportunities, it includes obviously the shareholder distributions. So I think that that's the foundation, and that's certainly how we're looking at the business and running the business.

The dilemma that we're facing is the rating agencies are concerned about the operating performance of the business and the trend that we've been on. We've had a lot of discussions with them about that and the plans that we have in place to address that. At least my interpretation, again, from chatting with them is it's not a concern around the balance sheet per se. In fact, just the opposite, they make the same comments that I think some of you have made around the strength of the balance sheet. It's really about the operating performance. So, again, repeating what I said in Detroit, based on our view of what the year – we expect the year to be, we would expect to generate a stronger level of cash flow. We expect to be able to fund all of our business needs including the regular dividend, but we have to prove that.

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC
Q

Okay.

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

Just having more cash isn't going to help. We're going to have to – we already have more than we're targeting. We have to demonstrate the business is turning on an operating performance level including cash generation.

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC
Q

Thanks, Bob.

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.
A

Hey, Adam.

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC
Q

Yes, Jim?

James P. Hackett
President, Chief Executive Officer & Director, Ford Motor Co.
A

Adam, I just want to add because we've had this conversation when we first met when you were thinking out loud with me. When you're facing this buffet of issues that you have to deal with, and you're thinking about the cash question. I want you to think out loud with me how we've tried to hedge some of that in some of these alliance structures. In that it gives us paths to new product ideas that we can share our costs. And, of course, in the MOU and AV opportunity we can share costs in there. And none of those have really flowed through to planning yet because they aren't all secured yet. But those are highly likely things that will improve hedging what you might see as a risk there.

Operator: That concludes the Q&A. I'd like to turn the call back over to Jim Hackett for closing remarks.

James P. Hackett

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

Yeah. I feel like Adam didn't get to ask all his questions. I apologize, Adam. And we don't know what the noise is, so again, thank you for your tolerance of that. It's not coming from here. But I'd like to just say I think I feel good that we got most of our comments out. 2018 was a year of progress in terms of laying the foundation for the global redesign of our business. It was all about sharpening the competitiveness, so we can better satisfy our customers while investing in the future. We aren't mortgaging that.

Ford enters – this is my second point – Ford enters 2019 with a very clear vision, and we're building momentum to improve profitability and returns. We're now in execution mode. Third, we're taking decisive action in all underperforming parts of the business, and we're allocating capital to higher return opportunities, as you know, what we did with the sedan issues this past year. In the coming months, you can expect us to share much more about specific initiatives in some of these areas that we're restructuring.

Finally, the work we're doing today to create this healthy, vibrant Ford for the benefit of all our stakeholders, as I said earlier, is going to allow us to invest in a future that will be even more rewarding in our mind for investors. We think this is a good time to invest in Ford. Our vision is to become the world's most trusted company, designing smart vehicles for a smart world. In doing so, we have the opportunity to participate in an exciting thing in a new huge addressable market because of that. It helps create a better transportation, better world, that will improve lives.

Thank you all for joining us tonight.

Operator: This concludes the Ford Motor Company Fourth Quarter Earnings Conference Call. Thank you for your participation. You may now disconnect.