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MANAGEMENT DISCUSSION SECTION

Operator: Good day ladies and gentlemen. My name is Ian, and I will be your conference operator today. At this time, I would like to welcome you to the Ford Motor Company Second Quarter 2019 Earnings Conference Call. [Operator Instructions] After the question-and-answer session, there will be closing remarks.

At this time, I would 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, Ian. Welcome everyone to Ford Motor Company's second quarter 2019 earnings call. Presenting today are Jim Hackett, our President and CEO and Tim Stone, our Chief Financial Officer. Also joining us are Joe Hinrichs, President, Automotive; Jim Farley, President, New Businesses, Technology & Strategy; and David McClelland, CEO of Ford Credit.

Jim Hackett will begin with a brief review of the quarter and our progress against our strategic initiatives. Tim will follow with a more detailed look at our results, and then we'll turn to Q&A. 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 68. In addition, unless otherwise noted, all comparisons are year-over-year.

Now let me turn the call over to Jim.

James P. Hackett

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

Thank you, Lynn, and hello to everyone. As we meet today, we're a little past the midpoint of 2019, which we said would be a great year of execution for Ford. And I am pleased with the progress we're making toward creating a more dynamic, innovative and profitably growing business.

As our second quarter results demonstrate, the global redesign of Ford is driving positive shifts in our business. We are improving our fitness or our ability to compete, and the trajectory of the company is improving in terms of growth, cash flow and profitability.

We are making tremendous progress in Europe, which I will expand on in a moment. We are also seeing discrete signs of stability in our business in China, even as the economy and vehicle market there are under recent and persistent stress. At the same time, we're actively working on the design and launch of new products that will help us grow in this market. Now additionally, the redesign and restructuring of our business in South America is on track as well.

We view all of this progress with humility. The reason is that it's been my experience that the compounding positive effects of getting so many aspects of our business in shape does take more time, yet at the same time, these disparate aspects build on each other which allows us to reach our full potential as an outstanding business.

To touch briefly on some other highlights in the quarter, in Automotive, we delivered a 19% increase in EBIT, supported by a broad-based improvement in market factors led by North America, Europe and China. We achieved these results even with the natural drag on profitability in North America from ramping three very important product launches in the quarter: our all-new Explorer and Police Interceptor Utility as well as our new-to-market Lincoln Aviator.

Now if you recall in Q1, we said our first quarter results would be the strongest of the year in part because of the magnitude and cadence of these future product launches as well as normal seasonality. Importantly, we delivered positive adjusted free cash flow in the quarter, significantly better than last year notwithstanding major launch headwinds. And on a year-to-date basis, we delivered $2.1 billion adjusted free cash flow which is up 80%. In addition, our cash balance of $23 billion and total liquidity of $37 billion remains strong and well above our target levels. Our year-to-date results support our target to improve both free cash flow and profitability this year. Tim will go into more detail about our results and perspectives on the full year in just a moment.

Now as we've discussed in the past, we're focused on four strategic areas for creating value. First is the winning portfolio where we are fortifying our strengths, improving mix and expanding our commitment to electric vehicles. Second is fitness. It's our ability to compete, including advancing alliances such as those with VW and Mahindra.

Third is acceleration of our global redesign which was to ensure each of our regions in generating sustainable profitable growth and cash flow. And fourth is smart vehicles for a smart world. We are scaling products and businesses that connect to the world around them in ways that benefits our customers.

Let me touch on a few highlights of each of these. We're now beginning to roll out our new portfolio, powered by the dramatic shifts in capital allocation to trucks, SUVs and performance vehicles, including the hybrid and all-electric offerings. This chart you see covers 2019 and 2020. We're expanding our lineup where the volume and profit is, where the growth is and where the Ford brand excels. Of course, this includes pickups like the new F-150, Super Duty and new Ranger. Commercial vans, like the new two-ton Transit and SUVs such as the new Explorer, Escape, Territory and Puma. Rugged off-road vehicles like the Raptor and upcoming Bronco and our Mustang-inspired BEV that's going to be an SUV.

In fact in North America, we're driving down the age of our passenger vehicle showroom by almost one-half as we replace 75% of our products by 2020. Over time, the new models we're adding for customers will more than make up for any share and volume loss by the phase-out of sedans, while simultaneously improving profitability and returns.

It's no small feat to deliver this many new products in such a short timeframe. I'm fortunate that I have a seasoned automotive veteran in Joe Hinrichs at the helm of our Automotive division. When you witness the extent of the work that was done, much of it like clockwork, we will complete our assignment to successfully launch these products. For example, the transformation of our Chicago plant to launch the Explorer, the Police Interceptor and the new Lincoln Aviator was in some ways a bigger endeavor than the 2014 overhaul of our truck plants in Dearborn and Kansas City for our aluminum-bodied F-150.

In fact, the Explorer launch is arguably our most complex one over the next 18 months, combining an all-new, high-volume platform along with what is effectively a new factory and a new body shop. We also launched our broadest-ever Explorer lineup, with both hybrid and ST performance models and we're introducing a plug-in hybrid version of that Aviator.

Now to achieve all this, we installed hundreds of robots, new technologies and moved out the scrap metal equivalent of the weight of the Eiffel Tower. I'm pleased to say that the demand for these two new products is strong. We are selling these vehicles as fast as we can build them. In fact, we're now expanding our capacity in Chicago. So when you have a moment, to do me a favor and click on the link on this page to watch a short video summarizing what it took to get our plant in Chicago ready for these key launches. I think you'll be positively impressed.

Explorer, Police Interceptor and Aviator are just three examples of our dramatic shift in capital allocation to higher-return trucks, utilities and crossovers. At the same time we are working to lower the capital intensity of our business. Of course, we remain highly committed to quality and customer satisfaction in everything we do. You can see that in the results from the most recent J.D. Power U.S. Initial Quality Study. For the first time ever, both Ford and Lincoln ranked among the top five auto brands in the U.S.

I'll expand a bit on our renaissance that is underway in Europe where we made significant progress in the quarter. In early January, our team in Europe unveiled a comprehensive roadmap to improve or exit less profitable vehicle lines, address underperforming parts of the business and improve profitability through efficiencies and a significant reduction in structural costs.

In the first half of this year, our team did a tremendous job, achieving important milestones as they position the business in Europe for a 6% EBIT margin longer term. These milestones include number one, a new operating model in organization including three customer-focused business groups, each with a dedicated management team and bottom-line accountability. The first of the three groups is commercial vehicles, where we have reallocated resources to capitalize on our position as a top commercial vehicle brand in Europe including leadership in the pickup segment. Now over the next five years we're targeting to double our profitability in commercial vehicles.

The second group is passenger vehicles which will focus on European-built cars and SUVs. The third group, well this is imports, a niche portfolio of iconic passenger vehicles including the Mustang and Explorer.

Importantly, we have largely concluded consultations with our social partners, and in the UK and Germany we have carried out separations. In Russia, we have completed the restructuring of our JV there which includes exiting passenger vehicles and Ford taking a minority stake. And to improve manufacturing efficiencies, we have proposed or confirmed the closure or sale of six assembly and component manufacturing plants in Europe by the end of 2020.

In the midst of this restructuring, we've also announced growth initiatives including producing new all-electric vehicles and electrified options for all new passenger vehicle models. These new vehicles will support our compliance with the new European CO2 regulations which we expect to achieve without having to buy credits or pay any kind of penalty and our alliance with VW to support commercial vehicle and electric vehicle growth.

Now if I can get you to turn to slide eight, earlier I mentioned a fourth strategic area that prepares Ford for this new era in our industry. I refer to this as smart vehicles for a smart world. Now while this strategic area has benefited, as I expected, early from Jim Farley's mix of automotive and entrepreneurial history, he appropriately focused early on the conclusion of the negotiations with VW to broaden our collaboration.

Now it's important to expand to you today why we're so enthusiastic about this news. At a time when industry consolidation is daily making news, we believe we found a more thoughtful approach to collaborating in key strategic areas without adding the complexity across ownership. It started back in January where Ford and VW announced a deal to develop commercial vans and medium-sized pickups for global markets. This collaboration remains on course, and we're excited about the potential.

Two weeks ago, VW CEO Herbert Diess and I said that our companies would expand this collaboration. Now this included VW joining us with an investment commitment to Argo AI. This is one of the most capable autonomous vehicle platform developers, as you know, based in Pittsburgh. The transaction with VW establishes an estimated value for Argo of more than $7 billion. Collectively, we believe we're on a path to create one of the most important autonomous vehicle platforms in the industry.

Here's how our companies will work together going forward on autonomy. First, we will collaborate with Argo on the self-driving system, known as the SDS. That means that Ford and VW will be able to reduce our respective investments and development costs for the future AV businesses. We will be able to co-create common AV standards both now and in the future, and we'll share valuable data with Argo to help build the best visioning and mapping models along with data utilization analysis for traffic and fleet management.

Second, we'll share costs and expertise so that we can each design and engineer unique, safe and efficient self-driving vehicles. Third, Ford and VW of course will remain vigorous competitors and pursue independent go-to-market strategies using this common Argo SDS platform, with each of us designing and delivering unique experiences for our customers.

In addition to our collaboration on autonomy, we also announced we are extending our alliance to electric vehicles. Ford will become the first additional automaker to use VW's MEB electric vehicle architecture. We'll leverage this architecture for a high-volume, zero-emissions passenger vehicle in Europe, and this is designed at our Ford Engineering Center in Cologne, Germany.

Ford of Europe will start building this vehicle in Ford facilities in 2023. We're also considering a second electric model based on this MEB architecture for our Ford line-up in Europe. This more expansive strategic relationship between Ford and VW is another important building block in the renaissance underway at Ford of Europe that I described earlier.

With that good news, let me turn the call over to our CFO, Tim Stone. Tim?

Timothy Stone

Chief Financial Officer, Ford Motor Co.

Thanks, Jim. Hi, everyone. A few things to keep in mind as we discuss our results. First, both 2019 and 2020 are robust launch years for us, as we bolster our winning portfolio for customers, reallocate capital to higher-return growth opportunities and execute changeovers of our most profitable and highest-volume vehicles. Second, our global redesign and fitness initiatives are progressing well, improving the trajectory of future growth, cash flow, profitability and returns on capital. Third, Ford Credit continues to deliver excellent results. And fourth, relative to Auto, we continue to expect strong execution this year, especially in North America, Europe and China.

In the quarter, we generated $0.2 billion in adjusted free cash flow, which was a significant improvement from last year. This performance includes the impact of our launches in the quarter. On a year-to-date basis, adjusted free cash flow was up 80% to $2.1 billion, supported by improvement in working capital in Auto. The ability to generate sustainable growth in free cash flow over time is our most important financial measure and we are on our way to achieving this.

Wholesales declined 9%, driven by China, lower industry and the launch-related volume impact in North America, as we ramped Explorer and Police Interceptor. Interceptor, by the way, accounted for half of all police vehicle sales in the U.S. last year and the new model is even more capable. Although wholesales were down, revenue was flat, as strong mix and pricing supported by our franchise strengths were offset by lower volumes and adverse exchange. Excluding the impact of exchange, revenue grew 3%.

Auto posted its second consecutive quarter of EBIT growth, something we've not achieved in over three years. EBIT grew 19%, up from 16% last quarter and EBIT margin expanded by 60 basis points. These results were supported by strong mix in North America, reflecting our franchise strengths and strong pricing in every region. In North America, EBIT declined 3%, driven by the changeover of Explorer, Interceptor and the introduction of Lincoln's all-new Aviator as well as higher warranty.

Our strategic investments in mobility increased by 46% as we continue to build out our capabilities including mobility services, connectivity and autonomy.

Ford Credit delivered another strong quarter, posting a 29% increase in earnings before taxes. Favorable loss metrics reflected healthy consumer credit conditions, and auction values for off-lease vehicles performed slightly better than expectations. We now believe auction values will be down by about 3% on average for the year.

Receivables were flat and remain below our previously announced cap of $155 billion. Corporate other expense of $286 million included a mark-to-market loss of $181 million for our investment in Pivotal. On an adjusted basis, both company EBIT and margin for the quarter were flat at $1.7 billion and 4.3% and EPS was $0.28. Excluding the Pivotal loss, adjusted EBIT would have been $1.8 billion, EBIT margin would have been 4.7% and EPS would have been $0.32.

In the quarter, we recorded $1.2 billion in special charges, with cash effects of $0.2 billion. As expected, the vast majority of the charges in the quarter were associated with the redesigns of Europe and South America. This year, we continue to expect to incur $3 billion to $3.5 billion of EBIT charges with negative cash effects of about $1.5 billion to $2 billion, reflecting a shift of about $0.5 billion to $1 billion in cash effects to 2020.

Lastly, we ended the quarter above our cash and liquidity targets with $23 billion in cash and $37 billion in total liquidity.

Let me touch on a few areas of the business in more detail. In North America, as I mentioned, EBIT was down, and margin contracted by 30 basis points to 7.1%. The region continued to deliver strong mix and net pricing supported by F-Series as well as our decision to exit traditional sedans. This favorability was more than offset with the launch-related declines in volume and higher warranty.

For additional perspective, wholesales for Explorer and Interceptor were down by 72,000 units year-over-year which led to 7% overall decline in wholesales in the quarter. As Jim mentioned, demand for Explorer is strong with production already oversubscribed. Relative to wholesales, it is interesting to note that in the quarter sales of Ranger completely offset the decline from discontinued sedans. Last quarter we showed you the benefit of this intentional shift in our portfolio using our Michigan assembly plant as an example. Once this plant completes the transition from sedans to Ranger and Bronco, EBIT will improve by over $1 billion.

In the U.S., our SUVs posted strong momentum in the quarter including a 50% increase in Expedition, and this month based on healthy customer demand, we started to run additional capacity for Expedition at our Kentucky truck plant. By the end of this year, on a volume-weighted basis, we will have the freshest SUV lineup in the industry led by our all-new Explorer and all-new Escape.

Also in the U.S., sales of total pickups accelerated in the quarter, marking our best overall pickup sales performance since 2004. F-Series continues to do well, maintaining market leadership with the lowest incentive spend of primary competitors and the highest transaction pricing. Ranger, which we launched at the end of 2018, more than doubled its volume sequentially while also steadily increasing segment share to 14.2%.

Europe delivered $53 million in EBIT in the quarter, an improvement of $126 million year-over-year supported by our redesign actions. Favorable market factors aided by flat structural costs excluding pension drove the improvement in profitability. This was the first quarterly year-over-year improvement in profitability for Europe in two years.

Commercial vehicles were once again a strength in the quarter, as Ford remained Europe's number one commercial vehicle brand, and as noted in our product roadmap, we will be launching an updated two-ton Transit in the second half of this year. In addition, Ford remained the market leader in the UK with Fiesta, Transit Custom and Focus as the top three selling models.

In China, consolidated revenue increased 48% year-over-year driven by higher Lincoln volumes. EBIT loss narrowed to $155 million, an improvement of $328 million year-over-year supported by improvements from consolidated operations in volume, mix and pricing, lower tariffs and structural costs as well as favorable exchange.

The team has taken action to stabilize sales with second quarter retail sales up 13% sequentially and aggressive reductions in inventory to improve dealer health. In fact, our dealer inventory is at its lowest level in the past 18 months, and we managed the run out of Stage V effectively. In addition, China has implemented initiatives ranging from enhanced capabilities with in-depth Chinese market experience to strengthening cooperation with joint venture partners. Sales of our new Ford Territory SUV accelerated in the second quarter, making it the best-selling Ford SUV in China this year.

Now let me turn to our updated outlook for the year, which focuses on growth in cash flow and profitability. We continue to target an improvement in adjusted free cash flow year-over-year driven by Auto, and we are now introducing a range for full year adjusted EBIT of between $7 billion and $7.5 billion compared with $7 billion last year, representing up to 7% growth. These targets include continued strength in market factors and improved structural costs excluding pension led by North America, China and Europe as well as launch-related impacts and strength in credit. As a reminder, we expect to conclude our negotiations with the UAW in the fourth quarter.

Assuming a full-year adjusted effective tax rate of between 18% and 20%, which would be up from 10% last year, we are introducing an adjusted EPS range of $1.20 to $1.35 compared with $1.30 last year. The tax headwind is worth roughly $0.12 to $0.16 in EPS for the year.

Due to the cadence of product launches and normal seasonality, we expect our fourth quarter adjusted EBIT to be higher than the third. Among other things, these targets are based on the current economic environment, including commodities, foreign exchange and tariffs. Relative to calls on capital for the year, we continue to expect CapEx to be similar to last year at roughly $7.7 billion, funded pension contributions to be about $650 million and shareholder distributions to be about $2.6 billion.

A few final comments before we move to Q&A. 2019 and 2020 are robust product launch years for us, as we bolster our winning portfolio for customers, reallocate capital to higher-return growth opportunities and execute changeovers of our most profitable and highest-volume vehicles. Our results this quarter and year to date demonstrate the trajectory of our business is meaningfully improving, supported by our product portfolio, global redesign and fitness initiatives. We have many opportunities across our business to drive free cash flow, long-term growth in revenue and profitability, including EBIT margins of 8% or better. And we continue to be committed to maintaining a strong balance sheet and investment-grade credit ratings.

Now let's open the call for questions. Operator?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Emmanuel Rosner from Deutsche Bank. Emanuel?

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

Hi. Good evening, everybody.

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

A

Good evening.

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

So my first question is about the second half guidance implied by your full year guidance. At midpoint, if I focus on the EBIT metric, it looks like your EBIT, you're guiding for an EBIT that would be down about $1 billion between the first half and the second half. And I was hoping you could maybe bucket this for us into what the main drivers are. It seems like you're flagging launches in particular, but obviously the second quarter had quite a bit of that as well. So maybe just from a high-level point of view, second half lower by $1 billion versus first half, what drives that?

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

A

Emmanuel, thanks. It's Jim Hackett. And as I hand – I'm going to hand this question to Tim, but I just want to tell the audience tonight that this is Tim's first call as our CFO, and he's really done a great job tethering into the Ford culture, bringing new perspective, new questions and he's become a great partner.

When we sat in front of you in January, I remember thinking about how we were going to help the Street see our year. And sitting in front of us, from my perspective as a CEO, was an open question about the tariffs. Joe can talk about the back-and-forth there. We were working on our corporate redesign. This is the white-collar kind of effort, the management reporting layers. We had restructuring that you were just starting to learn about in Europe, and we were actively working on our own recovery of China. In fact, I just came back from there.

So from January to July, I just want to report to you, Emmanuel, as you look at those five issues, I'm really happy with the way the company's tackled each one of them and the progress we've made. And you kind of teed up the good question and the right one, I think, about the second half of the year which are these product launches. So tonight, I want to make sure that you see that this is a capability that we have to prove we're really good at. I have a lot of confidence that we are, and you'll hear that we've tackled the toughest one first in Explorer and Aviator.

But, Tim, maybe before Joe, if Joe wants to add color on the launches, you could just talk about the guidance and how we worked ourselves to that.

Timothy Stone
Chief Financial Officer, Ford Motor Co.

A

You bet. So thanks for the question, Emmanuel. As you said, with the $4.1 billion in the books for the first half, the guidance range of $7 billion to $7.5 billion with growth up to 7% or $0.5 billion implies $2.9 billion to $3.5 billion, yeah, $3.4 billion, excuse me, in the second half. And as we said on the call, it is due to this cadence of product launches. And you can see in the materials we distributed in slide 5, the winning portfolio slide, got a number of launches ahead of us through the remainder of this year and we continue to ramp up on Explorer and Aviator. We have Corsair, Escape/Kuga, the two-ton Transit, for example, and then normal seasonality as well.

So for example, in 2018, 56% of our profits came in in the first half of the year. And as a reminder again, we have UAW negotiations concluding this fourth quarter. So we believe the guidance is appropriate based on what we're seeing in the business and including the risks and opportunities and thought it was appropriate to provide a range for the year.

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

A

Joe, do you want to add something about product launches? And then, Emmanuel, you said you had two questions, so we'll come right back.

Joseph R. Hinrichs
President, Automotive, Ford Motor Co.

A

Yeah, so quickly I'll add that we have Super Duty launch towards the end of the year which is really important, and the seasonality is real. You know we have the European shutdowns, and we have the North American shutdowns in the summer months, and then of course the holidays later in the year. So there is the annual seasonality. So it's launches, seasonality, and UAW negotiations.

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

A

Thanks.

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

That's very helpful. And then just sort of as a follow-up, would you be able to give us a sense, again second half versus first half, how you think about it for your main regions? I assume that the bulk of the decline is North America, at least based on the launches that you highlighted. But is there any other region where you expect this to be the case? And in particular in North America, anything else besides sort of like the launches? That's a big bucket.

Timothy Stone
Chief Financial Officer, Ford Motor Co.

A

Yeah, thanks again. And some of the launches we talked about are happening in Europe, for example, the two-ton Transit and Escape/Kuga, many of these launches around the world. But I just want to comment before we get too far down the path here that beyond the guidance that we provided for the EBIT range and the EPS range and most importantly free cash flow, we aren't going to be giving any further details on the inputs that go into the final output, so for example, regional guidance or macro commentary or commodities or exchange or tariffs and so forth. So I recognize that's a change, but we also changed by providing an EPS guidance range and a range for EBIT. So I just thought I'd comment on that in response to the question. Joe, something else you wanted to add?

Joseph R. Hinrichs
President, Automotive, Ford Motor Co.

A

Well, obviously the bigger launches are North America and the UAW. I'll leave it at that.

Timothy Stone
Chief Financial Officer, Ford Motor Co.

A

Great.

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

A

Thanks, Emmanuel.

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you.

Operator: And our next question is from the line of John Murphy from Bank of America Merrill Lynch. John?

Aileen Smith
Analyst, Bank of America Merrill Lynch

Q

Good morning, this is, or good afternoon. This is Aileen Smith on for John. First question on the structural cost headwind in North America, can you detail what these costs were specifically in the quarter? And how you think about controlling or offsetting some of these going forward, particularly ahead of the UAW negotiations that you know, and what could be labor or cost inflation among other factors?

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

A

Yeah. One thing, Tim. Can I sneak something in? You know, John Murphy and I have something in common. I just had a brand new baby granddaughter, and I guess John just had a new baby girl. So, John, we want to send out a hooray for that and hope mom and baby are doing well. So, Aileen, let's go back to her question.

Timothy Stone
Chief Financial Officer, Ford Motor Co.

A

No, that's great. Thanks for that.

Aileen Smith
Analyst, Bank of America Merrill Lynch

Q

Thank you very much. He appreciates that.

Timothy Stone
Chief Financial Officer, Ford Motor Co.

A

Congratulations. So on the structural costs, North America, Auto overall, sorry, it was good Auto overall. So EBIT increased to 19% year-over-year. That's up from 16%. It's the first time in over three years, two consecutive quarters of year-over-year growth and profit, and that's driven by structural costs. The commentary that I'd want to leave you with is structural costs are down ex-pension and OPEB overall. So as far as how that plays out for the rest of the year, again that's factored into our, as one of the many inputs into our guidance.

Aileen Smith Q
Analyst, Bank of America Merrill Lynch

Okay. That's helpful. And then second question on the year-over-year China walk. As you think about the outlook for the rest of the year and particularly into 2020, do you view positive contribution from volume mix, pricing cost, and everything else as being sustainable particularly in the face of a tough industry backdrop? Or are one of these factors or others going to be a bigger driver of profitability improvement?

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

Yeah, so this is something that we want to kind of emphasize. We want to talk about a color on China, so, Joe, maybe you can field that one.

Joseph R. Hinrichs A
President, Automotive, Ford Motor Co.

Sure. Thanks. So clearly we're glad to see the progress we saw in the first half of the year financially, especially on our consolidated results. As you think about China, in the last couple months we had very aggressive sell down of the Stage V emissions vehicles, especially in June. So I know you'll see some of the payback in the second half of the year, especially starting in July for some of that. So we're watching what's happening in the industry there.

Tim mentioned earlier that we're at the lowest level of our dealer inventories in 18 months, so we're feeling really good about where we are both with our Stage V-Stage VI transition and dealer inventory overall. And we're starting to see an improvement in dealer profitability. So we're pleased with that. Our Focus and Territory products are building momentum. We still have a ways to go, but they're building momentum. And we have other products coming, as Tim referred to, especially Escape later in the year.

Remember that year-over-year we'll have – we should at this present state, we have lower tariffs than we had in the second half of 2018, because of the import duties going into China are 15%, which they were 40% in the second half of last year. So right now, that's positive year-over-year. I think we're all watching what's happening in the Chinese industry. I won't go too much into it because we're going to have to see how things settle down after the last couple of months of the Stage V-Stage VI transition, but we do expect some payback to that in the second half of the year.

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

Thanks, Joe.

Aileen Smith Q
Analyst, Bank of America Merrill Lynch

Great. That's very helpful. Thanks for the question.

Operator: And our next question is from the line of David Tamberrino from Goldman Sachs. David?

David Tamberrino
Analyst, Goldman Sachs & Co. LLC
Q

Yeah, I'm going to keep picking at this point on structural costs. It was a positive tailwind of about $300 million in the first quarter and now you've got a negative in the second quarter. It was negative in North America and negative in Europe. Really want to unpack that and understand what the positive was ex-pension and OPEB and if you expect that to be repeatable. Do you expect to see that grow sequentially as we progress through the year after you've taken restructuring actions? That is my first question.

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

Tim, go ahead.

Timothy Stone
Chief Financial Officer, Ford Motor Co.
A

Yeah, so again, as it relates to what's going to happen for the remainder of the year that's factored into our guidance. I'll go back to content and structural costs ex-pension and OPEB were flat or sorry down in Auto overall. So, I think what you're seeing there is us continuing to execute on our fitness initiatives and the redesign and starting to see the early benefits from that in the overall EBIT results and structural costs as well for the across the business.

David Tamberrino
Analyst, Goldman Sachs & Co. LLC
Q

But you can't share the magnitude that it was down ex-pension and OPEB and there's no incremental color on Europe taking a step backwards from the benefits you saw in 1Q?

Timothy Stone
Chief Financial Officer, Ford Motor Co.
A

Not at this point. I mean, you can look at the fact that we continue to announce additional redesign actions in Europe, for example, Bridgend and then we'll continue to execute on our redesign initiatives. And as those play out over time, you'll see the benefits flow through the P&L.

David Tamberrino
Analyst, Goldman Sachs & Co. LLC
Q

Okay. So then, asking that restructuring question, I guess you've made some announcements more recently. You finished the consultation process with your partners within Europe. When do you anticipate the ability to provide some color as to the potential cost savings that you should be seeing as a result of those actions?

Timothy Stone
Chief Financial Officer, Ford Motor Co.
A

The cost savings that we're expecting from the redesign and the restructuring actions are factored into the guidance for 2019. And as we go forward and give guidance for 2020, you'll see that reflected there. We're moving as swiftly as practical to execute on all the redesign initiatives that we have in front of us as we've talked about. We have had $1.2 billion in the quarter, $1.7 billion year-to-date in charges. We still have a ways to go, but

2019 outlook is for $3 billion to $3.5 billion and then similar from a cash standpoint. But yeah, those are redesign and restructuring initiatives are also factored into the European long-term target of 6%.

David Tamberrino
Analyst, Goldman Sachs & Co. LLC

Q

Okay. So nothing to share today on the recent actions on annualized cost savings?

Timothy Stone
Chief Financial Officer, Ford Motor Co.

A

Not at this stage. No.

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

A

But, David, it's Jim. Just again, in my tour, I just was there, and I came away where Europe's performing in terms of this restructuring really well. We've actually been speeding it up. So I want to make sure there's confidence that that work is happening and proceeding well.

David Tamberrino
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Thanks for that, Jim. Thanks for taking my questions.

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

A

Yeah.

Operator: And our next question is from the line of Rod Lache from Wolfe Research. Rod?

Rod Lache
Analyst, Wolfe Research LLC

Q

Hi, everybody. Yeah. I wanted to just ask again about this just the regional performance. It doesn't sound like you want to talk too much about this with any specificity, but it seems logical that Europe and Asia improvement should continue year-over-year and what you're guiding to is a decline in North America related to launches. But can you help us frame this international improvement? There have been a number of announcements that you've made and you continue to work through this restructuring. How much of the cost improvement that you're looking at in China and in Europe are we already seeing reflected as a run rate in the Q2 numbers? And maybe at a high level, could you talk a little bit about what you still have ahead of you?

Timothy Stone
Chief Financial Officer, Ford Motor Co.

A

Hey, man. This is Tim. Let me start with what we've been seeing, as you said. So in Europe, we saw an improvement of $126 million in the quarter. That's year-over-year and that's the first year-over-year improvement we've seen in two years. That's a reflection of the redesign initiatives and the focus on the customer and commercial vehicles, passenger vehicles and imports from portfolio standpoint. So positive $53 million profit in Europe and that's driven by the market factors and commercial vehicles and structural cost declines ex-pension.

In China, again loss of negative $155 million, but the EBIT improved by $328 million year-over-year, and that's compared with Q1 momentum off of $22 million improvement. So, it went from $22 million to $328 million. And as Joe mentioned earlier, the dealer health is much improved, the best it's been from an inventory perspective in 18 months. And the China results are driven by Lincoln volume, the structural cost improvements and the favorable exchange. So, pleased with what we've been seeing in Europe and China.

And from a guidance perspective, looking forward, we expect $7 billion to $7.5 billion and the EPS to be driven by or led by the North America, Europe and China structural costs and market factors being the key drivers.

Rod Lache
Analyst, Wolfe Research LLC

Q

Okay. But there is some additional savings presumably, yeah.

Joseph R. Hinrichs
President, Automotive, Ford Motor Co.

A

Hey, Rod, this is Joe. I just want to add the – sorry, Rod. Can I just add, jump in here? Just on the Europe piece, specifically, there's been a significant number of announcements made this year and a lot of work by the team. A lot of that cost comes out over the preceding quarters, because we announced the 12,000 salaried, hourly and agency positions that are going to be gone by 2020, but a number of those are still to happen. So, that savings isn't in yet. And a lot of the plant restructurings, including a shift reduction and other things that we have going on doesn't happened yet.

So I think you'll see this play out over the next several quarters. Just a reminder though, as I said earlier, the third quarter in Europe typically is the lowest quarter, because of shutdowns that we have in our plants. So, just want to remind everybody that we're making very good progress on the structural costs in Europe, but we do have some seasonality to keep in mind.

Rod Lache
Analyst, Wolfe Research LLC

Q

That's helpful. And just switching gears, my second question is just if you could talk a little bit about how you're thinking about the market for full-size pickups, just from a volume perspective things look fine. From a share perspective, Ram is inching into the fleet market quite a bit. Any kind of high-level thoughts about what the prospects are for that market from your perspective?

Joseph R. Hinrichs
President, Automotive, Ford Motor Co.

A

Yeah, sure. We're very proud of the first-half performance on our F-Series trucks, strong mix as you noted, strong net pricing and really for the first six month of the year very pleased with the results. One thing we are seeing in the market is the market, while down a little bit in the first half of the year on retail overall is up on commercial and that's actually helping on the F-Series side, where we're so strong. And you've just seen recent examples of how strong our truck products are in the marketplace. I mean just today, the J.D. Power appeal results came out. In an unprecedented event, we won all three truck segments, Ranger, F-150 and Super Duty won their segments in appeal, and that's against newer trucks in the case of F-150. So, you can imagine how proud our team is of that.

We have the lowest incentive spending and the highest ADPs. You know this, but our truck brand on F-Series continues to hold up very well, and we're very pleased with the results. And the trucks market itself, well incentives have been growing. We're watching it very carefully. We'll remain competitive, but we also watch very carefully to maintain our discipline as we have always done, but actually you're seeing our business hold up pretty nicely with all those considerations to take into account.

Rod Lache
Analyst, Wolfe Research LLC

Q

Okay. Thank you.

Operator: And our next question is from the line of Adam Jonas from Morgan Stanley. Adam, your line is open.

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

Q

Hey, everybody. Good evening. My first question is, John Murphy is a grandpa?

Joseph R. Hinrichs
President, Automotive, Ford Motor Co.

A

No. Jim Hackett. Jim Hackett is the grandpa

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

Q

Oh, okay. Oh. Sorry. Okay. Mazel tov.

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

A

And I want to get credit for being a good one, Adam. So, throw that in.

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

Q

Mazel tov, and congrats also to John. So first question is on European CO2. I think I heard you right. You said that you're going to make the CO2 emission standards without buying any credits and paying any penalties, but my understanding is that those penalties start kicking in in 2020 when you need to get to 95 grams, and you're not going to have a BEV on sale. So I just want to confirm, you think you're going to get to 95 grams without BEVs?

Joseph R. Hinrichs
President, Automotive, Ford Motor Co.

A

Yeah, Adam, this is Joe. Thanks for the question. It's been getting a lot of attention. So you're right. And the regulations in Europe are not new to us. We've been planning for this really since 2013. And we have built the cost of this into our, compliance into our business plans. We'll do it with electrification and improvements to our ICE powertrains, both important parts of the compliance plan. As we said, we don't anticipate incurring fines or purchasing credits assuming consumer demand is there for the new products. I wouldn't assume that we won't have a BEV in the marketplace. We said electrification and improvement to ICE powertrains are part of that. But we feel very confident in our compliance plans and we've been planning for this for quite some time.

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

Q

Okay. I mean it's just a big statement. I mean, I think you're around 120. You got to get to 95 and maybe you can import some of the non-MEB BEVs, but I imagine that would be pretty small volume. So it just stands out as – we could take it offline – it stands out as a really big gap to cross in such a short time. But that's more an observation.

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

A

Yeah, I appreciate the challenge, but I want you to know we're planning to make it.

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

Q

Okay. The second question – thanks, Jim – second question is maybe for, I don't know if Dave McClelland or Joe, and you could take this on the Ford Credit side. If I asked you, obviously, money and supply of money and availability of credit is historically still pretty strong. Maybe not as strong as it's ever been but still in the strong category. I'm wondering if you see anything, if I push you, anything that you're seeing incrementally that might be a yellow light or a flickering green light in terms of credit quality at the margin or anything on the funding side or consumer behavior, delinquency side at all? Obviously, there's some natural seasoning and cyclicality. But I just wanted to know if there's anything that you thought was a little – some taking a little closer look at. Thanks.

Joseph R. Hinrichs
President, Automotive, Ford Motor Co.

A

So, David, it sounds like he's asking about PD ratings of our customers and then what the sources or source there is.

David McClelland
Vice President and Chief Executive Officer, Ford Motor Credit, Ford Motor Co.

A

So yeah, sure, so Adam, evening. This is David. Tim mentioned in his introduction that the credit environment looked pretty healthy. And if I think about your question and look at our portfolios, I look at the originations, the strength of what we're seeing coming through the door still is still really strong. Our average FICO is nearly 750. We're not seeing any change in the higher-risk mix of business. We're sitting at 5%. That hasn't moved. In fact generally, subprime placements are lower quarter over quarter. There's no increase in term. Our average term is 65 months and the industry is 69. We're not seeing any growth in 84 months. So at origination, I don't see any flickering at all. It's solidly green.

And then if I look at the performance of the portfolio, the portfolio continues to perform well. In fact quarter over quarter, our loss ratios have improved. 60-day delinquency is down. Repossession rate is down. And then even if I look at our leases, we've seen better than expected performance at auction. We now at constant mix think that the used vehicle prices will only be down 3%. So as Tim said, it's healthy. I think yes, to use your terminology, it's solidly green.

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

Q

Great, David. Thank you very much, everyone.

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

A

Thanks, Adam.

Operator: And our next question is from the line of Colin Langan from UBS. Colin, your line is open.

Colin Langan
Analyst, UBS Securities LLC

Q

Great. Thanks for taking my question. Just to start off, I mean if you look at the guidance for global redesign costs, you're trending well below the full year target, the outlook. Does that imply that there's still more major steps coming through the year? And given the size of these targets, does that mean something's going to be coming over the next few months? Any color there on how much more action we should be expecting?

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

A

Yeah, so it's Jim, Colin. So the way we're monitoring this is, we took on the structure, the management structure, what we call the bureaucracy, so we had four key goals in that. I'll just report to everyone, we exceeded every one of them. And this quarter was heavier in terms of impact of the cost of that than the first. There were more implications with people. And then in the restructuring, Tim, I'll let you talk about the flows there.

Timothy Stone
Chief Financial Officer, Ford Motor Co.

A

Great. Thanks, Jim. So as I mentioned earlier, we had $1.2 billion in charges in the second quarter, and then from a year-to-date standpoint, it's $1.7 billion in charges. And we're saying $3 billion to $3.5 billion for the full year. So it certainly implies you have quite a ways to go yet for the rest of the year. Further detail on that, it wouldn't be appropriate at this time. We haven't made the decision on the ideas that we have for further redesign. But that's against the total backdrop of $11 billion over the next several years, all of which will provide us with opportunity over time to fundamentally continue to improve the underlying business and our cash generation growth opportunities and so forth.

And then from a cash standpoint, we have had $0.2 billion in cash this quarter and so far year-to-date $0.4 billion, and we're expecting $1.5 billion to $2 billion for the year now. Last quarter we thought it may be closer to $2.5 billion, so we've had some deferral of $0.5 billion to $1 billion into 2020. But as you said, ways to go yet and lots of opportunity ahead to continue to redesign the business for the future.

Colin Langan
Analyst, UBS Securities LLC

Q

Got it. And in the quarter, commodity costs have really come down quite dramatically. And I know your contracts are lagged, but are we looking into the second half? Is that going to be a tailwind? Are you factoring in a tailwind to your guidance? Or any color there on the commodity.

Timothy Stone
Chief Financial Officer, Ford Motor Co.

A

Thanks, Colin. So on the commodity front, we're at $0.2 billion adverse in the first half, but beyond what we've seen thus far as it relates to macro trends or expectations, that's factored into the guidance. So there's no further commentary I'd offer for the back half of the year.

Colin Langan
Analyst, UBS Securities LLC

Q

Okay. Thank you very much for taking my questions.

Timothy Stone
Chief Financial Officer, Ford Motor Co.

A

You bet.

Operator: And our next question is from the line of Ryan Brinkman from JPMorgan. Ryan?

Ryan Brinkman
Analyst, JPMorgan Securities LLC

Q

Hi. Thanks for taking my question. It's great to see on slide 40 in the appendix so many EBIT drivers of the consolidated operations in China being positive year-over-year in 2Q amidst a tough industry. With that said, given the relative size of the consolidated and the non-consolidated operations in China, it would seem the biggest opportunity for improvement is probably in the JVs which were roughly flat year-over-year in 2Q. Can you give us some indication of what is happening within that relatively placid $4 million change in EBIT or equity income? I imagine material volume declines may be offset by cost.

And then I think you've downplayed expectations for much improvement in the JVs this year given the obvious industry headwinds and that the improvement will instead come from the consolidated ops. But going forward, how much of a driver do you think improving JV income could be? And when might we start to see some evidence of that?

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

A

I think that's an excellent question, and I want you to know it's something we talk about. Joe?

Joseph R. Hinrichs
President, Automotive, Ford Motor Co.

A

Yeah, sure. So thanks for the question. There is no question that in order for us to achieve the results we're looking for over time in China, our joint ventures, especially the Changan Ford joint ventures needs to improve its performance. I'd say that we have a lot of work to do. You referenced the consolidated operations improvements in the second quarter and first half of the year. And a part of it is the volume losses that we've seen due to sales but also managing the inventory down to the lowest level in 18 months. We feel good about that.

But going forward, we've just rebuilt the marketing and sales organization over the last several months with some very good hires and some very good restructuring. We're getting very strong participation with our joint venture partners, especially Changan, in the rework we're doing with our marketing and sales organization and the dealer relations. It's going to take some time to rebuild all of that, but I would say that we're on a path that we've seen for the last couple months. We saw stability in our sales really for the first time in about 18 months or so.

We got a lot of work to do. Part of it will be cost, of course. We have rightsized at least the manning part of our manufacturing. There's a lot more work to do given the lower volumes on the overall manufacturing footprint. But the biggest opportunity for us is to rebuild the dealer profitability, the dealer engagement, and the marketing and sales organization in the joint venture. And we'll have to see how long that takes, but we're making some good progress. But we think it's going to take some more time.

So then of course the new products. Remember that we said that we're going to localize five more vehicles starting in 2019. That will help the joint venture because a number of those products like Explorer, Lincoln, Corsair are built in the joint venture. So some of that localization will really help the joint venture, and of course the new product launches we have over the next 18 months will help in the JV as well. That's clearly our number one focus.

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

A

And I would just add, it's not something we talk a lot about a lot from this table, but there was a lot of turmoil and turbulence in the leadership in China for Ford. We had somebody that resigned for personal reasons. We replaced that, and then we had another change. And so I want to tell you with my tour that Joe and I, we really feel good about the management team that's in place there, and a lot of momentum starting to build with them, and because – how long has Anning been there now?

Joseph R. Hinrichs
President, Automotive, Ford Motor Co.

A

Yeah, Anning started in November.

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

A

November.

Joseph R. Hinrichs
President, Automotive, Ford Motor Co.

A

So not even close to a year and really starting to gain some momentum there.

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

A

Yeah, so I just want to make sure that you guys hear that.

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

So with the operator, I think it's time for us to wrap up. If it's okay, I'll go ahead and close with a few thoughts. I just want to say that our second quarter results demonstrate that this global redesign of Ford is driving positive shifts in our business and emphasize today that news in Europe is better and the redesign that we took with the bureaucratic structure of the company is we met all the goals there. So there's a lot of good news in this year of execution regarding that.

Thus, we are improving our fitness, and that was a goal to make us more competitive. We are driving a winning portfolio. The logic, as you know, to move out of the sedans and into products like Ranger are paying off, and we see ourselves fortifying strengths, improving mix. And there's a really strong commitment, as Adam asked us, to expand that electric vehicle portfolio quickly. And lastly, the trajectory of the company is improving, we believe, and is strong in terms of growth, cash flow and profitability.

So let me thank you for your attention this evening, and I'll turn it back to the operator.

Operator: Ladies and gentlemen, this concludes the Ford Motor Company Second Quarter Earnings Conference Call. Thank you for your participation. You may now disconnect.