

Ford Motor Company

Moderator: Ford Executives
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OPERATOR: This is Conference #9677173.

Operator: Good day, ladies and gentlemen. My name is (Holly), and I'll be your conference operator today. At this time, I would like to welcome you to the Ford Motor Company Third Quarter 2020 Earnings Conference Call. (Operator Instructions) I would now like to turn the call over to Lynn Antipas Tyson, Executive Director of Investor Relations. Lynn, I hand it to you.

Lynn Antipas Tyson: Thank you so much, (Holly), and welcome, everyone, to Ford Motor Company's Third Quarter 2020 Earnings Call. Presenting today are Jim Farley, our President and CEO; John Lawler, our Chief Financial Officer; and also joining us for Q&A is Marion Harris, CEO of Ford Credit. Jim will have some opening comments. John will talk about our third quarter results and then we'll turn to Q&A.

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 discussion includes forward-looking statements about our expectations.

Natural results may differ from those stated. The most significant factors that could cause actual results to differ are included on Slide 23. Unless otherwise noted, all comparisons are year-over-year. Company EBIT, EPS and free cash flow are on an adjusted basis and product mix is volume weighted.

A quick update on our IR events over the next few weeks. On Monday, November 2, Credit Suisse will host a fireside chat with John Lawler, Marion Harris and Kumar Galhotra, Ford's President of the Americas and our International Markets Group.

And then on November 10, Stuart Taylor, Executive Director of Enterprise Connectivity, will participate in Deutsche Bank's Auto Tech Virtual Conference. Now I'll turn the call over to Jim Farley. Jim?

James Farley: Thanks, Lynn, and hi, everyone. First, let me say how humbled I am and what a privilege it is to be the CEO of Ford. My family's been with Ford since 1916 when my grandfather started at Highland Park here in Michigan.

And in that moment, our family story really started to change for the better. And countless people all over have similar stories about Ford. We're a family company from the leadership of Bill Ford all the way to the members on our factory floor.

I'm extremely motivated to help build a vibrant and growing Ford that will have a positive effect for generations to come, benefiting all of our stakeholders. Now we've assembled a very talented leadership team to get this done, a combination of strong lifetime and long-time Ford people who truly know our business.

But we also have new colleagues, bringing very different experiences and know-how and talent to the company to execute our plan. And we plan to continue to add to this bench with key capabilities in marketing, in technology and many other areas.

Over the past several months, I've spoken to many of you, and I believe the plan we now have and have developed and are now executing on aligns well with many of your expectations.

We're committed to creating a Ford that grows profitably and generates sustainable free cash flow, led by our automotive business. And we're going to allocate capital to the best and highest usage to drive sustainable value creation.

Now that plan, which was introduced to the Ford team and many stakeholders on October 1 is very straightforward. Among other things, number one, we will compete like a challenger, earning each customer with great products but as well services with rewarding ownership experiences.

Number two, we're moving with urgency to turn around our automotive operations, improve our quality, reduce our cost and accelerate the restructuring of underperforming businesses. And third, we're going to grow again but in the right areas, allocating more capital, more resources, more talent to our very strongest businesses and vehicle franchises.

Incubating, scaling and integrating new businesses, some of them enabled by new technology like Argo's world-class self-driving system and expanding our leading commercial vehicle business with great margins but now with the suite of software services that drive loyalty and generate reoccurring annuity-like revenue streams. And being a leader in electric vehicle revolution around the world where we have strength and scale.

So now speaking about EVs. To start with, we're developing all new electric versions of the F-150 in the Transit, the 2 most important, highest volume commercial vehicles in our industry.

These leading vehicles really drive the commercial vehicle business at Ford and we're electrifying them. We own work at Ford and these electric vehicles will be true work vehicles, extremely capable and with unique digital services and over-the-air capabilities to improve the productivity and uptime of our important commercial customers.

The electric Transit, by the way, will be revealed next month. You heard about it here first, for all of our global markets. We believe the addressable market for a fully electric commercial van and pickup, the 2 largest addressable profit pools in commercial are going to be massive.

And we're going straight at this opportunity. Together, we think the accessible price points of these vehicles, the productivity, the capability, the cost of ownership will be very compelling for one of -- some of our customers. And

frankly, Ford is not only in front of developing the electric Transit F-150, we also have an unmatched dealer base to provide that anywhere service or great uptime for our customers.

We have a great customer base with deep know-how on their usage and expertise in the commercial vehicle business, such as the largest up-bidder community there is, period.

Also in the coming weeks, we will deliver the first Mustang Mach-E to customers in the U.S. and Europe. The reservations have been very strong for this vehicle, and soon after, it will go on sale even in China.

Now in 30 years of being in this wonderful business, I have never been so pumped up about one of the retail vehicles. I recently had a chance to put 1,000 miles on a Mach-E, and that Mustang and that engineering team had to pry that vehicle out of my hands.

It just elevated experience the way it drives, the connected technology in the cabin, the ingenious cloud-enabled services, it's all in the heart of the market from a price point. Such a large addressable market, the 2 real crossover business and we have a real advantage, especially in the U.S. with the EV tax credit.

Now you're going to see our strategy of electrifying our leading commercial vehicles and our iconic high-volume products expand very quickly at Ford. It's also important to note that we're building out our electric vehicle manufacturing footprint around the world.

And we now have 4 plants in North America alone, including an all-new carbon-neutral factory going up at the Rouge plant as we speak a few miles from here. We're also recently finalized an agreement with the Canadian Auto Workers Union, Unifor, that paves the way for future electric SUVs to be built by our team in Canada.

Now as we execute our plan, my commitment to each of you is transparency, including purposeful, measurable key performance indicators so you can

objectively track our progress. We plan to provide you with more details about our plan, including financial targets in the spring.

With that, let me briefly touch on the robust third quarter and what we have on tap for the fourth quarter. When you look at our results, they reflect the benefit of our decision 2 years ago to allocate capital to our strongest franchise, namely: pickups, a whole range of utilities across the world, commercial vehicles and iconic passenger vehicles.

Additionally, we saw higher-than-expected demand for our new vehicles in the quarter, at a time when inventories are really low following the virus-related first half factory shutdowns. Now this contributed to a very favorable pricing environment and mix.

Together, these factors, plus the strong performance from the -- the strongest performance from Ford Credit in 15 years, led to a total company adjusted EBIT margin of 9.7%. That's 490 basis points higher than last year.

As an outcome of all this, we generated \$6.3 billion in adjusted free cash flow. Throughout 2020, even during the industry-wide shutdown of COVID and as we prioritized the safety of our team, we've been disciplined in preparing for a high-quality fourth quarter launch, first of the 2021 F-150.

You can live in it, you can work in it, you can sleep in it; the Bronco Sport Ford, the first of many Broncos to come, and my favorite, the all-new all-electric Mustang Mach-E. In fact, we used the unanticipated downtime to continue to validate the preparations for these important launch vehicles, and in the case of the F-150, a methodical sell-down and the changeover for our current model.

While I'm proud of our team, I'm delighted to say that we're in good shape in important areas of readiness for these launches. Software, the hardware engineering is done. Supplier manufacturing readiness looks great. In fact, right now, our all-new F-150s are rolling off the line in Dearborn as we speak, and production will soon start in Kansas City. And we're starting to build the Mustang Mach-E and the Bronco Sport actually earlier this week.

Before I turn it over to John, I want to thank each of you for joining us today. Despite the strong numbers in the third quarter, we know we haven't fixed the issues that have held us back in our automotive business.

They include warranty costs, which remain unacceptably high. I plan to be transparent and focused on both customer and shareholder value, proving out this business and our plan quarter after quarter, year after year. And now John, let's take everyone through details.

John Lawler: Thanks, Jim. First, let me say, what an honor it is to be the CFO of this great company. And you know, I really can't remember a time when we've had this much opportunity to transform and grow our business. And so it's incredibly exciting and delivering on that potential, it's an important responsibility all of us have to our customers and to our stakeholders.

Now to be clear, our transformation and growth plan is predicated on delivering an 8% or better adjusted company EBIT margin and consistently generating free cash flow so we can invest in accretive, high-return products and services.

And so my initial priorities to help drive this are, one, help our team fix or dispose of underperforming parts of our business so we can allocate capital to its best and highest use; and two, further strengthen our balance sheet. We will make the tough decisions to improve our financial flexibility and ensure that we have the resources to build and grow our business.

Now let me summarize the third quarter. As Jim mentioned, we had a strong quarter, delivering a 9.7% company adjusted EBIT margin. Now that margin was driven largely by higher-than-expected vehicle demand, positive net pricing and favorable mix as inventories were limited because of the virus-related shutdowns in the first half of the year.

North America and China benefited from growth in both wholesales and revenue, while Europe, South America and our Internationals Market Group were still affected by COVID-related industry declines.

In addition, our performance continues to benefit from our portfolio refresh as we reallocate capital to our franchise strengths. Ford Credit also contributed, turning in its strongest performance since 2005, generating \$1.1 billion in earnings before taxes with help from strong auction values.

Now before I talk about the rest of our business, let me put our record \$6.3 billion of adjusted free cash flow in perspective. Not only does it reflect the strength of our EBIT in the quarter, but as we indicated last quarter, working capital recovered sharply as we rebuild production to full capacity after a shutdown, largely driven by supplier payables.

In the third quarter, the payable build was completed and this was worth about \$4 billion. The strong cash flow in the quarter gave us the confidence and the ability to make a second payment on our corporate revolver, which we did on September 24.

So now we have fully repaid the entire \$15 billion facility, and we ended the third quarter with a strong balance sheet, including nearly \$30 billion in cash and more than \$45 billion of liquidity, which puts us in vital -- which provides us with the vital financial flexibility we need.

Looking at North America. Despite the difficult backdrop of COVID, the Ford team executed well operationally. We optimized incentives for lower dealer stock levels. We maximized production and skillfully managed supply chains to meet stronger-than-expected customer demand.

The region delivered an EBIT margin of 12.5% as it benefited from top line growth of 8%. EBIT improved by \$1.2 billion, supported by \$900 million in net pricing and \$400 million in favorable volume and mix. The improvement in volume and mix reflects the effectiveness of our team in focusing on Ford's franchise strengths.

A few examples include F-Series. F-Series gained 1.7 points to a share of more than 35% in the U.S. Our mix of trucks and vans increased 1 point to 57%. Our mix -- our utility mix increased 3 points to 35%, with a very strong showing from Explorer. And the mix of cars declined 4 points to just under 8%. So in total, North America share increased 1 point to 13.6%.

In Europe, EBIT declined \$300 million in the quarter, but that was driven by lower volume and about \$400 million in costs related to a Kuga PHEV battery supplier issue. Those expenses included pooling costs that are required to comply with the EU's new CO2 emission standard this year.

Now we said earlier that we anticipated meeting those new standards based on our product road map, and the Kuga PHEV was a big part of that expectation. So we're working closely with our supplier to remediate the situation and minimize any inconveniences to our customers.

We plan to notify our customers in the coming days on how and when we will repair their vehicles. And had it not been for the Kuga issue, Europe would have been profitable for the third quarter.

Now since Europe began its sweeping redesign of the regional business in 2018, the European team successfully rationalized the manufacturing footprint, shifted resources to our leading position in commercial vehicles and dramatically lowered structural cost.

This year, the Europe team is on track to deliver \$1 billion of annual structural cost reductions. Now relative to mix, our commercial vehicle mix share increased by 50 basis points to 15.1% for the quarter, and SUVs accounted for more than 30% of our vehicle mix in Europe, nearly 9 points higher than a year ago.

Turning to China. Wholesale shipments in China were up 22%. That's the second consecutive quarter of year-over-year growth. That reflects strong sales of SUVs in commercial vehicles.

Our mix of SUVs increased 13 percentage points to 36%, and that was driven by locally-built Ford Explorer, Escape and Lincoln Aviator and Corsair, with Lincoln delivering its best-ever quarterly sales in China. And as planned, over 65% of Lincoln vehicles are now produced locally, following the introduction of the Corsair and the Aviator in the first half of 2020.

Commercial vehicle sale mix increased 5% -- 5 percentage points to 45%, and that reflects strong JMC sales, up 38% versus prior year. And that reflects the continued strong demand for light trucks, vans and pickups. So overall, the team delivered a third consecutive quarter of year-over-year share gains and marked the second consecutive quarter of year-over-year improvement in EBIT, the best performance in 3 years.

In South America, we continued to focus on derisking the business. The team there delivered its fourth quarter in a row of year-over-year EBIT improvement, with aggressive pricing and structural cost reductions mitigating the ongoing pressure from inflation, currency and the industry structural challenges.

And in IMG, IMG delivered a profit despite COVID-related industry declines in wholesales, which adversely affected their revenue. F-Series gained share and our share with the Ranger pickup in Australia increased 6 points to 27%. Profitability in IMG also benefited from the work the team has done to lower structural costs.

And finally, Ford Mobility, which is building fourth-generation autonomous test vehicles with the latest self-driving technology, generated its first AV-related revenue from a fleet operations pilot in Austin, Texas. And at the same time, we are strategically expanding our spin scooter business in the U.S., the U.K. and Germany and generating strong revenue growth.

Now before taking your questions, I'll make a few comments about the fourth quarter, which assumes no meaningful change to the current economic environment, continued steady improvement in the stability of the global automotive supply base and no further significant COVID-related disruptions to production or disruptions since the third quarter.

Our guidance for adjusted company EBIT for the fourth quarter is between a loss of \$500 million and breakeven. Now we recognize this is a big change both sequentially and year-over-year so I want to step through the key sequential drivers.

First, we expect a reduction in wholesales of about 100,000 units associated with the F-150 changeover. Now this volume effect is a result of our measured production ramp-up plan to ensure that every vehicle we wholesale is gate-released with the highest possible quality for our customers.

Now to put this in context, the approximate 100,000-unit impact in the fourth quarter will far outweigh the effect of our UAW ratification bonus in Q4 of last year, which was worth about \$600 million.

Second, we also expect higher structural and other costs from the manufacturing launch activities for the Mustang Mach-E and the Bronco Sport as well as advertising launch activities for the new products, including the all-new Bronco brand and higher material and other costs. And we expect EBT from Ford Credit to be lower sequentially, driven by strong but lower auction values and lower disposals at auction.

With this fourth quarter guidance, we now expect full year adjusted company EBIT to be profitable for the year. Other elements of our guidance for the year are unchanged with the exception of capital expenditures. We now expect a lower level for this year, down between \$1.2 billion and \$1.7 billion versus \$7.6 billion in 2019, and that reflects continued efficiencies.

Before we move to Q&A, I want to leave you with my key takeaways from the quarter. We had better execution, choosing where to play and our restructuring is paying off.

These things intersected very nicely with the stronger-than-expected demand. We know there's more to fix and we're carrying on a clear plan to do that, as Jim mentioned. And our balance sheet is solid, with nearly \$30 billion of cash and over \$45 billion of liquidity. Now operator, let's open the line for questions.

Operator: (Operator Instructions) And our first question will come from the line of John Murphy, Bank of America.

John Murphy: Congrats, Jim, for leading the call here. Interesting stuff, early days. Just a first question. As you look at the strength in the third quarter, obviously, there

was great execution and some strategy around buying mix and price that was helped by good industry dynamics.

I'm just curious if you think about those 3 key factors once we get through the changeover of the F-150 in the fourth quarter and might bleed into the first quarter of next year.

How much of that you think will reverse? And as you look at what you're producing at the moment and your focused shifted mix to a richer mix, how much of this stuff can be -- how much beneficial factors can be maintained going into 2021 or maybe just even on a run rate basis getting into '21 specifically?

John Lawler: So when you look at that, and we look at the business this year, really getting to the core of the run rate is a bit difficult, as you can expect, given going down in the first half and then coming back up and then the launches we have for the quarter. And so from a cost standpoint, we're going to continue to focus, as we said, on making sure that we can really lean into what we need to do to improve the business, improve the underperforming parts of the business.

And then when it comes to the mix and the top line, we saw some strength there. We had some wind at our back due to the strong supply -- strong demand with the short supply.

So seeing that going forward, we've been seeing our mix improve into our strengths of trucks, SUVs, in our iconic nameplates, and we continue to expect to push that. But as far as a run rate and what we see into 2021, we're not ready to talk about that at this point, and we'll come back and we'll have more to say on that early 2021. We'll give you a read on the business then.

John Murphy: Maybe to follow up on that. I mean, how much of this you think is somewhat transitory for market factors? Because you could argue right now that the industry volume is pretty -- it's relatively strong relative to peers but is not really, in absolute terms, quite that amazing.

So it seems like there's an underlying demand for stronger mix than we all may have thought 6, 12, 18, 24 months ago. So I mean, as you're going after this mix with this improved product, I mean, is there something that you're kind of seeing in the market, maybe just specifically even in the third quarter? Because I mean, this is really heady stuff that you're running into and it's a real positive.

John Lawler: Yes, it is a positive. You see strength there. The question is, there was an imbalance in supply and demand, and that gave us some of a tailwind, but we also are seeing, over time, as we've, over the last 2 years, made the concerted effort to shift into our strength of commercial vehicles and trucks.

And you see that in Europe, you see that here and you see that around the world. So we do see strength there. As far as how far that extends and what that looks like, we're not ready to comment on that now but we do see strength there.

John Murphy: Okay. And then maybe just 1 last question. On lease deferrals, I mean, how many leases did you defer in the second quarter that came back in the third quarter or might come back in the coming quarters? And sort of in addition to that, when you see auction volumes or auction values, I should say, being very strong, how long do you expect that to continue?

Because it just seems like there's a lot of positive news on these lease deferrals as well as what's going on in the used vehicle market that's helping out not just Ford Motor Credit but the core business as well.

Marion Harris: John, this is Marion Harris. We did a bunch of payment extensions for loans and leases. But if you're referring to lease deferrals for lease-in where a unit comes back to auction, we didn't really do many of those. And we had a pretty big inventory of used vehicles going into the third quarter.

And as we sold those units into an improving market, that's really what was the real benefit for Ford Credit. If you were talking about payment extensions though, of the -- we extended about 11% of our retail loan and lease portfolio. And of that, about 99% of those have already made a payment. And we're back to pre-pandemic levels of extensions.

John Murphy: Okay. So as far as what you're selling in the auctions right now, it's normal run rate of lease returns flowing directly into auctions and no edge or flows or pulls -- tugs or pulls by you?

Marion Harris: Yes, that's correct. We're back in normal inventory.

Operator: And our next question will come from the line of Rod Lache with Wolf Research.

Rod Lache: Congratulations on the performance in the quarter. I hope it is a sign of things to come. I had 3 questions for you. Number one, Jim, you've talked about 10% margin target for North America for some time, and now you've shown that you can get there.

Obviously, Q4, this launch phase will be a bit challenging. But could you talk a little bit about what you're thinking about as the time line for getting to that kind of a target more sustainably?

Secondly, I noticed that the warranty costs moderated a bit, at least the cost inflation moderated. Is that a sign that things are finally peaking? And then lastly, the drumbeat of activity in electrification obviously is something everyone's hearing, and companies are laying out some pretty aggressive targets for cost reduction in volumes.

The Mach-E looks great but it's still a relatively low volume product. Can you just talk a little bit about what your thinking is and how your thinking has evolved on what kind of volumes you're anticipating or how aggressively you intend to move into electrification on some of those commercial products?

James Farley: Yes. Thanks, Rod. On North America, I think it's really important for us to be clear, turn around our automotive operations and North America needs to absolutely be at 10-plus percent.

As you can see from the pricing and the mix, I think Ford is the strongest brand in the U.S. industry, mainstream brand on pricing and mix. Our issue in North America is cost and growth. On cost, it's really isolated to material cost,

which is tied to that higher pricing, of course, and warranty. A warranty in the last few years, coverage is up \$1 billion to \$2 billion depending on the year, and that is not okay.

So although it moderated in the quarter and we have taken a lot of actions on craftsmanship, long-term durability, we have a much bigger ambition to improve the quality of our vehicles. We have taken a lot of countermeasures. They will take time. I'm happy to go into those, if you'd like.

But I would say our North America 10% is really a cost journey for us because on the growth side, we have a whole new Bronco lineup coming, a brand-new F-Series coming. These are fantastic opportunities for us on the top line for the next many years to come. So our journey to get to 10% is a cost.

On electrification, I want to cover that 1 next because it's quite important. There's been a lot written about the electrification of our industry. And Ford's bet is different. We're betting on a full lineup of commercial electrified vehicles. We're building a plant at the Rouge.

We are the #1 nameplate in the U.S. industry. We sell over 1 million F-Series. We have an enormous customer base who are looking to reduce their costs. And so I'm not going to get into forecasting the volumes, but we really see in this first inning of electrification, and it will be a long game that plays out over many years, that we have tremendous volume opportunity.

We are not going after the \$100,000-plus market. These are affordable vehicles. They're in the key price points in the U.S., the Mach-E between \$45,000 and \$70,000 2-row crossovers, huge addressable market here in Western Europe.

And in commercial, we're not planning a very exclusive, small 1% of the addressable U.S. industry. We're talking about these vehicles being 10-plus percent of the revenue pool in North America at their price. So they look great financially for us.

But I guess we aren't looking at electrification for the propulsion. We think the real change here is the connectivity and to run a business based on the

data. So the upgraded electric architectures in the Mach-E and the F-150 electric, to me, is the most important because it allows us to reduce our costs inside the company and give customers a totally different experience. And your middle question?

Rod Lache: Yes. The warranty cost, is this a sign that you're starting to get your arms around that and that it's going to start -- that there's visibility on when that's going to start coming back down?

James Farley: We have more work to do, that's all I'll say. We are not satisfied with the quality run rate. It may be coming down but that's not what we're targeting. We're targeting a fully competitive level of warranty spend on coverages and that's got lots of zeros next to it.

To do that, Rod, there's a couple of things the team has decided to double down on. For suppliers who ship us bad parts, we're going to have punitive financial. I mean, if they're bad shippers for multiple times, we put more resources in our plants for supplier quality.

We have a lot more resources dedicated and a ton of transparency on quality issues that are open for more than 30 days in the company. It's a key metric that we drive our management team to. So those are the kind of changes we made. And I wouldn't say this quarter is anything that we're proud of.

Rod Lache: Okay. And just to clarify, Jim, you didn't really provide a time line on getting to sustainably -- a sustainable 10% or better margin. You said that you've got visibility on the revenue side and you still have work to do on the cost side. So is there line of sight for you on that? It seems like the product side and the revenue side for North America looks pretty powerful as you look out to next year.

James Farley: Yes.

Rod Lache: Okay. We'll follow up offline.

Operator: Our next question will come from the line of Emmanuel Rosner, Deutsche Bank.

Emmanuel Rosner: Jim and John, first, congratulations on your new roles. And Jim, certainly very encouraged by your commitment to transparency and measurable improvements.

So I guess in that spirit, when we look, I guess, at your performance in the quarter, the size for the stronger demand, pricing mix, which you commented on, are you able to point us to measurable areas of underlying cost improvement that you've seen, whether it is on these material freight we spoke -- you spoke a little bit about warranty on the structural side? Anything that's already bearing some fruits that you're excited about? Or should we think about it more as an opportunity for the future?

John Lawler: Yes. Emmanuel, when you look at the cost performance for the quarter, you really look at what we talked about with Europe is all the restructuring they've done, the headcount that they've taken out, they're now approaching and they will approach this year that \$1 billion of structural cost reductions.

And so we saw that flow through, that's coming through and that's going to continue to come through. What the team has done in South America in restructuring the business down there, getting out of low profitable vehicles, selling the San Bernardo plant and all the actions they've taken on their structure and headcount, that's going to continue to flow through.

And then we saw good performance out of International Markets Group this quarter. They were profitable and a lot of that -- most of that was driven on the back of structural cost reductions.

As far as what we saw here in North America, I think with the strength that we had in demand, the short supply, we saw some good news come through in areas that you'd expect like advertising, et cetera.

So we have to see how demand and supply balance out and what happens there. And as Jim said, we have a lot of work to do on our cost structure here in North America. And that's going to be one of our key focuses.

Emmanuel Rosner: So I guess you gave a little bit of color on the -- what needs to be done on the warranty side and the quality side. What is being done or can be done? I don't need the quantification but just in terms of what is it required to get the material and freight piece of it down? Looks like this is probably 1 of the 2 largest buckets on the cost side here.

James Farley: So thanks for your question. On the material cost side, it's kind of everywhere. A good example would be we have a proximity key in your pocket to unlock the door in all 4 doors of the F-150.

When we look at the vehicle usage data, we found that people use the proximity sensor for the front 2 doors. We do not need a proximity sensor in the rear 2 doors. Our jack on the F-150 looks like it will last about 50 years.

That's not the case for our competitors. So it's everything from the way we package our features, the actual bill of material, and the team has been working through all these opportunities since February. We made progress but we need to make a lot more progress, especially with the more expensive launch vehicles.

And I think the real enabler is going to be complexity reduction. We've been talking about complexity reduction for -- as a company for quite some time as a key fitness for the leadership team but we have a lot more work to do on complexity reduction. And that will be a huge enabler for not only our manufacturing operations but also our material cost.

Emmanuel Rosner: And then finally, there was no specific guidance on free cash flow for the fourth quarter. I think the last earnings call, the idea was that third quarter free cash flow would be better than the EBIT but fourth quarter worse than fourth quarter EBIT.

Any sort of sense you can give us on how you think about this quarter's free cash flow, and whether there will be some sort of timing or working capital payback from the strength that we've seen in the third quarter?

John Lawler: In the quarter, we got payables back to what we would say is a normal run rate. And so from a standpoint of the guidance on the cash flow for the

quarter, for the fourth quarter, it's going to, likely had said with EBIT, it's going to be driven by EBIT. So we haven't given a specific number on that. And at this point, I'm not sure we're going to do that today.

Operator: Our next question will come from the line of Adam Jonas with Morgan Stanley.

Adam Jonas: Jim, I got a few questions for you. I think you mentioned the phrase that EVs look great financially, I think when you're looking out, that they seem to line up well financially. Could you elaborate on that? My understanding is that EVs present a really great opportunity to decomplexify the vehicle, even allowing for the expensive battery costs.

The things that you can remove from an EV and the way you can design a lot more efficiently relative to the spider web of complexity of the internal combustion mechanism, that it's a great opportunity. Am I correct in that assumption? And I just didn't know if -- I wanted to hear if you could add some color to that hypothesis.

James Farley: Sure. Thank you. I guess, the 3 key messages for our electrification strategy of the company is we're going after very large addressable markets and profit pools and we're playing to our strengths.

I'll come back to your question. The second is to turn battery electrics into a digital kind of service model, not just a propulsion system and that we're in the first inning. And the second inning is going to be quite important for the company to transition as well.

Related to the cost, initially, several years ago when we made these investments and decisions, the cost of the battery, the profitability of the vehicles is really challenging.

What we found since then, once we started to look at the real cost of CO₂ of our internal combustion engine, when we started to look at in commercial terms, offering bidirectional charging, bringing charging to the job site and electricity job site, we started to realize that there's a lot more revenue

opportunity, a lot lower cost than marketing because of the connected services.

And of course, the cost, the way how and the team looked at the cost of our battery, we used kind of a temporary overcapacity situation to get very competitive cost and also cherry-picked the best chemistry out there.

All that kind of came together with much more compelling financial picture for these first cycle products. I think that's what I was referring to when you look at the all-in comparison to ICE, also the revenue opportunity.

We had never really -- when we got into the commercial world of electrification, I think we -- our eyes were very open and very informed by the aluminum investment in F-150, that people are willing to pay, in the case of lightweighting, more than just the lightweighting, fuel economy, it's a commercial vehicle for towing and payload.

When you think about bringing energy to the job site or bidirectional charging for a small, medium-sized business is kind of a game-changer for them in terms of -- and for us for revenue. I hope that makes sense.

Adam Jonas: Yes, it does. And you seem to have for -- even before you became CEO, express a lot of enthusiasm towards the software services, the data opportunity for the company. I think you said you want to run the business based on the data. Can you be specific on what services get you most excited and when that can be material?

James Farley: Yes. Great question. So first of all, it starts with the talent. We attracted Alex Purdy from Deere, who went through the whole Deere journey moving to software and data. We attracted Gil, who's now our data analytics lead. We now have -- we've had the talent on board for enough time.

We really understand the opportunity. I think the opportunity first came, Adam, with internal the company. You can imagine with our warranty, the data codes off the vehicle instantaneously having AI models, analyzing all those data codes, how exciting that is to our frontline engineers, how exciting it is to have that data be available to all of our engineers on actually the bill of

material and its usefulness for a company that has very expensive bill of material.

But then it became very quick for us, especially when we got outside of Dearborn and listened to the opportunity on services that over-the-air updates that are really relevant to the customer, in the case of commercial, they run their businesses off these vehicles.

So dynamic routing, telematics, driver coaching to drive more economically, the people that have our small fleets, they just love this because they haven't had that data before. And we can see a day not too distant future with a full lineup of pure battery electric commercials, where we have a whole service business.

And that service business is charging, it's small enterprise solutions for small, medium-sized businesses. It's repair -- a more affordable repair and upgrade of the physical vehicle, and that's what we're busy doing. That's our double transformation. One is to transform our automotive operations. The other one is, in a way, to kind of disrupt ourselves.

Operator: And our next question is going to come from the line of Ryan Brinkman with JPMorgan.

Ryan Brinkman: My question, which relates to the upcoming F-150 launch. Can you remind us of the timing and the impact you expect, both in terms of the profit or margin headwind from the lower production during the changeover as well as the benefit to sales mix or pricing subsequent to the rollout of the new version?

And how should investors think about execution risk during the launch? Can you talk about your confidence level there and -- that will go according to plan? And what steps that maybe you're taking to mitigate the risks?

John Lawler: Coming in, I'll answer the last question first on the product launch. We've spent a lot of time on these launches as they're very important, as you understand, and making sure we have all the design and engineering ready to go. We've made all the checkpoints. The suppliers are ready, manufacturing is ready and we started that production.

We haven't discussed what we expect from a pricing standpoint or what we expect from a margin standpoint on a new truck, and I don't think we want to talk about that today. But what we did talk about is the fact that we are taking a very pragmatic ramp-up plan to make sure that we deliver these with quality.

And that's leading us to have wholesales, on a sequential basis, down about 100,000 units, and that's what's impacting the fourth quarter. But getting any deeper than that, I'm not sure we're going to get into that today as far as the pricing and the cost impact of the vehicle.

James Farley: And as far as the launch, to complement John, we are so excited about this new F-150, all new powertrains, best towing, best payload. It's the best F-150 we've ever had and wait until you see the inside. It's incredible, the technology and customers are asking us for that.

Look, we've completed the design phase, the engineering phase, and the team did a great job. And we then finished the supplier readiness and manufacturing readiness.

My whole leadership team and myself went to both plants personally to review the launches a couple of times. And we're now in high production, starting the ramp-up curve at Dearborn and Kansas City. We expect to start soon. I think we don't know until we start getting up that ramp curve what we're going to see.

But I'd say one of the things I would complement the Ford team, how Linda the whole team was the way we used COVID. During the COVID shutdown, we didn't stop with the quality assessment of the launch and there was a lot of work done on the software, especially.

This is an all-new electrical architecture for us. There's a ton of new software and we used that downtime to really prove out our capability. And so we're a long way from declaring victory.

It's a daily huge global team working on the F-150 launch. But we've worked through the launch so far. We've made a lot of progress as a team and now we're into mass production. So stay tuned.

Ryan Brinkman: Okay, that's great. And then lastly, wanted to ask about the strong net pricing that you've been enjoying in Europe and South America. Can you talk about how you think your net pricing is tracking relative to the industry in those regions? And is the pricing strength more a function of the success of your company-specific product launches?

Or are there other more macro factors at play, for example, as automakers work to offset lower FX in South America, et cetera? Where are you in terms of your product life cycles in these regions? And how should we expect pricing to track going forward?

John Lawler: Yes. So if you -- let's just unpack that a little bit. If you look at Europe, we've had a strong shift into our SUVs, as we talked about earlier. And with that has come pricing power relative to the other vehicle lines, and we expect that to continue in Europe.

Down in South America, the team is being aggressive, and you're seeing product shift there that's driving some of the net pricing as well, the strength in pricing because we're getting out of low-profit lower-end vehicles, and we're being very focused on driving towards higher-margin products like Ranger and some of the other strengths that we have in the region. So we're going to see that continue through.

And then we're -- in Europe, they're managing through revenue management and looking at everything. We're doing the same thing here in North America. It's a focus we have but a lot of it's being driven by our strong mix.

We are seeing some pricing for product as new products coming out and that's flowing through as well. So we're very focused on driving the top line as best we can, but equally and more focused on the cost, as Jim's talked about and as we've talked about, that's one of our main focuses, keep moving forward on the top line and really hone in and focus in on getting the cost right.

Operator: Our next question is going to come from the line of Mark Delaney, Goldman Sachs.

Mark Delaney: Jim and John, you spoke to having urgency at achieving your goals in electrification that includes an electric F-150 and Transit as a few of the several electrified models that Ford is planning to bring to market over the next few years.

Hoping to better understand if the company plans to go beyond its \$11.5 billion investment target in electrification that was previously articulated. And does Ford plan to increase, in particular, the number of BEV models compared to its prior expectation?

James Farley: Thanks. I think the simple way to look at it is, we're kind of in the first inning of this transition of the industry to a battery electric future, and we're deep into the planning for the second cycle of those products. Competitive reasons, we're not going to share the cycle plan with you, but you can imagine that we're getting more and more excited about an electric future.

Now we have some great ICE products and we think that, that market will still be robust. But we're making our bets on iconic retail vehicles. And electric is definitely something that we're more and more excited about and our capital is following.

We don't want to just be one of the many OEMs to transition to electric. We want to lead the electric change. That's why we've committed to Paris. That's why we're standing with California. And that's in our capital.

And we feel that the way we're doing it at Ford is the most important message, which is commercial and work. Those customers run their business on these vehicles. They're more tempted to cost of ownership. The vehicles have higher utilization and therefore, the lower cost of ownership of operation is more important to them. And they're especially interested in the data.

And so I think although we could talk about general investment levels, the key message for Ford is more of the segments that we're investing in and that this

is not a propulsion story. This is an investment in the digitization of our business.

Mark Delaney: That's very helpful. And the company commented that because of the Kuga recall, the company will now have CO2 compliance cost this year. Are you anticipating a similar level of cost in the fourth quarter as was realized in 3Q?

And then perhaps more importantly, can you discuss if you think this issue will be resolved and if there's risk to any of your other hybrid or BEV products?

John Lawler: So from a cost standpoint, I'll start with that. As I said earlier, it's about \$400 million for the quarter. We do expect some costs in the fourth quarter somewhere between \$100 million to \$200 million, so that's the impact we see as it is today. And that does also -- that includes the impact of the pooling effort that we're going to have to undertake for passenger vehicles in Europe.

James Farley: And the battery that is used in the Kuga PHEV is not (inaudible) so it's a supply (inaudible)

Operator: And our next question will come from the line of Brian Johnson, Barclays.

Brian Johnson: Congratulations to the new Ford team. I want to drill down on the European CO2 compliance strategy, both on the light vehicle side and the LCV side. So first on the LCV side, which, of course, as you flagged earlier, your different standards, is that on track? And when can we expect an MEV-derived LCV platform for Europe?

James Farley: Very specific question, so thank you. First of all, we have a great plan for Europe. We were on track for our CO2 target this year until the Kuga PHEV situation came up with a supplier late in the year.

As I mentioned today, it's a bit new news, maybe not as -- maybe not as a dramatic as \$100,000 retail offroader, but the electric Transit is a really big deal for Ford Motor Company. It's -- we're #1 in the U.S. We're #1 in Western Europe. And we think electrifying this product is going to be really key, and that will be a key part of our CO2 compliance, that announcement.

So we continue to see in Europe more city restrictions. Many, many of our small and medium-sized business owners are now asking for all-electric solution. And we also think the quality of the product will be a benefit for our European customers as well. The Mach-E will be sold in Europe next year in volume.

And so we have a great plan next year with the Mach-E. And we have a number of hybrids coming out next year in Europe (in mile) hybrids. I can't be specific but we really have a great lineup in Europe, over 20 models.

But what gets the leadership team really excited about Europe is the commercial vehicle business and the electrification of our high-volume van.

Brian Johnson: Right. I would concur on that. So moving over to the light vehicle passenger car and CV market, it struck -- there certainly is a split of opinion, with many viewing plug-in hybrids as a transition and million-plus unit global EV platforms as the way to go.

A, what's your thinking on that strategy? And B, as we kind of go into '21, '22, can you flex between BEVs and plug-in hybrids or even move to a more consolidated BEV platform for Europe?

James Farley: I think the flexibility between battery electrics, plug-ins is not very high. So we're really locked in as we should be. So I wouldn't -- this is not like vehicle mix or something like that.

All the battery supplies are slightly different. And also the lead time for changing battery capacity is a lot longer than most other major components in the vehicle. So I would think about those capacities in terms of flexibility very different than I would a traditional ICE powertrain.

Brian Johnson: Okay. And finally, have you disclosed or can you disclose who the polling agreement is with? Maybe it will become a public record at some point in the EU.

James Farley: We're not going to do that today.

Operator: 49

Our next question will come from the line of Dan Levy with Credit Suisse.

Dan Levy: Jim, wanted to start out with a strategic question on how you plan to balance the near-term industrial recovery of the business alongside the longer-term transition to EVs. How many and how you view the interplay of those 2? Is pace of EV development set regardless of the pace of your near-term recovery? Or should we look at pace of EV development driven by the extensive near-term recovery?

So if you outperform on your near-term targets, you can accelerate on EV and vice versa, if the recovery is slower. So what's the interplay of sort of near-term recovery with the pace of your EV development?

James Farley: Well, first of all, for Ford, our plan is very simple, turn around automotive operations, modernize the company and, in a way, disrupt ourselves, launch high-growth businesses like our CV services business or a go-to-market customer-facing AV business.

And so our calls on capital are much more complicated than just EV and vehicles. We have 15,000 software engineers at Ford right now and that will grow. So our calls on capital are software, the credit company, obviously. But increasingly, it's these services businesses. And we need talent, we need cash and capital to support them. It's all funded essentially by our core automotive operations.

And so the turnaround of automotive operations is not just a share -- a stakeholder journey. It's actually the lifeblood of our future because it funds everything.

And so how we look at it is getting our automotive operations overseas to profit and then a solid sustainable return, dealing with the issues of passenger cars in Europe and South America and India, the 3 problem kind of areas we've had in automotive, and getting our North America operations 10-plus percent is an absolute minimum for the company to fund not just the electrification journey but as well our move to services, data and software.

Dan Levy: Understood. So help me understand, though, as far as you have these larger capital calls, and presumably, you have probably a priority list and then also a nice-to-have list in terms of your investments. Does the pace of recovery at all impact the way that you accelerate or decelerate spend on those?

James Farley: These are great questions. If you don't mind, I don't -- I think it's best if we take a pass and we talk about this next spring. It is such a fundamental question you're asking. It is such an important question for Ford. I don't think the third quarter earnings is the right venue.

We need to take our time and go through this with you and all of the key stakeholders at Ford. And I think you'll be -- I think you'll find it for all of us to be a lot wiser if we just take more time and we have specifics for you.

Dan Levy: Got it. And then just a follow-up on the concept of growth. You're focused on top line growth. I think it's also clear, at the same time, you're likely willing to further (sack) price, some of what maybe we can call lower quality or more to commoditize pass car volumes.

So question is, are we already seeing some structural volume decline in North America related to your AION Pass card in Europe as well. But could you give us a sense of maybe how much more we might expect to see volume decline in the coming years related to a more commoditized product? Or maybe said differently, in which regions do you think there is more room to go on moving more commoditized, less value-add type volume?

James Farley: Well, thank you for your question. It's a very important 1 for us. After several years of making really tough choices, we now have the opportunity in North America to grow. And I'll emphasize again as something I put in my speech and I think it's quite important for everyone to understand our ambition. As John mentioned, our share of F-Series grew.

Our mix of SUV grew. Our car share is declining almost below 10% now. And our North America share increased 1 full point in the quarter. And we have Bronco, we've never had before. We have Mach-E that we've never had

before. So -- and we're really excited about the profit potential for all those vehicles.

So here we are on the eve of Ford Motor Company being able to execute well and grow in North America. When you look outside of North America, the growth that matters for us is commercial vehicles in Europe, a key growth metric for us. In China, we have an opportunity to grow.

Again, we just localized the Explorer and the whole Lincoln lineup. We haven't sold as many Lincolns we did in September in 25 years and it's because of China. So we have a huge opportunity to grow in China. And we have an opportunity to grow with export models coming from Mahindra.

And I have to say, we haven't talked a lot about this but I'll leak it out. And that is we have some really exciting, affordable products for North America. They're going to help us grow profitably.

So I think what you'll see is China and North America growth opportunities and the rest of the world, we're really focused on where we can win with Ranger or the commercial vehicles in Europe. And you'll see us continue to grow these services businesses along the way.

I hope if there's 1 message you would get from Ford, from this leadership team is that we're really trying to think, everyone -- asking everyone to think about growth of Ford is more than unit volume growth. We want to grow our software business, our services business. I hope that made sense.

Dan Levy: That's helpful color.

Operator: And our last question for the day will come from the line of Joseph Spak with RBC Capital Markets.

Joseph Spak: Maybe just 2 quick ones since we touched on a lot. I realize you are not talking about free cash flow for the fourth quarter. But the Ford Credit EBT year-to-date is \$1.7 billion, the distribution is only \$1.1 billion. And I think you've committed in the past to dividending all that out. So should we expect a catch-up in the fourth quarter?

John Lawler: Yes, I'm not sure that I'm quite clear on that. The catch-up is, I think that we've been distributing from Ford Credit on a regular basis throughout the year, so I wouldn't expect there to be anything out of the ordinary there. Marion?

Marion Harris: Yes, Joe, the distributions from Ford Credit are going to reflect profits after tax, balance sheet size and leverage. It's going to be where it's going to be.

Joseph Spak: Okay. And then just lastly, John. I saw in the media, I think you made a comment about how it's too early to talk about the dividend reinstatement. I realize ultimately, it's a Board decision but I'll open this up, I guess, to Jim and John.

In each of your opinion, should Ford be paying a dividend over the coming years, given the transformation you're talking about? And if so, what are really the parameters you're looking for, for reinstating that dividend?

James Farley: That's -- Thanks for the question, Joe. I don't think this is the time to have that discussion. I think we need to have that framed up in our total capital strategy and calls on capital and where we're headed as a business, and I think next spring would be the time to do that.

Operator: Thank you. That will conclude today's Ford Motor Company Third Quarter 2020 Earnings Conference Call. We do appreciate your participation. You may now disconnect.

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