Ford Motor Company

Second Quarter 2022 Earnings Call

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CORPORATE PARTICIPANTS

Lynn Antipas Tyson - *Executive Director of Investor Relations.*

Jim Farley - *President & CEO.*

John Lawler - *CFO*

Marion Harris - *CEO, Ford Credit*

PRESENTATION

Operator: Good day, ladies and gentlemen. My name is Chad, and I will be your conference operator today. At this time, I would like to welcome you to the Ford Motor Company Second Quarter 2022 Earnings Conference call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question and answer session. If you would like to ask a question during this time, please press star, then one to join the question queue. Should you need to remove your question from the queue, please press star then two. Please, also note today's event is being recorded. At this time, I would like to turn the call over to Lynn Antipas Tyson, Executive Director of Investor Relations. Please, go ahead.

Lynn Antipas Tyson: Thanks, Chad. Welcome to Ford Motor Company Second Quarter 2022 Earnings call. With me today are Jim Farley, our President and CEO, and John Lawler, our Chief Financial Officer. Also, joining us for Q&A is Marion Harris, CEO of Ford Credit. Today's discussions include some non-GAAP references. These are reconciled to the most comparable US GAAP measures in the appendix of our earnings deck. You can find the deck along with the rest of our earnings materials and other important content @shareholder.ford.com.

Today's discussions also include forward-looking statements about our expectations. Actual results may differ from those stated. The most significant factors that could cause actual results differ are included on page 22. Unless otherwise noted, all comparisons are year over year. Company EBITDA, EPS, and free cashflow are on an adjusted basis, and product mix is volume weighted. Looking at our IR calendar, we have two upcoming engagements. Tomorrow, BNP Paribus will host a fireside chat with John Waller and Kumar Galhotra President of Ford Blue. And on August 10th at their Auto Conference in New York, JP Morgan will host a fireside chat with Ted Cannis, CEO of Ford Pro. Now, I'll turn the call over to Jim Farley.

Jim Farley: Thanks, Lynn. Hello, everyone. The Ford team delivered a very solid second quarter in a challenging environment where we saw supply chain disruptions, a lot of new economic headwinds, and uncertainty as a whole. Importantly, we achieved these results as we advance the Ford+ plan, which is the biggest opportunity to create value at Ford since we scaled the model T. And at the core of Ford+, a three fundamental promises to our customers, distinctive and breakthrough products and experiences, and always on relationship with Ford every day, every hour, every minute, and ever improving post-purchase user experiences powered by software.

Today, I'll give you an update on Ford+ and the early results of our decisions to reorganize the company into three distinct segments, model E, Ford Blue, and Ford Pro. Now, let me start with the progress we're making to lead the electric vehicle and digital revolution. What's lost in the industry's armrace of claims regarding capital invested, the number of top hats we all have, the promises of future leadership is one fundamental question, who is and will be the best position to design truly distinctive and appealing products that people actually love? That's the question.

Now, we've been overwhelmed with the demand for our first generation EVs, the Mustang Mach-E, the Lightning, and the E-transit. These products are in the market now, and we have strong multi-year order banks. We're selling them as fast as we can make them, and you can't say that about many of the EVs coming to market now. We believe that these great new products will enable us to grab an outsized share of the rapidly growing EV market combined with our healthy and vibrant shares of our ICE and growing hybrid markets. This month, we expect to produce 14,000 EVs globally. That's significantly higher than just a few months ago.

And we have a clear path to reach a run rate of 60,000 EVs by the end of next year. And that will lead to a foundation to 2 million by late 2026. In fact, our anticipated growth rate in EVs through 2026 is more than twice what we expect for the global EV industry in total. Now, securing the raw materials to produce batteries at scale is critical to our plan. It's estimated that at best 50% of all raw materials required to meet the combined announced targets for all EV OEMs is actually available 50%, and this is why speed to securing supply is so critical in strategic. So is diversifying our battery chemistries to increase our flexibility, supply and profit and to support different customer use cases. Last week, we announced a series of MOUs and agreements to fulfill our ambition - ambitious needs that I covered, and we are working to complete definitive agreements were necessary. Our model lead team will quickly capture these opportunities.

To summarize, we've added battery chemistries and secure contracts delivering 60 gigawatts hours of annual battery capacity, which will help us support fully the 600,000 units of that 2023 run rate of capacity. We now have lithium-ion phosphate or LFP battery packs coming for the Mach-E sold in North America next year, and for Lightning in early 2024, creating more capacity for these high demand products. We've secured 70% of the battery capacity needed to support 2 million units by the end of 2026. And we struck a new deal with CATL on strategic cooperation for global battery supplies, as well as deals for direct sourcing of critical battery raw materials in the US Australia, Indonesia, and more locations. And we have a plan to localize 40 gigawatt hours per year, LFP capacity in North America by 2026. These deals are a strong start as we fortify our EV supply chain that's aligned with our sustainability and human rights principles.

Now, let's talk about the progress we're making in building out and always on relationship with customers and that ever improving user experience enabled by software after the customer buys the vehicle. Now, along with product execution, these are really the relevant sustainable advantages we see to create, in today's hypercompetitive market, a difference where the real competition is not legacy OEMs, but pure play EV companies including emerging Chinese players. For example, more than 55,000 Ford customers have already driven nearly 10 million miles with BlueCruise, our handsfree L2 system. That's just one year after the capacity was launched, and we started OTAing this to our vehicles. We're using the data we get through BlueCruise to continue to improve the customer experience. And as it happens, you can imagine significant ADAS revenue profit stream being created by giving customers the ability to work, watch a film, or even take a nap during a long trip in their Ford. While the financial benefits of ADAS are clear as is our Ford Pro services stack, they're relatively small now, but we're rapidly increasing the number of digital vehicles on the road, as well as attach rates of the enabling services. And over time, much of the SAS revenue will be deferred on our balance sheet, providing an annuity like revenue stream that is highly accretive, something this company and this industry has never seen.

Now, before I turned to Ford Blue, let me talk briefly about our connected EV dealer model in the US. Changes in the market have compelled Ford and our dealers to revisit how customers shop, buy, and own, and how they will do this going forward. We're moving fast as the transition to these digital EV platforms allows us to help our dealers provide better customer ownership experience post purchase, and in turn enables them to expand the revenue and profit pools, expanding and improving their returns.

We're working with other dealers to create a retail model better than what's offered by any traditional OEM and better than the startups, who are now scrambling to develop sales and service networks to support customers in an attempt to sustain and grow share in UIO. In the US alone, if we can help our dealers increase service loyalty by just 20 points, that's $2.4 billion incremental revenue for them every year. Now, since March, we've conducted more than 30 workshops in the US and Canada reaching hundreds of our dealers. I have personally been involved in many of these meetings. What is clear to me, but not yet visible to the market, is that our dealers are embracing this change. They know the competitive threat is real and they want Ford and their dealership to lead and win. And we have more share as this develops.

Now, turning to Ford Blue, the team is motivated by this sharpening focus on our ICE and hybrid products. We've added new talent and leadership to drive performance and focus on our trucks, our great family lineup, and our enthusiast vehicles we're so proud of. We've revealed new vehicles like the Bronco Raptor, the Bronco Everglades, the F-150 Raptor-R, which my kids think sounds great. In the third quarter, we'll unveil an all-new 7th generation Mustang at the North America International Auto Show in Detroit. It is a stunning car and I'm so excited to share it with the world. And also, this fall, we'll be introducing an all-new super duty pickup, the workhorse at Ford, and it sets a standard in our industry. There's much more to come.

Our design center is filled with new products and derivatives that will further strengthen our hit vehicles in the ICE and hybrid franchises like F150 and Bronco and Maverick, the brand new global Ranger that's launching in Thailand and our new Everest. In short, our hottest and freshest lineup in recent history is getting even better. Now a commercial vehicle market Ford Pro, our industry-leading global business is leading the change into an electric software-driven world. Other OEMs are talking about large numbers of future electric orders, we're actually taking orders for manufacturing and selling commercial vehicles now.

Through the second quarter, we've sold more than 3,000 E-transits in the US. That's a market share of 95% in the full-size electric van market, 95%. In fact, our next two competitors combine sold just 159 vehicles. Beyond the vehicles, we're also rolling out our Ford Pro charging commercial solutions and the very exciting and fast growing E-telematics software solutions, and boy are they paying off. And in Europe where we continue to be the leading commercial vehicle brand, we're already received 8,000 orders for our two ton E-transit and our new one ton E-transit custom goes on sale next year. Now, our Ford Pro software business is growing quickly. Paid telematic subscriptions globally have grown over 40% sequentially for the last two quarters.

Turning to quality, we've made solid progress on initial quality, a s you've seen in the recent JD Powers IQs study, and our launches have improved. However, we continue to be hampered by recalls and customer satisfaction actions. Yes, this affects our cost, but more importantly, it falls short on our most fundamental commitment to our customers. Quality is our number one priority. In fact, we're recently brought on Josh Halliburton from JD Powers to head quality. Now, the team is focused on three critical areas, prevention, detection, and remediation. We've instituted more robust engineering signoff processes for the vehicles that are in the product development factory. As we speak, we're driving much more frequent alignment with our supply base on quality. And when identified issues, we take actions quickly to resolve them to protect our customer's experience, including by making much more frequent use of over their updates and boy has that work for us. We have more work to do in this space and we will keep you updated.

Overall, we're pleased with the progress this year, but we are not nearly satisfied. We remain clear-eye and determine to move with speed and determination on our Ford+ transformation. The underlying strength of our business supports our 2022 adjusted EBITDA guidance range of $11.5 billion to $12.5 billion unchanged from April. Before I turn over to John, I want to end with this. There's context that's critical to how we think about implementing our Ford+ plan. Traditionally, the auto industry has cut costs often indiscriminately as an effect, of course, from lower auto demands through economic softness and shifts for customer preferences. What we're undertaking forward is totally different than that. We're reshaping virtually every aspect of the way we've done business for a century. And we're doing that for a new industry based on new technology, new skills, and a new promise for customer value. And yet cost reduction will happen in our ICE business because that's primarily what is made up before today, but we're modernizing to take out unnecessary costs, redesigning work, and strategically investing across all of our auto businesses, ICE and hybrid, then EVs, and then Ford Pro, while at the same time transforming every function that supports them. Tweeping strategic change generates interest and speculation in the media, which we understand. However, we're going to comment on Ford+ actions we're taking and how they're going to strengthen our company on our own schedule. John?

John Lawler: Thanks, Jim. So, in the quarter, on an adjusted basis, we delivered EBITDA of $3.7 billion, and EBITDA margin of 9.3% and free cashflow of $3.6 billion. Our cash conversion in the quarter was very strong in lifting our first half to 50% with the target range of 50% to 60% that we set out at capital market. Today, we ended the quarter with strong cash and liquidity of $29 billion and $45 billion respectively. And now these numbers include our stake in Rivian, which was valued at $2 billion at the end of the quarter.

In Q2, we also successfully renewed our $17.2 billion sustainability-linked global credit facilities, which include a new $1.75 billion, 364 day revolver, which provides for additional working capital flexibility. Our strong balance sheet is a solid foundation for continuing to invest in our Ford+ priorities. Our results this quarter reflect the improved earnings and cashflow potential of our business along with leverage created from disciplined capital allocation and a much more focused business model, including our industrial footprint. The tough choices we made during the global redesign to de-risk our business and exit unprofitable markets and products is paying off from 2018 to 2021. Our markets outside North America consumed nearly $9 billion of free cashflow. This year, these markets are collectively expected to be free cashflow positive.

We are confident in the underlying strength of our business and our ability to fund all the calls of capital. All the calls that we have on capital, especially those fundamental to growth and value creation, we can achieve this while maintaining the financial flexibility to navigate external uncertainties. And as a result, we're increasing our regular quarterly dividend to $0.15 a share beginning this quarter, this returns us to the pre-pandemic dividend levels.

Now, let me touch on the performance of our business units. North America delivered $3.3 billion of EBITDA in a margin of 11.3%. Both of those measures were up year over year as an 89% increase in wholesale and strong net pricing and mix more than offset higher commodity costs and inflationary pressures. South America continues to benefit from our global redesign efforts delivering its fourth consecutive profitable quarter. In Europe, we posted a modest profit as a large increase in wholesale helped us reach just above breakeven EBITDA. The underlying trajectory of the region continues to improve. However, the adverse effects of the near-term supply chain disruption are dampening its overall results.

In China, we posted a loss as the local economy and auto industry were significantly disrupted by pandemic-related restrictions in lockdowns. Now, Lincoln continues to be a profit pillar for the region gaining share in the quarter along with commercial vehicles. Our international markets group continues to be sustainably profitable as a result of its restructuring efforts in mobility, we are progressing our in-market pilots for moving goods and moving people and remain committed to autonomous driving. And finally, Ford Credit delivered another strong quarter with the EBIT of $900 million reflecting strong lease residuals and credit loss performance.

Now, let me share with you our current thinking for the remainder of 2022. For the full year, our guidance is unchanged. We expect to earn between $11-and-a-half and $12-and-a-half billion in adjusted EBITDA, which is up 15% to 25% from 2021. This reflects 10% to 15% year over year growth in wholesale and assumes that semiconductor availability continues to improve. In addition, we're projecting to generate adjusted free cashflow of $5.5 billion to $6.5 billion with a significant portion of that coming from automotive operations relative to adjusted EBITDA on a year over year basis.

Our range assumes significantly higher profits in North America, collective profitability in the rest of the world, strong, but lower Ford Credit EBIT, it'll be in the $3 billion range and modest improvements in mobility in corporate. Other key assumptions include strong order banks and pent-up demand for our new and iconic products continued strengthened pricing, which includes the benefits of pricing actions taking during the year, commodity headwinds of about $4 billion, which we expect to offset with improvements in net pricing and mix a continuation of other broad-based inflationary pressures. And we now expect the full effect to be about $3 billion, which is up $1 billion from our estimate last quarter. And of course, we're aggressively working on offsets to these increases.

And finally, at Ford Credit auction values will remain strong, but decline in the second half as the supply of new vehicles improves. DBT will be strong, but lower, reflecting primarily lower credit loss reserve release, fewer returned off lease vehicles and more normalized credit losses. Our results in the quarter full year outlook and commitment to medium term targets together demonstrate the power of Ford+ as we invest aggressively to drive growth and value creation. But before we turn it to Q&A, let me provide a quick update on our new financial reporting. As we shared in March, starting in the first quarter of 2023, we will have three new business segments, Ford model E, Ford Blue, and Ford Pro, and we'll no longer report a combined automotive segment.

With Ford Next, which is formally Mobility and Ford Credit, this will bring our total reportable operating segments to five. Now, this change will not be a simple proforma exercise, it's much more fundamental. These are true segments with both operating and financial accountability, giving you added transparency on our business. So, to help you prepare for this change, we plan to hold a teach-in early next year prior to releasing our 2022 results. We will use our revised 2021 results as a template to reflect the new segments as part of the teach-in. We also plan to cover business rationale mechanics of the new reporting structure and how our earnings to disclosure and our SEC filings will change.

When we report our fourth quarter and our full-year results for 2022, they will be based on our existing reportable segments. And we are targeting to also share at the same time, 2022 results that are revised to reflect the new segments. And so, if you have any questions about this, please don't hesitate to reach out to Lynn and the rest of the IR team. So that wraps up our prepared remarks. We'll use the balance of the time to address what's on your minds. Thank you. Operator, please open it up for questions.

QUESTIONS AND ANSWERS

Operator: Thank you. We will now begin the question and answer session. To ask a question, you may press star then one on your telephone keypad. If you're using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two. At this time, we will pause momentarily to assemble our roster. And the first question will come from John Murphy from Bank of America. Please, go ahead.

John Murphy: Good evening guys. I wanted to ask somewhat mundane question first on, on, on the outlook and then getting to some pricing secondarily, but you know, first John, you know, you look at this, the seasonality of Ford's earnings traditionally is, you know, higher in the first half, lower in the second half. You know, there's timing of cost and volume that usually drive that. Why do you think it's going to be different this year? And, and I guess maybe one of the, the big things that might be developing as we get later in this year into early next year, is it raw math? Seem like they may be easing and fading, but the, the price mix opportunity seems like it'll be pretty strong so that might help late this year and early next year. But just curious if you can comment this on that change in a seasonal pattern so we can be comfortable with our estimates in the second half or your outlook in the second half.

John Lawler: Yeah. So, John, it is, it is different right? Ever since we've had COVID and coming out of COVID it, the patterns just haven't held. When you look at the second half versus the first half, I think that would be the best way to help kind of frame this up.

John Murphy: Yep.

John Lawler: You know, we do see continued volume mix and pricing being strong on a half over half basis, and of course we do expect to see commodities improve a bit as well in the second half on a half over half basis. And so, you know, buying pricing and mix, let's say in the $3 billion range. Commodities could be as much as $0.5 billion, but you know, the inflation that we're seeing, that's going to continue to run through. And we're seeing that, across the board, you know, from material cost, freight, fuel costs, et cetera. So, we see that continuing, and that's up. As I said in my remarks versus what we had talked about at the end of the last quarter. And then of course, FMCC is going to be down slightly half over half. Let's say, you know, eight tens to a billion as they approach $3 billion for the year.

We're also seeing headwinds in the second half, John, from currency and dollar strengthening. And we have more revenue exposure overseas than we do costs. So, we're going to see some of that happen as well, and then we're going to continue to invest in our growth and that'll be in areas, you know, engineering. We'll also see increasing investments in connectivity and spending. And then I guess the last thing I would talk about just to make the half over half complete, we did have some one-time items come to us in the second quarter. Roughly, an insurance claim and contract we renegotiated, which roughly would be maybe three tens, four tens of headwinds. So that's basically how we frame up the half over half. And, basically, what we're saying is that, you know, there'll be some headwinds and some tailwinds, but we're confident in our guidance of $11.5 billion to $12.5 billion.

John Murphy: That's very helpful. And then Jim, just on these higher trim levels or pseudo special editions, I mean, it's Forward Raptor F1. I mean, the F150 Raptor are pretty great looking truck you guys put on the slide deck there. Looking forward to driving that hopefully sometimes soon, but, you know, this seems like there's a real opportunity in for Blue, but there might be in model E for these high trim level special sort of special additions. I mean, how much of an opportunity is there on mix go forward maybe in both divisions? And you know, how do you think about, you know, going after that? Because that seems like that's something you could be a lot more sustainable than, than maybe just the supply demand and balance we have right now. That's helping price.

Jim Farley: Thank you, John. Yeah, we've always been really good on the truck side for those derivatives, but now our chances to expand that capability across all of our lineup, you know, Ranger is a good example. We're launching it in Thailand. We just launched a Raptor Tremor. You know, there's a lot we can do. Of course, Mustangs coming out. Maverick is, you know, our most affordable vehicle. You can only imagine the kind of things that were cooking up in our design studio with Maverick. And then of course, you know, on what we really do well, Broncos, you know, you can imagine high-end versions, all sorts of things. Everglade came out, it's very popular. And we do agree, our E side, you know, we don't have to change the body to refresh Mach-E, for example. We are actually completely redoing in a good way our HMI and OTA that to all of our EVs, but you can imagine, you know, with Mustang Mach-E, all the cool things we could do.

So, and it is a sustainable advantage and we're good at it. The tension point for us though is complexity. Ford is way too complex. So, as we do this, we have to bring our complexity down to get our build materials kind of in line with competition. It's great that we have all this pricing powered Ford. We do have a fresh lineup. We have lots of cool ideas, but we're not satisfied with that because we cannot just continue to build this complexity in our business. So, as we add those derivatives, we're going to have to, you know, we are planning much less complexity in our Blue business, and that is a theme that will run through Blue for years to come.

John Murphy: And Jim maybe if I could just follow-up real quick on the model E side to create a performance version of like the Mustang Mach-E might theoretically cost a lot less, but you might still be able to charge as much as you might on a Delta on, on a, on a, a Blue vehicle. Is that correct? And could we see sort of these, these specials or trim levels potentially garner even higher variable margin as we move into the model E world? Is that a fair statement or not?

Jim Farley: We look at - yeah, good question. The way we look at this, John, is the days are kind of over where you have to change the upper body to build a super car or to build an off-road car, like kind of days are over. Like, we don't have to do that anymore with these digital products, with the, you know, with EV propulsion, you know, with the motors, the software, we can, we can really take our vehicles and, and make very different kind of vehicles off of the same body engineering. And that, that is a complete game changer for us in terms of capital intensity, i.e., lower.

John Murphy: Thank you very much.

Jim Farley: And I'm really glad you brought that up because I try to emphasize this. Like we have to be really careful in our industry, and I'm constantly - we are constantly talking about this as a leadership team. We cannot have the complexity of top hats that we do on our ICE business. We have an opportunity as we go digital with these EVs to simplify our body engineering and put the engineer with customers really care. And it's not a different fender, it's software, it's a digital display technology, it's a self-driving system, and the AV tech, and of course it's going to be, you know, some cases, more powerful motors.

John Murphy: That's very helpful. Thank you, Jim.

Operator: Thank you. And the next question is from Adam Jonas from Morgan Stanley. Please, go ahead.

Adam Jonas: Jim, the, the Bronco Raptor, so badass. I don't know if I put an order in now, if I'll get it by the end of the decade, but maybe I'll try. Jim, this is one of the most positive Ford calls I can remember in a long, long time. Does Ford have too many people?

Jim Farley: You know, as I said, in my, in my comments, Adam, we, we absolutely have too many people in certain places, no doubt about it. And we have skills that don't work anymore. And we have jobs that need to change. And we have lots of new work statements that we've never had before. We are literally virtually we are reshaping our company, like every part of our company. And, you know, in our ICE business, we want to simplify it. We want to make sure the skills we have and the work statements we have, you know, at are as lean as possible. We know our costs are not competitive for it, and we are - that's what I mean by we are not satisfied.

But I just want to emphasize that in the past, at least in my career for 40 years, we've kind of often indiscriminately, you know, just taken the cost out. That's not what's happening at Ford now. This is a different kind of change where we're reshaping the company, you know, reshaping skills, investing in new technologies and simplifying investments in others i.e. spending less. So do we have too - it is kind of the old adage. Yes. I think every company probably has too many people. I just, you know, we have to go do the workflows and decide how this works now and going forward.

Adam Jonas: Appreciate that, Jim. Just one follow-up on the dealers. They're having an amazing time. Their new gross margins have more than tripled, and they're making dealer grosses that are in many cases higher than what you are making on selling the product, right? Like they're making more money selling the product that you - that the margin you're making on actually making the product. And all they're doing is just watching those things come off a truck and they're pre-sold. So, I know these guys spent a huge amount of time on pricing at Ford. Is there anything you can do to help even the score a bit on price? Because when I asked the dealers why aren't - why isn't Ford raising or your peers raising some of the invoice more even they don't have a reason. Like we don't know why they're not doing it. And then they, they often say things that I don't believe, which is that you can't, or you're not moving fast enough, or the systems aren't there. So, what, what are we missing? Thanks.

Jim Farley: Sure. So, you know, bottom line is we've taken a lot of pricing, you could see it in our numbers. And, and actually we all watch this very carefully at Ford. What does the dealers retain margin versus MSRP? And I have to tell you that ours, ours is, is one of the best in the industry i.e. our pricing and the retained margin, the MSRP of - are as close at Ford versus any other brand. There are others that are, are in different places. I think your question is actually bigger than that, which is, you know, we have ups and downs in our industry and how is this going to - how is our retailers going to shape as we change this company? And again, on the electric vehicles, you know, dynamic pricing, you know, is, is very important for us because we went to an ordering system and, and with an ordering system, you have there's certainty of orders, but you have to also be responsive on price.

I'm not going to get into details, but we think we have a way out of that tension point or conundrum. On overall how I see dealer margins, as we talk to our dealers and roll up our sleeves is we need - because I said our competitors are pure play EVs and the Chinese that are absolutely coming. And that means we have to get this $2,000 out of our distribution cost to be competitive with them. And we think a third of it is going to a low inventory model. Not, not, I'm not saying like 30-day supply or 50. I don't mean that kind of - like the customer orders the vehicle, and then we ship the vehicle to the customer. That's what I mean by a low inventory model. We have to go to that. We think that's about worth maybe $600, $700 in our system.

Another one is all the selling SG&A and advertisement costs. We have three tiers of marketing. We think that's another $600 a vehicle. We're going to simplify that. And we're going to just shift, where the eCommerce platform that we don't have today that, all of our E customers have a very predictable experience, whether they're in a dealership or in their bunny slippers, and they'll have a very simple, transparent, very easy purchase process and we're going to invest our marketing model is going to be post purchase. That will be our differentiator and that's where we'll invest. And I think that's a different play than the pure EV companies. So, I see dealer margins still being very competitive, but they are going to shift, the makeup of those margins going to change. That makes sense, Adam?

Adam Jonas: Makes a lot of sense. Thanks, Jim.

Operator: The next question will come from Rod Lache with Wolfe Research. Please, go ahead.

Rod Lache: All right, Jim and John. So, pricing has been a massive tailwind and it looks like mix is becoming pretty powerful now too. Can you just talk to us a little bit about the interplay between affordability and volume? Just especially in the environment that we're in right now and with still a lot of inflation on the horizon, do you think demand can return at this level of price and are you willing to forego volume to sustain contribution margins?

Jim Farley: Yeah. Thanks, Rod. So, we have seen strength in volume of pricing due to the volume that we can produce as an industry and us at Ford relative to the demand that we're seeing out there. So that has been a tailwind in the quarter. We did see quite a bit of a tailwind from mix as well. Affordability is something that we keep in of us all the time. We, you know, with the credit company, and we're very thoughtful about where it's headed from the standpoint to the consumer, what's affordable, et cetera., but we have not seen demand come off at this point. But we have, as we increase volumes through the second half of the year, as some of the chip constraints ease, and we see a better rate and flow, we do have provisioned in our second half, incentives increasing as volumes come back.

And we've always said that the relationship between volume and pricing is going to remain dynamic. And so, I think what you'll see is as volume comes back, you will see some pricing give back, you will see prices come down. So, the question for all of us is how are we going to manage stocks? How are we going to move to the build to order process? How are we going to change the dynamics and not have as much of a push system and have more of a natural demand system, and fulfilling that demand on a timely basis? So, I think that's the question for all of us and we need to maintain discipline as we head into, you know, an environment where we could potentially see demand come off and/or we start to have higher - start to have higher supply and therefore prices will come off.

Remember, following up on what Adam just said in the dealer margins, we still have, you know, across the industry dealer margins that need to come down first from a pricing standpoint, right? We did, as we've talked about in the past, we took an action which reduced floor plan for the dealers, which was a form of pricing for us, but overall, it's still inflated, and it estimates somewhere between $1,300 to $1,700 if dealer margin compression needs to come off first from a pricing standpoint.

Rod Lache: Yeah, that makes sense. And then just, secondly, can you just provide any color you can on what's happening from a supply chain perspective? Any thoughts on whether this Europe natural gas situation is something that is a big major concern for you? And then lastly, any detail on the $3 billion of cost inflation, North America, looked like a large number, was there anything unusual in that number?

Jim Farley: No, there wasn't anything unusual, Rod. I'll start with that, you know, it's across the board. It's in the areas you would expect material cost going up. We're seeing increases in freight. It's just across the board and it's driven by the inflationary pressures we're seeing across the board in the economy, nothing unusual.

John Lawler: And on the supply chain, how to characterize it. I mean, you know, chips are still an issue. Transparency is still an issue. In the second quarter specifically, you know, we had quite an issue in China with a Shanghai shutdown, and that affects - that could have affected on North America manufacturing system. The team did a great job. We had a daily call. We worked every issue. We built a digital model of all of supply chain down to supply chain, and it was really helpful, and we got through it. Like, you know, like Roseanne Rosea, Dan said, "If it's not one thing it's another." It just feels like, you know, what's next as far as, you know, we're planning everything we know could happen.

The next possibility is the energy crisis in Europe. We've played this out already. We've done our homework. We have about 550 active suppliers in what I would call the high-risk countries like Czech, Germany, Hungary, Austria, and Slovakia. We think that the risk is between now and mid 2023 when they can, you know, manage through the energy issues. We have about 130 suppliers for our North America vehicle production in that 550 list. And we now have a 30-day buffer stock. So, we are doing everything we can with the things we know. On the supply chain, outside of, you know, we have labor shortages and, you know, all sorts of things. The suppliers have been working nonstop during COVID, so machine maintenance and a lot of other things, you know, we see the output of the stress and the supply chain, and obviously their costs have gone up too. And we're working through all that with our suppliers, so I think we're well prepared for the things we can predict, but it's always a new day.

Rod Lache: All right. Thanks guys.

Operator: The next question will be from Emanuel Rosner from Deutsche bank. Please, go ahead.

Emanuel Rosner: Oh, thank you so much. My first question, I was hoping to ask you about the topic of EV profitability. So, Jim, during the quarter at an investor conference, I think you essentially gave some pretty good color on where Ford is standing right now. And I think you spoke about the cost of the Mach-E being a disadvantage of $25,00 to $27,000 versus a, you know, similarly contented edge. So, I guess my questions would be, how do you plan on offsetting this over time? I guess, what is the strategy going forward? And should we worry about large losses from EVs in the near term over the next few years as the EV volumes increase materially over the next few years?

Jim Farley: Well, thank you, Emanuel. I will say there's not going to be a lot of guesswork at Ford. We will financially report our businesses independently of each other. So, it will be all out there for everyone to see. I don't know about others, but at Ford it will be extremely transparent. I'm not going to get into specifics because I think this is such a material topic. We need to spend time on it. We can't rush through this. I will tell you that in the quarter, our announcement for LFP. Bringing that to North America is a big deal from a profit standpoint. That is very important chemistry on our roadmap for a profitability. We're going to be installing 60, 40 gigawatts hours in North America. That's a lot and we are not going to wait until that installed capacity is here, we're going to be bringing those batteries to our highest volume vehicles like next year.

So that's one, but there's, you know, distribution, there's the size of your battery, your engineering for low labor content. And I just don't think we're going to do justice such a serious and important topic in the earnings call, but you can expect a lot of engagement with Ford on this. And this is an incredibly important focus. This is why - one of the reasons why we created model E to be laser focused on profitable electric vehicles. And again, you'll see it all. John, you want comments on the segmentation reporting?

John Lawler: No yet. In segmentation reporting you'll see exactly where we're at between the five, businesses. And, Emmanuel, we know how important that is, so when we have our capital markets day early next year, we'll unpack that in more detail. As Jim said, well, we can spend some time on it and go through it and give it due justice.

Emanuel Rosner: Okay, that's fair. So let me ask you a separate topic then. So as I think one of the hardest things for investors here is to try to perform a sensitivity for a downturn scenario as consumer comes under more pressure, you know, risk of recession increase, what could that do for not so much volume because obviously we've been auto has been operating at low volume, for a while supply-driven, but pricing any stats you could share with us either based on history or, you know, for in the current context on how would you go about, you know, flexing down, you know, vehicle pricing, in the downturn scenario?

John Lawler: Yeah. So, Emmanuel, we've, we spent a lot of time on this as you would expect us to be doing, modeling set scenarios, looking at what that means for the business, looking at what we should be doing today to get out in front of any of these types of issues if a recession were to come. But, you know, the way we're thinking about it is if you step back and look at where we're at today relative to where we've been as a company heading into any, what could be a potential downturn, right? We're in much better shape. You mentioned it from a demand standpoint, we have three years of pent-up demand. And we have a very strong product lineup, and so that's a positive. We're also at a point right now where incentives are low, right? They're in the single digit versus what normally at this point in a cycle, we'd probably be in high teens.

And so, of course, as volume or demand comes off, there will be some pricing that will need to be given back, and that's a bit of a release valve if you will, but it's really important for us to be thoughtful about that, not only Ford, but as an industry. And then the other thing I would say, and I mentioned in my remarks, our business is very different than what it was in the past. Our ICE product clearly it's more - our lineup is more profitable as we've exited unprofitable vehicles, but we've de-risked the overall business. We've restructured our markets overseas. And I think a great proof point for that is the fact that between 2018 and 2021, we burn through $9 billion of free cashflow overseas. We're not in that position now, you know.

And we do expect this year, we're projecting that our overseas markets will be free cashflow positive. So, we're just in a completely different position. We're modeling it. We're looking at it. you know. We're getting out in front of things. As Jim said that we can today, but it's a new day every day, but you know, that's how we're thinking about it. We're clear-eyed. We understand what we're facing. We understand what could potentially be in front of us, and now we need to work it.

Emanuel Rosner: Great. I appreciate the input.

Operator: Thank you. And the next question will be from Colin Langen from Wells Fargo. Please, go ahead.

Colin Langen: [Inaudible] because you know, the outlook definite point is about flat. You highlighted, I think $3 billion pricing. I think the commodities over highlighted about a billion of Credit. So that's about $3 billion, good news. You didn't really quantify the bad news, and currency doesn't seem like something to be that material. You know, any sort of framing, is it the - is that inflationary costs predominantly? Is there [inaudible?

John Lawler: Colin, let me clarify. It's really hard to hear you it's quite static, but, you know, Ford Credit will be about $3 billion in total profits for the year. So, they'll be down half over half. So that's a headwind. And the inflationary costs on a half over half are a headwind. And so, when you walk through it, yeah, there will be some volume. We've said that volumes in the second half will be up roughly in the low 20 percentage range versus the first half. And so, you've got some mix improvement as well. So, you know, volume and pricing and mix are the tailwinds, little bit of a tailwind on commodities, but the headwinds are FMCC profits, they'll be down.

We've got the inflationary pressures we talked about will be, you know, an increase in the second half. We also have exchange that's hitting us in the second half relative to the first half, so that's a headwind as well. And then we had some one-timers in the second quarter that aren't going to repeat, and of course we're going to continue to invest in the business. So, there's going to be spending related costs. There's going to be connectivity costs. That will be increasing as well as we invest. So, you know, those are the puts and takes. Those are the tailwinds and the headwinds as you look at it from a half over half basis. And I hope that helps clarify things.

Colin Langen: Okay. And just to follow-up, I know you clearly are going to give more details on the EV perspective and how you going to do things, but you know, you're talking pretty dramatic increase in raw material costs. I think even in your comments, you indicated that you only about 50% of the materials are going to be available to produce all the unique targets, which kind would imply that prices of raw materials would actually remain high. You know, should you be thinking about pulling back on some of the EV investments if the economics of this plan off there?

Jim Farley: No, no, we don't plan on pulling back. If anything, the first generation of products has fired us to go faster. I think I would just emphasize that how we look at this change in our industry is it's not a change of propulsion. It's much bigger than that. It's a change to a vehicle whose differentiation will increasingly be software that you ship to the vehicle. We now have real experience on the first shipable software to these cars. The first is ADAS for sure, and the second one for us is Ford Pro. We're shipping telematics to the customer, driver coaching, energy management, our attach rate for charging now on our E-transits where we're 95% share is like 30-plus percent. So, there are a lot of services connected these vehicles because of the software. And that that's a, that's a really big revenue opportunity for us.

When you talk about the base, you know, walk to 8%, we're not going to, as John said, we're not going to go through that here, but I will tell you that LFP has a dramatically different exposure to raw materials than an MCM cell. Like there's no nickel in it, so the chemistry strategy for the company in diversifying that is a very key part of our profitability walk. But

I think the most important thing to think about is not that we're investing or not in electric cars, we're investing in digital products, and we can keep them longer because we don't have to upgrade the upper bodies because they're software enabled vehicles. There's so much we can do to change the profit profile of these vehicles. The biggest thing we have to solve for in all of that is the battery cost, and we can't wait to take you through all of that.

Colin Langen: Okay. All right. Thanks for taking the question.

Operator: Yeah. The next question will come from Joseph Spak from RBC Capital Markets. Please, go ahead.

Joseph Spak: Thank you, Jim, and appreciate the old school lesson. I'll reference it didn't get by me. The - I just want to - John, can we just go over this? So, $3 billion of other inflationary costs, that's $2 billion higher than before. Are you - I know you said you're working to offset it. Are you assuming you offset that delta in the guide and maybe you could just let us know how much of that was already incurred in the first half?

John Lawler: So, we had - it's $1 billion higher than what we had talked about previously, Joe. So, we're looking at about $3 billion for the year. And, you know, that's part of what we're doing. We're working to offset those inflationary costs. You know, and that's something that we need to continue to work through. We're not all the way there, of course, but we're working on it, and, you know, we do have the rest of the year to go, and it is a significant focus of our team as we've talked about, but, you know, the cost efforts are a significant focus of the team as we remake, you know, the company in Ford+. So that's a really important part of what we're doing. And so, it's $3 billion for the year. We had said $2 billion. We've seen about another $1 billion come through and it's across the board.

Joseph Spak: Okay. The second question is just on for Credit. And so you're pointed to lower second half, which of you analyze that would get you to, you know, something in the low twos, is that, is that a good base to think about, you know, next year and go forward because, you know, if we look at the pretax [inaudible] in this business, it's been well above average. And I think we understand why there's been some unusual circumstances, but is that the right way that you're thinking about it, that to return to sort of more normal, or historical returns, or is there anything structural underneath that Ford Credits that's changed the profitability profile?

Marion Harris: Hey, Joe, this is Marion Harris. Thanks for the question. You're thinking about it correctly. So, if you go back to pre-COVID and balance sheet was quite a, quite a bit larger. We were at about $145 billion at that time. We were at a run rate of about $2.5, $2.6 billion of EBT, and so that was, that was the normal level. Our balance sheet's somewhat smaller now. And so, I think what you're seeing is a more normalized level of profits. You know we're back at our pre-COVID reserve level. We're not releasing reserves. And as it relates to lease residuals, that's pretty much worked this way through as book, so you're seeing that more normal performance.

Joseph Spak: Okay. Thanks very much.

Operator: And our final question of today will come from James Picarillo from Xane PNB Paribas. Please, go ahead.

James Picarillo: Hey, guys. Just for commodities, you know, at current spot rates, just as a theoretical exercise, right? If we take into account the lagging effect to your P&L, can you just, you know, think about maybe directionally, just, you know, what commodities - what the commodities impact would look like for next year at current spot rates?

John Lawler: Yeah, I think, you know, we do see it coming off some - you know, part of what complicates the commodity situation is, you know, as we go through any year, we lock into contracts and they roll, and that protects us on the up run when prices are increasing sum, but it also has a lag effect when prices are coming down sum. And so, we'll have to deal with that as we run through the year as well. And so, you know, I think really, it's going to depend on what happens with the overall macroeconomic environment. If we do see us tripping into more of a recessionary period, we should see those fall quicker, like we have in the past. If not, you know, I think that, you know, they'll come down more moderately. So, we're planning and looking at both of those scenarios. From a spot standpoint, you know, it is good news, as we roll through next year, but you can't just take that spot good news and roll it through everything because we do have contracts that we're locked into on a rolling basis through the year.

James Picarillo: Okay. Understood. And then just with respect to the cadence for the second half, I mean, how should we be thinking about the, you know, the quarterly volume, the volume ramp and the back half? And can you provide color on, you know, Ford's progress in shipping the on wheels inventory? I think total is 53,000 entering the quarter.

John Lawler: Yeah. So, 53,000 entering the quarter. The team did a good job on the drawdown. We're down to 18,000 at the end of the quarter, and we'll work to get those out, you know, over the second half of the year, as we can, you know, free up the chips that impacted us. I think when you look at the volumes, in the second quarter we saw, you know, an increase in volume in North America, which helped drive the strong performance for North America. When you look at the second half, as we said, volumes would be up in the low 20% range compared with the first half, but that volume growth there's greater volume growth in the overseas markets in the second half than in North America.

We have the Ranger launching in IMG. We have volume in the second half growing at a quicker rate in Europe. And then, of course, China was significantly depressed from a volume standpoint in the second quarter due to the shutdown. And so, that's what will be happening from a standpoint. But when you look at the volumes for Q3, they'll be lower than they will be in Q4 because in Q4 we should see the rate and flow of the chips improve as we go through the third quarter into the fourth quarter. So that's how the volume is framing up in the second half relative to the first half. And then the walk from, you know, Q2 into Q3. So, you know, volume and mix in Q3 - Q3 is going to be less than Q2, right? It's not going to be as strong as Q2. We have a couple of things hitting us in Q3. You know, volume and mix, most of the volume growth in Q3 relative to Q2 is going to be in Europe and China.

And then, you know, we still have commodity cost hitting us. And we're investing in connectivity, and our spending - well, you know, in the third quarter, Ford Credit, of course as the second half is lower than the first half you see that come through in third quarter. And then we have the non-repeat of the one-timers I talked about in the second quarter. So, third quarter will be down compared to the second quarter. Volume increases will be overseas. And then, you know, as we get to the fourth quarter volume in the fourth quarter on a sequential basis will be better than the third quarter.

James Picarillo: Very helpful. Thank you.

Operator: Ladies and gentlemen, this concludes the Ford Motor Company Second Quarter 2022 Earnings Conference call. We thank you for your participation. You may now disconnect. Take care.