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CORPORATE PARTICIPANTS

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

James D. Farley
President, Chief Executive Officer, Director & President-Ford Model e, Ford Motor Co.

Peter C. Stern
President-Ford Integrated Services, Ford Motor Co.

John T. Lawler
Chief Financial Officer, Ford Motor Co.

OTHER PARTICIPANTS

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

John Murphy
Analyst, BofA Securities, Inc.

Dan Levy
Analyst, Barclays Capital, Inc.

Rod Lache
Analyst, Wolfe Research LLC

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone. My name is Gary and I will be your conference operator today. At this time, I would like to welcome you to the Ford Motor Company Third Quarter 2023 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Please note, this 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
Executive Director-Investor Relations, Ford Motor Co.

Thank you, Gary. Welcome to Ford Motor Company's Third Quarter 2023 Earnings Call. With me today are Jim Farley, President and CEO; John Lawler, Chief Financial Officer; and Peter Stern, President, Ford Integrated Services. 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 that deck along with the rest of our earnings materials and other important content at shareholder.ford.com.

Our discussion also includes forward-looking statements about our expectations. Actual results may differ from those stated. The most significant factors that could cause results to differ are included on page 27. Unless otherwise noted, all comparisons are year-over-year. Company EBIT, EPS and free cash flow are on an adjusted basis.

Now, I'd like to turn the call over to Jim.

James D. Farley

President, Chief Executive Officer, Director & President-Ford Model e, Ford Motor Co.

Thank you, Lynn. Hello, everyone, and thanks for joining us today. I wanted to start by thanking the Ford team who worked tirelessly and creatively over the several months to reach a tentative agreement with the United Auto Workers. I'm so pleased for our employees. This week, I was able to visit each of the struck plants. I was impressed by their preparation for start-up, and the feeling I got is people just want to get back to work.

Once the deal is ratified, we will provide all of you a deeper look at the contract and its impact on our business. Right now, we're focused on restarting three important assembly plants, calling back more than 20,000 Ford employees to work, supporting our suppliers as they restart and shipping lots of Super Duties, Explorers and Broncos to our customers.

It's been a challenging situation for sure. Matter of fact, our business is never short of challenges, especially right now with the evolution of the EV market and new global competitors from China as well as the technology disruptions. But I am more excited and motivated than ever. Our team is making tremendous progress every day towards building a Ford that thrives at the intersection of fantastic and iconic vehicles, terrific brands and especially software and services. We are deep into the development of our future software platforms which provide the foundation for rapid innovation and a profitable new software and services business, and constantly improving experiences for our customers. We believe Ford+ is the right strategy to win in this constantly evolving industry transformation. We are building a more dynamic and less cyclical company. And we are nowhere near peak profitability. We have the right team and talent, and we are in the process of building a culture of excellence in execution.

In a moment, John will detail the quarter, which I would call mixed. The strength of our products and revenues and businesses definitely came through in our results. But at the same time, we were negatively impacted by the strike and our cost and quality remained a drag on our business.

Now, last week, we made some important leadership changes. Kumar Galhotra as COO will now control the key levers for transformative change in our industrial system: powertrain, ICE and hybrid products, vehicle hardware engineering, cycle plants, quality, supply chain and manufacturing. He'll work in tandem, of course, with Doug Field, Chief of our EV, Digital and Design Officer, to move us forward. I believe this will accelerate our progress on cost and quality. And I hope we get into that in the Q&A. These are my top two priorities.

Overall, we are seeing the clear benefits of creating three distinct growth businesses now with Ford Blue, Model e and Pro. The story of Ford Blue comes down to product strength, incredibly strong brands like Mustang and Bronco and Raptor, they have durable pricing power, and a real choice between gas and hybrid. Ford is America's best-selling brand now through three quarters, even with the effects of the strike. And we have a wave of new products coming in the next few months: the new F-150, the Ranger, a brand-new Explorer and Expedition and Navigator. In fact, close to 60% of our volume and revenues in the US will be new and refreshed next year. I am so thankful we have kept our foot on the gas to freshen our ICE and ATV products as we enter a changing market.

And in Europe, we bring out new versions of Puma and Kuga, our high-volume gas and hybrid SUVs. And the Ranger pickup and our Everest SUV it is based on continue to gain share in international markets. So bottom line, Ford Blue will be strong and a growing business for years to come. We also remain bullish on Model e and our EV future. But clearly, the market is a moving target. I'm optimistic because customers are smart and they are rational and for many of them, EVs are a great choice.

I have been spending a ton of time in our product development center with both Doug Field and Alan Clark. And you should see the Gen 2 and Gen 3 EVs we're working on. Our Gen 2, all-new full-size pickup truck, for example, is one of the most thrilling vehicles I have ever seen in my career. Let me be specific. Stunning performance, like no truck has ever performed, ability, unexpected innovation for truck customers far beyond the normal truck attributes; a super flexible cabin that feels like a lounge or a tiny office. Take the wheels off of this truck, and it's still a mind-blowing product. And a digital experience that totally is immersive and personalized. I'd take this truck seven days of the week over a Cybertruck.

A great product is not enough in the EV business anymore. We have to be totally competitive on cost. Tesla actually gave us a huge gift with the laser focus on cost and scaling the Model Y. They set the standard, and we are now making real progress on our second and third cycle EVs that are in the midst of being developed today, as we get closer to the introduction.

While our Gen 2 EVs we're targeting to deliver an EBIT margin comparable to ICE by 2026, the dynamic changes in the market, pricing, adoption rates, regulations are forcing us to further reduce the cost of our EVs. The key levers to deliver this competitive cost structure are scaling, vertical integration and batteries. So let's double-click on each of these three.

On scaling, this is much more than building new facilities or scaling high-quality batteries of thermal propagation. We're leveraging digital prognostic capabilities in our manufacturing lines to improve quality. We are also reducing complexity. And we are optimizing our vehicle design and engineering for manufacturability. Yeah, we're designing these vehicles for our manufacturing team.

On vertical integration, this is the most fundamental change. We are in-sourcing batteries, inverters, scaling production over drive units and gearboxes and designing and producing unicastings in-house at Ford. In addition, on our next-generation utility vehicles, vertical integration will increase by nearly 50%. This level of integration allows along with the new zonal electric architecture and designing in-house modules, and battery cell to structure will allow us to significantly reduce material cost.

Now, none of this will be easy and has some risk, and you've seen our competitors struggle as they build out and ramp up these capabilities. So we are so glad we started years ago on this journey.

And finally, batteries. They are the single biggest cost component of any EV. Our more energy-efficient Gen 2 products we use extreme aero to get the very smallest batteries possible for a competitive range. And with our LFP batteries, we'll have the lowest or one of the lowest cost batteries assembled in the US.

Our overall EV priorities are very clear, disciplined capital allocation and investment that drives profitable, high-returning and enduring EV business. And we will constantly balance growth, scale and profitability. These great EVs will be paired with modern shopping and buying experiences that are transparent, will have non-negotiated pricing and a streamlined checkout and delivery that will come to life early in 2024. And this is also a significant cost reduction.

I saved Ford Pro for the last because it's a massive driver of Ford's growth and profitability. Our competitors seem to be trying to cut and paste our strategy, but the reality is the moats we've built over many decades for our Pro business won't be easy to cross. The network of literally thousands of local upfitters across Europe, North

America and China, and customer-driven engineering we have for vehicles like F-Series and Transit is formable across all those regions.

Our commercial order banks are healthy. This may be a bit of surprise to everyone. We see large backlog of infrastructure projects, thank you, 5G and road works. And we have very loyal customers. Fleet orders, for example, for the 2024 Super Duty are coming in faster than last year's orders and we expect strong demand to continue as more customers recognize what Ford has to offer in total.

In addition to the new Super Duty, we are preparing to launch the new Transit Custom in Europe. Think of this product as a Super Duty for Europe. It's the best-selling vehicle in the UK, not the best-selling commercial vehicle, the best-selling vehicle and the leading one-ton van in Europe. And it's a key profit pillar for Europe and one of the reasons why we stayed there.

When it comes to software and services, Ford Pro is the tip of our digital spear. Customers know and trust our vehicles, of course, and we're building on this with software-driven services that provide businesses with data insights, vehicle access, even vehicle control and functionality. This helps them drive productivity and efficiency in their fleet operations.

And I've asked Ted Cannis to also lead our large and profitable after-sales business. His focus will increase our post-warranty service business and profitability. He's already adding mobile service capability and delivering an effortless experience to both commercial and retail customers. There is so much upside in this after sales, parts, repair and collision business, especially with Ted leading it and for Ford Pro.

I want to briefly touch on China where our strategy to turn our business around is gaining traction. The restructuring of our EV business there is nearly complete, and the internal combustion engine business is now profitable. We are now expanding China's role to a profitable export hub, including Ford Pro. We've already exported a record number of vehicles so far from China to markets like Mexico, South America and Asia. There is so much more opportunity ahead for us.

Yes, the China market is extremely competitive in the middle, but Ford can succeed by staying asset-light, partnering where it makes sense, and competing in very narrow segments where we can clearly win, like commercial vehicles, off-road vehicles, large SUVs and Lincoln.

Finally, I am so pleased to have Peter Stern on today to share more about our newly formed Ford Integrative Services, which will create and market valuable, software-enabled customer experiences across Blue, e and Pro.

Now, this is transformational because the cornerstone of Ford+, the + in our plan is creating incredible customer services and experiences enabled by not just hardware, but software. There's simply no one in the world better able than Peter, who was a driving force behind services at Apple to build this strategically vital business for us. Peter, over to you.

Peter C. Stern

President-Ford Integrated Services, Ford Motor Co.

Thanks, Jim. I've spent my career creating new customer experiences and launching businesses at the intersection of hardware, software and services. And I came to Ford because this company puts that kind of innovation at the center of its long-term strategy. As you said, it's literally the + in Ford+.

Now over two months in, I'm even more excited to be here and to be part of this exceptional team that's working together to bring the Ford+ plan to life for our customers, employees and shareholders.

Our vision for integrated services is to transform every aspect of the Ford customer experience across our three segments. We're making our vehicles even more connected, convenient, productive, secure and exhilarating.

Over the past couple of months, we've identified a portfolio of services that will improve our customers' lives and businesses by building on our industry-leading early successes with Ford Pro Intelligence and BlueCruise. This portfolio will elevate the Ford brand and introduce us to millions of new customers who may have never considered a Ford before. It will drive new high-margin, acyclical, reoccurring revenue streams for Ford and result in stronger relationships with our customers.

And we'll do this while adhering to the values that distinguish Ford from our competitors, like our respect for customer privacy, safety, and very importantly, choice. Whether you choose to add our services or not, you'll have an amazing vehicle.

Our momentum around software and services is building fast. Here are three examples. First, Ford Pro Intelligence builds on Ford's industry-leading share in the commercial vehicle space by making the people who drive our vehicles even more productive and by reducing total cost of ownership. Adoption of vehicle telematics, fleet management, and charging optimization were up 20% sequentially in the third quarter, and our average revenue per subscription was up nearly 10% over the past six months, both contributing to strong revenue growth. And we're still in the early stages of our rollout.

We ended the quarter with 476,000 paid subscriptions for our Commercial Solutions, a jump of nearly 50% year over year. And we have an ambitious product roadmap for Pro. For example, over the next few weeks, we'll launch the Ford Pro Dashcam. This product uses machine vision and in-vehicle intelligence to detect in-cab and on-road events, simplify fleet operations, and encourage safer driving. While we're still early in our journey, Pro intelligence is an area that will continue to expand and drive value for both our customers and Ford.

Second, in September, we announced that the 2024 F-150 will be the first vehicle available in North America with Ford's Stolen Vehicle Services. This is a fully integrated theft prevention and recovery service that provides unique features like inclination and movement alerts. So you get notified if your truck is jacked up or moved while the engine is off.

And third, BlueCruise is one of the most consequential consumer applications of artificial intelligence in the world today. Some of you experienced our last version at Capital Market's Day . If you haven't felt what it's like to take your hands off the wheel and your foot off of the gas and let BlueCruise take over steering, acceleration and braking, please visit a Ford dealer so we can demonstrate it. Launch to date, our vehicles have been driven hands-free for 125 million miles. That's the equivalent of 500 trips to the moon, which I imagine would be largely hands-free as well.

Real-world driving data from Mustang Mach-E vehicles using BlueCruise shows a more than 10 times reduction in lane departures compared with unassisted driving. And for the second time in a row, BlueCruise was just rated the best hands-free system on the market. And this was based on BlueCruise 1.0. BlueCruise 1.3 is rolling out now and adds lane change support and other refinements that keep drivers in hands-free mode on average 5 times longer than version 1.0. Our technology team, led by my partner Doug Field, is the best in the business and BlueCruise is the proof.

Despite these encouraging successes, what we are about to do in Integrated Services won't be easy. Our multiyear playbook depends on our next generation vehicles that are even more connected. We must also round out our customer centric portfolio of services and evolve our customer relationship management technologies. Our dealers are a key competitive advantage for Ford, and with them, we need to make it easier to become and stay a services customer. We need to build a relationship centered around the customer, not the vehicle, because in the services space, the sale of the vehicle should be the beginning of a beautiful, long-term relationship with our customers.

And that necessitates not only new people, processes and technologies, but also new measures of success. So as we progress in our services evolution, you're going to hear us talk about key metrics like addressable units in operation, attach rates and average revenue per subscription. And as we move each of these levers in the context of a low-variable-cost, high-margin service business, it will have a multiplicative effect on profits. There's incredible value to be unlocked here for our customers and for Ford. And I'm proud to be a part of the team making that happen during this pivotal moment in our history.

John, over to you.

John T. Lawler

Chief Financial Officer, Ford Motor Co.

Thanks, Peter. Through the first three quarters we delivered $9.4 billion in adjusted EBIT, a strong result that is indicative of our underlying run rate of the business. Now, given our year-to-date performance, we were on track to comfortably deliver our full-year adjusted EBIT guidance of $11 billion to $12 billion. Now, that said, the UAW strike created significant uncertainty regarding our full-year results. And even though we have reached a tentative agreement and our employees are starting to return to work, we have withdrawn our guidance for the year. This is in part because of the continued disruption in the industry with the ongoing strikes and the follow-on impact to our shared supply base, the ramp-up of production in our plants and at our supplier partners, as well as other ancillary effects.

Now, to provide some context, in the third quarter the strike had an EBIT impact of roughly $100 million. And so far, the strike has trimmed about 80,000 units from our plan. This would reduce 2023 EBIT by roughly $1.3 billion. Once we have a ratified agreement and begin to ramp operations, we will be in a better position to update you on our full-year guidance.

So, let me now turn to our third quarter results, which was, once again – it once again showed our Ford+ plan in action and the benefits of our diversified portfolio. Our leading Pro business and resilient Ice and hybrid products continued to deliver solid results that more than offset the investments we are making in our EV future. Our revenue remained strong, up 11%, reflecting a product lineup that resonates with customers, driving higher net pricing that remains resilient. Wholesales were flat, dampened by supply constraints affecting both F-Series and Transit production, additional unit holds for quality assurance and the first UAW work stoppage for Ford in almost 50 years.

Adjusted EBIT in the quarter was $2.2 billion with a margin of 5%. Both improved year-over-year. However, costs increased, underscoring the fact that we still have more work to do especially on warranty expense and material cost.

Adjusted free cash flow was $1.2 billion in the quarter, down year-over-year driven by unfavorable working capital. Through the first nine months, we generated $4.8 billion of adjusted free cash flow, resulting in a conversion rate of 51%, in line with our target range. Our disciplined capital allocation continues to drive strong free cash flow which will be critical as we adjust our spending to match the pace of EV adoption. We ended the quarter with over $29 billion in cash and $50 billion in liquidity, one of our strongest quarters ever, and this includes the new $4 billion contingent liquidity facility we put in place in August to help withstand uncertainties in the present environment.

Now turning to our customer-focused segments, Ford Pro generated EBIT of $1.7 billion and delivered a strong double-digit margin of 12%. Both metrics improved driven by our Super Duty and Transit franchises that helped deliver a 16% improvement in revenue that's reflecting strong demand and continued pricing power. In addition, we are launching a new version of our flagship product in Europe, the Transit Custom, which along with the new Super Duty and F-150, will give Pro its freshest vehicle lineup in years. We also continued to see strong growth in both our new software subscriptions and mobile repair orders, up roughly 50% and 200%, respectively, for the quarter.

Regarding Model e, our EV start-up incurred $1.3 billion of losses in the quarter, reflecting continued investment in our next-generation products and a more challenging market for our Gen 1 products. Given the dynamic EV environment, we are being judicious about our production and adjusting future capacity to better match market demand.

For example, we have taken out some Mustang Mach-E production, and we are also slowing down several investments including making a decision with SK On to delay the second BlueOval SK JV battery plant in Kentucky. Now, we have also said we are evaluating our BlueOval Battery Park Michigan plant to determine the best path forward.

In fact, all told, we have pushed about $12 billion of EV spend which includes CapEx, direct investment and expense. The ultimate success of our EV transition will be driven by our Gen 2 and Gen 3 products which will be cost-optimized and guided by the learnings of our first-generation vehicles that are currently in the markets.

Turning to Ford Blue, in the third quarter we delivered EBIT of $1.7 billion, up $300 million driven by lower commodity costs and higher net pricing that more than offset higher warranty costs. The higher warranty was driven by recalls and higher per-unit repair costs due to inflation. Importantly, Blue continues to be profitable in all regions with a strong, fresh portfolio poised for continued global success

Hybrids also continue to be a success, a strategy we've had in place now for almost two decades. We are the clear leader of the hybrid pickup truck segment in the US thanks to Maverick and F-150. We expect to extend this lead next year when we introduce our refreshed 2024 F-150 with more advanced technologies. The F-150 PowerBoost Hybrid not only offers a 25% improvement in CO_2 emissions, but on average, they are more profitable than our highest volume gas powertrains. And hybrids aren't just limited to North America, as we are launching a PHEV Ranger for Europe and IMG next year.

Ford Credit generated EBT of $358 million. As expected, our results were down year-over-year, reflecting lower lease residuals and financing margin and the non-recurrence of derivatives market valuation gains. Credit loss performance remained strong and below our historical average but continues to normalize. Auction values remain strong but are down sequentially, in line with our expectations.

Finally, turning to software and services, we continue to see sustained quarter-over-quarter growth in subscriptions across all of our business segments and most importantly at gross margins of around 50%. And our next-generation digital platform will enable a step function change in capability, allowing us to scale and deliver value to both our retail and commercial customers even faster. And as Peter highlighted, as we continue to build out our capabilities here, we expect it to be a significant source of future value creation.

In closing, there's obviously a tremendous amount going on in our business, but I'm confident in our Ford+ plan and the underlying run rate of our business. So that wraps up our prepared remarks. We'll use the balance of the time to address what's on your minds. Thank you.

And, operator, please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question today is from Adam Jonas with Morgan Stanley. Please go ahead.

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

Q

Thanks, everybody. So, John, I know you push out the $12 billion of the direct investment and other expenditure on EVs. But I guess I'm interpreting that as just temporary, that you still plan on spending it. My question is, how long can you keep allocating $10 billion a year, round number, to EVs?

John T. Lawler
Chief Financial Officer, Ford Motor Co.

A

Yeah. So, Adam, we're going to match demand and capital needed to meet that demand. The first step here is given the flatter growth curve that we're seeing relative to what the industry expected, and we expected, we've made this decision to push out $12 billion of capital expenditures. But it doesn't mean that we'll actually go ahead and pull the trigger on it if we don't need to. And we're going to look at the overall EV business and be balanced about that. There's a lot that's going to change between now and 2026 and 2030. And we're going to adjust appropriately. So it's something that's going to adjust as we move and how that business develops. And we'll adjust that capital allocation appropriately and we'll change our strategy and make different decisions as well.

And one of the other things I'd say is that, well, I'll pass it over to Jim, because Jim has something that he wants to say.

James D. Farley
President, Chief Executive Officer, Director & President-Ford Model e, Ford Motor Co.

A

Hey, Adam.

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

Q

Hey, Jim.

James D. Farley
President, Chief Executive Officer, Director & President-Ford Model e, Ford Motor Co.

A

Thanks for your question. I just want to emphasize the importance of our Gen 2 and Gen 3 products because they are very transformation in our profitability in EV. We've learned a lot on Gen 1. We reduced some material costs.

We got the learning loop on software. We learned how to scale batteries. We have the LFP battery now, we are starting to ship to customers. But there's only so much we can do on Gen 1.

On Gen 2, as I said, we have a totally different approach from aero, vertical integration, design for manufacturability. And there's a lot of other things we can do beyond allocating less capital to battery plants, for example. We've learned a lot about derivatives like Rally. We're going to push services a lot more like Level 2 plus, Level 3 autonomy. And we really plan on even redesign or improving the scale of our components by working with other companies.

And the other big breakthrough is going to be, which we are designing in parallel, the Gen 3 products where we use the battery as a structural member of the vehicle. We go to low-cost sourcing, go to smaller vehicles. We maximize unicasting even more than we are. And radical cost reduction in our distribution.

I think the other thing that's important to understand about Ford's strategy on EVs is Pro. We actually followed a very different strategy for Pro using a multi-energy platform. So we didn't bet on pure electric vehicles for Transit, for example. And we're now launching the Transit Custom in Europe. And that has diesel, gas and it will have eventually hybrid and pure electric. That's a very different bent on our Pro. We are even starting to export Pro vehicles from China to developed markets around the world that are pure electric. And that part won't change our product strategy.

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

Appreciate that, Jim. Maybe just a follow up. Hybrids, you pointed out in the prepared remarks the growth there. And I think you've made comments that that technology is something you want to lean in on more as a transition. Not that you won't continue to sell your Gen 1 EVs, but that there is just real demand for hybrids. Can you refresh us as you kind of turn that dial back up on hybrids categorically how the margins on those products might compare to your ICE, your normal ICE margins? Is it accretive? Is it kind of in the ballpark? I didn't know if there was any kind of sacrifice or gap there between hybrid and the normal pure ICE. Thanks.

John T. Lawler A
Chief Financial Officer, Ford Motor Co.

Yeah. You want me to jump in, Jim?

James D. Farley A
President, Chief Executive Officer, Director & President-Ford Model e, Ford Motor Co.

Yes, yes.

John T. Lawler A
Chief Financial Officer, Ford Motor Co.

There's added costs as you'd expect for the battery and the motors, et cetera. But if you look at let's just take F-Series, for example, if you take the hybrid, on average, they have a higher margin than our highest volume gas versions because of the mix and what we have in the vehicle, and the pricing we can get for the hybrid technology and the fuel efficiency that comes along with that.

James D. Farley A
President, Chief Executive Officer, Director & President-Ford Model e, Ford Motor Co.

And then one of the things we learned about hybrid is we're executing very differently than our first-gen hybrids, is we have Pro Power Onboard. We have a lot of other attributes that people are willing to pay for like F-150 powering a job site or your house as backup energy. That's another advantage of having those batteries that maybe some of our competitors haven't had the same pricing power. The F-150 now, a hybrid, is up 40% year-over-year, and we think the new F-150 and new hybrid will be 20% mix and it may be the best-selling hybrid in the United States.

So our hybrid strategy is a little different than our competitors because the work cycle for our products are different but hybrid has a really big place. We're trying to challenge ourselves, Adam, to execute hybrids so they do more than just propel the vehicle for pricing power.

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

Q

Thanks, Jim. Thanks, John.

Operator: The next question is from John Murphy with Bank of America. Please go ahead.

John Murphy
Analyst, BofA Securities, Inc.

Q

Good afternoon, guys. Just a first question, Jim, on warranty and an accelerated – or sort of headwind on a year-over-year basis accelerated a bit in the quarter. But if I look at like the full year numbers even if we add it back this, I think it's slide 32, if we add it back to 41.7 billion on warranty to the $9.4 billion in EBIT, you've done your date, it will already even be in your range in the first three quarters of the $11 billion to $12 billion in EBIT you've been talking about before.

So, I mean, it's a major issue here for the numbers and results in cash flow. What's going on? And how are you going to get a handle on this and reverse this, hopefully, in the next year or two?

John T. Lawler
Chief Financial Officer, Ford Motor Co.

A

Yeah. So, Adam, that's exactly right. One of the things we're – sorry, John. One of the things we're seeing is that it's not just the quality issues, which are an important piece of this, and I think Jim wants to comment on that. But we're also seeing tremendous inflation from the dealers on the repair costs. And that's driving quite a bit of it. If you looked at the increase that we had in the quarter for the warranty on a year-over-year, the $1.2 billion, I'd say that about $300 million of that was inflationary costs, and roughly $900 million was the issue with the warranties. So that's what we're seeing there. And the issue around the quality, that's something that Jim's going to cover here.

James D. Farley
President, Chief Executive Officer, Director & President-Ford Model e, Ford Motor Co.

A

Hey, John. Again, thanks for your question. I want to slow it down a little bit and explain kind of our operational headwinds, not just quality, but cost as well and give a little bit of context and maybe highlight some of the stuff we've done but the work we have to do. You know, a couple years ago, when we started as a management team, the team that's doing cost and quality is the same team. And we have a lot of revenue power in the company, but we also have a lot of technology and that technology that we rolled out like cameras before our competitors, it puts a huge burden on that electric architecture with a lot of extra modules and software.

We definitely had the largest complexity customer-facing of any brand and we also ran the business on products instead of platforms and systems. Our engineers and supply chain team did not have competitive tools like IT systems and parts release IT. We weren't cooperating with the suppliers the right way on cost reduction, we kind of negotiated them every year but we weren't really getting into redesigning the parts and getting the complexity out of the suppliers' manufacturing system. We didn't really use a lot of strategic sourcing. So we had a lot of concentration of our suppliers, and a lack of leverage.

We had inconsistent application within our manufacturing system for our QOS. So some plants were fantastic like in China and Mexico. Other plants were completely uncompetitive and run differently. And we traveled hopefully on a lot of the launches. The gateways we would have some issues and the team had kind of a hero mentality to try to close them out the end of the launch and we would get in trouble. I'm really proud of the progress we made like in the last 18 months. But it's maybe just the tip above the water and the low-lying fruit. We now have to get after that systematic issue. And that's those issues that I mentioned.

On complexity, we have reduced the new F-Series from 1.4 billion combinations to less than 1,000. And on our new SUVs, we reduced the customer facing complexity by over 90%. Our QOS execution is getting better. We're about 10% improvement in our problems at three months in service, which is a lot of progress for North America. So, the initial quality is getting better. We now have the talent, both the expertise, but also the execution talent. We are now starting to strategically source our EV components, which we now can apply to our ICE business.

I'm really proud of the launch progress we've made. We're now seeing launch spikes we've never seen in a decade at Ford. We are slowing down those launches. And in the case of Super Duty, it's cost us $1 billion. But it was the right trade because it prevents a lot of recalls and issues down the road for the company. And we have made progress on material. We have billions of dollars of opportunity next year, but we have to deliver and release the parts. And I'm very confident that Kumar's new organization will be able to really get after the part of the iceberg that's below the water that's been a problem at Ford for decades. So, thank you for asking your question, and I just wanted to take a little extra time to give the full context.

John Murphy
Analyst, BofA Securities, Inc.

Q

That's great. Can I maybe sneak in one follow-up? EV demand is not materializing quite as robustly as we were expecting this year. Pricing is a little bit down. Costs are going to be up with labor. So, I mean, as you mentioned, EVs are going to become more challenging going forward. But when you think about a program like the – or product like the Explorer that we have at least in Car Wars launching in calendar 2026, 2025 as a model year 2026. And you might disagree or agree with that, but that product is coming at some point soon.

That was an EV variance and an ICE variance we had and we were expecting. And it would've been sort of an expectation that maybe you would've crossed out that ICE variance and just had the EV six months ago.

James D. Farley
President, Chief Executive Officer, Director & President-Ford Model e, Ford Motor Co.

A

Yes.

John Murphy
Analyst, BofA Securities, Inc.

Q

But now actually things have switched in the other direction, and you might actually cross out the EV and just keep the ICE. How are you making these decisions right now with sort of these tectonic shifts going on? I mean, there's data, there's consumer groups, and all sorts of stuff. But there are incredibly difficult and impactful decisions that you have to make. What is the process, Jim, that you are going through on these powertrain decisions as you're going through the product launches over the coming years and planning?

James D. Farley
President, Chief Executive Officer, Director & President-Ford Model e, Ford Motor Co.

A

Yeah. Got it. So things are changing. EVs are still in high demand. It's just as you said; the pricing is much lower and there's a lot of overcapacity in the middle of the market. For us, I think our EV strategy and our ICE strategy is to go after customers we know really well. And so, on our ICE and hybrids very much of a loyalty target. And in the case of EVs, in many of the same segments, but a conquest strategy. And I would say we feel very confident on that strategy because Ford has a great reputation in those segments like full-size truck or pickups, or vans, commercial vehicles, or three row crossovers. But our products are not substitutional, because the customers we're going after are different. But they are the same segment. So we know the use cycle really well, but the innovation will be pointed at different things.

The F-150, I think, is probably the best example at Ford. Because we have world-class ICE. We have a hybrid that will probably be 20% mix. And then we have Lightning and the next generation Lightning that we're working on right now. And when you compare the hybrid F-150 to the EV F-150, you will be surprised at how much more Conquest the vehicle is executed. And we believe that innovation will give us pricing power for those EV Conquest customers. The first generation has helped us there, but I think that's our strategy.

As far as the changeability of that strategy or flexibility, we certainly have choice. But as John mentioned, we're really flexing the capital and the timing of the capital, especially around battery, plants and overall manufacturing capacity.

John T. Lawler
Chief Financial Officer, Ford Motor Co.

A

Yes.

James D. Farley
President, Chief Executive Officer, Director & President-Ford Model e, Ford Motor Co.

A

So we're not changing the product strategy, but we are flexing. And that's our bet is that we will flex the capacity. From a product planning standpoint, we have made, I think, really good bets on the ICE and HEV side in case the EV market is not as fast as we thought.

We have affordable Mavericks. We have a strong international business now with Ranger and Everest. Those markets won't go EV anytime soon. And the markets where we're in, like F-150, Super Duty, Pro, they're not duty cycles that are going to go EV, and we have really fresh product. So our bet is maybe different than others, who just said, look, we're going to get rid of an ICE Explorer and go to an EV Explorer. That's not our strategy.

John Murphy
Analyst, BofA Securities, Inc.

Q

That's very helpful. Thank you.

Operator: The next question is from Dan Levy with Barclays. Please go ahead.

Dan Levy
Analyst, Barclays Capital, Inc.

Q

Hi. Good evening. Thank you for taking my question. I appreciate, Jim, the commentary that you gave on warranty and just costs more broadly. But wanted to ask the question maybe in a slightly different way. This is obviously, as you pointed out, the lingering issue, I think you said at the CMD earlier this year, it's a $7 billion cost gap versus your competitors for Blue.

What exactly is the line of sight? Or how confident are you that these issues can be turned around? Just because these have been issues for some years. And specifically, in the context of you're pivoting to new architectures here where there's obviously going to be some uncertainty on your end, what gives you the confidence or the line of sight to actually turning around these cost headwinds.

John T. Lawler
Chief Financial Officer, Ford Motor Co.

A

Yeah. Maybe I'll start, Jim, and then...

James D. Farley
President, Chief Executive Officer, Director & President-Ford Model e, Ford Motor Co.

A

Yeah.

John T. Lawler
Chief Financial Officer, Ford Motor Co.

A

...hand it over to you. What I would say is that there's a real focus now in the company, and Jim mentioned it in his remarks, around excellence and delivering, right, execution. When you look at the real fundamental issues that we've had across the industrial platform, it's the way we work together, our focus of the work and the structure of the work.

And there have been those that have thought this has been an issue for years and others that haven't. And I think we're finally starting – not finally, as a team – we are coalesced around those root cause issues. We have great new talent in the company.

Liz Door, from a supply chain standpoint, her domain expertise is outstanding. Bryce Currie, from a manufacturing standpoint, outstanding; and then in addition to having Doug bringing Kumar back into the fold, who grew up in the system as a design and release engineer and understands support system and understands the [ph] air states (00:46:33) really well, having them all together now driving this foundational change is important.

And as Jim said, it's the area under the iceberg. Right? It's what's under the water, and it's the most important piece of it. And the progress isn't showing up as quickly as we would like, and the part you see above the water, but the change is being driven below the water. And it's the same root cause issues that are driving the quality problems as well as the cost structure issues. And it's the material cost at about $4 billion, and now we have warranties about $2 billion, and then you have manufacturing, et cetera, in there.

And so it's the talent, it's what we're attacking, it's the relentless focus on excellence, and it's the way we're working together as a team to go after these issues. And having the new team in place and having the new talent in place and watching what they're going after and how they're working together as an integrated team is what we need to get this done.

James D. Farley
President, Chief Executive Officer, Director & President-Ford Model e, Ford Motor Co.

A

And I would just complement that in two ways. Our quality, a real test for our commitment, talent, all the things that John talked about came together in the launches of our most important products like Super Duty. And I am so confident in our tackling these systemic issues because of what happened on our recent lunches.

The team doubled down on testing. They did the extra work on supplier quality and readiness in the factory and really tested the vehicle for failure. And we did something that Ford maybe hasn't done in the past. We held the vehicle until it was right. And in the case of Super Duty, that was a $1-billion-plus decision. And that was proof to me this team understands that quality is our top priority. That message was sent throughout the company. Everyone got the memo.

On costs, on EV, I am encouraged because we're designing from scratch. And a lot of the talent we brought in approaches that. Cost is a pride point for them in designing it in. The real test for us as a leadership team beyond quality is going to be bringing our material cost and negotiated parts price cost down on our carryover ICE vehicles. That is going to be the test. And we believe we have more than $1 billion of ideas already in the hopper for this year, for 2024. And we got to deliver it on those ideas. They'll test our standards, rust protection and NVH. They're going to test our standards. They are going to test our parts release process. It's going to be – but it's us to execute.

Dan Levy
Analyst, Barclays Capital, Inc.

Q

Great. Thank you. Just a follow-up quickly on pricing, which I think has continued to outperform beyond anyone's expectations. Maybe you can give a little bit of voiceover on what you're seeing on pricing, especially in light of all the questions out there on affordability and how long you think some of these pricing tailwinds can be sustained [ph] next year (00:50:01)?

John T. Lawler
Chief Financial Officer, Ford Motor Co.

A

Yeah. I think it's different for each of the business segments, right? We are continuing to see incredible downward pressure in pricing this year on the EVs, right? But, Pro, really strong pricing power right now. As Jim mentioned in his prepared remarks, we've got really good strength in the orders coming in for the model year. We are a good ways through the model year and the pricing has held. And then when you look at the fresh lineup we have on Blue, we're continuing to see the pricing hold for the most part.

Now, are we starting to see that there is some pressure on pricing? Sure. And we said that there would be, but it's been more resilient than we thought this year, that's for sure, especially through the third quarter.

But affordability, we've talked about this before. Affordability is an issue. Right now, it takes a consumer about 14% of their monthly disposable income for a vehicle. Pre-COVID and pre the inflation that we've seen, it was about 13%. So we think it's going to revert back to that. And then we think that it's going to happen over the next 12 to 18 months. And so, to do that, it would be about a net price reduction of $1,800. But we also believe that part of that is going to come through the OEMs and lower prices. But it's also going to come through dealer margins because dealers are still transacting at a much higher percent of MSRP than they have in the past. And so it's going to be both of those.

Now, we expected some of that to occur throughout the year so far. It hasn't much. And so, I think you're going to start to see that come through as we move into next year.

Operator: The next question is from Rod Lache with Wolfe Research. Please go ahead.

Rod Lache
Analyst, Wolfe Research LLC

Q

Hi, everybody. Wanted to ask a couple things on EVs. I think that, certainly, I mean, I don't think, you've been saying that the deflation that you're seeing in EVs has been steeper than you assumed. But, obviously, your original plan assumed some level of deflation through 2026. I think it was even price parity with ICE in some cases. And yet, you assumed 8% margin in that timeframe.

Am I correct in those assumptions that your ultimate view was that you would get to price parity with ICE? And if that's the case, what do you need to do in order to push harder? Do you need to actually reduce prices even below ICE in order to achieve your plan or do you need to achieve even a greater price premium?

John T. Lawler
Chief Financial Officer, Ford Motor Co.

A

Yeah, Rod. John. Exactly. If you look at our three-row SUV, the way we thought about that our Gen 2 product was it's going to have the exterior size of an Explorer and the interior space of an Expedition. And so when we looked at that and setting the targets for the team in 2026, we said, well, we should start out with the revenue assumption that it would be priced on an ICE – as an ICE would be between those two vehicles. And so that's how we set up the affordable targets that we gave the team to design to. And a lot has changed, but the team is working diligently to try to deliver that. And we are continuing to see pricing pressure in the EV segment but right now there's still a premium to gas in many areas.

So I think what you're going to find is over time that premium is going to reduce as we move forward. And that's what we have built into our planning assumptions for our second-generation vehicle and then as well for our third-generation vehicle that you're going to see another step-down on pricing so that these vehicles are affordable. And that's all setting up our cost structure that we're targeting and going after, which was the basis of setting our 8% margin.

Rod Lache
Analyst, Wolfe Research LLC

Q

Okay. So that's still your expectation that you would get to an 8% margin and you would have a cost structure that reflects price parity with ICE?

John T. Lawler
Chief Financial Officer, Ford Motor Co.

A

Yes. That is the target that the team is going after. There's a lot that has changed, as you know, and the team is working through that. And the key three elements Jim went over is most importantly, the size of the battery, the efficiencies of watts needed to move the vehicle, the vertical integration, the partnering on what we would say are commodity parts of the business, things that aren't differentiating for additional opportunity there. The scaling and using the capabilities of the vehicle as we built out the manufacturing facilities to be as lean, as efficient as possible. And the team is pushing hard to get every say that we can through there to build out our Gen 2 vehicles that are profitable and deliver ultimately, the 8% target that we have set for them.

Rod Lache
Analyst, Wolfe Research LLC

Q

Okay. And just secondly, I'm assuming that you still view vertical integration in batteries and LFP as critical to achieving your cost targets.

John T. Lawler
Chief Financial Officer, Ford Motor Co.

A

Yes.

Rod Lache
Analyst, Wolfe Research LLC

Q

Just given all of the issues around that and some of the pauses or delays that you've got on some of these plants, can you just give us an update on what the trajectory is to achieving those lower costs in batteries and how is your plan changing?

John T. Lawler
Chief Financial Officer, Ford Motor Co.

A

Yeah. So we're continuing to move forward with vertical integration on the battery itself, working on cell design, we are working on the chemistries, as we said, we have no real change to what we have put out forward before on BlueOval Park Battery (sic) [BlueOval Battery Park] (00:56:17) plant here in Michigan, but LFP is definitely going to be part of our future – our EVs and that is a very important cost reduction step in our path for the Gen 2 vehicles.

So it's a combination of all of that. It's a combination of the battery size and efficiency of the vehicle to get the lowest watt possible to hit the ranges that we are looking to hit. It's the vertical integration across the vehicle, the vertical integration across the battery, and then as well as the chemistries. And all of that comes together to drive the cost reductions we need and the team is working towards is that part of the vehicle's target.

Rod Lache
Analyst, Wolfe Research LLC

Q

Okay. Thank you.

John T. Lawler
Chief Financial Officer, Ford Motor Co.

A

Yeah.

Operator: And our final question today comes from Emmanuel Rosner with Deutsche Bank. Please go ahead.

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you very much. So I appreciate your candid assessment of the EV business as well as all of the actions that you detailed in terms of trying to reduce the investment and losses in the near term. At the same time, you rightly acknowledge that impacting change, effecting change on the first generation is not going to be the easiest. More change will come in Gen 2, Gen 3. So any way you could just frame for us how much improvement can we expect during this first generation?

You are now running at something like a $5 billion annual loss on Model e. Not that long ago, a few months ago, you still had fairly near-term targets to bring that through EBIT positive. Obviously, a lot has changed but then you are addressing these changes with your actions. So where does it go from here? Does it get worse? Does it get better? Can something be done before Gen 2 and Gen 3 in terms of improving the losses?

John T. Lawler
Chief Financial Officer, Ford Motor Co.

A

Yeah. You're right, Emmanuel. Step function change is going to be on the Gen 2s where we'll have more degrees of freedom to make the types of changes I just talked about. On the Gen 1s, we've seen the price come down much quicker than we had expected, of course. That's showing up in our results.

We're continuing to work very diligently on additional cost and design reductions on the Gen 1 products. And the team is also working very diligently to minimize the impact of the lower prices in the near term, in the next couple years before Gen 2 comes out. And so it's going to be a battle between managing the top line as best we can, adjusting the supply of products relative to demand so that we can balance the pricing from that standpoint and then working like crazy to put whatever cost reductions we can on that Gen 1 vehicle through to the bottom line.

So I think it's going to be – in the near term it's going to continue to be just that. It's going to continue to be quarter to quarter and the team working very diligently to hold as much revenue as we can and bring as much cost reduction to the product as we can.

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you. And then a quick follow-up on Ford Pro. Obviously extremely strong business and very solid quarter, but at the same time there was a little bit of a pullback in both volume and mix and margin in the quarter. So can you just go over the factors that drove this and the prospects and timing for normalizing back up?

John T. Lawler
Chief Financial Officer, Ford Motor Co.

A

Yeah. So when you look at Pro, the volume was down a bit. Part of that was we had some disruptions or hiccups from some suppliers which caused us to lose some F-150 commercial volume in the quarter. We had normal seasonality as well like on motor homes and things like that. And then when you look at Ranger in Europe, that was down a bit still because of the ramp that we have going on, on the new Ranger. And then there was a little bit of improvement with Super Duty.

So I think you saw some seasonality. You saw some fluctuations due to some supplier constraints and some missed volume in the quarter. And then of course we continue to see the strength of the pricing on Super Duty, which is showing up with the higher revenues, yet the volumes were down a bit.

So overall, I think it's not that we're seeing a significant reduction in the demand for our Pro vehicles. We're not. The order bank is very robust. We have a lot of demand for the model year, and I think Europe Pro is going to continue to be performing at a high level as we move forward here.

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you very much.

Operator: This concludes the Ford Motor Company Third Quarter 2023 Earnings Conference Call. Thank you for your participation. You may now disconnect.