02-May-2023

Ford Motor Co. (F)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen. 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 First 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.

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

Thank you, Gary, and welcome to the Ford Motor Company's first quarter 2023 earnings call. With me today are Jim Farley, President and CEO; John Lawler, Chief Financial Officer; and also joining us for Q&A is Marion Harris, CEO, 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 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 actual results to differ are included on page 25. Unless otherwise noted, all comparisons are year-over-year. Company EBIT, EPS and free cash flow are on an adjusted basis, and product mix is volume-weighted.

I want to make sure you've got a few near-term IR engagements on your calendars. On May 21 and 22, we'll host our Capital Markets event in Dearborn, Michigan. For the first time in over seven years, we're looking forward to welcoming representatives of the capital markets to our headquarters. The event will feature unprecedented experiences, including one of the largest displays of our global vehicle portfolio in recent memory and immersive presentations on the strategic plans of our three new customer-centered business segments. We will also feature details of our software and services strategy, both retail and commercial, as well as ample time to network with our senior leaders.

On May 25, Jim Farley will keynote at Morgan Stanley's Sustainability Conference in New York City; and on May 31, Jim will participate in a fireside chat with Toni Sacconaghi at the Bernstein Strategic Decisions conference also in New York City.

Now, I'll turn the call over to Jim.

James D. Farley

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

Thank you, Lynn, and hello, everyone. And thanks for joining us today. I'd bottom-line the first quarter like this. Our team delivered a solid quarter while making real progress on our Ford+ growth plan, and I hope that becomes a trend at Ford, boringly predictable when it comes to execution and delivering financials, but extremely ambitious and dynamic in creating the Ford of the future.

For the quarter, we saw growth across all of our key metrics. In addition, Ford Pro and Blue were profitable in every region where we operate. Our balance sheet is strong and we ended the quarter with close to $29 billion in cash, even as we invest in growth and return capital to our shareholders.

With each quarter that passes, I'm more confident and convinced and thankful we made the decision to create three separate customer-focused businesses. This has unleashed clarity, speed and accountability across the company, not to mention a whole new level of discipline on capital allocation.

So let me cover a few highlights. I'd like to start with Ford Pro. I know many of you were surprised at the true size of the Pro business in March when we recast our financials. Pro starts with marking leadership in our vehicles across the world, tremendous scale, and customer knowledge, and we're layering on top of that the future of our industry, an ecosystem of software and services and EV charging that we believe will be invaluable to our commercial customers, and this will unlock tremendous loyalty and profitable growth.

Our strong order books in North America and Europe as well as all the demand signals we can see for Pro support our target to nearly double Pro's EBIT this year.

In March, we launched the all-new Super Duty in Kentucky and Ohio. It has received tremendous reception, and it's going to strengthen a franchise that is already the market leader. Importantly, Super Duty is the platform for software and services that help our customers maximize their up time, accelerate their productivity and lower total cost of ownership.

I would also say the Super Duty launch is a good case study for the disciplined approach we're implementing across our industrial system. Simply put, we slowed the launch down, significantly increased on-road and in-plant quality testing. We dispatched a large and skilled launch team to our plant. We added test vehicles. We drove millions of miles to prove out durability, and we deployed new technology and artificial intelligence to catch issues. Basically, we put all the pressure in the system to find and then prevent future quality issues, rather than speeding up the line to match our launch curve.

Short-term patience we believe that will result in long-term gain for our customers, and yes, the company.

In the quarter, Ford Pro extended its leadership in true commercial vehicle categories. Our share of the Class 1-through-7 truck and vans in the US increased by one full share point to 41% share. In Europe, we've already been the top commercial brand for eight years now running, and our share grew to more than 15%.

We also maintained our EV strength in North America and Europe. In the US, E-Transit has already a 50% market share. And in the quarter, we won a contract to deliver more than 9,000 E-Transit vans to the US Postal Service.

Ford Pro's paid software subscriptions rose 64% in the quarter, including higher revenue per unit software sales like our telematics and charging software. With these and all the other initiatives, Ford Pro is developing into a resilient business, certainly less cyclical than the broader automotive sector.

In Ford Blue, the team is focused on capitalizing on our red-hot product lineup. Our opportunity to smartly grow extends to valuable franchises with great pricing power like the F-150, the new Maverick, the new Bronco, and of course, the Mustang. We'll grow our leadership position in pickups, in off-road, in performance, and in SUVs with all-new derivatives.

For example, we just introduced the Bronco less than three years ago, and already it's neck-and-neck in sales with the Jeep Wrangler, and it has higher transaction prices. We've also recently expanded the Bronco lineup with exciting derivatives like the Bronco Everglades, the Bronco Raptor and the Bronco Heritage.

Derivatives not only continue to contribute to our growth, but importantly, they can also drive higher transaction prices and higher returns. See, these derivatives often have 80% part commonality with the base models but their contribution margin percents can be 30% higher with a twofold increase in capital efficiency.

We also have one of the strongest product years coming for Ford Blue, so it's just beginning. We have the new Escape, including a new hybrid that's just arriving in dealerships now. Next week, we will reveal the all-new Ranger and the highly-anticipated Ranger Raptor. That will be followed by an all-new Mustang and high-performance Dark Horse Mustang this summer.

While I can't get into the details yet, we have more exciting news to share about two of America's best-selling vehicles, the F-150 and the Explorer later this year. And on top of all of that, we have the Lincoln Corsair arriving in dealerships now, and of course, we just revealed the Lincoln Nautilus.

Now, Ford Model e operates with a start-up intensity to build a profitable EV business with a differentiated portfolio and a differentiated customer experience. US investors now have true visibility into how Ford Model e's profitability strengthens over time supported by volume-driven operating leverage, improvements in design and efficiency, and of course, lower battery costs. We're on track this year towards a contribution margin approaching break-even in Model e, and for our first generation products to be EBIT margin positive by the end of next year.

Wholesales were down in the quarter which deleveraged our cost structure. Part of the decline was planned as we have brought Mustang Mach-E production down for several weeks so we could almost double the capacity and we are now hitting that 35 job per hour run rate in the plant.

Volumes were also impacted by the lower output of F-150 Lightning. We did the right thing, and I congratulated my team many times by immediately stopping production and working with our battery supplier finding and then fixing the root cause of the fire that happened on the Ford property. We're now shipping Lightnings again, taking new orders, and increasing production to an annual run rate of 150,000 units, about double what we do now.

We are also revealing – we revealed an all-electric Explorer in Europe, which is now very well-received. We made progress on Model e in the quarter, advancing our industrial system to scale EVs. The site preparation is already underway for our LFP battery plant in Michigan, and construction continues at the BlueOval SK Battery Park in Kentucky and of course BlueOval City in Tennessee. We now plan to transform our Oakville Assembly complex into a Canadian hub of electric vehicle and battery pack manufacturing.

We also continue to make progress towards locking in all the raw materials that we need to support our capacity targets in 2026 and beyond.

Model e is our Center of Excellence for technology, including software. A good example of that is BlueCruise, which continues to be a hit with our customers. Consumer Reports rated it the Top Advanced Hands-Free Driver Assist System on the market in the US, and that was just Version 1.0. Our latest release, which we're OTAing to customers is Version 1.2. It automatically changes lanes with the tap of a turn signal and it delivers a much more natural driving experience hands-free.

We also launched BlueCruise in the UK, our Mustang Mach-E, and became the first OEM to gain approval for hands-free highway driving speed anywhere in Europe, with more than – and now BlueCruise has more than 70 million miles driven to date and we continue to upgrade BlueCruise for customers with each over their update.

Before I turn it over to John, I want to share our thoughts on how the EV market is evolving in our eyes. You know, it's easy to look at the landscape of the EV market as a monolith, but we plan to be surgical about where we play and how we win with the right products, the right cost structure and the right price points. We do not subscribe to a win vehicle share at any cost approach. We look at share of vehicles of course and share of revenue. We also look at share of profits and share of the customer lifetime value, and we believe this is the only way to ensure we drive appropriate return on capital over time.

By 2025, we now expect there to be 45 EV models to be offered in the US in the small and medium utility segment. It will be a very saturated two-row EV market. Against this backdrop, to ensure profitable growth, we know we have to have a fresh, compelling offering with the right cost structure, something we continue to improve with the Mustang Mach-E.

We also found that customers are very loyal to full EV powertrains once they enter, but they are not brand loyal for their first purchase. We capitalize on that by getting to the market early with the Mustang Mach-E and our whole lineup, and it continues to reward us with over 60% of the customers new to Ford. We're seeing that the second EV purchase is much more loyal to the brand in these developed EV markets, so we're glad that we have all these customers in our digital and physical ecosystem.

We are aggressively lowering our product costs for our current and next-generation products. You'll find out a lot more on Capital Markets Day, but in fact, for Mustang Mach-E from launch through the end of this year, we'll have reduced the bill-of-materials for Mustang Mach-E by $5,000 per vehicle.

Now, in contrast to two-row crossovers that we believe will be a very saturated market, we believe Model e can be highly differentiated in markets where we know the customer well, like the three-row utility space. And as I said, we'll share more at our Capital Markets event later this month on our product strategy.

I had a chance along with John and most of our leadership team to go to China in the last few weeks and look at the EV market in a Gemba go-and-see activity up close. It's interesting to see how customers are no longer just attracted to traditional luxury brands with EVs or even hardware design anymore. Outstanding hardware styling, performance, quality, are just a given in the EV digital marketplace today. The best new brands are offering integrated digital, retail, lifestyle, and experience that are software-defined. This is firmly in our sights for our second-generation EVs.

This software as a differentiator plus a radically different cost structure and the ability to attract – attach value-added software and services gives us confidence we can compete and win in unit, revenue, profit, and vehicle share while delivering appropriate returns, and Ford Pro is already there.

I'll wrap-up by saying we are pleased, but we are not satisfied. As I said, solid execution and some really thrilling progress advancing our Ford+ plan. I look forward to seeing many of you in-person in three weeks for our Capital Markets event where we will go much deeper into our strategy and our progress.

John?

John T. Lawler

Chief Financial Officer and Interim Chief Supply Chain Officer, Ford Motor Co.

Thanks, Jim. First quarter wholesales were up 9% year-over-year as we delivered $3.4 billion in adjusted EBIT. Margin was 8.1%, up 140 basis points. Ford Blue and Ford Pro profit improved, reflecting favorable mix and higher net pricing, and as expected, those benefits were partially offset with a loss in Model e as we invested in our clean sheet next-generation EVs and scale our leading portfolio of first generation electric vehicles.

For the quarter, we delivered $700 million of adjusted free cash flow. Improving consistent free cash flow from our industrial footprint combined with disciplined capital allocation provides us with significant flexibility to fund our growth while also consistently returning capital to our shareholders.

Our balance sheet remains strong. We ended the quarter with close to $29 billion of cash and over $46 billion of liquidity. In addition, despite the recent market volatility, we successfully completed the renewal of our $17 billion sustainability-linked corporate credit facilities.

So, turning to our customer-focused business segments, with wholesales up 6%, Ford Blue delivered $2.6 billion in EBIT and a 10.4% margin that was 400 basis points higher than a year ago supported by favorable mix and higher volume. Our fresh and exciting product lineup continues to drive strong demand.

Wholesales for Model e declined in the quarter reflecting planned downtime that allowed us to almost double our production capacity for Mustang Mach-E. Now, the profitability of any EV start-up including Ford Model e is highly levered to volume. Importantly, holding volume constant, our first quarter EBIT margin would have been roughly flat compared to the fourth quarter at around negative 40%.

We expect Ford Model e EBIT margin to improve to around negative 20% in the second half of this year reflecting stronger per unit contribution margin and significantly higher volumes. In fact, we expect Model e contribution margin to approach break even this year and we continue to target positive EBIT margin for our first generation vehicles by the end of 2024.

Ford Pro delivered an 18% increase in wholesales and EBIT improved $900 million to $1.4 billion for the quarter, delivering a margin of 10.3%. The improvement in profitability was supported by higher net pricing, increased volume and favorable mix. Importantly, this was achieved during a quarter when wholesales for Super Duty were down both year-over-year and sequentially as we ramped up production of our all-new version of this highly popular truck.

Ford Credit delivered EBT of $300 million, down $600 million from a year ago reflecting lower financing margin, higher credit losses and lower lease income, all of which has been reflected in our full year outlook. Credit loss performance remained strong and is still below the historical average, but beginning to normalize. Auction values remain robust but down from their peak in the first half of 2022.

Ford Credit liquidity remains strong at $26 billion, up $5 billion from year end. In addition, despite the volatile market conditions, the company has already completed $12 billion of public issuance or roughly 50% of its 2023 funding plan.

Turning to our outlook, we continue to expect full year 2023 total company adjusted EBIT of $9 billion to $11 billion, adjusted free cash flow of about $6 billion, and capital expenditures between $8 billion to $9 billion.

This guidance includes headwinds that reflect global economic uncertainty, higher industry-wide customer incentives as vehicle supply and demand rebalance, lower past service pension income/exchange, and investments in growth such as customer service and connected services, and tailwinds driven by improvement in the supply chain, our higher industry volume with SAARs of about 15 million and 13 million in the US and Europe, respectively, launch of our all-new Super Duty, and lower cost of goods sold including materials and commodities.

Turning to the segments, Ford Blue to deliver full year EBIT of about $7 billion. Cost improvements and higher industry volumes will likely be offset partially by pricing headwinds as inventory stocks continue to normalize and industry incentives rise through the year along with adverse exchange. Ford Model e to report an EBIT loss of around $3 billion, largely reflecting disciplined investment in new products and capacity. We also anticipate Ford Pro's EBIT to nearly double to around $6 billion compared to our 2022 result. The gain is driven by improved pricing and volume including the benefits from the launch of our all-new Super Duty. And EBT for Ford Credit is anticipated to be around $1.3 billion.

Additionally, I hope that all of you are blocking time for our next Capital Markets event on May 21 and 22 here in Dearborn. This will be an important couple of days as we update you on Ford+ strategy, take a deep dive into financial targets and KPIs for each of our customer-centered business segments, and talk about our capabilities and expectations for software and services. By the time we're done, I believe you will even be better equipped to value the expected contributions of each of the segments to Ford's overall growth and return.

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 the line for questions.

QUESTION AND ANSWER SECTION

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

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

Q

Thanks, everybody. So, Jim, you've compared the current environment for EVs to the year 1913, saying that no one should really be surprised that Tesla is cutting price so much, and then I think you asked the question maybe rhetorically, who's going to blink on growth? So if I put your own question to you, Jim, will Ford blink on growth?

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

A

Thanks, Adam. It depends. Well, first of all, our first three EVs are all very different in terms of pricing. I think the Lightning's price is up $11,000 since we launched, and E-Transit is up a lot, and of course we're increasing production to get that scale benefit.

So the most important thing we've learned three, four years ago is be careful where you compete, and we have selected where we compete extremely carefully. We want to go after segments where we have a great reputation, but there's a lot of conquest customers, and we want to innovate beyond just the powertrain, like Pro Power on board, and as well, software.

We now know the three shippable software stacks, safety and security, productivity for Pro, and of course, partial autonomy. All of those are really great hedges against the inevitable overcapacity in certain segments.

We could see the overcapacity in the two-row electric utility segment like years ago, Adam. Literally, like before we had finished the Mach-E development. We knew this was coming. That's why we got a team together. We brought down the cost of the bill-of-material by $5,000. We aren't waiting for a minor change. We're not doing things like we normally do and we continue to get the data off the vehicle to make the software better and better so the customers' vehicles get better every day.

So I would say the message from me as the CEO is that we are not going to price just to gain market share. We will always balance a healthy profit roadmap. In the first generation of products, it's pretty challenging because we didn't know what we didn't know four years ago when we designed them. But now, we're two years into the design in the second cycle, and on Capital Markets day, we will take you through why we believe that 8% margin is totally realistic despite all the pricing pressure that we will absolutely get because everyone wants to grow.

So I would say we're quite different than maybe some of the peer EV players that are pricing just for growth. We will always balance that, because we want a profitable EV business and we're pulling every lever we can in the first-gen products. The second-gen is where we can really make hay.

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

Q

I appreciate that, Jim. And just as a quick follow-up because what you're saying is really landing well with me. It's resonating. But I just get a little nervous with the 2 million unit capacity target that you have hanging out there for the second half of 2026, which just in my opinion is a crazy high number.

Can I get you to admit that volume targets, and I think you're saying this, and I don't want to preempt the Capital Markets Day, but can I get you to admit that volume targets as the success criteria alone, really is the wrong thing to continue to perpetuate? Thanks, Jim.

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

A

Yeah, absolutely. Look, we all have to plan our business professionally, and scaling is important. Look what happened in first quarter for Model e. We want that scaling benefit, but that is not success. In fact, I would say the more we study this – our trip to China was a real epiphany for our leadership team.

I would say the more – the thing that I look for as a CEO is not necessarily just the volume growth. It's actually how fast we use the data off the vehicle to make the customers' software experience better. That, to me, the quickness of that loop is the fitness for differentiating brand and profit in the future for this new digital product category we happen to call electric vehicles.

To me, yes, volume is important. But that quickness of that loop, which we're already on our 10th million OTA. We've now gained 65% more miles traveled on BlueCruise in three months. We were only 42 million miles three months ago. We're now at 70 million. And the reason why that's growing so fast is because we continue to do OTAs to BlueCruise to make it better and better.

On Ford Pro, those software subscriptions are growing fast. So to me, of all the metrics I look for as a proof point for our success in this new digital product category we call EVs, I think that's the one, Adam, I look for the best. And we will always balance profit with scaling.

Adam Michael Jonas
Analyst, Morgan Stanley & Co. LLC

Q

Thanks, Jim.

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

Rod Lache
Analyst, Wolfe Research LLC

Q

Hi, everybody. I'd actually like to follow up on Adam's question. I'm just looking at the $900 million increase in structural costs in the quarter, and I know that the investments that you're making are aimed at driving growth. But in the past, when the industry has experienced higher structural costs, it put a lot of pressure on everybody to hit volume targets which ultimately wasn't good for pricing.

And I know you said, Jim, that you're planning to target segments where you've got strong pricing power and you're confident in conquesting customers. But can you just talk a little bit about whether you agree with that assertion that there's going to be pressure even on Ford, just given the magnitude of the structural cost increase that you're taking on, and what kind of flexibility do you have to make the targets if volume or pricing assumptions come in a bit short?

John T. Lawler
Chief Financial Officer and Interim Chief Supply Chain Officer, Ford Motor Co.
A

Yeah, Adam, let me – sorry, you're following up on Adam's question. Let me, Rod, start off on the cost there. Yeah, you're right. We did see our structural costs go up in the quarter on a year-over-year basis as we continued to invest, as Jim said, in our EVs and in our digital architecture and in our software.

I think for us, a key part of that is bringing those structural costs down in Blue over time and then driving efficiencies on our overall cost structure and contribution costs and material costs and warranty and freight, et cetera. So that's where we need to see return on our cost structure in those areas as well and then cost structure coming out of Blue as we then continue to invest in e and Pro.

Now, of course we have to do that at an efficient level so that it doesn't put that much pressure on the business. But Jim can talk about this more, but as we're investing in the growth of EVs, we're not doing it where we're proliferating. We're looking to be very focused on the segments we're going into, be very disciplined on the complexity and the number of top hats and models that we have, have the right footprint, the industrial plants need to have the right efficiency levels, and we'll talk more about that at Capital Markets Day. But we're very, very thoughtful of the fact that as that investment goes in, it needs to be very efficient.

Rod Lache
Analyst, Wolfe Research LLC
Q

Okay. And just maybe secondly, just switching gears to – your variable costs like material, freight and commodities were up $1.3 billion in the quarter. Are you still expecting $1 billion of savings in variable costs and $1 billion, $1.5 billion in commodities? And if that's the case, can you also have the Super Duty volume ramping later this year? I just would be curious about whether you can give us a little bit more color on the first half, second half assumptions since your full year guidance implies some pretty meaningful decline on the year versus the level we're seeing right now?

John T. Lawler
Chief Financial Officer and Interim Chief Supply Chain Officer, Ford Motor Co.
A

Yeah, so when you look at it from a cost standpoint, let's just unpack what happened last year. When you look at the cost increases in 2022, only about 15% of that happened in the first quarter. So on a year-over-year basis coming out of last year, this was a tough read. If you look at it sequentially, when you look at our costs on a sequential basis, our costs were down in the quarter and they were down significantly in Blue. They were up a little bit in E, and they were about flat in Pro. So yeah, we have got to gain traction on the cost reductions, for sure, as we go through the second half of the year and you'll start to see that come through in the second half.

Overall, when you look at it from a cost standpoint, we expect our total cost to come down and cost of goods sold to come down about $2 billion versus the $2.5 billion, and that's primarily reflecting the fact that commodities aren't coming down as quickly as we thought, so that's where we see costs unfolding through the second half of the year.

Rod Lache
Analyst, Wolfe Research LLC
Q

Thank you.

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 on fleet, because that seems to be leading the volume recovery here early in 2023. I'm just curious how much of a tailwind that was for you and where that shows up in the numbers whether it's all in Pro or do we actually see something actually showing up on the Blue and E side? And how much do you expect that to continue to sort of be a tailwind as we go through the course of this year and maybe even for the next year or two?

John T. Lawler
Chief Financial Officer and Interim Chief Supply Chain Officer, Ford Motor Co.

A

Yeah, the weakness is largely sitting in Pro, John. We see that continuing through the year. We see Pro – strength in Pro as we go through the year. There's considerable pent-up demand. We now have the new Super Duty. We'll be launching the Transit in the second half of the year. And we expect that to continue. So that's where we see quite a bit of opportunity as we go through the year as we expect profits in Pro to double this year versus last year.

On Blue, what we saw in the first quarter for Blue was about flat pricing, it was up a tenth, a strong mix, really strong mix, and some volume increases in Blue in the first quarter, and that strong mix was on F-Series and that's because last year we had the TRICO issue which kept our F series mix down plus we were launching Escape this year in the first quarter. So when you look at it, that's where we see things unfolding.

When we go through the rest of the year on Blue, we expect that mix to come off. That's not going to repeat itself as we run through the rest of the year.

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

A

On Pro, I just want to highlight a few things, John. There was a huge backorder of vehicle pent-up demand for small business in the US and Europe that has still not even close to being satisfied, so a lot of the bigger fleets, U-Hauls, you can imagine who they are, the truck and van customers, we've done a good job getting them the product they want. They still want more, a lot more, and this is before we launched the new Super Duty and of course the new Transit in Europe. And so there's a lot of pent-up demand for large fleets.

But most of the real profitable Pro business is small and medium-size business, and they have been waiting literally three to four years for their Transit and Super Duty's. So the pent-up demand we're seeing now is really those customers, and there's still a lot of pricing power and lots of pent-up orders for and especially now that we have brand-new Super Duty and Transit in Europe, it's going to be even more intense to get those products. So the larger fleets, we've done a good job getting them more product, but there's a ton of pent-up demand for Pro vehicles with those small and medium-size business which is the heart and soul of the TAM.

John Murphy
Analyst, BofA Securities, Inc.

Q

And, Jim, if I could follow-up just on the pricing discussion. There seems to be a change in the philosophy of the way that people are thinking about this particularly that new large competitor that is cutting price, and that you can cut price on the front-end and not make a lot of money on the hardware but you can make a whole lot of money on the software and services on the back-end so you're not so worried about profit on the front-end. You think you can make it up on the back-end.

As you think about your business evolving over time, do you think in five years' time plus that you're going to be sort of selling the vehicle as a hardware and making all the money on the back-end? I mean, how should we think about sort of the balance of how the money is earned on vehicles going forward?

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

A

Well, that business model, I mean, outside of maybe Tesla, that business model is [ph] alive and well (00:37:44) at Ford right now in Pro. So when I answer your question, please understand that we are operating that kind of business where our after sales and software is now large 30-plus percent attach rates, and I would say the answer is I am not giving any relief to my vehicle teams for software sales or any kind of margin advantage.

Those products have to get to 8% on their own, and we see the software and especially for Pro, the physical after sales, those attach rates, some charging equipment that we're seeing 30-plus percent attach rates, that's plus business for us. That's an annuity we want to create and we do not want to commoditize our products. That is not our strategy. Maybe someone else's, but not ours. And that's coming from a company that is already doing, like we could do that now with Pro, but we are not going to do that.

I hope that's clear.

John Murphy
Analyst, BofA Securities, Inc.

Q

Very helpful. Thank you.

Operator: The next question is from Ryan Brinkman with JPMorgan. Please go ahead.

Ryan Brinkman
Analyst, JPMorgan Securities LLC

Q

Hi. Thanks for taking my question. I read, Jim, that you recently said at a charity event in Detroit, we're going to have to rethink what the Ford brand means in a place like China. So where do you think you stand with regard to your China operations currently? I mean, Lincoln seems like a bright spot, but what aspirations do you have for your operations in that market either in terms of the portfolio or margins or returns, and what timeframe would you like to achieve those aspirations?

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

A

Well, thank you, and I guess that's the end of my charity work. But Pro and Blue are profitable everywhere in the world, including China, but I'm glad you asked this question because we went to China to finalize our strategy as a leadership team, and I guess I would explain – so our ICE business there is profitable, Lincoln is a success, but you have to look at China through the strategy lens. It's not a huge business for us and we believe that not only is it the biggest EV market in the world but customers digitally are ahead of the rest of the world, and so it's a really important market for us.

And what we really see in our presence there is battery tech, digital experience for the customer, and advanced product, both software and hardware integrated.

Our strategy going forward in China will change. We're going to go to a much lower investment, leaner, more focused business in China, with higher returns. And I'll give you an example. I don't want to lay out the whole strategy here, but since you asked the question, I think our partnership with JMC is a good example. We're going to double-down on our commercial business, including EVs in China. We also believe that JMC can be an export hub for affordable EVs and ICE commercial vehicles using the Ford distribution network for our Pro business around the world. We have great Pro dealers in South America and South Africa and Australia, Mexico, places that we can export, and now we have a source of a fantastic, affordable EVs and commercial ICE products with JMC.

That's an example how we're going to approach China from now on. And we're not going to try to serve everyone. It'll be a lower investment, leaner, much more focused business in China, and we're going to have a team on the ground that will be global resources for the company because of how important the market is in EV.

Ryan Brinkman
Analyst, JPMorgan Securities LLC

Q

Okay. Great. Thanks. And then just lastly, what is the latest you're seeing in terms of auto loan APR, credit availability, maybe in light of some of the turmoil that we've seen in the banking sector in the US? The SAARs have been very strong this year, in line or stronger than your expectation for 15 million total SAAR, particularly in light of the higher rates maybe helped by the strong equity in used vehicles. But just curious if you're hearing anything maybe different at the margin from your dealers or customers or just how you're thinking about the auto finance market generally.

Marion B. Harris
President and Chief Executive Officer, Ford Motor Credit Company, Ford Motor Co.

A

Yeah, hey, Ryan. It's Marion. We have seen a number of banks pulling back from auto lending which is kind of a hallmark of banks through difficult markets, and that's created a bit of a pricing opportunity for us as well as improvement in share, financing share for us. So I don't see it getting a lot better over the coming months for banks, but the credit availability is still there for customers and captives across the industry are going to continue to support the OEMs.

Ryan Brinkman
Analyst, JPMorgan Securities LLC

Q

Very helpful. Thank you.

Operator: The next question is from James Picariello with BNP Paribas. Please go ahead.

James Albert Picariello
Analyst, BNP Paribas Exane

Q

Hi, everyone. First question on price. So is pricing overall you still expect it to be neutral for the year? It sounds as though Blue is guided to be negative for the full year as incentive spend picks up, but yeah, can you just help unpack how we should be thinking about this year's price for Model e and Pro with the Super Duty strength still to come?

John T. Lawler
Chief Financial Officer and Interim Chief Supply Chain Officer, Ford Motor Co.

A

Yeah, so overall, for us, our bridge from 2022, 2023, we expect pricing for us to be neutral. We still expect that to be the case. We do expect the second half to see pricing pressures, especially on Blue as we see supply and demand normalize. Pro, we believe there will be pricing strength throughout the year. And on E, we see pricing being slightly down on a year-over-year basis as well. So overall, no change to what we have talked about at the Teach-In. We see pricing as neutral for Ford.

James Albert Picariello
Analyst, BNP Paribas Exane
Q

Okay. Got it. And then just to confirm, you talked about 20%, a minus 20% Model e margins for the second half. Is that right?

John T. Lawler
Chief Financial Officer and Interim Chief Supply Chain Officer, Ford Motor Co.
A

Contribution margin, yeah.

James Albert Picariello
Analyst, BNP Paribas Exane
Q

Contribution margin. Okay. All right. Thank you. Appreciate it.

John T. Lawler
Chief Financial Officer and Interim Chief Supply Chain Officer, Ford Motor Co.
A

Sorry about that, no, no, no. Total margin. Contribution margin positive. Total margin would be – EBIT margin would be minus 20%.

James Albert Picariello
Analyst, BNP Paribas Exane
Q

Got it. Yeah. So then my follow-on to that, because that's what I thought you had said, can you help bridge what the benefits are from a materials perspective, scaling in terms of the buckets maybe that you provided at the Teach-In? What helps get to that minus 20% run rate for the second half? Thanks.

John T. Lawler
Chief Financial Officer and Interim Chief Supply Chain Officer, Ford Motor Co.
A

It's not different than what's in the Teach-In. When you look at it, we're going to scale through the year, we start to grow our volumes, we have the LFP battery coming in, and then we have the design reductions that Jim talked about getting to about a $5,000 reduction on Mach-E, we have a significant reduction in play on Lightning as well, so it's the same buckets that we talked about at the Teach-In.

James Albert Picariello
Analyst, BNP Paribas Exane
Q

Thanks.

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

Dan Levy
Analyst, Barclays Capital, Inc.
Q

Hi. Good evening. Thanks for taking the questions. I just want to follow up on that last question on the contribution margin. You know, and I know you didn't disclose contribution margin at the Teach-In, but at the midpoint if I look at what you disclosed in your deck, it's roughly negative $4,000 contribution margin right now, and you said a lot of this is on sort of material reduction.

So I just wanted to understand how easily you can reduce content mid-cycle of a product. I know you said that there's some design changes that you can do, but typically, you see more material content modifications at the end of a product cycle, so just want to get a sense of your visibility on content modifications to get that contribution margin to break-even.

John T. Lawler
Chief Financial Officer and Interim Chief Supply Chain Officer, Ford Motor Co.

A

So there's a couple of things you can do from a content standpoint to drive your costs down. One of them is we're using the digital connectivity of the vehicle to understand what features the customers find valuable. And if they're not using something that we have on the vehicle, we can design that out.

The other thing we're doing is, as Jim said, we didn't wait on Mach-E. So we started to put together what we thought of as bundled actions into minor programs as we work through Model e and we're launching those as we go through the year this year and into next year to get us to that $5,000 reduction.

As a first-mover, we felt it was important to get to market quickly. We've readily admitted that the design and efficiency of our first generation products isn't where it needs to be, and we're working on that, those reductions now, and we're taking all the learnings from that and incorporating it into our second-generation products. And we'll talk more about that in a couple weeks at Capital Markets Day.

So, yeah, there's things you can do. You just need to be thoughtful about it as you go through the product. And where there's opportunities, you bundle them together, you do a minor launch, you do a change and you go. And that's what we're doing on E, and we're using the connected data to take out features that the customers don't value.

Dan Levy
Analyst, Barclays Capital, Inc.

Q

Great. Thank you. And then as my follow-up, I just want to touch on some of the earlier questions that were asked and this notion of how you're looking at volume. You know, and I think the message clearly you're making is that you're not necessarily – or you're balancing that volume with profit. But historically, this has been a business that is dictated by volume. This is dictated by utilization. And if I read your comments correctly that you're focused on sort of unique segments and you want to sort of get out of the fray a little bit. That would probably tell me that if you're punching at 4 million units a year now which is low versus actually where you've been historically, that if you're focused on these more premium segments or more unique segments, that there could be a much lower volume going forward.

So how should we think about your volume more broadly? I realize that's probably a better question for the CMD, but how are you thinking about sort of structurally what type of volume we should look at in the future?

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

A

Yeah, good question. So I want to make it really clear that our growth strategy for the company is very aggressive and it focuses on conquest customers. So we plan to grow, and that capacity increase for E and Pro is mostly additive to the company's overall growth. And what gives us confidence in that is that we are targeting conquest vehicles and software to customer categories that we know really well.

You know, it's not lost on us that when we launched Lightning, almost all the full-size pickup truck EV customers were new to Ford and new to the segment. So what we learned in Lightning's case, a segment traditionally that's been 13% of the industry for pretty much my whole career, can be much, much bigger when you add new product features like a frunk, lockable storage for a full-size truck, zero emissions, and the ability to power your house for three days. A lot of new customers bought a Lightning that never owned a pickup truck before. And we intend to do that with three-row crossover, and with a bunch of EV Pro vehicles which we think will be huge growth for us.

So you should expect that a lot of that capacity we're putting in is for growth for the company. But we are not going to grow at any cost. We're going to manage that incremental new growth for profitability and growth together, and we've put a lot of thinking into our product strategy.

One of the most important aspects of our product strategy is not to have too much top hat engineering. We want to have a lot of scale per top hat. And again, we'll go into this at Capital Markets Day, as you said, because I think it's best answered there with real examples where you can really see our strategy coming to life. But we've learned a lot from Lightning and from Mach-E. Frankly, the number of new customers we're seeing is very encouraging for us because of our capacity increase, and we know that the second cycle product can be radically simpler and lower cost aside from the scaling effect. And again, we'll lay this out at Capital Markets Day for you and for everyone else.

Dan Levy
Analyst, Barclays Capital, Inc.

Q

Great. Thank you.

Operator: The next question is from Tom Narayan with RBC. Please go ahead.

Tom Narayan
Analyst, RBC Capital Markets LLC

Q

Hi, guys. Thanks for taking the question. Just had two quick follow-ups. So for Blue, it sounds like the downshift implied in the rest of the year is really coming more from mix and not price as you're saying net neutral on price for the full year. Is that right?

John T. Lawler
Chief Financial Officer and Interim Chief Supply Chain Officer, Ford Motor Co.

A

Yeah, so mix, we have very strong mix in Q1. We don't expect that to repeat as we go through the year, and we do expect on a full year basis that we will see some pressures on pricing in Blue on a full year basis as we go through the second half of the year.

Remember, what's really important is to understand that run rate of price as you come out of the back end of the year because you have the [ph] accrual (00:52:25) impact for all of the units that are in stock and then you have to take the incentive levels from Q1 of 2024 and apply it to those units that are in stock. So you've got to think about that on a run rate business coming out of the end of the year. But overall, yeah, it's for Blue, we definitely see that there will be some pressure on pricing.

Tom Narayan
Analyst, RBC Capital Markets LLC

Q

Okay. And then another follow-up. So on this question of attach rates, you have 30% attach rate on Pro, which is amazing. And just curious, as you think about that, is there an incentive perhaps to increase that attach rate perhaps by sacrificing on price? Presumably those subscription revenues come in at higher margins. Or is the view, no we're not going to – at the end of the day, we make these products, and the subscription services are add-on to enhance the product. I mean, how do you think about that trade-off? Thanks.

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

A

It's a great question. Right now, given the order bank we see for Pro's business, the more we can invest in profitable high-growth products, the better. But you should think, it's a very important question you're asking for Pro because I don't think everyone would realize that the margins on software and the margins on parts are actually pretty similar.

So in the end of the day, the customer wants us to have fantastic products for Pro but they're largely regulated, kind of box or pickup truck bed or whatever. So really, for the customer, the value is going to be the software, the attach rates, and the experience they get with an integrated approach.

Think about this future state, which we are executing to. 100% prediction of failure of components before they fail. Okay? You sensor the vehicle to do that. It's integrated in software. The software gets better every day so you can predict failure more precisely and for more components. The customer gets a vehicle that never really goes out of service. If you're a small, medium-size commercial Pro customer, which is most of the TAM in Europe and the US, those customers, they take one van down, that's 20% of the revenue, so they will pay because they can drive more business with a vehicle that's never off the road. So think about this not as a trade-off between the vehicle profit, the parts business, and the software. Think about it from the customer standpoint as an integrated approach where everything is designed for each other, where you can't think of doing prognostics without a vehicle design to do that or the fulfillment of the parts business pre-picking the part before the customer even gets there so that they could do the service really quickly so the vehicle's not off the road for very long if it does need service.

So I don't really think we think of it from the customer standpoint as a like trade from margin. We think of designing the whole system so that every piece of it adds value and you can't kind of think of the physical product or the software independently of each other.

Now, it may turn out over time let's say on the low part of Pro that the software and the parts business are more profitable. But from the customer standpoint, we're designing the Pro business where they're inseparable, like the prognostic example. I hope that makes sense to you.

Tom Narayan
Analyst, RBC Capital Markets LLC

Q

Yeah, it does. Thank you.

Operator: And the last question today is from Emmanuel Rosner with Deutsche Bank. Please go ahead.

Emmanuel Rosner

Analyst, Deutsche Bank Securities, Inc.

Q

Oh, thank you very much. So I think you announced a price cut on the Mach-E today, and to your point, Jim, I think this is a more competitive segment within all the various EV segments. Can you maybe comment on the demand environment for Lightning? I've seen some anecdotal evidence of some decent amount sitting on some dealers' lots. I read that you're planning to ship some to Norway which it feels like the US pickup market should have more demand than your ability to supply, so can you just maybe talk a little bit about where Lightning demand is in general and whether sort of like cost actions on EVs in order to bring down the price.

James D. Farley

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

A

But there's only one or two in the market, so I can understand why maybe some people would look at it that way if they don't have a product in the market, but from our standpoint, the Lightning demand is outstanding. We've taken $11,000 worth of pricing on Lightning. $11,000. And yes, thank goodness that we are seeing now some dealer stock for the first time in like two years for Lightning, and we're real excited about our cost reductions and of course the software we're shipping to the vehicle like BlueCruise 1.2. But the demand for Lightning is really, really strong.

I look at bringing a trailer every week, because two years ago, it was like, I don't know, the most popular new vehicle on bringing a trailer was a Lightning with four miles on it that someone was flipping. And the prices have come down and they're basically at MSRP now, so we're selling at full MSRP, the demand is higher. In fact, I would say that the pricing is higher than MSRP still, and we're totally sold out in Norway like we are everywhere.

So this is a global segment we believe. Ford is clearly the number-one pickup truck maker in the world, and we're not just going to keep our pickup trucks in the US. It's a global market. So we feel great about the demand or else we wouldn't be doubling production this year.

Emmanuel Rosner

Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Thanks for that, Jim. And then just maybe one follow-up for John. So curious if you could just put a finer point on the puts and takes for your unchanged 2023 guidance. I think you mentioned in terms of costs for materials and freight, maybe now it's $2 billion benefit instead of $2.5 billion. Are there any other big pieces which are either more or less of a benefit or a headwind than you saw previously?

John T. Lawler

Chief Financial Officer and Interim Chief Supply Chain Officer, Ford Motor Co.

A

Yeah, sure. So we had shared what we thought the bridge was earlier this year, and so as I said, we think pricing overall for us will be about neutral for the year. We said that our COGS are primarily material and logistics. We had said that it would be about $2.5 billion, we think it's about $2 billion now. That's primarily due to commodities not coming down as quickly as we had thought.

Volumes, we were up 9% in Q1. We expect to be about, up about 6-ish percent for the full year overall, so I think you can look at that and those are the three areas that have basically changed versus what we had bridged before. We see past service pension at about a $2 billion negative, credit we don't change there, we're about that $1.4 billion, and we're going to continue to invest in growth, and then we saw exchange and other of about $1 billion. So that bridge largely remains the same, except we've got a little bit of movement between some volume and some commodity costs.

Emmanuel Rosner
Analyst, Deutsche Bank Securities, Inc.

Q

Perfect. Thank you.

John T. Lawler
Chief Financial Officer and Interim Chief Supply Chain Officer, Ford Motor Co.

A

Yeah.

Operator: This concludes the Ford Motor Company first quarter 2023 earnings conference call. Thank you for your participation. You may now disconnect.