Ford Motor Company

Moderator: Ford Executives
July 28, 2021
5:00 p.m. ET

OPERATOR: This is Conference #7590793.

Operator: Good day, ladies and gentlemen. My name is (Holly), and I'll be your conference operator today. At this time, I would like to welcome you to the Ford Motor Company Second Quarter 2021 Earnings Conference Call. (Operator Instructions) At this time, I would like to turn the call over to Lynn Antipas Tyson, Executive Director of Investor Relations. Lynn, I hand it to you.

Lynn Tyson: Thank you, (Holly). Welcome to Ford Motor Company's Second Quarter 2021 Earnings Call. With me today are Jim Farley, our President and CEO; and John Lawler, our Chief Financial Officer. Also joining us for Q&A is Marion Harris, CEO of Ford Credit.

Today's discussions include some non-GAAP references. These are reconciled to the most comparable U.S. GAAP measures in the appendix of our earnings deck. You can find the deck along with the rest of our earnings materials as well as content from our Capital Markets Day at shareholder.ford.com.

Today's 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 21. Unless otherwise noted, all comparisons are year-over-year. Company EBIT, EPS and free cash flow are on an adjusted basis and product mix is volume weighted.

A quick update on our upcoming IR events. On Monday, August 2, Barclays will host a fireside chat with John Lawler and Lisa Drake, our Chief Operating Officer for North America. On Tuesday, August 3, Jefferies will host a virtual fireside chat with Alex Purdy, our Director for Business Operations for Enterprise Connectivity.

And on August 11, JPMorgan will host a virtual fireside chat with Hau Thai-Tang, our Chief Product Platform and Operations Officer. Now I'll turn the call over to Jim Farley.

James Farley: Thank you, Lynn. Hello, everyone, and thanks for joining us today. Early in the second quarter 2 months ago, we detailed our strategy for the future of Ford. Put simply, our Ford+ plan is focused on 2 things:really distinctive products that only Ford could do; and an always-on relationship and experience for our customers that gets better and better over time.

We're building on our foundational strengths, our iconic products, the uniquely appealing vehicles, our manufacturing excellence and the industry's best captive finance company. But we're now adding new capabilities and new talents and we're investing in new businesses that will accelerate our value we create for customers and our investors.

We're committed to delivering a richer experience for our Ford and Lincoln customers, one that improves over time with things like our over-the-air software upgrades, data-driven experiences, productivity and uptime services for our critical commercial customers, charging software and a lot more.

Ford+ also means introducing the industry's most compelling high-volume electric vehicle lineup and investing the capital and human resources required to design and build world-class batteries and electric powertrain components.

And with Argo AI, we're well positioned to launch an autonomous people and goods delivery business with significant future growth potential. But fundamental to transforming Ford is to further strengthen our auto operations while we're also expanding our addressable market.

Our commitment is to earn your confidence with strong execution quarter after quarter, year after year, delivering solid returns regardless of the challenges that we face with external environment, like we did in the second quarter.

Despite the many headwinds from the semiconductor shortage, some of which were unique to Ford, our team skillfully managed our business and we generated a positive EBIT. And I can tell you that this outcome was far from certain at the beginning of the quarter. It required intense focus from our team on cost, pricing and mix.

The primary advantage we have right now is the strength of our product portfolio, and it's about to get a lot stronger. We stopped making me-too products in declining segments a few years ago, and we unleashed our product development team to create emotional and distinctive products that only can come from Ford.

The Mustang Mach-E, which is already the second best-selling electric SUV in the United States, was recently named Car and Driver Electric Vehicle of the Year after rigorous testing against 10 other great EVs, including the Tesla Model Y performance, the Porsche Taycan and the Audi e-tron.

The demand for our first round of high-volume EVs clearly has exceeded our most optimistic projections. The reservations for the F-150 Lightning have now climbed well past 120,000 units, and 75% of those customers are new to Ford. We are now working around the clock to break constraints and increasing our manufacturing capacity for these red-hot new battery electric vehicles.

We're working with LG Chem, SK Innovation to increase our annual battery capacity for the Mustang Mach-E by 70%, and we're taking similar actions ahead of the launches of the E-Transit later this year and the F-150 Lightning early next year.

The customer and critical reception to our new Bronco lineup has also been remarkable. In June, we started shipments to fulfill 125,000 orders we have for Bronco 2- and 4-door models, and 70% of those Bronco customers are also new to Ford.

And then there's the Maverick, our upcoming hybrid pickup that offers room for 5, gets 40 miles per gallon in the city and is priced starting at less than $20,000. And customers already recognize the value of this product, and the initial interest to our dealers is more than almost 80,000 orders.

Great products alone are not sufficient, though, to deliver Ford+. Always on means we are regularly interacting with our customers on things large and small, and we're building new capabilities like connected services to enrich the customer experience and drive reoccurring revenue streams.

We developed a proprietary software and hardware stack we call Blue Oval Intelligence to deliver updates to customers' vehicles over the air. Some of our competitors can do it for their entertainment systems, we do it for almost all of our modules in the vehicle.

For example, the Mustang Mach-E activation rates, the number of customers who opt in to connected services like FordPass are now over 95%. We have now updated more than 150,000 vehicles over the year just this year, and we expect this to top 600,000 vehicles by year-end. And by 2028, we will have 33 million OTA capability vehicles on the road around the world.

And we're mining the real-world data from these vehicles real time to better meet our customer needs. To me, this is the most important point. For example, driven by the vehicle data from the Mustang Mach-E and the F-150 already, we've identified $50 million in efficiencies just from warranty cost avoidance and other opportunities.

We're also building out our global Ford Pro commercial business, which we expect to grow from $45 billion in 2025 from $27 billion in 2019. Last month, we announced our acquisition of Electriphi to help accelerate electric vehicle fleet adoption by offering those customers the best scaled depot charging experience for all commercial customers. It's an example of how we're building out Ford Pro now.

In mobility, we are now focused on planning and executing a phased deployment of AVs that will lead to large-scale commercialization of Ford's AVs. Last week, as you've seen, we reached the industry-first collaboration between Argo and Lyft to deploy Ford driverless vehicles on the Lyft TNC network.

This collaboration will enable commercial deployment at scale and demonstrate Ford and Argo's ability to connect into multiple TNCs or transportation networks.

And on the technology front, Argo, I'm really excited about this, introduced Argo LiDAR, which will help us expand our autonomous services beyond the dense urban areas that most are focused on.

This new LIDAR, designed to be cost effective and manufacturing at scale, will offer what we believe is the industry's longest distance-sensing range of 400 meters with dark object detection or safe highway driving.

Now before John reports on the quarter and our expectations for the rest of the year, let me give you an update on the semiconductor situation. In April, we said we'd expect to lose about 50% of our planned volume in the second quarter, which then implied a loss in adjusted EBIT.

In fact, we did better than expected. We leveraged the strong demand to optimize our revenue and profits. We are seeing signs of improvement in the flow of chips now in the third quarter, but the situation remains fluid, especially due to the delay in ramp-up of one of our key suppliers, Renesas, that Ford is uniquely exposed to in the first half.

Overall, after effectively managing through the first half, we are now spring-loaded for growth in the second half and beyond because of those red-hot products, pent-up demand and improving chip supply.

Navigating these chip constraints has led us to make important permanent changes in our business model at Ford. We are modernizing our go-to-market strategy.

What does that mean? We're placing a greater emphasis on build-to-order sales bank, not just low stocks. We have learned that, yes, operating with fewer vehicles on lots is not only possible but it's better for customers, dealers and Ford.

But we're also driving a significant increase in the number of customers configuring and ordering their vehicles online, so we have better visibility to real demand using an order bank. This allows us to lower inventories, simplify our incentives and reduce our order complexity and the industrial systems cost.

For our customers, upside is that they more quickly get the precise vehicle they want. Now this isn't theoretical. I hope we get into the Q&A. We're doing it right now as we speak.

Relative to the supply chain, we made 3 notable changes. First, we are no longer relying on -- heavily on a tiered procurement structure for transparency. We are now engaging directly, for example, with the fabs on semiconductors and key points in the supply chain for our critical components, electronic components.

With closer relationships and more transparent exchange of information such as technology road maps, we can integrate their know-how into our designs to better align supply and demand.

Second, we are providing longer-term forecast to critical vendors so they can better understand and accommodate our requirements. And third, we are more comprehensively scanning for obstacles in our supply chain. Risk mitigation actions include stockpiling of critical parts like semis, dual sourcing and design interchangeability in the case of single sources.

These changes are all being applied to new technologies as well, including batteries, which are rapidly becoming a larger portion of our bill of material at Ford.

Our pending joint venture with SK Innovation called Blue Oval SK will produce EV battery cells and arrays, helping us secure supplies of batteries at competitive cost and performance levels really critical, given our demand for our new electric vehicles. And now I'd like to turn it over to John to take us through the results for the quarter and our outlook.

John Lawler: Thank you, Jim. So first, I want to reiterate that everything we do and every decision we are making, including capital allocation, is squarely focused on delivering our Ford+ plan. And you'll see that as I share our key takeaways from the quarter, our full year outlook and describe how we are positioned for even stronger performance heading into 2022.

As Jim said, we delivered better-than-expected results, given the semiconductor constraints. Year-over-year, our automotive business improved across several key financial metrics as we overlapped the industry-wide COVID-related manufacturing shutdowns we saw in the second quarter of last year.

Now for a more accurate picture of our true trajectory in this present environment, we're focusing more on sequential comparisons and we think those are more appropriate.

While wholesales were down 28% sequentially, our teams optimized for revenue and profit with disciplined incentive spending and mix management. We allocated chips to customer orders, new launches and our more profitable vehicles.

In addition, the strength of our sales order bank gives us confidence and our ability to drive a more balanced performance of wholesales, revenue and profit in the second half of this year, including sequential improvement in wholesale and share.

So let's turn to our results. On a consolidated basis, wholesales and revenue were up 18% and 38% year-over-year, respectively, and we delivered adjusted EBIT of $1.1 billion with adjusted margin of 4%. Outside of North America, our underlying trajectory continues to improve despite the impact of the semiconductors, and that's driven by more focused product portfolios, geographic footprint as well as lower costs.

And Ford Credit continued to deliver strong performance with record quarterly EBT of $1.6 billion, and that's demonstrating why it's a strategic asset and critical to enabling Ford+.

And a prime example is through the launch of a new service like Ford Pro FinSimple, which provides bundled financing for commercial vehicles, services and EV charging. And so it's another example of Ford Credit being a strategic weapon for us.

Now turning to the regions. North America posted a 40% sequential decline in wholesales due to the semiconductor shortage. Now as we manage the chip constraints, we've focused our efforts on customer or customers ordering vehicles for future delivery. We exited the second quarter with our U.S. customer sold order bank up more than 7x compared to a year ago.

And with new models to come, we are clearly poised for a rebound in North America when the semiconductor supply stabilizes and aligns with demand. On a year-over-year basis, EBIT was up $1.1 billion.

Outside of North America, the turnaround of our operations remains on track. In aggregate, EBIT improved $800 million year-over-year but declined sequentially, mainly driven by Europe where the semiconductor shortage caused wholesale units to drop sequentially by nearly 35%.

The transformation in Europe continues as the region capitalizes on strength in commercial vehicles with Ford Pro and a more focused passenger portfolio, including key imports. Europe has stepped up investments in electrification, including [1 billion] for a new EV manufacturing center in Cologne, the launch of our E-Transit next spring and a new all-electric light commercial vehicle from Romania.

In South America, our restructuring is on track. Our lean, derisked and asset-light business model is focused on our strengths with Ranger, Transit and key imported vehicles. The region introduced Bronco Sport and Mustang Mach 1 in selected markets and is preparing now for the launch of the new Transit van in the second half of this year.

In China, we continued to see improvement in key areas of focus, including Lincoln, commercial vehicles, electric vehicles and with our portfolio of near-premium Ford vehicles. Lincoln attained its highest-ever quarterly sales was profitable and also captured the #1 spot in J.D. Power's luxury sales satisfaction ranking, unseating Audi, which had held the position for 11 years.

In addition, 97% of Lincoln's volume is now produced locally, and commercial vehicles now account for 52% of our overall sales mix in China. And finally, we are readying for the launch of the localized Mustang Mach-E later this year.

Our international markets group, we delivered another solid quarter, leveraging its portfolio strengths with Ranger pickups and Everest SUV. And we're continuing to assess our business in India and we'll have more to say on this later this year.

Company-wide, second quarter adjusted free cash flow was negative $5.1 billion. As expected, semiconductor-related volume losses had a greater impact on the free cash flow than EBIT because of adverse working capital and timing differences related to customer allowances for marketing incentives.

Ford Credit did provide a partial offset with distributions of $4 billion in the quarter. Now we expect working capital and these timing differences to normalize over time as the semiconductor supply is restored.

Cash and liquidity remained very strong, ending the quarter at $25.1 billion and $41 billion, respectively. The strength of our balance sheet provides significant financial flexibility to navigate periods of stress while also continuing to invest in growth in our Ford+ plan.

So now let's turn to the outlook. Based on the underlying strength of our business and present assessment of the semiconductor supplies through the second half, along with other factors, we have increased our outlook for full year adjusted EBIT to between $9 billion to $10 billion.

Now this assumes about a 30% sequential increase in volume in our second half versus our first half, which is supported by the anticipated improvement in the supply of semiconductors.

Our guidance implies we are -- we expect second half adjusted EBIT to be lower than the first half of the year. And so we provided a bridge to help with this, and we've included that on Page 19 of our earnings presentation. So let me provide a little bit of color around this. Relative to tailwinds, we expect about $3 billion to $4 billion in favorable market factors, net of an increase in volume-related production costs for the higher volumes.

Headwinds, right? We see headwinds coming through, and we see pressure on contribution margin. We expect commodities to be up almost $2 billion half-over-half. Warranty costs are expected to be higher in the second half, up about $500 million, though we still expect full year warranty expense to be down year-over-year.

Relative to structural costs, about $1.5 billion in investments in modernization, consistent with what we laid out in May, including customer experiences, connectivity, IT, new product launches.

Looking at Ford Credit. Based on current market dynamics, we expect Ford Credit to decline by about $1 billion as auction values begin to normalize, and we also have a non-repeat of reserve releases that we had in the first half. And lastly, we also have the nonrecurrence of the $900 million noncash gain on Rivian we booked in the first quarter. And it's important to note that this gain also impacts our run rate heading into 2022.

We are also increasing our full year adjusted free cash flow target to $4 billion to $5 billion, supported by expected favorable working capital in the second half as production increases from an anticipated improvement in chip availability.

Now as our operating results improve, so does our cash conversion, which we continue to target in the range of 50% to 60%. And the strength in cash conversion and our balance sheet provides us ample financial flexibility to invest in growth, including in EVs, Ford Pro, our connected services and mobility.

Now looking towards 2022, we are confident in the underlying trajectory of our business and excited to see the momentum continue as we leverage one of the strongest product lineups in our history and continue to implement our Ford+ plan. We're on a new path at Ford. We've got a plan, the resources and the resolve to build a better business. So now I'll hand it over to the operator to open it up for questions.

Operator: (Operator Instructions). Our first question comes from the line of Brian Johnson, Barclays.

Brian Johnson: I've got a couple of questions. First, a little bit of housekeeping, but just thinking ahead to '22. If we take the second half at a good rate of $3.5 billion, but also bear in mind that your first half is typically the stronger half of the year for Ford, is there any readthrough for 2022?

John Lawler: Brian, thanks. Yes, I think the way we see it is that we've got strength in the underlying performance of our business. As we head into 2022, we also know that the product lineup is going to get stronger, right? We're just launching Bronco now. We've got F-150 Lightning next year.

We have Maverick next year. And we also expect that we should get to more of a full line rate on our manufacturing of all our other vehicles and new vehicles that we've had this year. So we do see strength in the product line up heading into next year.

But what we also see heading into next year, a few headwinds. Ford Credit, we expect that to be more normalized to our run rate that we normally see. And that's because we see auction values coming down, and then we should see our credit reserves and our credit losses normalize as well.

We also see that next year, as volumes increase and stocks increase across the industry, we should see some pricing moderation. Again, we also see commodities being higher next year as well. And we're going to continue to invest in our new product portfolios. We've got the launches coming in next year.

We've got our Ford+ plan so we see that continuing as we head into next year as well. So there are some headwinds but the underlying strength of the business continues to be positive. And with that, we see that trajectory continuing into '22 and then on our way to the 8% EBIT margin for '23.

Brian Johnson: Okay. And just a follow-up. The $1.5 billion 2H headwind from investments in modernization, is that something new that was planned for this year but maybe back-end loaded due to management focusing on the chip shortage? Or kind of how do you think about that?

John Lawler: No, that was planned. That's coming in. Part of that is due to the launches of the vehicles and with that launch cost comes advertising. But we're also investing in connectivity, the IT we need to put in place for the connectivity as well as customer experiences, digital experiences, user experiences with the vehicle. So we're continuing to invest to build out our Ford+ plan.

James Farley: And we are not slowing down on modernization because of the chip situation. In fact, we're doing the opposite.

Brian Johnson: Okay. And a question for Jim. As you look at the order book for the F-150 Lightning and what's shaping up for the Bronco and the Maverick, any sense of how many of those customers are, as you mentioned, the [F-150] new to Ford but also maybe new to that segment, so for example, SUV buyers migrating to the Lightning due to the storage or the bi-directional charging and other features?

James Farley: Great question. put simply, what we've learned about our very large order bank for Lightning is way over-indexed on the coast. Almost [80%] are new to Ford. What's interesting, 2 out of 5 are people who are going to trade in pick-up, which is very important because it indicates a move a little bit faster to full-size truck BEV than maybe our optimistic assumptions.

And so I would say what we've learned so far is that the customers are largely new to Ford but they aren't new to this segment. These are customers who really like these silhouetted vehicles.

What is really interesting for me is someone portray the full-size truck industry is kind of a conservative customer, that's not what we're seeing. These very large order bank for F-150 Lightning, they're new to BEV and they are excited to move to BEV. And they are -- more than half of them are pickup truck customers.

Operator: (Operator Instructions). Our next question comes from the line of Rod Lache with Wolfe Research.

Rod Lache: I just first wanted to clarify the answer that you gave to Brian's question. So you're going to be annualizing at $6 billion to $8 billion in the back half. And I think what a lot of people want to understand, is that kind of a fair bridging off point for us to think about what happens from here into 2022 and beyond?

So did you assume some moderation of pricing already in that number? Is that level of investment kind of the run rate? And how should we think about the incremental benefit from that run rate for Bronco, Maverick, the further warranty improvement and some of the international improvements that you're working on?

John Lawler: Rod, thanks. So in the second half, we show the net number there for the volume, net of the manufacturing production costs and other market factors.

So what we are assuming is that in the second half of the year, particularly in the fourth quarter, we start to see some moderation in pricing due to the fact that we should see volumes and inventories and stocks coming up a bit. So that is something that we do have built into that number for the second half, particularly in the fourth quarter.

And then when it comes to 2022, Bronco is just getting up now, up and running now, launch now. As Jim said, we have a hefty order bank there. And then F-150 Lightning, Maverick, they're launching next year. So our product portfolio is strong today, is going to be even stronger next year.

And so we see that contributing to the run rate as well. So I think coming out of Capital Markets Day, we talked about the trajectory of the business, 2022 being definitely stronger than '21 as we walk towards 2023 and the 8% EBIT margin that we plan to hit.

Rod Lache: And just secondly, really interesting comment about that sevenfold increase in your order bank and changing the way that vehicles are sold. Can you just talk a little bit about what that actually means from a volume perspective because I don't think we've ever really known what your actual customer order bank actually, but what's the magnitude of that?

Maybe you could just tell us what that number was a year ago? And any thoughts on what this actually means for pricing? Obviously, it's positive, but those units are not going to land on dealer lots for very long. So it would seem that there's really not a big reason to significantly boost incentives anytime soon if they're leaving lots very quickly.

James Farley: Thank you, Rod. Put simply, we're really committed to both going to an order-based system and keeping our inventories between 50 and 60 days supply. I've been here at Ford for 13 years.

There were many years after the financial crisis where our days supply was 20, 30, 40 days. And in those years, the maximum retail order bank we had in the U.S. was 1,000 to 2,000 a month. We are now at 70,000 units on our way to 80,000 units. That gives you the order of magnitude difference in the way we're looking at this order bank change for the company.

A lot of people in our industry are making a big deal about the move online, sure. But for Ford, we think there's massive benefit across all stakeholders for going to an order bank system. You put pressure on our industrial system to deliver quickly. It reduces our dealers' costs more than just low days supply as you mentioned. It allows us to significantly reduce our incentives.

And I guarantee you -- I don't know how much money we're wasting. I know we're wasting money on incentives. I just don't know where. With an order-based system, we will have much less risk of that.

It requires us to dramatically reduce our order complexity as well. So there are a lot of enablers that have been put in place to move us to this new system and new go-to-market approach. I'd love to talk to you more about it but I've tried to give you the high hard ones.

Operator: Our next question comes from John Murphy, Bank of America.

John Murphy: I just wanted to actually follow up quickly on that. Jim, you mentioned getting back to 50 to 60 days supply. That sounds closer to normal than not, but you're also, the way you're describing the order bank, it sounds like 20% to 25% of your sales would be built to order, horseshoes and hand grenades.

So I'm just curious how you decide where that balance lands, how you keep the inventory tight, your partners' dealership happy and selling and creating value for you.

But then also a big part of the story is the tightness in the secondary market, in the used market, keeping high, which is helping the new vehicle price and it's certainly helping out at Ford Motor Credit. So I mean, there's kind of a seesaw effect to get the benefit on both sides. I just -- how do you figure out where this should land and how you actually execute on it?

James Farley: Yes, really good question. So the team has done a lot of work on this. I'll try to answer it very simply. Our target is 50 to 60 days supply. That means trucks will be a little bit higher. We have a lot -- about 1/3 of our truck dealers in County. Five trucks to them could be 100 days supply but they need 5 trucks for the local community. And for urban and suburban dealers, it will be less than that range.

Different segments will have different targets. We actually did this post financial crisis for a few years and then over time, lost discipline. And this is quite important for this management team. We have a weekly and a monthly operations review, where we'll look at this very carefully by segment for each of the regions. That's the kind of soft wiring or management judgment.

Going to an order bank, I would say, is a hardwired way of reducing the stock. And I think it's going to take both for Ford to make this transition. It can't be just relying on management keeping within that range. We certainly will have exception -- an exception process to go beyond that, and there will be a pretty tough discussion with our operating teams.

But I think what I'm more excited about is the hardwiring of going to an order to delivery order system, which actually our new launches gave us that gift because for Bronco and Mach-E and some of the other high-demand vehicles, we moved the reservation system into an order bank system.

We then realized, "My God, why don't we do this for all the vehicles, not just those vehicles?" And that's when we had to put a series of incentives and more policy changes, like order complexity reduction in the system to make it kind of the way we do things at Ford. I think it's going to require both changes.

John Murphy: Okay, that's helpful. And just a follow-up on that. On current state of affairs of retail versus fleet mix, I mean, it seems like talk to the dealers is an emphasis on retail, the dealers certainly at your level. Just curious if fleet comes back, I mean, the demand is there, right? How are you balancing that...

James Farley: Sure, it is.

John Murphy: Current days and go forward? I mean, because the demand is there. It's just some of it's getting fulfilled in the used market, right? I mean, they're going after auctions instead of even ordering from you guys. So I mean, how do we think about that recovery go forward and where does it stand right now?

James Farley: Really good questions, so it depends on the region. Of course, we're a dominant commercial brand in multiple regions like Western Europe and the U.S., even in China in certain segments.

And we're seeing in Europe a very dramatic order bank on our vans. It is something I've never seen in my career. We're talking months and months and months of back orders. So the demand for our commercial vehicles in Europe is extremely strong and the order bank is months and months.

In the U.S., we're very fortunate that our commercial business is heavily focused on Transit and Super Duty. And of course, F-150 is kind of mixed. And so for those vehicle lines, Transit and Super Duty is very easy to -- we don't have to prioritize between retail and commercial because those vehicle lines are almost 100% commercial. The 1 that's challenging for us to balance is F-150.

And we -- as you could see in this quarter, we're very carefully mixed managing. But we are very respectful of the needs of our commercial customers. We know where our toast is buttered.

And those customers are really important for us. In fact, we are in discussions with them right now about the trade-off between feature content and availability. We have many commercial customers in the U.S. that have been waiting for months and months for the vehicle.

And we are discussing with them, would you be willing to take off feature content to get your vehicles now? And that's -- and you can expect us to be balanced about that discussion and negotiation and compromise. And it's -- we'll make the right call for the company and for the customer, but they are pushing us for availability now, even if it means lower feature content.

Operator: Our next question comes from the line of Adam Jonas, Morgan Stanley.

Adam Jonas: Great call so far. And Jim, I have to say I did a Control F for the word hybrid in the deck and in the press release and I don't see it, man, no hybrid. It's a beautiful thing. So good.

James Farley: (Inaudible).

Adam Jonas: Yes, but they're dead. They're gone. All right. My question on EVs, right, your BEVs, when do you think that they can be a positive profit on a fully costed basis, not contribution? Like when can they be profitable? And do you think it's 2022 is still too early for that? My first, and I have a follow-up.

John Lawler: Yes. Thanks, Adam. Actually, Mach-E is profitable, contribution margin positive and profitable on the bottom line today. So we've seen strong demand for that, yes. So I think when we look at it, over time, as we've talked about at Capital Markets Day and we've talked about with you, we've got to ride that technology curve down.

We've got to get to the $80 per kilowatt-hour for the battery pack before the end of the decade. We've got to scale the BEV content. We have commonality in the top hats and other components that will help us as well. And then, of course, we need to build on our services and such to really improve the profitability of the BEVs as we move forward. But I can tell you that Mach-E is profitable today.

Adam Jonas: Well, that's incredible at a $50,000 type run rate for that to be correct. Okay. My follow-on question, Jim, is about always-on in the order bank. I mean, I think this is really huge. Just really interesting, when you combine the order bank system with always-on, where you go kind of can engage the consumer directly for services and F&I and insurance in the OTA.

But I am talking to some dealers that are freaking out, that some Darwinian forces could be at work where you're not, let's say, directly infringing on the franchise laws but you're dancing close as you probably should, given all the technological changes over the past 70 or 80 years since these laws came.

So what's your message to them? What if order book goes to 80% of your units or the majority and then the dealers are just the delivery centers, and then you're going direct on all the other wonderful services? What's the message to the dealers?

James Farley: Great question. Well, we're going to have a couple of different population of dealers. We're going to have our professional dealers, and the answer is a little different for them versus our retail dealers.

We'll have our rural dealers and the answer is a little bit different for them than the suburban urban dealers. The -- I would say the message we're giving to our team, our dealers is, look, we're going to have to work really carefully together so -- because the customers are going to have a lot of questions on Ford BlueCruise, for example.

So we want to make sure the dealers are very knowledgeable about these new OTA features that are really meaningful in the use of the customer's life. That's one.

The second 1 is service, service, service, service. That is the most important thing for us is wiring a closed loop between the vehicle, the condition of the vehicle, the service capacity of the dealers and the customer is going to be the most important valet we're going to have to play together with the dealers.

This is especially true for Ford Pro. And in fact, today, we already have 160 remote trucks doing service for our commercial customers at their business, warranty work. That's a good example of the evolution of the business model where they're taking their service department from a fixed hub and going on the road with their service capacity.

And those trucks have to be cooked into the vehicle data and the prognostics, our parts legacy system to order parts and the dealers on a dispatch system. That has to be a closed loop.

So all I would say to you is the orchestration and our benefit, our chance to win just like maybe targets a chance to win versus the online retailers is that in-person service, especially in professional customers.

Operator: Our next question will come from the line of Colin Langan with Wells Fargo.

Colin Langan: Congrats on a good quarter. Inventory levels, we've never seen them at these levels, obviously, before, and obviously, it's impacting your market share. Any sense of how much of that you think you could recoup and how much may -- are you concerned may switch to other brands if people might only wait for so long?

John Lawler: Colin, it's John. So I think what we're seeing here from a market share drop, it's completely related to the fact that our stocks reduced so much. We have the chip issue. We lost the volumes that we lost in the second quarter.

We expect that as we work to improve the run rate and through the third quarter, we're very focused on maintaining this high turn rate, filling the orders that we have. As Jim said, we're going to continue to work on retail orders and continue to bring our customers along that way as well.

So we think that we have a good chance to regain that share, especially with the strong lineup that we have. And so we see this as a temporary issue related to the chip issue and the volume and production we had in the quarter.

James Farley: And we will not cede truck leadership to anyone.

Colin Langan: Okay. Maybe we touch on connected services. You rolled out FORDLiive in Europe on commercial vehicles. I believe it's free right now. I mean, how is that rollout going? And when do you sort of try to monetize that and get revenue out of these services?

James Farley: Great question. So we do -- we just launched FORDLiive, as you mentioned, in the U.K. and Spain. We have 5 more EU countries covered by the end of the year to launch. So we're really excited about FORDLiive. What we've committed to so far is in the next couple of years, by 2025, we expect our digital and charging revenue in Ford Pro to be about $1 billion.

Today, I wish we had more time to focus on this, frankly. We have about just under 200,000 unique subscriptions for our telematics and data services. We grew at about 20,000 units in the core, 20,000 subscriptions in the quarter.

And we feel like that digital telematics and selling data like fuel tank information, plus adding the charging services like Electriphi for depot charging for our customers, are high-growth area with the revenue to that level in the next couple of years.

The monetization of FORDLiive is really around our traditional parts business, which is very high margins and we have a very low share. So the opportunity for us upside is tremendous.

Post warranty, even in our commercial customers, we get very few of those customers. And so the real payoff for this closed loop is going to be much higher share post warranty of that very profitable business.

Operator: Our next question will come from the line of Ryan Brinkman with JPMorgan.

Ryan Brinkman: One thing that especially stood out in your results, I think, is on Slide 6 where it shows that units wholesaled in the quarter rose 18% year-over-year, but that revenue was up by more than twice as much by 38%. So just a few questions around pricing and overall revenue per unit.

I can see from the global walk on Slide 9 that net pricing helped EBIT by $1.9 billion or kind of like 10% of last year's revenue, which seems to suggest of the idea that like half of the growth in revenue over unit volume in 2Q was driven by price and the other half by mix. Is that roughly correct? And what do you think the outlook is for continuing to grow revenue in excess of the change in volume?

John Lawler: Yes, thanks. I think pricing is the majority of what was behind that growth. We had a very strong quarter relative to pricing as we saw our inventory shrink and we see the strength in the underlying demand of the products that we have. And so I think I would think about it more as pricing, a little bit of mix in there but more of it is pricing.

Ryan Brinkman: Okay, very helpful. And then just as a follow-up, we saw some estimates that your incentive spending in June in the U.S., it may have fallen like 50% year-over-year, leading the decline in industry-wide incentives.

I'm curious how much of the decline in incentives do you think may be driven by hot new products like the F-150, Bronco, Bronco Sport, Mach-E, et cetera, versus how much is a function of the low inventory environment or maybe just a general inflationary environment?

And to that end, it might be helpful to know if carryover pricing, which I think usually declines year-over-year, if that might also be tracking stronger and what your outlook is for incentive spending going forward, maybe in light of some of the comments you made earlier on the call about inventories and order bank, et cetera.

John Lawler: Yes, that's a great question. I think we've been working and unpacking this, as you'd expect. Well, it's a combination of all of the above, right? We have strong products. We see continued demand for those strong products. Supply is well short of that. It's allowed us to continue to keep the pricing strong and improve the pricing in the second quarter versus what we had expected.

And I think as long as the -- you see this imbalance between supply and demand, you'll continue to have stronger pricing power as we've seen through the first quarter and the second quarter.

As we go through the year and we start to see supply and demand normalize, we'll see some of this pricing come off a little bit in the fourth quarter, and then we have to see how that runs through next year. But given the strength of our product lineup and the demand we see, we expect to have a relatively strong pricing power for the foreseeable future.

Operator: Our next question will come from the line of Joseph Spak with RBC Capital Markets.

Joseph Spak: I wanted to get back to the investments in modernization and maybe frame that in the context of a 2023 view you laid out at the Capital Markets Day. Like how does that investment trend through those years as you think about your -- the margin targets you laid out?

And is there an assumption that by the time you get to '23 or maybe a little bit later, there's a return on that investment such that it becomes a neutral or even positive to the margin?

John Lawler: Yes, thanks. Of course, as we make our capital allocations and we make these investments, we expect that we're going to get a return on them. And that's all part of our walk-up into 2023 and the 8% margin. We're also continuing to work on cost reductions elsewhere, right?

These are investments that we're making in our new products with the launches and connectivity and IT. We've got advertising in there for these launches and then, of course, customer experiences, as I talked about earlier.

But we're also driving cost reductions elsewhere as we continue to improve the business towards that 8% margin in 2023. So we'll invest in certain areas.

We'll see costs go up in certain areas but we should also see costs coming down in other areas, particularly material cost, et cetera.

James Farley: One particular area of modernization that doesn't -- I don't think get enough attention in where we're investing as a company, certainly, $30 billion in electrification and the vertical integration of batteries and, of course, our investment in autonomy. I think you all know about where we're spending our money in the general categories.

The one I really want to highlight is the very significant investment in our embedded electrical architecture upgrade. This is really a significant move by Ford to not just invest in electrification but move those products to fully digital, updatable in all modules and go to a fully modern electric architecture.

I'm not going to go through the details, but this is a very expensive transition but it will enable a whole new capability for the always-on experience than even today's connected vehicles like Mustang Mach-E. And I want to highlight that because it often gets lost in the other categories of investment and modernization.

Joseph Spak: Okay. So just to clarify, so the EV spend is included in that bucket that you mentioned?

James Farley: Yes, yes. So when we talk about upgrading our electric vehicles, it's much more fundamental than just the investment in the tooling and the engineering of the electric vehicle and its components and propulsion. It also includes a completely new approach to an embedded software and hardware system.

Joseph Spak: Okay. And just -- and going back to the order bank, which is clearly interesting, like that's -- it seems like an easier task, quite frankly, when you have great product like you do with the Bronco, the Mach-E and the Lightning, which are -- seem well received and also limited.

I guess what I'm wondering is, how are you going to sort of balance that with inventory as you sort of think about like an Edge or an Explorer in year 4 or 5 of its product life cycle?

Like is the plan to still keep inventories of the older product or a more mature product tight such that you can still get some into the order bank? Or are there other plans to keep that product fresh throughout the life cycle that can lead people to (inaudible)

James Farley: Sure. I mean, we'll have ground stock for sure in dealers, and we obviously have to keep the vehicle fresh. More and more of that will be the digital freshness of the vehicle.

But I would say, if you look at our 60-plus thousand unit order bank in North America, a lot of -- not all of those are Broncos and Mustang Mach-Es. There -- we're doing this for our whole brand.

Operator: Our next question will come from the line of Philippe Houchois with Jefferies.

Philippe Houchois: I've got two questions. The first one, sorry, to go back on this order bank and inventory levels. To be honest, I'm a bit surprised you're talking about 50 to 60 days of inventory in the future because that's done much lower than what we've had in the past.

And I would have thought the order bank would actually enable you to actually carry much less inventory and we've seen the benefit of that to pricing. So I wonder if the 50, 60 days kind of the first step that you think you can do better in the future.

And along those lines, and then maybe more on the Ford Credit side, but when I look at European car companies, they carry more finished products on their balance sheet, the core balance sheet and then relatively less on the finco balance sheet through the dealer receivables they use as a proxy.

Is the opposite in the U.S.? And I'm just wondering, if you look at a situation where you go to more order banking for your production, if you end up carrying more inventory on your industrial balance sheet, which would increase your working capital requirement from an industrial standpoint. That was my first question.

And the second one, if I can ask briefly on China. It seems like you're stalling a bit in China. And because you've localized a lot more of Lincoln, more profitable, you had big losses in consolidated side before.

And I'm just wondering, can you comment maybe on what is happening generally in China? Is there -- there seems to be a concern about how the Chinese brands are making good progress.

Some of the EVs launched by your competitors are not quite getting the love from customers that was expected. And I'm just wondering if you see a more difficult environment for -- in China for you in the balance of the year and to next year.

John Lawler: Yes, so I'll take the working capital. Now the way we see the order bank helping us is we actually see it simplifying the industrial system because we'll know exactly what we're going to build.

So we're actually working through that now and trying to use that to simplify and reduce things like working capital. So I think if anything, it would have the opposite impact. It would increase working capital, we'd use it to drive down working capital.

Then on the days supply, what we've seen in the past is around a 75-day supply, so 50 days, it's a 25-day reduction. So we do see that as substantial. And of course, that will be different across the different vehicle lines. So we do see that as a substantial pullback in the days supply.

James Farley: And just remember, in Europe, just running Ford of Europe, the cross-border issue in Europe is not so small. We have holding centers and lots of ways to manage the stock. We don't plan to implement that system in the U.S. It evolved over time and we have 1 country. So I think we can -- our intention is, as John said, is not to handle it that way.

In China, the team has made tremendous progress from a $1.5 billion loss, hovering around breakeven now or slightly below that. And we're in a very important time for Ford in China.

Lincoln is now profitable and we just localized those models. We only launched Lincoln in 2015. I was there. So it's a recent phenomena. And we're just about to launch a whole plethora of brand-new vehicles like we're doing in North America today.

So we're on the eve of the Mustang Mach-E launch localized. And then we have all these new vehicles. The EVOs, I can go on a long list, And it will be just like what we're seeing in North America, full freshness and that will play out over the next couple of years. So China is very important for our profit plans.

I think the team has done a tremendous job in stabilizing our sales situation and improving our cost. And now it's going to be a growth story in China. We're just commercializing and industrializing the vehicles as we speak. And Mustang Mach-E is kind of the first major 1.

Operator: And our final question for the day will come from the line of Dan Levy with Credit Suisse.

Dan Levy: First, I wanted to just ask on the chip shortage. And I fully recognize the situation is very fluid and your crystal ball is as good as anyone else's. But do you have a sense for how long it might take until you're no longer supply constrained on production?

Is this something that's fully resolved, by your best guess, by early next year? Or do you think that this -- there might be still some supply constraint lasting much longer and deeper into 2022? So just the baseline expectations around that.

John Lawler: Yes. So Dan, yes. I mean, I think my guess is as good as anybody's on this. We do see the chip issue running through this year, and we could see it bleeding into the first part of next year. But I think we won't really have a good feel for that until later in this year.

We know that as we've had discussions with the fab suppliers, they're telling us they're reallocating capital. They're increasing supply for automotive, et cetera. But I think this is one of those things where we need to see the relief coming through before we can really feel comfortable that we're out of the woods here.

Dan Levy: Great, understood. And second question is just on ICE versus BEV. And clearly, you're deemphasizing ICE, and presumably, that means the investment is coming down. I assume that's part of that $30 billion headline number you gave includes some reallocation from ICE to EV.

But I think we also know right now that, and maybe this is just a function of the market, but ICE sales are extremely strong in the U.S. It could remain the case for a while.

So what should we expect on margin for ICE vehicles, especially as some of that investment comes down? Is it possible that the outgoing margin on some of the ICE vehicles actually increases and you could potentially run into a negative mix issue as we -- as you start to pivot from ICE to the BEVs?

James Farley: Yes. It's a good question. Generally speaking, that certainly could happen. We don't know how the demand will shift. Obviously, our guess is 40% of our mix, 240-gigawatt capacity by 2030. So we're busy making all that happen, as you say. 40% is a lot higher than today. And I think we have -- well, I know we have the right strategy for the company.

But so much of this transition is going to depend on government support, infrastructure build-out. And we need to be patient and I think agility will become a very important skill for the company.

So far, the first inning would imply that Ford's #1 in sports cars in Mustang. We're #1 in vans with Transit. We're #1 in pickups with F-150. We're electrifying all 3 of those in the next 6 months. And so far, the demand is actually higher than we expected.

So I don't know what's going to happen. We don't know what's going to happen. The support in China but especially in Europe has accelerated the BEV adoption in those regions. But as you say, we get into the next phase of expansion with a lot more product offering and all that capital pointed at BEVs, it's hard to say.

And it's hard to handicap the government's policy at a government level over time. I think the most important thing isn't how much money we're spending because that's enough.

It is our agility and the kind of execution of our BEVs and our management of the profitability of those vehicles, and that's where we're putting our energy, the agility of our industrial system, our manufacturing, our focus on the profitability improvement and the vertical integration for key electric components and making our vehicles different and more competitive than others. I know it's a very general answer, but I don't think we know enough to answer your question.

Dan Levy: Understood. That's helpful, nevertheless.

Operator: Thank you. And with that, this concludes the Ford Motor Company's Second Quarter 2021 Earnings Conference Call. We'd like to thank you for your participation. You may now disconnect.

END