Ford Motor Company

Moderator: Ford Executives
October 27, 2021
5:00 p.m. ET

OPERATOR: This is Conference #7768099.

Operator: Good day, ladies and gentlemen. My name is Erica, and I will be your conference operator today. At this time, I would like to welcome you to the Ford Motor Company Third 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 Tyson: Thank you, Erica. Welcome to Ford Motor Company's third quarter 2021 earnings call. With me today are Jim Farley, 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 and other important content, at shareholder.ford.com, including some updated videos and proof points around our Ford+ plan for growth.

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 23.

Unless otherwise noted, all comparisons are year-over-year. Company EBIT, EPS and free cash flow are on an adjusted basis. Product mix is volume weighted. A quick update on our IR events for the balance of the year. We have 5.

On Monday, the 1st, November 1, Wolfe will host a fireside chat with John Lawler and Hau Thai-Tang, our Chief Product Platform and Operations Officer. On the 18th of November, Barclays will host a virtual fireside chat with Ted Cannis, our CEO of Ford Pro.

In December, on the 3rd, Goldman Sachs will host a virtual fireside chat with Lisa Drake, our Chief Operating Officer for North America. On the 3rd, Credit Suisse will host a fireside chat with Hau Thai-Tang. And finally, on the 9th, Deutsche Bank will host a virtual fireside chat with Alex Purdy, our Director of Business Operations, Enterprise Connectivity. Now I'll turn the call over to Jim Farley.

James Farley: Thank you, Lynn. Hello, everyone, and thanks for joining us today. Well, this month marks 1 year since we began executing our Ford+ plan. It creates growth, value, and it allows us to win in emerging area of electric and connected vehicles.

We built a strong team that combines top leaders from Ford, with world-class talent recruited from outside of our company, specific talent, specific people that are largely outside of our industry. This leadership team is committed to this plan, and we're accelerating our progress.

Now, Ford+ is not a tagline. It's not advertising. It's a larger, more ambitious way to think about our business and how we bring value to our customers. We're creating iconic and distinctive products that only Ford can do, increasingly always on relationships with our customers and ever-improving user experiences, all while creating value for our shareholders. We're fully vested in this future, and we're taking big swings.

Key to the plan is harnessing the power of connectivity. We're designing a new generation of fully networked vehicles, not delegated to our supply chain, but done inside the company to revolutionize the experience of owning and operating Ford vehicle. That's embedded technology to unleash unlimited innovation.

We're scaling the number of vehicles capable of over their updates. We'll be moving from 1 million vehicles today to 33 million by 2028. That's scale.

At the same time, we're moving aggressively to lead the electric vehicle revolution, substantially expanding our battery production as we speak today in the U.S. In fact, we already announced plans that will give us enough battery production to meet our mid-decade goal of 141 gigawatts, which is enough to build more than 1 million battery electric vehicles a year, and I think we'll need more.

Our $7 billion investment in BlueOval City in Tennessee and the BlueOval SK Battery Park in Kentucky sets a new standard for scale, sustainability, advanced manufacturing and training the next generation of technology leaders. At the same time, the $1 billion of investment in our electrified center in Cologne, Germany will allow us to go all electric soon. That center will be all electric by 2023.

We're making final preparations to launch the F-150 Lightning, the defining zero-emission version of America's best-selling vehicle for the past 40-plus years.

Our all-electric Mustang Mach-E is a hit with customers, not just in the U.S., but around the world, bringing a stunning number of new customers to the Ford brand. Over 90% of the Mach-E owners say they would recommend a Mach-E to other customers, critical as a new generation of battery electric customers make new brand choices.

Our challenge now is to break production constraints and increase availability to meet this incredible demand both in North America and in Europe and also in China, the biggest EV market in the world where we are just starting production of Mach-E. We believe the global demand just for Mustang Mach-E could approach about 200,000 vehicles a year.

We've created new organization, Ford Pro, to change and power the future work with compelling commercial vehicles, distribution and services, while growing revenues to Ford. In the few weeks, we will start production of the new E-Transit, an electric version of the world's best-selling commercial van.

And in the third quarter alone, FORDLiive, Europe's new connected uptime center, which I wish you could all see for our commercial customers, helps customers in the U.K. secure additional uptime, preventing about $8 million of lost revenue and associated costs for our valuable customers.

We're reinventing icons like Bronco and creating new ones like Maverick. In fact, the all-new Maverick, 42 miles per gallon, I might add, is the first standard hybrid pickup in the United States. It's also America's most fuel-efficient hybrid pickup. This is the strongest, most compelling lineup I've ever seen from any mass market brand in my career.

And we are creating a spring-loaded future as we emerge from the chip shortages and COVID constraints, and we continue to make important strides in the technology and go-to-market strategy for autonomous vehicles.

In the second quarter, we told you about a new partnership with Argo AI and Lyft. And in the third quarter, we announced a new partnership with Argo AI and Walmart.

This is Walmart's first-ever multicity autonomous delivery service, and it will be anchored in cities where we already have operations, not the easiest miles in one city, but multiple cities and hard miles. In addition to making real progress on autonomy vehicles, operating domains, SDS, we fully support Argo AI's aspiration to access public capital.

To build this future and generate the margins and cash flow we need to fund Ford+, we had to turn around our automotive operations and improve our competitiveness. Our results in the third quarter show we are making significant progress. In fact, company-wide, we achieved an 8.4% EBIT margin, including 10.1% in North America. Those margins, I'll remind you, are in line with our targets for 2023.

More importantly, our operations outside of North America are likely to post their best performance in 4 years. Please note the performance in South

America, largely driven by our success of our global redesign. We've been able to achieve this while thoughtfully managing our supply chain for short-term sustainable improvements, including semiconductors, and prioritizing high demand and high-profit vehicles.

Now before I turn it over to John, a few thoughts. I believe we have the right plan to drive growth and unlock unprecedented value. You are already seeing a favorable change in the slope of our earnings and cash flow. There is more to come.

Given the strength of our business this year, we are increasing our full year adjusted EBIT guidance to between $10.5 billion and $11.5 billion. As we plan in earnest for next year, we're excited and energized about the opportunity in front of us and clear that we have so much more work to do to deliver on Ford's potential.

The word I would leave you with is focus. The competitive environment has never been more interesting and tough, and we intend to live up to our promise to compete like a challenger, focusing on our top priorities to unlock Ford+ growth with customers at the very center of everything we do.

Now I'll turn it over to John, who will take you through our results for the quarter, our outlook for the full year, our capital allocation priorities and our expectations heading into next year. John?

John Lawler: Thank you, Jim. Now in the face of continued industry-wide semiconductor constraints, we stayed focused on our plan, strengthening our portfolio and investing in opportunities fundamental to growth and value creation. We delivered a solid quarter with $3 billion in adjusted company EBIT and a margin of 8.4%.

Free cash flow of $7.7 billion was, as we expected, up sharply on a sequential basis driven by the positive working capital effects from higher wholesale and EBIT. We ended the quarter with strong cash and liquidity at over $31 billion and $47 billion, respectively.

Now across our Automotive business, our playbook remained consistent as we optimize production for customer orders, new launches and our most profitable vehicles. And as expected, on a sequential basis, our wholesales improved dramatically as chip supply for Ford improved. We also remain disciplined with incentive spending and mix management, which, on a year-over-year basis, more than offset chip-related declines in volume.

Ford Credit delivered another solid quarter with $1.1 billion in EBT as auction values continue to remain strong and credit losses continue at near-record lows. For the fourth quarter, we're assuming a sequential increase in wholesale.

We also expect continued healthy mix and net pricing and solid results from Ford Credit, although not as strong as the third quarter. Headwinds include inflationary impacts on commodities and freight, and we also expect planned sequential increases in our Ford+ modernization investments, including customer experience and IT.

So let me share with you some highlights from the quarter before I turn to guidance, capital allocation and our preliminary view of 2022. With improved chip supply, North America wholesales increased sequentially by 67% as the team prioritized launches, customer orders and high-margin units while reducing the number of vehicles built but waiting for chips.

Demand remains strong for our exciting vehicles. The order bank we are building paid off in the third quarter, representing 28% of our retail sales in the third quarter and reaching a high of 31% in September.

And our overall customer orders increased over 50% from the second quarter to more than 100,000 orders, excluding Bronco. With a 10.1% EBIT margin in the quarter, North America is now at a 9% margin year-to-date, just 100 basis points shy of our 2023 target of 10%.

South America marked its eighth consecutive quarter of year-over-year improvement in EBIT, and the business run rate is now approaching breakeven. The region also launched its new commercial vehicle organization with the introduction of the new Transit, which is manufactured in Uruguay.

This Transit is the first light commercial van to market in Brazil that includes connectivity as a standard feature.

In Europe, the underlying trajectory of our business continues to strengthen, though the adverse impact from chips has masked this improvement. In the third quarter, the business lost about 50,000 units, which would have had a substantial favorable impact on EBIT. Our leadership as the #1 commercial vehicle brand continued in the quarter, along with an extremely robust order bank.

In China, Lincoln continues to perform well, extending its success in the most profitable segment luxury. With retail sales up 24% year-over-year, in fact, Lincoln has doubled its share of the China luxury market over the past 18 months. Our newly created BEV organization to open its first 13 direct-to-consumer Ford Select city stores, with a total of 25 expected to open by year-end.

In IMG, our leadership team in India made the difficult decision to end manufacturing following accumulated operating losses of more than $2 billion over the past 10 years. Going forward, we will focus on importing iconic vehicles, including EVs. And overall, IMG had a solid quarter, capitalizing on our strengths, including Ranger.

Now as Jim highlighted, the underlying strength of our business supports increasing our adjusted EBIT guidance for 2021 to between $10.5 billion and $11.5 billion, and that's despite a lower-than-anticipated improvement in chip availability in the second half of the year. Consistent with our adjusted EBIT guidance through this year, our updated guidance for 2021 includes the $900 million noncash gain on our investment in Rivian in our first quarter adjusted results.

So let me spend a minute on Rivian. Now in the event that Rivian completes its IPO, we will record any gain on our investment in any subsequent adjustments as special items. Accordingly, we will recast the $900 million noncash gain from adjusted EBIT in the first quarter to a special item. If

Rivian completes their IPO in the fourth quarter, we will make this change when we report our fourth quarter earnings on February 3, 2022.

Our guidance for 2021 adjusted free cash flow is unchanged at $4 billion to $5 billion, reflecting the higher EBIT, but less favorable improvement in working capital and timing difference -- timing differences.

Now this is due to lower-than-anticipated volumes than previously assumed in the back half of the quarter, and that's as a result of chip constraints. We do expect free cash flow to increase with higher production and the associated improvement in supplier payables and other timing differences.

So now let me turn to capital allocation, which again is the foundation of our value creation framework. Our capital allocation discipline is driving a strong core business and balance sheet that provides the flexibility to invest in new growth opportunities as we deliver our Ford+ plan. Ultimately, it ensures we return value to our shareholders, both in the form of a higher share price and dividends.

Today, we announced the reinstatement of our dividend. Our Board has approved restarting a regular quarterly dividend of $0.10 per share in the fourth quarter of 2021. Importantly, the dividend reflects our confidence in the improving run rate of the business and our ability to fund all of our calls on capital, including the growing investment in electrification and the trajectory of our Ford+ plan. The dividend was also sized to ensure we maintain appropriate optionality to manage continued uncertainties in the external environment.

To give you a better sense of our calls on capital between 2020 and 2025, we expect total capital expenditures of about $40 billion to $45 billion or a run rate of roughly $7 billion per year. Now over the same time, we expect to invest over $30 billion in BEVs.

And of the investment in BEVs, about 50% is CapEx, 25% is expense and 25% is direct investments. And these numbers, they'll be dynamic, and we are confident we have ample financial flexibility to increase our investment, even if BEV adoption further accelerates.

Now let me share with you our early thinking about 2022, a year, which, like this one, is likely to experience some industry crosswinds that could drive a range of outcomes. Now we typically don't talk about the upcoming year this soon, and we're not yet prepared to give financial guidance, but we do want to share how we're thinking about next year, given the dynamic operating environment.

Ford's underlying strengths give me great confidence we can build on our results in 2021. First, our portfolio of products and services is exceptional, and we have a significant amount of new product coming to market spanning our iconic high-volume nameplates.

Second, our industrial base gives us significant optionality as the adoption of electric vehicles accelerates.

Third, driven by the chip shortage to roughly $4 million in wholesales we are likely to deliver this year fall significantly below our capacity. And based on our current assessment, we believe our wholesales could be up about 10% in 2022, but that number is very dynamic and changes almost weekly.

And fourth, the effects of our global redesign, which is largely completed, are now evident and substantial. We have drastically de-risked and rationalized our global footprint and product lineup, vastly improving our earnings and cash generation power in the process.

Now for headwinds next year, it's difficult to predict the interplay between semiconductor-related constraints, volume and pricing, and this will continue to remain dynamic. For 2021, we expect commodities to be up $3 billion to $3.5 billion, and they could be up another $1.5 billion in 2022, largely driven by steel and aluminum similar to this year. There will also likely be other inflationary costs, but it's too early to size that right now.

Ford Credit is likely to be lower as strong auction values will be moderated by a smaller inventory of vehicles and lower lease and return rates.

And lastly, we're obviously going to continue to invest in our Ford+ plan for growth and value creation, and this includes in customer-facing technology, connectivity, our always on relationships with customers and electrification. And of course, we believe the long-term payback from those investments will be substantial.

Now that wraps up our prepared remarks. And if you perceive that the upfront portion of these calls is becoming more efficient, well, you're right. And that's a function of us being very specific with you and our team about what's truly important and our confidence in executing effectively against those things and reporting, accordingly. We'll use the balance of the time to hear and address what's on your minds. Thank you.

+++q-and-a

Operator: (Operator Instructions) Your first question comes from the line of John Murphy with Bank of America.

John Murphy: It's going to be tough to limit to one question, but I will. As you think about the 10% increase you're talking about in 2022 wholesales, and if we could focus on North America and just assume you're going to do about 2 million units this year and '21, give or take, we're only talking about 200,000 units of increase next year.

There's an assumption that price and mix will deteriorate, and incremental units are produced as the semi shortage is relieved. But given that, that's still going to be a relatively low -- a very low level of production, do you believe that the price and mix are really going to actually come under pressure next year?

And aren't we really going to stay in a very tight environment that you're selling through and not even building inventory, if that's true, which means that price and mix might stay very strong next year, and they'll still get the benefit?

John Lawler: Thanks, John. John here. You're right, it's going to remain dynamic. And that's what the interplay is going to be. Volume increases for the industry if they're higher, we'll probably see more pressure on price. If they remain as they are today, we see a moderate increase.

I think you're going to continue to see strong pricing and mix continue through next year. So that's where we have to stay disciplined, and we have to stay very focused on managing that well so that we can have, as you said, the play through next year relative to what happens from an overall volume standpoint, and we're focused on that. So I agree with you. That's going to be one of the key dynamic elements for next year.

John Murphy: And just to follow up on that. I think right now, based on awards, you have about 213,000 units in dealer inventory. Pre-COVID, travel rate was about 650,000 units.

As you think about ultimately getting into a time where you can rebuild or restock that inventory, where do you think that runs? And how much opportunity is there to try to maintain some of this mix and price discipline to offset any cost inflation and then also invest in the future?

John Lawler: Yes. So if you look at where we ended in September, we ended at about 20 days supply in the U.S., and we're watching it very closely from a day supply standpoint. And as we talked about last quarter, our historical day supply was somewhere around 75 days. We're not going back there. And as Jim said, we're going to be very disciplined, and we expect to be in the 50-day supply when we're fully at full capacity, and we're running and producing everything that we can. So that's going to be the key.

The other thing I would say, John, is that the move, as we talked about in our remarks, to having more of our sales come through orders, online orders in the order bank, that's really important for us to manage our day supply so that it's less of a ground stock push through and its customer demand pull-through based on the orders. And we had over 100,000 orders at the end of the quarter, and that's grown since then in our order bank. And that played well for us in the third quarter.

James Farley: 139,454 orders...

John Lawler: As of...

James Farley: As of today.

John Murphy: To be exact. It sounds like you're on that. And maybe if I could sneak one in just on capital allocation real quick on the dividend. I mean why now? And I'll hop back in the queue.

John Lawler: Yes. It's the underlying strength of the business, John. And we're not capital constrained. We're able to fund our initiatives for growth. We know that there are going to be other opportunities that surface.

We're confident that we can fund those, and we're focused on total shareholder returns, not only stock appreciation, but also the dividend. And so given the strength of the business, the Board elected that we would restart the dividend this quarter.

Operator: Your next question comes from the line of Dan Levy with Credit Suisse.

Dan Levy: I'd first just like to ask a question on the shape of recovery in volumes. A, is this magnesium shortage going to cause any sort of near-term supply disruption for you?

I mean we heard some draconian comments that it could just outright stop European production, and just maybe you can give us a sense broadly of how you anticipate the shape of recovery in terms of volumes.

At what point do we get -- or is your baseline expectation that the chip shortage is fully mitigated, and you can be back at full run rate production?

John Lawler: Yes. So from the magnesium standpoint, when we look at that, we are seeing price pressure on aluminum broadly. We saw that all year, and we probably see a little bit more price pressure due to the magnesium issue. But our sheet metal suppliers, our sheet aluminum suppliers don't purchase magnesium from China for North American production. So we don't see that having any significant impact or any impact on us.

We do see the chip issue continuing to run through '22. As we said, it's very dynamic. Right now, you ask us what we think the sequential increase in supply will be year-over-year, we think we'll have about 10% more, but that's changing weekly. And we're doing everything we can to get our hands on as many chips as we can. But we do see that running through 2022. It could extend into 2023, although we do anticipate the scope and severity of that to reduce as we move through '22 into '23.

Dan Levy: Great. Second question, I'd like to zoom out, it's a bit more strategic. I think if we just look at the pace of progress at Ford, just both financially and in terms of EV, AV, halting digital, and just what we're seeing today is it's far greater than what you saw 12 or 18 months ago, which is actually pretty impressive given the large organization just takes time to really affect change.

So I just want to -- I'm trying to understand how much of what we're seeing today was something that was always there and just only starting to come to the surface now, you're sort of getting the fruits of prior initiatives? Or has something fundamentally changed in the past 12, 18 months?

What does this just tell us about the pace of change at Ford with the next comparison? Maybe just to be a bit more specific because I know you can take that in a number of ways. Maybe you can answer that specifically to what we're seeing on product and planning on the business transition to EV.

James Farley: Thank you for your question. A lot of the product we've been working on for several years. We made the tough choices. I would say the answer is, we have a plan. It's not an advertising or PR taglines.

It's our plan. Everyone in the company knows what we have to do. We are out of time and we have focus. We need to get an 8% margin like we did this quarter as a company regularly because we have to fund a high-growth BEV and digital business.

It's not to make more money. Yes, it is that, but it's motivated in the mission of transforming Ford through these digital products. So running the ICE business for cash, getting serious about our cost, our quality, our launches, our 8% return, it's all a mission, and the team knows the plan. And I think the culture is starting to change, to be quicker, more accountability, less bureaucracy. And that mission permeates through the company.

I'm probably the worst person to ask whether something has changed because it sure has changed for me and my leadership team. But to me, the proof is in the pudding, like our third quarter. And whether we've really changed as a company will be proven out in our numbers over time like they have the last year.

Dan Levy: And just to be more specific on the product front because I think we're seeing a much faster pace of product, is the time of development products like -- how much have you accelerated that? Meaning, typically, in the past, we hear of 3.5 to 4 years of drawing board to product in showroom. Is there a new normal for what that is?

James Farley: If we make up our mind and we come together as a team like we did on Maverick, it could be just 2 years. We did -- we knocked 20 months off the Maverick development, but it required the leadership team to not have the handwringing on the studio for 6 months like we normally did. I think that's a new proof point.

But the question I ask myself is a little different. When we see a technology change like this -- like BEV, it's not just the speed of your product creation. It's can you be flexible and agile in your industrial system like in manufacturing. We have 3 complete hits on our hands, a Mach-E with 200,000 units of demand. That's -- we have the Lightning with over 160,000 orders, and the E-Transit is completely sold out.

So how I like to think about it, it's not just the product creation speeding up. It's whole company. And we have to do our job to break constraints now so that we can deliver hundreds of thousands of battery electrics next year. That, to me, is the proof of our change, not just how fast the product creation process works.

Operator: Your next question comes from the line of Ryan Brinkman with JPMorgan.

Ryan Brinkman: I thought to ask a few on the order bank, just given the commentary that it grew 50% sequentially in 3Q, excluding the Bronco. So can you talk about the benefits of the order bank? How it helps to optimize your operations?

And what kind of pricing or other trends you might be seeing with regard to the order bank? And then how much of the increase in orders do you think may stem from the currently very strong new product cadence or from the currently low inventory environment? And what avenues are there available to drive orders as industry conditions eventually normalize?

James Farley: Thank you so much for your question. I'll ask John to comment. From my view, the order bank model that we're going through in North America that we're in right now has benefits across the patch.

We are an incredibly complicated company. And so having an order bank allows us to push simplification into the order, the customer-facing options, which we need to do, and it reduces cost and improves our quality. Number two, it eliminates the need for expensive conquest fixed marketing. Number three, it's incredibly helpful for industrial system.

You cannot imagine, Ryan, how much money we waste by not -- by guessing what our launch mix is for a new product. When you have an order bank, especially for new models, you could capacitize the high series mix that are very profitable right in line with customer demand. So it's incredibly cost-effective, and it allows you to address the long-tail revenues that we have lost in the past because of our internal ground stock model.

And the last one is, it's lower cost. There's less parts hanging around. We can manage our industrial system and our manufacturing in a leaner way. The question really is, how we maintain it, as you said, as the market improves.

And the way we're looking at that is not just having a day supply target in the past that we've managed but actually putting in the infrastructure to maintain or prefer a order-based system. That means we train our system to put in orders. We reward people for putting in orders.

We dynamically price for customers so that they're incentivized to keep ordering versus buying off the lot. So it's going to be a journey. It's been a very rewarding one so far, and we're just beginning. This is the model we have to go through as most of our business or majority of our business goes battery electric and digital. It's the right loyalty model.

Ryan Brinkman: Okay. Great. And then just as a quick follow-up to that. It seems as which was discussed earlier that product development times are speeding up, maybe particularly with regard to EVs. The Lightning, for example, seem to come together very fast.

Another trend seems to be that automakers are revealing their EVs for a longer period of time before the actual start of production, maybe because they're so eager to show them, consumers are so clamoring for them. Does that mean that you think that order banks and ordering in advance might be even more popular with electric vehicles? What are you seeing with regard to that?

James Farley: The move to a digital product means we have to go to a 100% loyalty model. So the reason why you're seeing us launch battery electrics early is very simple. It's our Super Bowl ad.

Our new Super Bowl ad -- our new Detroit Motor Show is our reveal because this starts the clock on reservations, and you have to do it early enough, so your industrial system gets informed by the results of your reservation. That's the closed loop that has to happen.

We need to open it early enough so that our industrial system can react to the orders, and we don't waste money and take advantage of long-tail revenue. And it's a more controlled environment than a broadcast media advertising on the Super Bowl.

Operator: Your next question comes from the line of Rod Lache with Wolfe Research.

Rod Lache: I have just two questions. So first, you've got a lot of growth that you're targeting in BEVs and digital businesses. So it's not surprising that we would see some structural cost inflation.

What we're seeing right now is actually really benign. This $200 million in the quarter, considering what you've got going on. But maybe can you talk a little bit about how we should think about the feathering in of those additional structural costs, which presumably come in ahead of the revenue? So how should we think about that as we look out to the next year or 2?

John Lawler: Yes, Rod. We'll start to see those come in as we get into '22, and then they'll feather in through '23 as we continue to ramp our investments in our plan, our priorities, not only in the products, the BEVs, but also as we're building out our customer-facing technologies, our connectivity, et cetera. So yes, you'll see that start to come in on a year-over-year basis next year, and it will continue in through '23.

Rod Lache: Can you just give us any sort of brackets around what -- I mean you did mention that 25% of the EV spending will be expensed. But any sort of thoughts on the magnitude of what that headwind is?

John Lawler: Not -- I'm not ready to do that today for '22 and going in through '23. We're completely targeted on getting to that 8% in 2023. So we'll manage it within that. But today, I'm not ready to talk in that level of detail about it.

Rod Lache: Okay. And I was a little surprised about the comment about just 10% volume growth for next year. It seems to me like the Renesas fire and Texas storms alone might have knocked 200,000 units of your production in Q2.

And it wasn't too long ago that you guys were routinely doing over 700,000 units a quarter. So do you have any thoughts that you might be able to share about when would you be able to get back up to that kind of a level of production? And if so, when should we expect that to happen?

John Lawler: Right. So I think what you'll find is that, as you look through 2022, the first half, we'll have less supply than through the second half. And as I said earlier, we see this mitigating over time.

It may extend into 2023. But I would say that we should be back up and running based on what we're seeing today, a run rate, the end of next year into '23. And then in 2023, we'd start to rebuild our inventories.

But it's dynamic, Rod, and it's hard to make a pinpoint call at this point in time. But we wanted to share with you what we're seeing is that, we're seeing about 10% for next year. And we see that the chip constraint is going to still hit us. It's going to still be a factor next year. So we have to keep managing as we are this year.

Operator: Your next question comes from the line of Brian Johnson with Barclays.

Brian Johnson: Two questions. First, a quick -- not quite housekeeping, but definitely, balance sheet question. As you restated the dividend at the level, just could you maybe talk us through the investment-grade rating implications and timeline to get there that you consider -- that you and the Board considered when setting that?

John Lawler: So we're going to continue to work and focus on improving our business, right? Our target is to have an investment-grade balance sheet, but that's going to come by improving the business. And you're seeing the strength of that come through. And so that's what we're focused on.

What the rating agencies decide to do with our rating, they'll manage that, and that's up to them. What we're laser focused on is improving the run rate of the business, improving our performance, improving our overall metrics. And eventually, the rating agencies and the ratings will take care of themselves.

Brian Johnson: Okay. Second question. As you think about that 10% volume increase, rough guidance, a couple of things, one, where do you see fleet sales coming back as you kind of bring that up? And second, are you going to take a different attitude towards fleet sales than in sort of the past?

I remember Don Leclair saying, he had 2 factories making door assist. And rental car companies were about the only buyers for them. So -- but there's also -- to really rental cars, but maybe some of the government business that's not -- police is not quite the same.

And kind of related to that, as you kind of think about prioritizing production, are there models where you're more comfortable you'll get good price retention, and other models, and I'm going to pick on like the Escape maybe that have a lot of competition in their segment and as capacity comes back less likely to hold price, say, compared to a Bronco.

John Lawler: So it's interesting because I remember those days when Don probably made that comment about rental fleets and that they were low margin, et cetera. I think what you're finding is business models are changing, and the fleet business is evolving, just like everything else in our industry.

And we see that there could potentially be a positive fleet business where they could make good money. And so we're not going to shy away from that if we see that it's right for our brand, and we think it's right for the bottom line. And so we're going to continue to look at fleets differently.

We're going to continue to think about vehicles as a service and what that potential holds for us as that business model changes, and we'll see where that takes us. But we're not going to go back to the times where we're putting in capacity, we're pumping out units, selling them at little to no margin for rental cars. That's not going to happen again. And -- go ahead. I'm sorry.

James Farley: That's okay. I was just going to say, our fleet business now, now that we've rationalized the company, our fleet business is very strategic for us. It's also very profitable. It certainly varies in Europe and North America and China. Different fleet segments have different profitability.

The one thing I would ask you to think about is that most of the fleet that matters at Ford is commercial vehicles. And the most important commercial vehicles for us is small, medium-sized businesses, and those are very profitable business for us. For Transit for Super Duty. That's where Ford excels in the fleet business and its smaller fleets. It's not big fleet sales.

So the texture of this is that we're revenue-managing the company very carefully. We know the margins by geography, even within the country, and we know by distribution channel.

So this is a very thoughtful approach for us. But strategically, especially because of the Pro business and its profitability, we want to make sure we have -- we're reliable partner with fleet customers.

They do business with companies that are reliable. They don't come in and out of the market. They do business with companies that have a full range of products, a full range of services. That's why Marion is investing in Ford Pro and why we're vertically integrating our services.

So I think we have a really good profitable fleet business around the world. We look at the margins very carefully, but it's strategically very important for the company to be a reliable partner.

Brian Johnson: Okay. And in terms of price retention and how that's going to vary across your product line?

James Farley: Well, John, I think you should answer that one in terms of how we revenue-manage in a constrained environment.

John Lawler: Yes. So as you would expect, we're very conscientious about the dynamic of the supply and demand and the impact that, that has on the pricing. And we look at this on a daily basis, managing our incentives, looking at if we should be taking top line pricing given the inflationary pressures we're seeing.

And as we talked about, we're not going to go back to the old habit of loading up the dealers with stock and then looking through the push-through of -- for sales.

We're going to focus more on orders coming through online. Specific orders to customers being satisfied, understanding what their demands are, simplifying the system. And with all of that, we expect to retain quite a bit of the price.

Now will it mitigate as we go through next year as supply and demand comes more in balance and into '23? Yes. But our job is going to be to manage that and retain as much pricing as we can and -- while providing customers good value for those products. So it's something that we look at very closely on a daily basis.

James Farley: In the Escape business, we now have another player called Bronco Sport in the segment. It's incredibly profitable, and people really appreciate the product. We are not in the business of commodity products in that segment anymore. We've changed. We made that investment several years ago.

Operator: Your next question comes from the line of Colin Langan with Wells Fargo.

Colin Langan: I just wanted to clarify, I saw your original guidance was that the first -- the second half was supposed to be up in volume, 30%. I mean I'm not sure if I'm misreading it, it sounds like Q3 may be up a bit from Q4. So is that 30% still not accurate? Obviously, it's kind of important when you think about the 10% into 2022, what pace we're going off of?

John Lawler: Yes. Colin, that's a great question. Thank you. Now we did say last quarter that we expected the second half to be up about 30%. Looks like it's going to be up somewhere around 15%. And so what you're seeing flow through is the strength we had in the quarter relative to the top line and other actions that we took relative to cost, et cetera.

So when you look at that walk, that bridge between Q3 to Q4, we expect market factors to be positive. We said we think volume is going to be up sequentially about 10%. We also see a little bit stronger mix continuing.

And then, of course, you'll have some product-related costs, production-related costs associated with that. But net-net, market factors net of those costs to produce the increased volumes is going to be positive.

What we're seeing from a headwind standpoint, if you look at Q3 to Q4, are commodities. We expect that on a quarter-over-quarter basis, they're going to be up about $700 million.

And if you look at that, so far year-to-date, we've seen about $1.6 billion of commodities hit us. And when you get to the fourth quarter, and you get the cumulative effect of that. On a year-over-year basis, commodities are going to be up about another $1.5 billion in the fourth quarter. So year-over-year, up $1.5 billion, sequentially, up $700 million.

And then we are going to see some higher warranty costs on a sequential basis in the fourth quarter for things that we have to take care of around extended warranties and a little bit higher coverages.

But again, on a year-over-year basis, our warranty will improve in the fourth quarter and full year on a year-over-year basis. Our warranty, we expect to be good by about $1.4 billion.

Colin Langan: Got it, John. That's very helpful.

John Lawler: Does that help you with the bridge?

Colin Langan: Yes. No, that's great. And just secondly, in terms of the redesign plan that's been out for a while, is India the last major step? I mean is this going to sort of -- is this fit over next quarter, maybe the last time we see these slides? Just got of curious. Or is there more still coming?

James Farley: Well, I think we're in good shape for now. Obviously, the acceleration of the BEV business and our ICE assets will be, I think, the next big transition for the whole industry, not just Ford.

But Ford specifically, India is really the principal region country where we have struggled over time. And it's really great to see the progress the team is making in India and the very vibrant position we'll now have with the new lineup. And I'd just like to highlight the progress in South America for this quarter. John, when is the last time we were profitable in South America?

John Lawler: I believe it was 2013.

James Farley: So let's hang that in the air for a second, 2013.

Operator: Your next question comes from the line of Joseph Spak with RBC.

Joseph Spak: Maybe just one quick one on the free cash guidance, which I think you maintained despite the EBIT guidance going higher. So is there something going on with working capital or something because you're saying you're releasing more vehicles. So I wouldn't think that would actually be a positive factor in the fourth quarter as well. So I'm curious what the offset is.

John Lawler: Yes. So what we're seeing there is that we've got the EBIT coming in, right, that improvement, but the less favorable improvement in working capital and timing differences hitting us in the quarter because we have lower-than-anticipated volume in the back half of the quarter due to the chip constraints.

And so we get hit with that working capital at the end of the year. So that's what's happening to us on the free cash flow. So it's a timing issue.

Joseph Spak: Okay. And then I want to go back to some of the BEV announcements you've made over the past couple of months. And I know you talked again about the spend today, and you're now spending more than $30 billion. And I appreciate the breakdown you gave us sort of how you're spending that.

Maybe this is just me, but I actually find it still fairly difficult to track what exactly you're spending over the coming years because I believe some of that has already been spent. So is it possible to maybe just say like of that $30 billion, what's being spent like starting next year through the middle of the decade?

John Lawler: So of the $30 billion, when you look at the cap, very little -- when you said about half of that was cap, very little of that has been spent through 2021 relative to the 13 -- to the $15 billion, about half of it.

Of course, you're going to see the expense front loaded because that's primarily the engineering that we have in developing the battery electric vehicles.

And then the direct investment, which is about 25% of it, that's for things like the vertical integration of the JVs and those types of things. And you saw those announcements this quarter with our plan in BlueOval SK, the battery plant. So that's how we're going to unfold that spending over time.

Operator: Your next question comes from the line of Itay Michaeli with Citi.

Itay Michaeli: Just 2 quick ones for me. First, is there any update on the BlueCruise deployment, including through OTA, maybe some initial customer feedback?

James Farley: Great. We're shipping with Mach-E F-Series now BlueCruise as they leave the factory, and we're going to be OTA-ing BlueCruise in the first quarter. We wanted to improve the customer experience.

So we pushed it back in terms of an OTA because we want it to be much simpler for the customer than was originally planned. And that takes a little planning to consolidate.

Often these level 2 systems require multiple updates to the car, we want it to be very simple. That took a little bit more work on our team's part. And so it's available as we ship products now.

And as an OTA, it will be in the first quarter, and it will be a lot simpler to use and get that OTA and update for the customer than it was originally planned. Does that answer your question?

Itay Michaeli: Yes. That's very, very helpful. And then maybe just a super quick follow-up, just a point of clarification. Thank you for the 2022 initial indications. In the release, at least it mentioned you expect to build on the strong performance in 2021. I'm just curious of that -- if we should interpret that as you expect to grow EBIT adjusted year-over-year in 2022.

John Lawler: Yes. So we're not going to give a number at this point, Itay, but what we're saying is that the strength of our new product lineup, our high-volume nameplates like in the strength of what we're seeing from Mach-E, as Jim said, we think there's about demand for 200,000 units.

We've got the Bronco and Maverick, E-Transit and F-150 Lightning are coming. It's the best lineup we've had. And so that's going to be a tailwind for us for sure as we go into next year. And you're seeing that come through this year, and we're going to build on that, but we're also going to have to manage the headwinds that we've talked about and the other puts and takes.

But what we can tell you is we are laser-focused on getting to the 8% target in 2023. And so we will manage into next year. These are the types of things we're seeing from a puts and takes standpoint, strengths, and all the tailwinds and then the headwinds. And we will manage that next year, and we'll be on the path next year towards our 8% target in 2020.

Operator: Your next question comes from the line of Emmanuel Rosner with Deutsche Bank.

Emmanuel Rosner: Two questions, please. Two questions. The first one, very pleased to see beyond a target and -- for this 8% margin by 2023, a big focus of the company and clearly showing some progress there.

How should we think about the impact on this from the margins on your electric vehicles? Obviously, the scale takes some time to build up, but you're going through that right now and probably have some level of visibility.

So what's your lead to thinking around trajectory for margins on some of your BEVs? And to what extent you will or will not impact overall company margins and potentially how do we think about it beyond 2023?

James Farley: Thanks. Such an important question for the company. I'd like John to comment on the margins. Right now, we have 3 high-volume, very well-accepted battery electric vehicles on our hands, Mach-E, E-Transit and the F-150 Lightning. So the way we look at it is, we want to grow this business really fast. Just the Mach-E demand itself, we think, is 200,000 units. That does not include the Lightning or the E-Transit.

So our first job is, of course, post job 1 customer experience improvement. Post job 1 simplification and improvement of the cost of the vehicle. And post job 1 quality improvements using the data off the vehicles.

But perhaps our biggest job, in my opinion, is to break the constraints we have in manufacturing and our supply chain so we can get these products out to these customers. And that post job 1 orientation is quite different than how we historically looked at the ICE business where we wait to a minor change or something later to make those changes.

The constraint from Mach-E right now is batteries. We think we can break some of those constraints by working creatively with our China team and get batteries from China. So stay tuned, and I'll ask John to comment on the margins.

John Lawler: All right. Well, as we talked about last quarter, Mach-E is EBIT profitable today, but we also know -- we also know that the margins are not as strong as our ICE margins. And so we're working on that. Over time, we expect as we scale, as you said.

And as the technology costs come down, we will grow those margins. And ultimately, we do expect with these connected vehicles, these connected BEVs that the profit margins will be better than what we're seeing on ICE today, but that's over time.

Emmanuel Rosner: And then my second question was on Argo. So very encouraged to see that you would like to encourage them as supportive of accessing the public markets. How do you envisage the future relationship between Ford and Argo to be? How important is that going to be as part of your overall business model?

James Farley: Mission-critical. For us to truly disrupt personal ownership, we have to democratize shared mobility. And the self-driving and mobility in the driven world are absolutely mission-critical for the company to disrupt ourself. I am really proud of the team's progress. It's different than our competitors in the space. We've gone to the most difficult miles in 4, 5 different cities.

Our mapping, our SDS deployment and the algorithms are built to be scaled for production deployment. So we're not going to a small market area in easy miles like others. We're taking on the toughest problems now and building our capability for scaling quickly. And I think that's always been our approach.

The relationship with Argo and us and Volkswagen is very close, but we do see us moving into more of a production mode now, and we're really ready for that. And we think this will take more capital and a little more time, and we think the access to public capital is really mission-critical for our journey.

Operator: Your final question comes from the line of Adam Jonas with Morgan Stanley.

Adam Jonas: Sorry for the background noise here. There's (inaudible) First, who do you like better Ford or Tesla? Ford.

There we go. He's a Ford fan. He's got -- we got a Ford fan here. Jim, nobody has, I think, explained as lucidly and clearly the always on and the Ford Pro stuff the way you have, right? So you get kudos for that.

But you're seeing some of your competitors who make some spherical investments in the downstream to make kind of -- for that customer experience. Volkswagen buying your car.

And some start-ups, including ones that you know pretty well kind of owning that physical part of it. Is there any gap in your strategy as you go always on and really the full service -- is there anything you want to vertically integrate to either the Ford umbrella? Or is working with the franchisers and the third parties sufficient given this big change in (inaudible)?

James Farley: Great question. Our philosophy is different. We think partnership on the demand layers for autonomy and pre-autonomy is mission-critical for our always-on strategy. Are there pieces missing that we're working really hard on? You bet you. We're not going to talk about them today, though.

Adam Jonas: All right. Wonderful follow-up for you and your dealers. They're crushing it. Some people say they're gouging, that might be unfair because they're paying high prices, too, for the vehicles, but we're starting to see 4 handles, 5 handles, 6-handled GPUs all in, it's really big chunk at the price of a car, Jim.

At the risk of selling do you think you're making too much because I know that's a [grouchy] question, do you think as far as that, that you can capture for a Ford in the consumer?

James Farley: Well, this is also really important. First of all, I would say the heart and soul of Ford's strategy is our commercial business. In that business where vehicles are highly utilized, our dealer network is one of our most important advantages versus the new competitors.

I'll give you some statistics. We have 650 dedicated commercial, mostly service centers in the United States and 850 transit centers across Europe. That will take a lot of time and a lot of money for someone to recreate. Every one of those dealers has multiple bodybuilders that can call design for those trades in those locations for our Ford vehicles.

So the dealer body is not only important for the aftersales experience in making sure those vehicles can be serviced, but it's also mission-critical for the outfit of those products. So the dealer network is absolutely strategically critical for our leadership and maintaining that as we go to digital connected vehicles for our commercial customers.

There's no doubt that many customers want a 3 or 4-click, very easy service experience on the retail side. And we're working really carefully on that, including a simple e-commerce platform. And actually, in China, our BEV business already has 25 direct stores by the end of this year. So we're starting to experiment.

I think our dealers have served us really well. I'm very proud of them. I'm especially proud of our commercial dealer. And we are very vigilant. You can imagine, I get lots of e-mails every day about transaction prices from customers on our hottest products. And we all feel obligated to represent the brand professionally for our customers.

Operator: This concludes the Ford Motor Company third quarter 2021 earnings conference call. Thank you for your participation. You may now disconnect.

END