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John Murphy:

Thanks for coming back. We are very happy to have Ford in this next session. Ford is a company that, at least in our opinion, has the box loaded for the next three years on some traditional and EV products. So they're in a great position from a car war cycle standpoint, but also is doing a great job in its quarter future transition and not just resting on its laurels and obviously using the success of those core products and the business to fund the future. So we really think Ford has got its act in gear and doing as much as it possibly can. I think the separation to Model e, Ford Blue and Ford Pro has shed a lot of light, given us a lot of information externally, but maybe even more importantly, helped the management team internally manage the good, the great, and a little bit of the ugly on the EV side and do it very efficiently with a lot of clarity, particularly for folks like us from the outside. So we greatly appreciate that.

Today we're very happy to have Ford CFO, John Lawler, who knows the business inside and out in addition to being a master capital allocator. We're going to prey you on that later too as well. John, thanks so much for joining us today. I'll turn it over to you for some opening comments and then we got a whole host of questions for you too.

John Lawler:

Okay, great. Thanks for having me. I'd first start out by saying that the Ford+ plan is on track. It really is driving higher growth, higher margins, a more capital efficient business and a less cyclical business. And those are four key priorities for us as a team as we move forward. We reaffirmed our guidance today of an adjusted EBIT of 10 to 12 billion, and the high end of that guidance would be a record for Ford. So it does really point out the underlying earnings power of our businesses. And then I'd say that no change to the guidance around our segments. Ford Blue is about seven to seven and a half billion of adjusted EBIT. Model e, we are still projecting a loss of between five and a half to five billion, and then of course Ford Pro, eight to nine billion dollars of adjusted EBIT. Free cash flow, six to seven billion dollars of free cash flow.

So all of the guidance we gave earlier in the year is on track, we see ourselves on track to deliver the $2 billion of cost efficiencies leading us to what we see as a flat cost year over year for the business, offsetting the impacts of the UAW agreement as well as the impacts of all the new products that we have launching this year. 60% of our products in Ford Blue are new or major modified this year. So that's a lot of change we have coming. So we've got a great strong product lineup as we head through this year, and as John said into the future on both Blue e and Pro.

John Murphy:

As we go through the course of the year, seasonality has obviously changed a lot more recently because there's not been a lot of normal seasonality in the past two or three years. Maybe you talk about how the year is starting out in the first quarter a little bit so we can understand the immediate near term in the context of that reaffirmation.

John Lawler:

Well, we're seeing some calendarization out of Q1 into Q2. Our number one priority is quality and we're being thoughtful as we launch the F-150. Arguably many would say it's our most important or second most important product after Super Duty. And so we're being very thoughtful as we launch that this year. So we'll have a little bit of units and inventory as we're verifying and ensuring the quality levels and standards that we expect for our customers, and those will flip into the second quarter. But as I said, full year, we're on track to what we had guided and so far from a market standpoint, things are looking pretty good.

John Murphy:

If we think about the guidance though, $10 to $12 billion in EBIT and we're layering in five to five and a half billion, and I understand 12 would be a record in its own right, but if we pulled out the spending on EVs, we'd be talking, and I'm not saying this is going to happen, but we'd be talking about sort of 15 to 17 and a half billion in EBIT. That can't happen. I know you have to invest for the future, but those kinds of numbers in the core business are the kinds of numbers that, I've been doing this for 25 years, nobody would even dream could possibly ever happen. Forget about what's going on right now and some of the macro pressures that are out there. What is going on in the core business that we're just absolutely shooting the lights out in the core business and able to fund this massive bill for the future?

John Lawler:

I think a couple of things. Let me take it by business unit. Ford Credit, that continues to just do what it's done for many years. Our guidance this year is a billion and a half. That's continuing to grow. Looking at Blue, one of the important things about our Blue business is we have done a lot of heavy lifting to restructure that business. If you go back '18 to '21, that time period, we lost over $8 billion of EBIT overseas. '22 and '23, we made more than $2.4 billion of EBIT over that period of time. And cash flows follow with that. So large cash losses. Now we're generating cash flow in our overseas markets. We've got a really strong product lineup. Remember in Blue are our HEV, our plugin and our pure HEV vehicles, and so there's a lot of demand there. We have a new product in F-150 coming this year, number one selling vehicle. We're covering the lower end with Maverick and we have a hybrid in Maverick. We've got the Escape hybrid. And so we've got a really strong product lineup right now across Blue globally.

Ranger is new, it's doing very well in our Asian markets as well as in Europe. And so you see a lot of strength there in the product portfolio. Restructuring the business, improved cash flow, and you're starting to see that come through the bottom line. And then the segmentation in Ford Pro, the clarity, the focus by that team around those customers in meeting their needs, it's not dispersed throughout the company. That team is insanely focused on delivering productivity improvements for those customers. And we have an incredible market share, 40% plus here. We have a strong brand position in Europe. We have the best relationship and I think the broadest relationship with bodybuilders and upfitters that turn our incredible vehicles into tools for our customers. And then we have the software and services on top of that, which allows us to work with our commercial vehicle partners to improve their productivity and drive the business.

And you're seeing that come through the business. We made $7.4 billion last year, 7.2 to 7.4, 12%, 12,5% percent margin. And this year we're targeting eight to nine billion. We're guiding. So it is an incredibly strong business with a deep mote that we're just focused on expanding.

John Murphy:

Got it. One of the things that the skeptics will point to is record pricing. Obviously having pricing at all time records makes you skeptical and concerned that things could fade away. I think you guys and your guide are talking down about 2% in 2024, yet when we look at this, there's a significant layer of gross profit per unit that's in that ATP that goes to the dealers. And if we went pre-COVID that GPU was roughly about 2000. At its peak, it was about 6,000. It's come down to about four and a half thousand, but it's still more than twice what it was pre-COVID. As you're talking about that 2% decline in pricing, is that the aggregate ATP or is that the recognized revenue per unit that you guys are seeing? And how much will the dealers' profit normalize before you get significant pricing pressure and forward?

I think this is something that is a potential positive for you guys and for the industry. The pricing is early days and it's not falling apart in January or February. It's holding in very well. So how do you think about that 2% pricing? What does it mean?

John Lawler:

We tend to start out looking at the customer and affordability, the percent of disposable income monthly that it takes to purchase a new vehicle. And that spike during COVID was enormous. It's now come down to about 14%, whereas pre-COVID it was 13% to 13.5%. So when we look at that, we say, "Okay, we believe that that's going to start to normalize more this year." So we said about a 2% pullback in pricing for the industry, and that would be the OEM pricing through incentives or with new vehicle models, maybe they'll take some top line down. I also think that there's still room where the dealers, as the market continues to move to a more competitive imbalance between supply and demand, I believe the dealers will start to revert back more to the mean they had previously as well, to get back to the type of run rate we had pre-COVID from the standpoint of the dealer margin.

So we've got to get the consumers back to where that affordability level was before pre-COVID. And then I think once it gets there, it's going to move relative to the strength of your product lineup, the freshness of your product lineup. You've written a lot about that. So that's how we see it. Now this year we see ourselves having some positive upside there, both in Blue and in Pro, given the freshness of our product lineup, 60% of the products are new in Blue, so with that comes pricing power. And then in the Pro business, we continue to see strong pricing power because of the demand relative to the supply over the last few years. And about 15% of the commercial vehicles reach their useful life every year. So they're tools that wear out. And we're seeing order rates about two times what our production capacity is, and we're continuing to see that.

So the amount of infrastructure work happening in industry across the United States, between roadworks, local, state, and federal, you've got the CHIPS Act, you have the build out of the network for cellular, et cetera, 5G. So we're really starting to see that is gaining traction, it's growing, that spending is increasing, and that's increasing the demand for commercial vehicles.

John Murphy:

And the other thing that is intriguing on the supply side is that capacity utilization in the industry is running in North America at 70%, 75%. So you could argue that discipline could easily be lost because there's a lot of room to produce more vehicles within the industry at large, yet that's not happening. Is there something else, and the DPI number is actually very interesting, but is there something else going on here where we are actually seeing some reasonable discipline in the market and that pricing, the pricing dynamic is just shaping up a bit better than the people that are Chicken Little on this that are very concerned? I understand running the business for the 2% price down is a good way to run it, but it just seems like fundamentally there's something going on there that's pretty resilient in the face of some large excess supply on an install basis, if you will.

John Lawler:

I think that we're still being disciplined with day supply. We know that when you get into a heavy push environment, then that erodes pricing really quickly. So I think we still have that in the industry. Everybody's remained disciplined. I think the other thing, John, is there's always that risk that it could become less disciplined, but so far we haven't seen that this year. It's going quite well. Last year a lot of people were predicting that we'd see a collapse in pricing and it didn't happen. So I see market factors remaining relatively strong through the first quarter, and we'll see how that goes through the rest of the year but I'm optimistic.

John Murphy:

Doug, sorry.

Doug Karson:

I want to maybe dig down in Ford Pro a little bit more. The first time I really got smarter on the product was in the capital markets day when we drove the trucks and so the system integration. I just picked up on something you'd said that the demand is outstripping the capacity. You could probably build more. How do you think about how big that product could be relative to your capital planning?

John Lawler:

The interesting thing is now that we have the segmentation, when we look at capital planning, we have created separate hurdle rates for each of the businesses. We have a capital committee where each of the businesses come in and we look at their requests and its highest best use. Who's got the higher margin? Who's going to scale above their weighted average cost to capital? What's the probability of that project delivering upside downside? And that's how we're allocating capital. That's a new process for us, and we put that in place. So we see tremendous upside with Ford Pro. Tremendous upside. And the thing is, it's not just with the vehicles.

John, you wrote a paper recently around service parts. What we see, and that was a good paper by the way, because that's how we think about it. And that's something that we need to understand, is that beyond just the vehicles, we have 40% market share. I think 25% of fleets are pure 100% Ford fleets in the Pro business. About a third of our vehicles are sold to large fleets, about a third to small fleets, about 18% to local government, so state and local and federal government and then about 15% is in rental. So it's a diversified business. So we're not overexposed in any one area, and there's ability for us to continue to provide new product, improved product, but then on top of that, there's the servicing, physical services and the parts services, plus software on top of that. That's a huge potential upside for that. And we'll come back to that.

John Murphy:

Yeah. Well, we can jump ahead to Ford Pro and go back to Model e. So on the Ford Pro side, I think you were talking about 20% of Ford Pro profit coming from attached services over time. What is the time frame for that? And as you're doing that, people could talk about subscriptions, they could talk about wheels and tires, they could talk about oil changes, they could talk about a whole lot of things in attached services. What is the general composition of that attached services?

John Lawler:

Let me break it down. Let's look at physical services first, repairing the vehicles. The most important thing for a commercial customer is up time. Their vehicle's off the road, they lose money. So that is one thing that we're working to ensure doesn't happen for our commercial customers. So there's a couple of things there. Right now, our post warranty parts penetration is somewhere around 30 to 35%. Each point is worth about 30 million in adjusted EBIT. By 2026, we see ourselves growing that to a 50% penetration. So from 30 to 50 with each point being about 30 million of EBIT, and that is business that is less cyclical. So that's important. The four points I raised in the beginning was lower cyclicality. That's a key stake into that. And the way we're going to do that is we are going to expand our physical service network by about 3000 facilities over the next few years. And these are commercial specific facilities that can handle the size of the vehicles, up fitted vehicles with a cherry picker on it or something like that.

Then we're also going to grow our number of mobile service vehicles. This is really important. I think we're number one in mobile service vehicles, and 80% of the repairs for a commercial customer can be handled with a mobile unit. And the net promoter score of our commercial customers, when they are serviced through a mobile unit, is 10 points higher.

John Murphy:

They like it better, you're saying.

John Lawler:

They love it because they're out. We know where they're going to be. They're going to be on a job site all day. We'll send the van out and fix the vehicle, no downtime, or do the normal service for them. And then on software services, and by the way I need to say is that margins on the service parts are 40% plus, right?

John Murphy:

They're high.

John Lawler:

They are. And so this is a great opportunity for us. So it's less cyclical, it's growth, it's higher margin so we're leaning into that very, very hard. Second point is software services. What we're focused on in Pro is making sure that we're working with our commercial customers to improve the productivity of their business. And that's where the software comes in, helping them manage their fleet. Especially many of our customers have a mixed fleet. They have gas, they have diesel, they have a plug-in or HEV, and they have now electric. And so we have the software to manage that fleet. We have the software to manage that charging. We have the charging infrastructure we're putting in for those customers, and it's about driving their productivity, allowing their vehicles to be on road longer. Right now, we have about a 12% attach rate on subscription services. It's about 500,000 we have right now, about 30% of our vehicles are equipped with modems that are on the road today.

By '26, we're going to grow the number of vehicles equipped with modems to 60%, and we're going to take our attach rate from 12 to 36%.

John Murphy:

When you have someone's fleet in your system, is it super sticky?

John Lawler:

Yes. It is sticky, and we're seeing more and more of that, especially with what we can do with the fleet management business and the software because we can pull all the data off the vehicle. It's not limited through a plug-in type device. And so there's things that we can do, especially as our electrical architectures advance, we'll have more and more knowledge on the vehicle. Eventually, when we get to our fully networked vehicle architecture, we will have predictive maintenance. So we will be able to, at a point in the future, guarantee uptime because we will be able to read all the systems on the vehicle and know if something's going to fail or if something's wearing out, wiper blades, tires, brakes, etc. So that we can then work with... Get ahead of it and work with them to have the right time to service that vehicle so they're not off the road and they don't lose any business.

John Murphy:

So that's on the Pro side. So that's an incremental 600 million of EBIT. Maybe just stay on the Pro side for a second. Does this allow you to keep your margins or even margins in the low teens or is this a potential expansion from where we're running now over time?

John Lawler:

Yeah, that's a great question, John. How am I going to not answer that?

John Murphy:

I know.

John Lawler:

So our target, margin target, is mid-teens, but what I will say about that is if you think about it, we have strong top line pricing right now. We have strong demand. Eventually, one might argue that top line pricing and that demand's going to come off a bit, so you might see some compression on the top line. But the way we're thinking about it is if that happens, if that happens, then we start to grow the services businesses. We're growing the software business that offsets that and allows us to maintain those mid-teen margins, even if the top line softening a bit due to an economic cycle. Now if that doesn't happen, then you could see there could be upside.

John Murphy:

Got it. Okay. So let's swing back to Ford Blue for a second and try to draw a corollary. On the light vehicle side, so there would be some overlap with some of the fleet vehicles here. The dealers capture about 1.1 trillion in revenue, 55 billion in EBIT. Right? Dealers like to make more money. You guys like to make more money. There's another billion one roughly by our estimates of revenue that goes away from them. Some of that is actually in very short order and a capture rate on zero to three is less than 40%. So I mean there's huge opportunity early on to capture more revenue. So there's 1.1 trillion below that that they're not capturing and there's another 133 billion in EBIT meaning it's much higher margin than what they're currently capturing.

You're going to have more and more connected vehicles. So unlike vehicle business, how many of these vehicles have modems and this connectivity capability that you're talking about on the Pro side, maybe now and in the future? Round numbers, it's fine. But is there a strategy then to use this to drive these cars back to the dealers to help them capture more revenue and profit? And then, obviously, you would share in that in a big way. And it just seems like as you're fighting this tide of the great investment, you're doing a great job right now, but of this massive investment in future powertrain and some tech, there's this huge iceberg of opportunity that is massive underneath that you're kind of starting to really capture on the Pro side, and you haven't really scratched the surface.

You scratched the surface reasonably well in sort of a core basis, but as this connected car technology takes off, you can really go after.

John Lawler:

Exactly. What we're learning in Pro on the service. It will translate back into retail as well. Absolutely. And our capture rate isn't dissimilar to what we have on the Pro side. It's actually a bit lower and so there's more opportunity to grow there as well. When you look at the connected vehicle and the software services, and that's why we brought in Peter Stern to look at that holistically for the consumer is how do we best meet their needs? And the software services, and again, the electrical architecture will allow us to provide them those types of services you're talking about that are sticky, that would keep that in the network and, therefore, then drive that vehicle into the service with the dealers, which then we make more money, the dealers make more money. And then on top of that, there's the services around the vehicle operation. Go beyond what happens with self-driving, right?

Go from what we have today, BlueCruise L2. Eventually, it will go to L3 and the operating domains will expand and that will be a revenue opportunity and a growth opportunity. But there are... I'd argue that there are services that will be able to do with the vehicle software-generated services, conveniences and improvements for the customer's use of that vehicle that we haven't even begun to start to imagine until that starts to really open up and it starts to develop. And you can use other proxies, other devices that have come out. I mean when the iPhone first came out or the iPad first came out, or other products like that, the ability for folks to innovate and identify ways to use those devices to increase productivity and make people's lives better grew. And I think the same thing is going to happen on the retail side and that capture then will make it stickier.

And the way we started thinking about this years ago when we put modems in is we called it products, accessories, services, and experiences. And taking that ecosystem and continuing to drive improvement on that. So it goes beyond just the physical vehicle, it goes to the overall experience with the vehicle that drives value for the consumer and we're just getting started in that space.

John Murphy:

And have you brought this up? I mean, has this been discussed with the dealers? I mean Auto Nation was the first dealer, large dealer group that I heard. We had a conference back in December for just dealers where they started talking about the connectivity being this opportunity. Are the dealers understanding that this is not an end around, this actually is something that could be very profitable for them as well and working with you as a partner is a huge opportunity for you both to make a whole lot more money?

John Lawler:

Definitely on the Pro side, because they're service focused, they get it. They know that that's where their bread and butter is. On the retail side, it's mixed, right? It's mixed. We've got some really good operators that understand the entire ecosystem. Many of the operators capture a broader slice of the ecosystem just beyond just selling vehicles in F&I in the dealership. So there are some that really do understand where it's headed and are excited and working with us.

John Murphy:

As we look at the next few years. Based on the Car Wars analysis, it looks like Super Duty is finishing up its launch, but the benefit will really come this year. I think it's a billion dollar positive swing. Expedition and Navigator later this year. Explorer and Aviator in '25. F-150, Escape and Transit all new potentially at least by 2026. I can't remember a time staring forward and we'll do the update in April or May this year, but that you were staring down a better three years of core product.

As you think about that in the context of all the investment that has to go into the business for the long term, how happy are you as a CFO that you have that kind of profile in front of you? Is that going to allow you to invest more or do you potentially throttle back and build cash on the balance sheet? I mean, how do you think about this product cadence and just what it means for what you can do as a business on top of hopefully executing well with that, with those launches? It just creates an unbelievable runway and a degree of freedom that other folks don't have right now.

John Lawler:

It does, and I'm very excited about how we're managing the launches as well, and the focus on quality. As I said, this quarter, we'll have about 60,000 units of F-series in stock that'll flow into the second quarter. And that's all about the quality. But launching these products and having this incredibly fresh lineup at this point in time is a great opportunity for us. And so when you come back to that is the capital allocation. It does allow us to continue to invest in the business, but we have to be mindful that we have to be more efficient with our capital allocation. I think that's one of the things that's held back this industry is how we've managed our capital and we've done capital allocation. We're focused on returning capital to the shareholders and being balanced. I think over the last 24 months, we returned $7.7 billion in dividends and we pay out 40 to 50% of our free cash flow.

But outside of that, we're focused on investing in growth. Opportunities for us to continue to grow, profitably grow. We're targeting a return on invested capital of 20%, and we have hurdle rates and WACCs for each of the different businesses. And as I said, we have our capital committee that's reviewing that, but we have such a strong core and foundation. This gives us the opportunity to continue to invest across all three businesses, Blue, Pro, and E.

John Murphy:

So on that cap allocation, and I want to get into model E in a second. As you think about you sitting there as a CFO, somebody comes to you with a program, an idea, a potential opportunity. In the past, people would kind of finagle a way to make the returns work and the program would get passed through and it would get put out in the market and then sometimes it would not be great. You're sitting in, obviously, you're the CFO for Ford. You're sitting in a very important seat, but you're in a very important seat right now to say no to something.

How often are you in these reviews saying like, "Listen, we just can't do that. That's a no-go. We're going in this direction. We're going with these programs, not that program." Are you saying no 10% of the time when you used to say no 5% of the time? As you looked... I mean, if you give us some order of magnitude of how much more discipline, what does that really mean?

John Lawler:

Well, we have clear metrics for, as I said, the businesses with a weighted average cost, risk-adjusted WACC for each of the businesses. Then we've translated that into what the WACC needs to be for us across the three businesses to drive to a 20% ROIC, and then we have for each of the programs that comes forward, a return on assets so each of them. So we have hurdle rates and they're very clear for them. So if they're not reaching those guardrails, they know what the conversation's going to be. We're not moving forward until we can confidently meet those guardrails. And as you said, you can make any program or any project look good on paper. Right? So then it's around what are the probabilities of upside and what are the probabilities of downside and how are you doing that risk analysis? And so we're being very discerning with the teams when they come forward and they're requesting capital.

And so how often am I saying no? I guess maybe a better question is how often are the teams coming back? And quite often. So they've got work to do to meet the thresholds, to meet the hurdle rates. And there's one thing about our leadership team, there's a phrase going around with the team, and that is, no longer shall you travel, hopefully. Meaning the numbers that you're bringing forward and the assumptions that you're making need to be very robust. They can't be on the high end, and you're hopefully going to deliver those. You need to have high confidence that you're going to meet those numbers.

John Murphy:

The road to rise up and meet you is no longer a mantra at Ford.

John Lawler:

That's right.

Doug Karson:

But you still on capital allocation? Can I ask a question?

John Lawler:

Sure.

Doug Karson:

So balance sheet's in great shape.

John Lawler:

Yeah.

Doug Karson:

Worked hard for that for a long time.

John Lawler:

We did.

Doug Karson:

Yeah. And you're generating cash now and you have 40, 50% of free cash flow. What's a future you think... How could the balance sheet help you over the next three to five years with this transition to EV and the kind of untapped potential you have in the balance sheet?

John Lawler:

Yeah, so we ended the year with about 29 billion in cash, 46 billion in liquidity. So yeah, the balance sheet's in great shape. We like the flexibility we have right now during this incredible transition for the industry to have the flexibility to make moves if we want to. If we see something that's worthwhile making a move with. And like I said, we generate free cash flows 6 to 7 billion this year. We've paid out 7.7 billion in dividends as we pay out 40 to 50% of our free cashflow.

So we want to continue to provide to our shareholders as well. So we see the opportunity here to invest in the business and invest for growth and drive us towards that 20% return on invested capital. Eventually, if we don't see opportunities and we're through the incredible transition of this industry, then you have to think about what are other ways to provide that to the shareholders. I think we're being very thoughtful right now about the balance sheet, the cash position, how we'd use it, but we would much prefer to invest that in the business.

John Murphy:

Makes Sense.

John Lawler:

Thank you.

John Murphy:

Back to one of the big topics at hand on model E and EVs. There's been an actual slowdown that's reasonably significant relative to expectations. Still moving somewhat in the right direction. We'll see where it ultimately lands. How do you see this blip, particularly in the North American market in EVs or the slowdown? Is it a blip? Is this something that is sort of transitory and we're going to get through this and it's just part of the ramp curve? Or is there something maybe greater here in the US where you start need to thinking about a product portfolio that is not that heavy in EVs and you need to pull back in the spending and investment on that side?

John Lawler:

Well, we definitely need to work to match capacity with demand and demand is much lower than the industry expected when it comes to EVs. When we look at that, prices came down dramatically. Growth is much less than what we thought. So we are right sizing our capacity in the investments that we're putting into EVs, but it's not a matter of if, it's a matter of when. I think we're in the transition between the early adopters that were much more willing to deal with some of the ancillary items that come with EVs: charging, range and things like that. We're moving into the early majority and the early majority is much less forgiving and pricing is an issue. One of the things we're finding, and we realize this, and I think this was the benefit of being one of the first movers in the market is that we don't believe the game is going to be really fought in one with larger vehicles.

We think it's going to be in the smaller, more affordable vehicles. That's why we started the group out in California, which is a group of highly successful EV engineers designing a new platform for us in a much different way. It'll allow us to have that low cost affordable EV platform where we can create multiple top hats off of that. I think that's where we're really going to start to see the traction because the real competition, where we see it, is the low cost EVs from China as well as Tesla. So we're working towards that future. Now, of course we're going to have some large EVs as well, but they're going to be very limited in the scope and the number of top hats that we have. So we're thinking about it in that way. One of the things about the segmentation that's different, clearly, is everybody gets to see exactly where we are on EVs.

There's no wondering what's happening with EVs with Ford. It's a pure business. There are no credits in there for the greenhouse gas or the emissions that they provide for us. Every Lightning allows us to sell twelve 150s, but there’s nothing numerical in there. There’s nothing financial in there. So you see the pure business. The reason why we did that with the EV business is because eventually it has to stand on its own. It can’t be there only to provide credits for your blue and pro business because eventually it has to stand on its own. So that's how we're thinking about it, John. We think that the first real inflection point is going to come when some of the lower priced EVs come online.

John Murphy:

We used to think, and this is our faulty thinking, or maybe not I don't know, we'll ultimately see how this works out is that if you came in with high-end, high-performance, high-priced EVs, that might work. It seems like that there's a tiny part of the market, so that's actually maybe true, but it's small. So the small EVs might be a larger market. I guess the question is, when you talk about a small vehicle, does that mean Escape size? Does that mean sub-Escape size? What does that mean? Because Americans, whether it be an EV, a diesel, a four-cylinder, whatever it may be, don't like small vehicles and your business is predicated on these unbelievably great, large trucks.

So now you're talking about a small vehicle, what does that mean? And does that mean that Ford is coming back into- Maybe it's not, we'll see... Is it a car and who are you going to supplant in that part of the market? There's some pretty good competition on the ICE side there. I'm just curious what this really means. There's some concern that this might be, and that you just answered the question, that it could be a compliance vehicle. That's not what you're saying. You're saying it's the exact opposite of that. How does the American market work for a vehicle like this?

John Lawler:

Yeah, I think so. You have to start to unpack what an EV is and what an EV isn't from a standpoint of, as Doug explains the physics around the size and the battery. In the conventional internal combustion business, the larger the vehicle, the more margin there was because the cost to add from the size is much less than the value to the consumer, the margin of utility of the vehicle: the third row, the ability to tow more, the ability to haul more. So the margin goes up. It's the exact opposite with EVs, because the bigger the vehicle, the bigger the battery, and the battery is the most expensive thing in the vehicle. Then the bigger the battery, the more weight, the more battery you need, the less efficient the vehicle is. So the costs just spiral out of control, which is the exact opposite to what an internal combustion vehicle does, a gas or a diesel.

So it's about that smaller platform. Now, the great thing about EVs is when you look at the design footprint, the way you can think about is that the exterior size of an Escape could be the interior size of an Explorer because you don't have the package limitations of the front. There's a lot of degrees of freedom, especially when you're designing it with a new platform with individuals that are on their third or fourth platform of EVs that they're designing. The way they do it is allowing us to create a platform that we believe is going to be able to cover a large segment of the population and give them the needs through different top hats on that platform. So that's how we're thinking about it. I know it's a little bit opaque because we haven't introduced the vehicle and we need a little bit more time before we do that. I think there's a lot of opportunity there to take the benefits of an EV and meet the consumer's needs with a smaller platform type that requires less of a battery, which then brings the affordability down.

John Murphy:

Okay, I'm going to ask you a follow up to that. And you might say, "Hey, listen, we just can't answer it because we're not talking about it yet." I think you said the footprint of Escape with the interior of an Explorer.

John Lawler:

Yeah.

John Murphy:

Okay. All right. So that changes the game, right? Because the Explorer is almost the heart of the U.S market. If you can give it to somebody in that performance range, they would lap it up all day long.

John Lawler:

Think about it, you could probably do the footprint of an Explorer with the interior of an Expedition. I think it's basically, it's not exact, but it's almost one size from the exterior to the interior degree of freedom that you can do with an EV.

John Murphy:

This is not recreating the Pinto? This is recreating an Escape-sized exterior with a big interior.

John Lawler:

Yeah. It could be an SUV, it could be a truck, it could be a van, it could be a lot of different things.

John Murphy:

Now I guess you guys have talked about that vehicle coming out in 2025. I think that's what the statements have been. Is that something where it would be revealed in 2025 or SOP would be 2025, or is that still TBD?

John Lawler:

That's still TBD.

John Murphy:

Okay.

John Lawler:

That's still TBD.

John Murphy:

Okay. If we think about the Gen 1 product being essentially Mach-E, Gen 2, and then Gen 3, which you guys have talked about, this vehicle is separate from that development process?

John Lawler:

So hopefully I can clarify this without adding confusion. So check me on it. So Gen 1, of course was the Lightning, the Mach-E in the transit van, right? The E-van. E-transit van. So Gen 2, we've been talking about Gen 2, but I don't think we can think about it as Gen 2. I think it's our next EV platforms. There's one that is the ground-up pickup, and then the potential to have other vehicles off that platform. Then there is the small platform that we're developing. I wouldn't think about them as Gen 2 or Gen 3. I'd just say it's our next generation platforms and one's a larger platform and one's a smaller platform.

John Murphy:

Got it. Okay. So both would be Gen 2-A and Gen 2-B. You're saying they're coming in Gen 2.

Okay.

Doug Karson:

Is the same group making the ground-up pickup to the small platform or is it separate?

John Lawler:

No, the small platform is a group of individuals. We call it our Skunk Works in California led by Alan Clark who came from Tesla. It's a group of individuals that he's recruited into the company to develop this platform in a different way. I think that's important to understand because cost is critical on this platform, and it's the next leaps forward in the design and how you design, manufacture, and develop an electric vehicle platform.

John Murphy:

Exciting.

So it sounds like there's a greater recognition-

It's the full package as opposed to just a hyper-focus just on the battery that it's the total vehicle integration?

John Lawler:

It's the total vehicle integration, complete systems design, not a waterfall process, an agile process. Completely different design process from what traditional OEMs have used to design vehicles over the years. There's a thought out there about how are the Chinese able to design their electric vehicles so quickly relative to what the traditional OEMs are taking. It's a different approach. It's an agile approach. It's not the traditional waterfall approach that we've had for decades. Alan and his team are using that type of approach to design this vehicle.

John Murphy:

So if you think about those products, I mean, is this an acceptance that battery technology might not make breakthroughs? I mean, how do you think about the potential for battery technology in the context of this? I mean, we just had QuantumScape on there, and they sound like they have some really interesting things. Not to say it's going to be solid state, but how do you think about the technological breakthroughs in batteries, on costs, efficiency, and it's all kind of intertwined to make the future of EVs work for Ford.

John Lawler:

That's going to have to continue. It's got to be a core part of it. The battery technology is going to have to advance, especially when you start to get into advanced duty cycles. The technologies that exist today are not going to allow you to put a battery in a vehicle that has a high towing duty cycle. It's just not going to work. The battery will have to be too big. So there's going to have to be advances in the technology and that'll cascade down, and that'll be available to the smaller vehicles. That'll help drive down cost in the future because less battery, more efficiency, quicker charge times, et cetera.

John Murphy:

When you think about getting to break even or, potentially, I think the ultimate target of mid to high single digit EBIT profit margins on Gen 2 products... I don't know if you can give us sort of an idea of volumes to get there, timeframe to get there, what drives the five and a half billion dollar losses to something that would be a nice, good, positive profit generation?

John Lawler:

Hurdling the WACC.

John Murphy:

Hopefully. Yeah.

John Lawler:

Yeah. So-

John Murphy:

It would take Edwin Moses to clear the hurdle, but I mean, it's going to have to be real.

John Lawler:

So it has to be real. Some would say we're exposed because you can see exactly where we're at in the progress that we're going to make. I think some might say that's a bad thing. I think the transparency is a good thing, especially for our investors. Battery technology is a big part of it and advances in battery technology. Then again, it's the integrated system design and it's the complete process that we're using from a ground up standpoint. Although the group in California is designing the platform separate from the larger vehicle platform, remember Doug's in charge of both. Doug is leading both of those and he's bringing as much back into our larger platform that the next Lightning pickup truck will be on, or pickup truck will be on. I don't know that it's going to be called Lightning. Now I'm getting out of my comfort zone there. So no one say I said it's the next Lightning. It's the next pickup truck.

But yeah, John, it absolutely has to be breakthroughs from a battery standpoint, from the ground up design, moving into a more efficient design, less complexity. Then, of course, the electrical architecture is going to play a role in that in providing more advanced interface from that standpoint, the ability to provide services and experiences, improving the manufacturing ability of the vehicle, designing better for manufacturing. So all of those things are coming into play to improve the margins. As I said earlier, the most important thing is the EV business, Model E, has to stand on its own. It has to get there. It's going to be through these next generations that will get to those points or we are not going to move forward and we said that.

John Murphy:

Is there any potential that you would tag on to that high to mid single-digit EBIT margin incremental services and post-sale sales and profit to get to that adequate margin in return for Model e in the way that you're not currently doing it for Blue, and assuming that you have a higher attachment with those kinds of consumers and that kind of product?

John Lawler:

So there is services revenue and margin assumes, but I wouldn't say that in that time period that we're assuming it's going to be that much different than what we'd see on the Blue side.

John Murphy:

Got it. IRA. We didn't even ask about that yet and we're talking about Model e. What is your take on how good that is for Ford at the moment as far as making these EVs more affordable? And what do you think the risk is and how would the business shift if consumer incentives were somehow cancelled post-November election? Maybe even election out of it. If these got rolled back for whatever reason they got rolled back, how impactful do you think that would be in the way you think about developing Model e here in North America?

John Lawler:

Yeah. First of all, we think that the probability that they could be rolled back quickly is relatively low. But never say never. Clearly it's going to add to an affordability issue for consumers and so it's going to put more pressure on the business, but that's why I think the ramp and what we're seeing as far as the rollout is important from the standpoint of the technologies and the efficiencies that we need to bring forward. So it's just another reason why it's important that in our next gen and then the generation after that we're continuing to drive those new technologies from a battery standpoint, the efficiencies, et cetera, because eventually they do roll off and the business needs to stand on its own. So it's going to come down to affordability. And if they were to go away, that's going to be the issue, is either the demand's going to come down because the price is going to have to... is going to be higher, or the OEMs are going to have to find offsets.

John Murphy:

And is the change in the EPA revision in these final rules? We'll see what's final in a year or two. Right? Things shift. There's nothing final unfortunately from the regulatory front, which I feel for you guys because that makes it very difficult to run a business and allocate capital. But based on what you know right now, does that glide path match more what you think is going on in the market and allow you to operate the business more efficiently and more directly at what's happening in the market as opposed to have to meet some onerous near term regulations? You're tough in the long term, but I mean, it gives you a little bit of a breathing room here in the near term.

John Lawler:

Yeah, they're ambitious and challenging. I would say that. That's for sure. But I do think that EPA has been working with us to better construct the ramp for those consistent with how we're seeing EVs come in and what we're seeing in the marketplace. But by no means they are ambitious and challenging. But one of the things that is important for us is that we continue to have hybrid technologies. We continue to invest in them. We've been building hybrids for 20 years and we never pulled back from them. And we see that as an important part of that bridge in that transition over the next, let's say, five years as we move through the rest of the decade of how you meet that compliance. But we're going to continue to provide HEVs, plug-in hybrids, battery electric vehicles, exciting products that our customers are going to love that'll allow us to meet those requirements.

John Murphy:

Competitive landscape is shifting quite a bit. Chinese vehicles were net exported 2.6 million units last year; three years prior, essentially none. So not only are you facing great competition in the domestic market in China, you're starting to face these companies and these vehicles around the world. How do you keep up with them, how out-compete them? Forget about regulation. You're going to have to out-compete them. That's just the way the world is going to work. How do you do that over time? And do you think there is something that maybe the European government, maybe the US government needs to do to intervene? Because things are not a level playing field at the moment. I think we all don't want regulation. You just want to compete. And I'm pretty sure you could compete pretty well if things were level. But I mean, how do you think about that new competitive threat and then potentially the playing field needing to be leveled in some way?

John Lawler:

Yeah. I think ultimately we have to compete head-to-head with them. And that's why I think we raised the alarm bell on it I think before anybody else did. We started talking about it. And that was a big impetus to why we've gone ahead with the small platform in California, our Skunkworks project, because we knew we would need to compete there. Jim and I went to China last year. And it had been the first time we went since COVID, right? And as you know, I spent six years in China; I ran our China business. And one of the key observations that we both had is previously our partners were reliant on us, our platforms, building vehicles off our platforms, learning from us. When we got out there and we saw the products that they have and their EVs, and it flipped. And we said, "This is going to be a huge competitive disadvantage." So we doubled down on our aggressiveness towards the low-cost platform because we know that is ultimately going to be our key competitor.

John Murphy:

And is there anything that you think is going on at the moment, and you can say no answer on this, that is being offered to them by the Chinese government, or even local provinces there that is allowing them to get access to low-cost capital that is allowing them to compete sort of in some ways on an unlevel playing field that the US government needs to respond to as the Chinese ultimately try to come here to the US, or do you think right now it's they're moving very fast, they've got low labor costs and they're just making headway?

John Lawler:

I think it's not black and white. I think there's some truth in everything that you just said, is that I think that China has always wanted to have its global champion, and I think that the ability for them to do that with an internal combustion engine had proved to be very difficult. And back in 2010 when I first arrived in China, they were very aggressively investing in technology for battery electric vehicles. And I think you're starting to see that. And their best opportunity to have a global champion is in the BEV space. And I think that's what you're seeing coming out. So it's here to stay and it's going to be something we have to deal with. And so you got to take it head on.

John Murphy:

Yep. I've got two very equity focused questions left, but are there any questions in the room? Take one or two really quick. I'll keep firing. So as you look at this, share buybacks have been largely focused as anti-dilutive measures over time. So you do buybacks, but they're not that large and they're not that focused on shrinking the share account. As Doug mentioned earlier, you're doing 40% to 50% out to shareholders, mostly through dividend and supplemental dividend, which I think shareholders appreciate too. I don't think anybody's complaining about receiving a dividend, but is there an opportunity potentially over time as capital builds, which I think it probably will due to a buyback program, or are dividends the most favored direction for external cash return to shareholders?

John Lawler:

Well, right now we have our policy of paying out 40% to 50% in dividends. We paid out $7.7 billion over the last 24 months. We like our position on the balance sheet. We're in a very tumultuous time of transition in this industry. And we think the highest and best use at this point will be to invest in the business. But over time, if opportunity presents itself where there isn't that opportunity to invest in the business and we're through the transition of the industry, then we'll look at everything. Now, nothing's off the table for us and we'll be thoughtful about it, but right now we're focused on 40% to 50% and having a strong balance sheet as we go through this transition, and focused on investing in elements of the business where we can ultimately get to that 20% return on invested capital and being good stewards of that capital.

John Murphy:

And dumb guy's math, I mean, if you're paying out 40% to 50% of the free cash flow, there is some cash that's building up on the balance sheet.

John Lawler:

Yes, there is.

John Murphy:

Is there a point at which you say, "Listen, we just have too much cash on the balance sheet that we might even do a larger supplemental or something like that"? I mean, what's the gross cash position or even net cash position where you're just like, "Listen, we have too much cash, we've got to return even more to shareholders"?

John Lawler:

Yeah, I'm not going to answer that there's a set number or there's a specific. We look at it all the time. And we're looking at it all the time when we discuss all the time the balance sheet, where we're at-

John Murphy:

We like-

John Lawler:

... cash we have, and where we're headed, and what we're going to invest in. And our capital committee discusses it. So there isn't a hard and fast rule around that, John, but it's something that we keep in front of us.

John Murphy:

So maybe just to wrap up here, we have four or five minutes. The stock, at least from our opinion, is incredibly inexpensive. And I'm sure it must frustrate you as a management team that you don't get credit for some of the stuff that you're doing. And you really are taking some hard, tough actions, particularly as we're going through this transition and really showing everybody the great, the good, and even the ugly as far as the losses on EVs at the moment. You're not hiding anything, you're really putting it out there, but you're still putting up EBITDA and EBIT numbers and earnings per share numbers that are near records or at records if not beating prior records, and the stock is just not reacting that much. What are you hearing or what do you think is really the biggest disconnect in sort of the reality of what you guys are doing in an incredibly difficult transition versus what some investors are saying and just not believing? I mean, what's your take on what this real disconnect is?

John Lawler:

Well, we think the segmentation and the transparency is important. You see the incredible strength of Blue and Pro. And eventually as we progress the EV business, we'll see improvements there as well and see the potential of that business coming through the bottom line. What I would say is that we've spent a lot of time dissecting not only ourselves but the industry. And we think it comes back to four things relative to other, let's just say, industrials. When you look at it, the top line growth over the last decades hasn't been there relative to what other industrials provide. And therefore then you're not seeing the EBIT growth. Right? The earnings growth. And then it's comes down to where are you on a relative capital efficiency to best in class industrials? And then it comes down to the cyclicality, right? The peak to trough of the industry. And that's what we're focused on because that's what we can control and delivering across those four elements, which is the core of our Ford+ plan.

And so we are building a business that's growing. We grew last year, we grew year before, and we're doing pretty well this year so far. Right? February was a good month. Our margins and EBIT earning potential is improving. You see the potential that we have in Pro, 8 to 9 billion, 12.5% roughly last year from a margin standpoint. And you see that there's a lot of upside potential in that business beyond the vehicles.

Blue is doing very well, a strong product lineup. Choice. Customer choice between what we provide them. And then capital efficiency. We're intently focused on that capital efficiency, the highest best use for every dollar, each of the segments hurtling their WACC, driving the ROIC up. And then as we go into services, physical services and software services, it starts to take down, especially with the margins in those businesses that cyclicality peak to trough. And so we believe that as we execute our Ford+ plan, we deliver on those four variables, you'll see that strength continue to come through, and then we should be rewarded by the market.

John Murphy:

We completely agree. I think there's a lot of opportunity. So thank you very much for the time, John. We really, really appreciate it. It was a great session. Thank you.

John Lawler:

Thank you.