

Event Update — May 3, 2021

Autos and Auto Parts

Ford Motor Company (F)

F: More Optimistic Following Fireside Chat with Ford Management

Initial Thoughts

Today (5/3), we hosted a [post Q1 earnings](#) call with Ford's CFO, John Lawler; Ford's President of Americas and International Markets Group, Kumar Galhotra; and Ford's Head of Investor Relations, Lynn Tyson. While the Q2 semi-related production cuts were disappointing, it is a one-time issue, and we remain upbeat about the potential of the underlying business. We also are optimistic heading into the May 26th investor day with likely positive updates on EV and connected car strategies. There were three key highlights from our call.

1) Despite >3 fold increase in lost units, Ford held the impact to the high end of guidance

Coming out of Q1, investors were unclear how to frame the size of the guidance cut. Ford clarified original guidance for the semi impact was \$1-2.5bn, reflecting the loss of ~200-400k units. Post the Renesas fire the number of units impacted rose to 1.1m, yet the impact was contained at \$2.5bn. Ford highlighted the underlying performance for the business is running at the original \$8-9bn excluding the semi supply issue.

2) Sounds like Ford will not be alone in the Q2 semiconductor supply impact

In our recent [semi supply chain update note](#), we highlighted VC's guidance of production of down ~18-27% q/q, implies Ford (~30% q/q) might not be a large Q2 outlier. On our call today, we got the same impression. While Ford could not speak directly to competitors, the company thinks it too early to say they are more impacted. Ford highlighted most of the chips are supplied in modules sourced by the shared global supply chain, therefore, it would be surprising that only Ford would see a large impact if other automakers depend on these same suppliers. Ford also indicated cuts are now made on relatively short notice, as supplier schedules are changing weekly vs. monthly. This may explain why the large cut surprised most forecasters. Visibility into the semi supply chain is very challenging given there are several layers of companies between the semi manufacturers and the automakers. It is unclear how much semi inventory had been held at suppliers, though most suppliers are likely depleted of buffer stocks as this point. We also note that over the last few days, more cuts were announced. According to Auto News, GM extended downtime at Fairfax (Malibu) to July 5, Lansing (Camaro, CT4/5) is down next week until June 28, and CAMI (Equinox) is down until June 28. VW indicated it lost 100k units in March and that shortages will intensify in Q2.

3) Ford is making strong progress on warranty costs

Ford reported a \$400m y/y decline in Q1. The CFO noted there was nothing one-time driving that improvement. In addition, the warranty change was mostly driven by normal coverage, not recall related (which may be more lumpy). This indicates positive performance should be sustained if current quality holds. Ford also indicated that warranty could improve as the company leverages their connected capabilities to do over-the-air (OTA) updates, which have already been done on the Mustang Mach-E.

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Our Call

We remain OW on Ford given significant margin upside driven by new higher profit products (trucks and SUVs), the acceleration in its restructuring actions, and lower warranty.

Ford Motor Company (F)/Overweight

Price as of 05/03/2021: \$11.63

FY 2021 EPS: \$1.00

FY 2022 EPS: \$2.40

Shares Out.: 3,920,792,383

Market Cap: \$45,599 MM

How will Ford emerge different from supply issue?

Ford is focused on learning from this supplier chain crisis. There are three key areas Ford will operate differently going forward. One, the company is assessing its supply chain and determining where more buffer stock may be needed going forward. Two, the company has learned how to better manage sales with low inventory levels, and therefore will keep inventory lower than historic levels post crisis. Three, Ford is more focused on a seamless on-line order system, having developed an improved reservation system during the crisis.

More restructuring to come

Ford has indicated it will announce another \$2.5bn in restructuring actions by year-end. The company has already announced \$2.5bn of actions related to the Brazil plant closures announced in January (accrued in Q4). We think it sounds like the facilities in India might be at risk as this is the only region that was unprofitable for International. Ford has indicated it will wait until the second half of the year to provide an update on India. International margins of 8.9% in Q1 were impressive considering India was unprofitable. While Ford downplayed the potential for closing another plant in Europe, we still see the Focus plant as at risk.

Expect more color on future mobility themes at investor day

Ford will host an investor day on May 26th. We expect an update on its electric, autonomous, and connected strategies. While Ford has highlighted the need for vertical integration in EVs, we expect the company to still partner on cells, though develop and maintain propriety cell IP though Ford Ion Park. We are optimistic Ford may surprise on its connected strategy. Ford already plans to release BlueCruise on the Mach-E and F-150 via an OTA update in the second half. More importantly, Ford discussed the "lifecycle" engagement of the vehicle. Automakers that can successfully engage customers over the vehicle life will likely see significant benefits around loyalty which is massively underappreciated given the high auto marketing spend.

Investment Thesis

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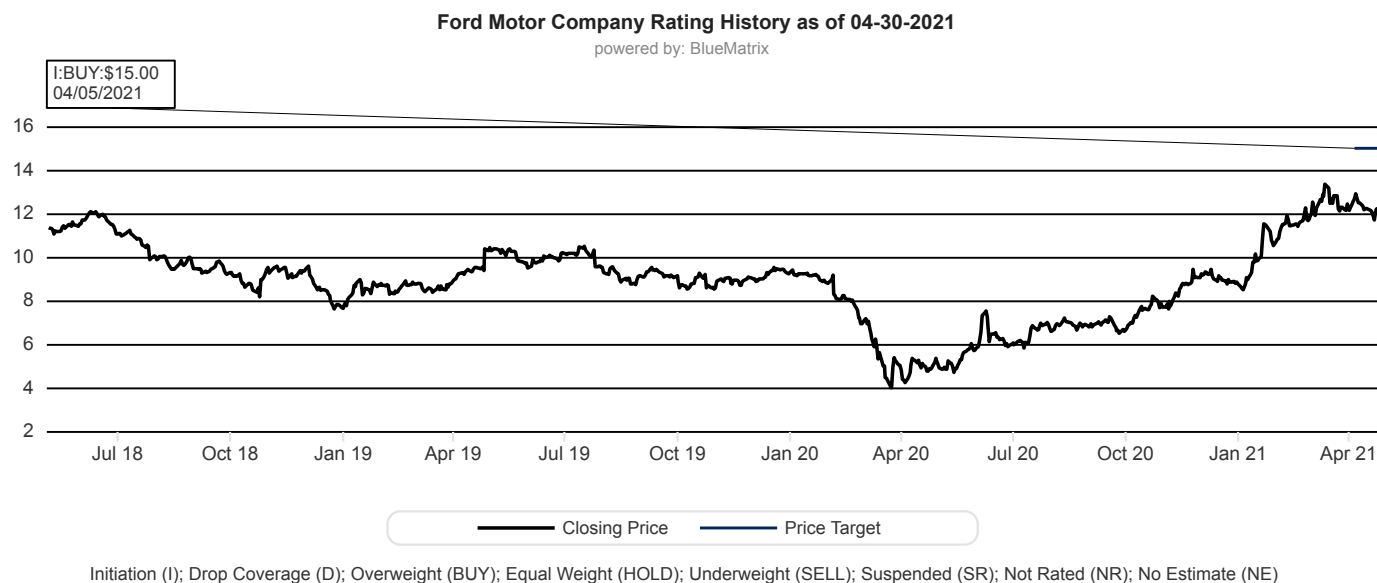
We are Overweight Ford as the new CEO is finally executing on the long awaited turnaround plan which should focus the company on profitable businesses. The company should also see tailwinds from a very strong launch lineup with the new F-150, the Bronco Sport, and the Bronco. In addition, while Ford is considered a laggard on future mobility trends, in our view recent actions show the company is leading. Their AV partner, Argo AI, is likely among the top 5 autonomous leaders; the Mach-E is a proof point that Ford is serious about EVs; and now that its vehicles are connected, we are seeing the rollout of connected features. Our \$15 price target is based on 3.25x 2022E EV to EBITDA.

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F: There are numerous risks that automakers face. Notable risks into 2021 include the impact of sudden rises in commodity prices, production volatility around the semiconductor shortage, and other supply chain disruption risks. Ford has also experienced significantly elevated levels of warranty costs over the last few years, and therefore continued performance would negatively impact results. The industry has been significantly impacted by production disruptions due to COVID; this continues to be a risk to production.

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