BEHIND THE NUMBERS

EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

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Ford Motor Co. (F) EQ Update 3Q '19

Current EQ Rating*	Previous EQ Rating
4-	4-

6- "Exceptionally Strong"
5- "Strong"
4- "Acceptable"
3- "Minor Concern"
2- "Weak"
1- "Strong Concerns"

Note that a "+" sign indicates the earnings quality improved in the most recent quarter while a "–" sign indicates deterioration

*For a more detailed explanation of the EQ Review Rating scale, please refer to the end of this report

We are maintaining the 4- (Acceptable) rating on Ford after 3Q results.

From an accounting standpoint, we still have very few points of major concern regarding Ford. **Working capital ratios for receivables, inventories, and payables all improved slightly y/y,** which we regard as a positive.

Working Cap Ratios	3Q19	2Q19	1Q19	4Q18
Total A/R DSO	149.7	152.0	152.6	140.7
Inv. DSI	36.0	34.0	33.2	29.3
Payables Days	64.3	62.3	62.7	56.1

Working Cap Ratios	3Q18	2Q18	1Q18	4Q17
Total A/R DSO	153.1	146.3	145.9	138.8
Inv. DSI	36.2	34.5	31.6	26.4
Payables Days	65.8	62.5	65.0	59.8

Working Cap Ratios	3Q17	2Q17	1Q17	4Q16
Total A/R DSO	149.8	137.5	138.2	135.3
Inv. DSI	33.9	30.4	29.4	24.2
Payables Days	71.0	64.5	64.9	58.0

Ford did lower guidance specifically related to two issues we called out in August as potential drags on performance – warranties rising faster than sales and higher incentives needed to lower inventories. *"However, fourth-quarter headwinds – higher warranty costs, higher than planned incentives in North America, and lower volumes in China – have intensified since Ford last gave financial guidance for 2019. As a result, Ford is lowering its guidance for full-year company adjusted EBIT to between $6.5 billion and $7.0 billion, compared with $7.0 billion in 2018."*

We were concerned that Ford was overly dependent on taking pricing and that continued into 3Q. We still believe when the company is dealing with rising incentives and trying to work down inventories – taking pricing is tougher to do:

Auto Y/Y EBIT Chg.	3Q19	2Q19	1Q19
Volume/Mix	-$175	-$23	-$275
Pricing	$937	$855	$1,057
Costs	-$679	-$367	-$50
FX	-$205	-$245	-$224
Other (JVs)	$49	-$4	-$231
Y/Y Chg EBIT	-$73	$216	$277

Ford Credit continues to hold its managed leverage ratio between 8-9x. However, it did tick up last quarter to 8.8x. We also noted some deterioration in its dealer credit quality. Overall, it still appears higher quality than GM. Group III credits are defined as having *"marginal to weak financial metrics."* As total dealer receivables fell by $2.9 billion, Grade III credits rose from $1.6 billion to $2.0 billion. Overall, that is still only 6% of the total.

Explanation of EQ Rating Scale

6- "Exceptionally Strong"	Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises
5- "Strong"	Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.
4- "Acceptable"	Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement
3- "Minor Concern"	Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.
2- "Weak"	Indicates the company's recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.
1- "Strong Concerns"	Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely.

In addition to the numerical rating, the EQ Review Rating may also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into the next quarter. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

Disclosure

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