



CAIRN
INVESTMENT
GROUP

COMPANY SPOTLIGHT:

Ford Motor Company

COMPANY DESCRIPTION

Headquartered in Dearborn, Michigan, Ford Motor Company is a global auto and mobility company. The company operates under two segments, automotive (design, manufacturing, marketing of automobiles) and financial services.

Bill Ford is the Executive Chairman of the Board and has been with the company over 20 years. He is the great-grandson of the company's founder, Henry Ford.

Mark Fields has been the CEO since 2014.

COMPANY HIGHLIGHTS AND FINANCIALS

As a global leader in automobile design and manufacturing, Ford has done a commendable job of reinventing itself after the global financial crisis. Ford's most recent models (Fusion, Focus, and Fiesta) have been received very well, allowing Ford to leverage its scale and size to become a leader in fuel efficient/hybrid auto manufacturing. They generate roughly 40% of revenues outside the U.S. If the U.S. dollar stays relatively stable on a year-over-year comparison this could provide a nice tailwind to reported sales and profits.

Ford has also been spending aggressively in technology to expand its smart mobility platform. This supports Ford's goal of becoming a leader in connectivity, mobility, autonomous vehicles, and data analytics (vehicle location and basic controls using smart phones, self-driving vehicles, ride sharing, and multimodal transportation).

Ford's operating performance has improved since avoiding bankruptcy in 2008 with automotive operating margins of 6% vs. an average of 1% over the last 10 years. Ford also generated over \$12 billion in free cash flow last year and has improved return on capital from the low single digits in 2015 to 9.8%, as of this report date. This, combined with Ford's consistency with returning cash to shareholders via dividends and strategic buybacks shows how focused and shareholder friendly the management team has been over time. Ford has over \$30 billion of cash on hand providing financial flexibility to pursue growth initiatives.

KEY POINTS

- :: Global leader in car design and manufacturing.
- :: High barriers to entry allow for consistent cash flow generation and high operational efficiency.
- :: Consistently in the top 20 R&D spenders worldwide according to Fortune Magazine.
- :: Above average financial health in the automotive segment with low debt levels and high cash flow generation (\$15 billion in automotive debt and \$38 billion in cash).
- :: Compelling upside as valuations and growth remain attractive.

VALUATION AND RISKS

Ford is trading at a discount compared to historical valuations and below fair value based on scenario analysis of free cash flow growth. Ford has a dividend yield of 4.7% and generates over \$12 billion in free cash flow, allowing flexibility to continue to raise the dividend over time. On a free cash flow basis, we expect the company's free cash flow to remain at current levels over the next decade. This is below its current growth rate of 12% over the previous 10 years, due to the cyclical nature of its business and where the current business cycle stands. If our conservative assumptions still turn out to be overly optimistic, we feel there is a margin of safety built into the current price based on strong cash flow generation.

Ford is in a highly economic sensitive business with strong competition amongst the concentrated auto manufacturing sector. We would like to see continued discipline in regards to capital spending and a focus on fully funding its pension plan, which currently stands at 89% funded. Continued focus on Ford's credit portfolio and its quality, along with consumer spending on automobiles, will be monitored going forward. At this point, we feel Ford offers a compelling opportunity.

—Patrick Mason, Investment Analyst, Cairn Investment Group



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