Attendance List: Ken Gregor

Title of Meeting: Fiscal 2018 Quarter 1 Results Call

Hosted By: Ken Gregor

Ken

Thank you. Good afternoon, good evening and good morning to those of you in the US. Thank you for joining us on the First Quarter Jaguar Land Rover Financial Results Call. As usual, I'll run through the presentation fairly quickly and leave time for some Q&A, which we'll endeavour to answer as straightforwardly as we can.

Therefore, I go to Slide 4 of the presentation which shows some of the key metrics, basically revenue of £5.6 billion in the quarter, up slightly on the same quarter a year ago. The underlying EBITDA, that excludes one-off items I'm going to talk about in a minute, was down in the quarter from £672 million, to £442 million this quarter. The profit before tax was up year-on-year from £399 million up to £595 million. That does include a one-time credit relating to changes that we made to put our defined benefit pension schemes on to a more sustainable basis. Those changes that we made reduced the liabilities of the scheme by £437 million, and that item is included as a credit this quarter in our profit before tax of £595 million, which leads me to Slide 5.

Slide 5 has some of those metrics plus a couple of others. Our retail volume was about 3.5% up year-on-year in the quarter to 137,000 units. And I've also shown one or two other metrics on the slide, but I think I'll move on and talk about those volumes on Slide 6.

And basically a little bit of a balanced picture here. China continued to grow strongly, supported by growth year-on-year of the XF long wheelbase in China, as well as growth of other models in China. So, China was up 30% year-on-year. Europe was solid, flat year-on-year. The US was up year-on-year 16%. However, the UK was down, due mainly to two factors. The biggest single factor was the vehicle excise duty changes in the UK at the beginning of April, and that has caused the UK market to be down. I think we're also seeing the UK market being down a bit in more general terms after a record year last year.

Overseas we are seeing a mixed picture also. Overseas for us includes, for example, Russia, the Middle East, Brazil, South Africa, Australia, and some of those markets are also down year-on-year due to continued more challenging economic conditions in those markets. But overall our sales are up year-on-year 3.5%.

Sales by model, which is on Slide 7, and I won't go through all the numbers, but just calling out one or two. You can see that we have started sales of the new Discovery and it's still in its ramp up phase right now, but solid sales for that from the markets that we had launched it in the quarter. In this quarter, no volume to speak of yet of Velar, but we'll see that a bit in July in a second. You see Range Rover, Range Rover Sport sales very solid, net up year-on-year, and a full quarter of

F-Pace this year compared to the same quarter a year ago supporting volume growth, and the increase in XF year-on-year is basically driven by the long wheelbase in China. So, overall a solid picture on the sales by model.

If you move to Slide 8, we've included a couple of bridges in Slide 8 and 9 to seek to explain the changes in profitability year-on-year. The first one we have here is the change compared to the same quarter a year ago. And there are various things going on here. First off, in terms of volume and mix in markets, although the retail volume was up, the wholesale volume excluding our joint venture, was slightly down year-on-year and that has produced the minus 28, together with some marketing costs associated with launching the new Discovery and the new Velar that we have in the quarter, and that's in the first bar.

Maybe the more significant item, from a year-over-year market point of view, is the net pricing of £93 million. And it's fair to say this is really a continuation of a trend that we've talked about in the last two calls where we've seen a higher level of incentive spending required to compete in the markets which we're in, in particular in the US, although I'd say it isn't limited to the US, but that's the largest part of this. And although the overall level of incentive spending actually remains relatively low, we have seen an increase from the very low level that we were at a couple of years ago, and that is a continuation of this trend you see in that £93 million.

In terms of material and operating costs, we see within those a number of things but mainly it's the non-recurrence of some positive items that we had last year impacting material and operating costs. We also had some of the costs associated with the growth that we're targeting in supporting the launch of the new products like the Velar, the Discovery, the Jaguar E-Pace, the Jaguar I-Pace and other models that we haven't talked about but are all coming this year. There's a certain amount of launch and growth costs associated with that, which you see in this bar.

Depreciation and amortization will continue to grow as we invest in those new models. Exchange net is positive year-on-year which is mostly revaluation of foreign currency liabilities. And then in the last bar, as you see, the one-time items, in particular the change in the defined benefit pension schemes, which we moved from a final salary basis to a career average basis and changed a number of other technical details of the scheme, that by and large reduced the liabilities of the scheme by the £437 million. And that's what you're seeing as a gain or a credit here in the quarter, adding up to be £595 million profit for the quarter.

If you move on to the next slide, Slide 9. As an extra way of maybe trying to explain what's happening in the quarter I included a running quarter that's compared to the immediately preceding quarter Q4 FY17. What you see here really illustrates something that we do face in the business, and we've talked about as being something that we expect to happen and to continue to happen, which is that our business is quite seasonal from a volume point of view, for a number of different factors.

And the two biggest factors are perhaps that the January to March period is a strong selling season in both the US, and the UK in particular with the registration plate change in March, and also in China ahead of Chinese New Year, and therefore we tend to have stronger sales in January to March than we have in April to June. We expected that to happen and that is what's happened. You see the effect of it in terms of the reverse operating levers that happened this quarter compared to the prior quarter. And you can actually see in terms of running quarters, from a cost point of view net-net it's actually modestly positive, exchange slightly negative, and the one-time items are broadly the same.

One thought with this chart is, in the full year we're clearly planning to continue to grow our volume. And although I expect our volume to continue to be seasonal relating to some model run in, model run out, some of the seasonal factors I've discussed of other vehicle launches, it does illustrate the operating leverage of the business that is there for the quarters in which we have bigger sales volumes.

Cash flow for the quarter followed a normal trend for the first quarter in this period with working capital outflow in this quarter. The working capital outflow in this quarter was around about £700 million, similar to the working capital outflow that we had last year. And within that working capital change there's also growth in inventory, in particular as we launched the Velar and launched the Discovery in the first quarter, which is a normal feature that again we expected and we planned for this quarter.

The other thing that you see from a year-to-year perspective is the growth in the product investment of £300 million, and again, of course, that's something that we expected and planned for this quarter. It's one of the reasons we're maintaining the strong liquidity that we do, in order to manage the ebb and flow of the working capital cycle within the year due to the seasonal pattern of our volumes and the timing of model run-ins and the timing of plant shutdowns. This ebb and flow of working capital is something that we're used to and are used to navigating our way around.

Slide 11 has the debt maturity profile of the business. All the bonds that we've issued that you hold are nicely timed from a maturity profile point of view across the next five calendar years. The refinancing risk in any one year is pretty modest, to be honest. And one other point to note is we did extend the revolving credit facility, which is £1.9 billion, and it's undrawn. That was extended to 2022 and basically on the same terms as the bonds that we've issued in terms of not having any financial covenant. So, a strong liquidity profile, which helps us have the confidence to move forward with the investment plans and navigate the working capital ebb and flow that I've just described.

Product is our lifeblood, and this is a very exciting year from a new product point of view, and it's bringing definitely with it launch costs and growth costs, that I've talked about. But on Slide 12 you see the positive side of all that with the brand new Discovery, a really exciting new versatile vehicle and the Range Rover Velar, which is truly stunning, the fourth Range Rover filling the gap for us that exists between Evoque and Range Rover Sport, which and has just commenced sales in the UK and will roll out to our other markets over the coming months.

The Jaguar E-Pace is a really strong addition to the Jaguar line-up of smaller crossover vehicles, a junior brother, if you like, to the F-Pace that has been successful for Jaguar, and that will commence sales in the next quarter. The Jaguar I-Pace electric vehicle we've talked about before, to be launched in 2018, and the Jaguar Sportbrake, which is a body style addition for the XF, which is also a very versatile vehicle for the Jaguar range.

So, on both sides of our brands we've got a really strong product pipeline, all these vehicles being launched this year except the I-Pace in 2018, and with other product actions that we haven't talked about still to be announced. So, yes, there's lots of launch costs and growth costs, but there's some fantastic new products which we do believe give us the possibility of driving profitable volume growth this year.

I've included on Slide 13 July retail sales, and those were also up, just over 3.5% year-on-year. You can see, for example, in here Discovery is up year-on-year as it gets launched into other markets, and you can see the commencement of sales of the Range Rover Velar. I guess some of the other features are similar to what I talked about on the prior chart, so I won't labour it, but those new models are giving us the opportunity to continue to grow our sales.

Looking forward a bit further, of course I talked about our product investment. It's not just product investment in new vehicles that we're making, we're obviously investing heavily in autonomous, connected and electric technology also. Our vehicles currently include level two features on the autonomous side, and we are investing in driver assistance technology to move forward in line with how we see the development of that going forward.

We're very much working on technology so that our vehicles are connected, everyone wishes your vehicle to connect to your mobile device, to be connected to other parts of the way we live our lives these days, and so we're investing in those systems, which is included in the $15 million equity investment in a company called CloudCar that is developing some of the technology that we expect to include in our vehicles in a couple of years' time.

We're obviously investing heavily in electrification, with the I-Pace being our first battery electric vehicle on sale next year, but also plug-in hybrids starting in 2018 that will span most of our vehicle lines in the forthcoming years and will be a very important part of giving customers what they want and what they are demanding in terms of fuel efficiency, but also obviously in terms of meeting our regulatory requirements. And although modest at the present time, we're obviously thinking also about the sharing economy and how that might develop over time, and we've made our first steps into that space, albeit modest, but it's a good opportunity for us to learn, and we've stepped up a small venturing activity called InMotion which is investing in a series of start-up activities, most of which are connected to the future of transport and mobility.

Our InMotion business unit made a $25 million-dollar investment in Lyft, which those of you in the US will probably be more familiar with as a competitor to Uber, which gives us a good opportunity to learn and also to collaborate on as that business model evolves and changes. So, you can imagine these priorities are something we're giving a huge amount of attention to as we shape the business to be sustainable for the next decade.

So, looking ahead to the balance of this year, as I've said, a very clear strategy to achieve sustainably profitable growth by investing in those products and technologies and the associated capacity. We do expect that investment spending to be over £4 billion, perhaps £4.35 billion this fiscal year, which includes the investment in the Slovakia plant. As I said, we have seen more competitive market conditions and higher incentive levels, but it is also the case most of the markets in which we're competing in are still exhibiting economic growth.

With those higher incentive levels and also the launch andgrowth costs I talked about, which we saw in FY17, we do expect those to continue in FY18. As I said already, I expect seasonality in volume and profit to continue, and typically, as you saw last year, Q4 tends to be our strongest quarter and that continues to be our expectation for this year.

With that in mind and all of those products that I've already mentioned, I think do give us the opportunity to strengthen our portfolio, attract new customers, drive sustainable profitable growth, even in markets which may be slightly less favourable than they've been in the past. Those new products give us that opportunity, and very much in the medium term we continue to plan to target to achieve a competitive EBIT margin.

And with that, I'll say thank you for your support of the Jaguar Land Rover business and joining us on the call. We're very happy to take a few questions.

Coordinator — Thank you very much. We will now begin the question and answer session. . We have a first question from the line of Binay Singh from Morgan Stanley. Please proceed.

Binay — Hi. Thanks for the opportunity. I have three questions. Firstly, on the product mix, how do you feel about the product mix for the company in the coming quarters? With the first quarter of the new Discovery and strong growth of Range Rover and Range Rover Sport, we are seeing a very strong mix, but then in the coming year we have a slew of models coming up also, so how would you see product mix moving from here on?

Ken There's always pluses and minuses with product mix, but I think product mix should be on balance a positive factor for us this year. I think the new Velar is a strong addition to the product line, and by and large as a Range Rover product it should have some good margins. So, I think that offers the opportunity of a slightly richer product mix through the year. Also, a full year of the new Discovery offers the opportunity for solid volume growth. The Jaguar E-Pace will have a good margin, but maybe a little bit lower than the average. I think net-net hopefully product mix should be on balance a positive for us this year.

Binay And relating to that, I know we are seeing a lot of debate going on in Europe on diesel, so what is the impact that you've started to see in terms of residuals or discounting, or any comments on that?

Ken It's a little bit early to say. I don't believe I've seen a significant effect on residual values at this point in time connected with that. I think we're going to need to watch and see how the argumentation and the debate plays out. From our point of view, we would say that our modern diesel engine is compliant with EU6, filtering out 99.9% of the NOx emissions and are as clean as petrol engines. Therefore customers should have absolutely no concern in buying an EU6 diesel engine car in terms of its cleanliness and of course a diesel car with that cleanliness is roughly 25% more fuel efficient than a petrol car.

We're convinced that modern clean diesel has a very important role to play in helping the automotive sector meet its fuel efficiency targets that regulators and customers wish us to meet, as well as meeting the emissions targets in terms of NOx. I think, although that debate perhaps has a little bit more to play out, I'm confident that over time we'll be able to explain that to customers and regulators because I do believe those diesel cars are very clean and an important contributor to fuel efficiency.

Vinay And just a last question, I know it was touched upon in the other call also, on other expenses we've seen even something like staff costs move up on an absolute basis, so on both these points could you share a little on that. Are we done with all the hiring for the year? It was all pushed into one quarter which is where you see the run rate in staff moving up. And in other expenses, could you divide it in terms of what is relating to publicity, something that is more new model linked which will probably sustain through the year, or is there any one-offs in terms of some markets which needed support or something of that sort which came in the other expenses?

Ken In terms of the employee costs, yes, it's increased year-on-year. Are we done with the hiring, though? I would say no, because as we continue to grow our volume we clearly need to continue to grow our workforce in order to support the growth of that volume, both in terms of the employment in our manufacturing facilities and in other areas. So, for example, this year we were producing four-cylinder petrol engines in our plant in Wolverhampton, which a year ago we were still buying from Ford. So, therefore, that is also something that grows employment in the business.

We also of course are continuing to invest in all of the products and technologies that I talked about, and I would continue to expect to see the employee costs in connection with, for example, automotive engineering, particularly in electrical and electronic engineering software engineering are areas in which we are continuing to recruit and add employment.

And a third area would be in Slovakia, where we're building our manufacturing plants, I think we have 250 people in Slovakia. At the present time, the first model that we're producing in Slovakia is intended to be launched in just over a year, and therefore in Slovakia we'll be growing our head count over the course of the next 12 months. So, yes, I would look to the employee cost in absolute terms continuing to grow.

In terms of the other income and expense, I did talk about other growth in marketing cost, and that some of that marketing cost that we've seen is included in that line. And again, most of that growth in that cost is connected with supporting the future growth in our model line-up and the future growth in our overall product portfolio. And that's a mixture of immediate launch costs that we have, for example, the big marketing costs associated with launching a new product like Velar that broadly we're doing right now, or a new product like Discovery, or a new product like the E-Pace, those costs are reflecting the launch of a lot of new products. And then there's also a bit of infrastructure cost associated with supporting the investment in new product and technology. All of those things run through that line.

Vinay — Thanks a lot for that.

Coordinator — Thank you very much for your questions, Mr. Singh. Please be advised you will be limited to two questions just so we can take as many questions as possible from our other attendees as well. Thank you.

We have the next question in the queue, and it's from the line of Florent Vallespir from Western Asset Management. Please proceed.

Florent — Hello. Good afternoon. Just a question on the rate, you're giving a profit margin before tax, and maybe it would be useful actually to get one on this EBITDA which is down 230 million. So, can you maybe quickly walk us through, because some of us haven't heard exactly what you said, unless you mean this excludes the impact of this one-off item you have at the EBITDA level. So, maybe you can walk us through the EBITDA margin.

Ken — That's actually a very good question. In simple terms, the percentage variances that are running along the bottom there are very closely the same percentage changes in the EBITDA margin year-on-year, with exchange and D&A of course being the only ones that are slightly different. So, when you look at the EBITDA margin being down just over four points year-on-year from 12.5% down to 7.9%, and yes, that excludes the one-time pension item, to answer part of your question. Those 4.5 points of reduction in EBITDA margin are mostly in the 2.5 points of volume mix and market in net pricing, and the 1.5 points of material and operating cost. Then the one other piece is the exchange variances which have elements above EBITDA and there are elements below EBITDA, and I think that's where the difference is.

Florent Okay. So, the additional £28 million, is probably something to do with the forex rate.

Ken Yes. And there is a backup slide in the investor deck, which I won't necessarily turn to now, but it does include details of which bits of FX are sitting in which line item.

Florent Okay. Understood. And just a follow up, you've given on the profitability some medium-term indication at the EBIT level, can you give us for the current year some indication either in terms of EBIT or EBITDA margin of where we should look at.

Ken We don't give specific guidance for this year, so, no, I wasn't going to give a specific forecast for this year. What I did say, though, was that broadly we expected the margin pressures that we saw last year to continue this year, and I guess a different way to interpret that might be that therefore our margins this year and the full year will be in a similar range to the margins that we saw last year, but without giving necessarily specific EBIT margin guidance, which I'm not doing.

Florent Understood. Thank you.

Coordinator Thank you very much for your question. We have the next question in the queue from the line of Sonal Gupta from UBS Securities. Please proceed.

Sonal Hi. Good evening. Thanks for taking my question. Given that the launch cost has been big, can you just quantify in terms of what's been the launch cost related impact this quarter and how much will that have been last year? So, just on a current basis what is the launch cost impact versus what we've seen this quarter?

Ken I think I wasn't going to step into that level of detail. But what, for example, I could say is our marketing and selling cost is up about £50 million year-on-year, and within the material operating costs there's about £20-£30 million of higher costs year-on-year associated with costs in our manufacturing facilities. So, it just gives you a dimension of the size of the costs that we see year-over-year, most of which is connected with the growth of the business, some of which have been specific launch costs and some of which is more connected with the general growth, but that dimensions it.

Sonal	Sure. Just moving back to another participant's question on diesel mix, just related to that, from a longer-term perspective by FY20 what should be the percentage of hybrids in terms of our volume mix, and I understand you launch the I-Pace next year, so hybrid and electrics in terms of fuel mix, and what does that mean for margins over the medium term? If you can give some qualitative view on that.
Ken	I think that's probably one for a future, more strategic presentation and discussion, to be honest. So, I think I'll probably defer that for a future discussion. It's undoubtedly the case that the mix of electric vehicles and plug-in hybrids will be significant come 2020. But it's very difficult to give a precise forecast of what they will be because of course it's tremendously uncertain in terms of the consumer pickup and demand for those products. So, I think at this time what I would say is you can trust that we're investing in our family of battery electric vehicles, we're investing in our family of plug-in hybrid vehicles in order that in FY20,'21,'22 and beyond we're able to meet customer demand. But it's fair to say that even internally we would keep quite a wide range of possible outcomes in terms of where that volume would be. But I think maybe those bigger, more strategic questions, I think I'll park for a future call.
Sonal	And in terms of the China draft reglations on emission vehicles, I just want to clarify, when they look at the entity, would they include Chery as well, or will JLR be separate from Chery?
Ken	In terms of China emissions regulations?
Sonal	Yes.
Ken	By and large it's done on an entity basis, so our joint venture needs to be compliant in its own right, and our sales company in China needs to be compliant in its own right.
Sonal	Okay. Great. Thank you so much.
Coordinator	Thanks for your questions. The next question is from the line of Kumar Rakesh from BNP Paribas. Please proceed.
Kumar	Hi, again, and good evening. Thanks for the opportunity. You guys talked about a higher value in marketing expenses, especially in the US. My first question is, do you think in the coming quarters you can see this trend expanding to other geographies as well?
Ken	I think overall we are seeing a somewhat higher level of those variable marketing expenses. As I said, the US was the largest single market within that £90 million increase year-over-year, perhaps just over half, but in other words we are seeing those higher levels in other geographies, maybe at a more modest level but nonetheless higher. So, I think we're already seeing it, to be honest, is what I would say. And looking forward, I think it's a trend that we've seen and so in principle probably year-on-year we'll see another increase in the next quarter,

but in principle if it stays at this level perhaps the year-on-year increases will be a bit more modest in Q3 and Q4. But clearly time will tell, because we need to see the way in which those markets develop.

Kumar Understood. My second question is, do you think the higher competitive intensity which you talked about could result in a weaker ramp up of your recently launched and upcoming models than what you were initially expecting?

Ken I hope not. I think one of the very positive things about the experience of our business has been even in times when economies and markets have been relatively more challenging, the one thing that really helps a business in the premium automotive business do well is having fresh, relevant new products. And I think, therefore, having all of the products that I talked about being launched this year gives us really the best antidote to those somewhat more challenging market conditions than we could possibly hope for, and therefore I'm pretty excited about the possibility of the Velar building our volume and our sales this year, and for the Jaguar E-Pace, for example, doing the same thing on the Jaguar side of the brand.

I think those offer good chances to move forward just like, for example, over the last 12 months the F-Pace has sold broadly 70,000 units from a standing start, and that has been in those somewhat less favourable market conditions than maybe we had two or three years ago. So, I think we have a good track record that so long as we get those products really exciting and relevant for consumers, then they give us a chance to move our business forward.

Kumar Thanks for that. I'll go back in the queue.

Coordinator Thank you very much for your question, Mr. Rakesh. We have the next question from the line of Harsh Agarwal from Deutsche Bank. Please proceed, Harsh.

Harsh Hi. I have a couple of questions as well. One is, given the pressure on margins and talking about this year the high capex needs, is there a potential that you see that the balance sheet turns into a big open net debt position, at least in the near to medium term? That's the first question.

The second question is really more housekeeping. I see you paid about £60 million sterling in dividends in the first quarter of this year, and correct me if I'm wrong, historically, I think last year that number was £150 million. Is there a reason why that cash outflow in the first quarter has come down from £150 million to £60 million? That's it. Thank you.

Ken The £150 million dividend, if I just take that, that will still be paid at the same level, it's just being spread over a couple of quarters this year.

Harsh Okay.

Ken	So, there's really no change there. So, the balance will be in Q2.
Harsh	Got it.
Ken	On the net debt question, we would be going some before we get into a net debt situation, it's fair to say, given the cash and the debt that we presently have. But I think what I have said is we do see the possibility of some negative cash flow after the investment spending in this fiscal year, that was our guidance, and that is still the case. We started the year with around about £5.5 billion of cash and £3.5 billion of debt, so I think we would be running forward a little bit of time before we saw a repeated net debt situation.
Harsh	Okay. Got it. Thank you.
Coordinator	Thank you very much for your questions, Harsh. Ladies and gentlemen, unfortunately that's all the time we have for questions today. I will now hand it back to Ken Gregor for closing remarks. Thank you.
Ken	I just wanted to thank you for taking the time to join us, thank you for your support for the business, and I look forward to talking about our further growth in future quarters.
Coordinator	Thank you. Ladies and gentlemen, thank you. On behalf of Jaguar Land Rover this concludes your conference. Thank you all for joining. You may now disconnect. Have a great day ahead.
	[END OF CALL]