Attendance List:	Ken Gregor – Chief Financial Officer Ben Birgbauer –Group Treasurer
Title of Meeting:	Fiscal 2018 Quarter 3 Results Call
Hosted By:	Ken Gregor

Coordinator

A very good day to you, ladies and gentlemen. Welcome to the Jaguar Land Rover's Fiscal 2018 Quarter 3 Results Conference Call. We have with us today, Mr. Ken Gregor, Chief Financial Officer, Jaguar Land Rover; and Mr. Ben Birgbauer, Group Treasurer, Jaguar Land Rover. Please note that this conference is being recorded.

I will now hand the conference over to Mr. Ken Gregor. Thank you. Over to you, sir.

K. Gregor

Thank you very much, and good afternoon, everyone. Thank you for joining us on the call. Just a point of housekeeping, I guess, is advice of our different approach this quarter. Yesterday we had a combined Tata Motors and Jaguar Land Rover investor call, open to equity investors and also bond investors, as well as analysts, etc., and obviously we had a lengthy Q&A session yesterday.

The purpose of this session today is for JLR bond holders specifically, and therefore in the Q&A, at the end we will only be taking questions from bond holders, not from equity holders or equity analysts. I hope you understand, and bear with us on that if you do; to those guys involved on the equity side, the time for that discussion was yesterday.

Let me move into the presentation. Slide 4, we're talking about some of the business highlights for the Jaguar Land Rover business that even in these challenging market conditions that we've been experiencing, we're obviously continuing to press ahead with what we believe in, and what is our life blood, which is our new products and the associated capacity and technologies that support them.

In particular, we're really excited about the fact that we started sales of E-Pace in the UK. In the quarter, we have started now with the '18 model year Range Rover and Range Rover Sport, including PHEVs on both models. We've got a long wheel base XE on sale in China now, in our joint venture, which is locally produced there. So from the model point of view, lots of fresh new product, which is great.

And from the infrastructure point of view, we continue to press ahead with the development of our manufacturing facility in Slovakia, which remains on track for production at the end of 2018. And of course we continue to invest in our engine facility, and the transition of our engines from Ford-derived engines to our own developed engines, which is ongoing.

If I just move on to slide 5. In the quarter the revenue was higher, up about 4% on a similar increase in wholesale volume, I'll talk a bit more about volumes in a second. The profit before tax was a little bit lower, largely due to the non-recurrence of a one-time factor in the same quarter a year ago, and underlying that the EBITDA margin was modestly higher than the same quarter a year ago, although the EBIT margin itself, because of the higher depreciation and amortization, was lower than the same quarter a year ago. And then the nine month figures obviously just build on the six month that we've already discussed.

How do we see volume development in the quarter? Well, I think it's fair to say there's relatively more challenging market conditions that we've seen across the world in the quarter, building on trends that, to be honest, we've seen emerge, develop, and continue over the past year.

In particular in the UK where the market peaked in 2016, we did expect to see the market reduce in 2017, which it did indeed do. It's fair to say that the size of the reduction was bigger than most people were expecting, but also, within it, the size of the reduction in the diesel segment of the marketplace was bigger. And both those factors have impacted our sales in the quarter, which were down 8.5% year-on-year in the quarter.

Similarly in mainland Europe, where we saw volumes lower by about 3% year-on-year, again that's impacted the market overall in Europe, it was a bit higher, but the proportion of diesel within Europe was somewhat lower. We do believe that that has had an impact on our sales in Europe in the quarter.

And in North America, I think we saw again, a little bit like in the UK, to some extent we saw a peak of the market in 2016, and then through 2017 a somewhat lower overall industry in the US. I think that's part of the reason we're seeing lower volumes in the US.

Against all of that, China has been a strong point. Actually, the market overall in China has been relatively flat, but we have managed to remain on the front foot in China during the course of this year, which has been good to see. And also some of the markets in our overseas region have started to recover a bit from where they were, so that's also been a positive for us. A mixed picture, I think it's fair to say. Overall up, but certainly with some challenges related to diesel in the UK and Europe.

When we look at it from a model perspective, on slide 7, one of the other features in the quarter has been the changeover—that I've already alluded to—of the Range Rover and Range Rover Sport, from '17 model year production to '18 model year and therefore all sales ramping down somewhat in the quarter before the ramp up of '18 model year with the plug-in hybrids on Range Rover and Range Rover Sport, which really from a retail point of view we should start to see the benefit of this quarter and then developing over time through the next fiscal year.

The other reason for mentioning it of course is those are two important products from a margin point of view. So the lower wholesale volume that you see there in Range Rover and Range Rover Sport from a year-over-year point of view has a negative impact on our overall product mix in the quarter.

Against that, not all negative of course on the volume front. We've got the Velar starting to make a solid contribution in the quarter. We built the awareness and the retail sales development of the model, 17,000 units in the quarter, and good performance from the new Discovery model continuing to build through the year compared to this time a year ago.

A couple of highlights on the new models. Range Rover and Range Rover Sport, a bit more in transition is really the picture there for the quarter. In terms of just getting into a bit more detail on the drivers of the change in profitability, they're kind of set out on the bridge on slide 8, walking from the £255 million last Q3 to the £192 million this Q3. Also with the memo line for the impact on EBIT margin running along the bottom, and really what you can see there is a couple of features I mentioned.

We do have positive volume, that I've talked about, but we also have higher variable marketing that we have seen in the quarter in order to support, including the run out of the '17 model year product that I mentioned, but also just relatively more challenging market conditions that I've already been describing, for various reasons, US, UK, and Europe in particular, causing that £73 million negative movement in the quarter year-on-year, and really, unfortunately, building on a trend that we have seen in prior quarters.

The structural cost increase of 178 is mostly depreciation amortization, although it also includes somewhat higher marketing and selling costs on the advertising and promotion side in order to support the launch of those new models.

On the foreign exchange side, positive year-on-year. That's mostly the non-recurrence of a negative revaluation in the same quarter a year ago, and in the other column you've got two factors. You've got the non-recurrence of the £85 million Tianjin-related recovery that was there in the same quarter last year, which has been offset by a local market incentive that we get from time to time in China, and we've called that out there. So that was received this quarter.

And then the one other thing, a positive on the contribution cost that's mostly related to the net of various factors on the material cost of our products, including commodity hedge gains, offsetting some negative underlying commodity price movement that happened in the quarter.

So, if we just move on, the cash flow side is impacted by the continuing level of investment that we expected and also the working capital movement, which is primarily inventory related to the model changeovers that I've already described, which did mean that we had more work in progress in our factories and vehicles in transit to markets at the end of the quarter than we did this time last year, and therefore saw a negative working capital movement in the quarter. And all of those things together resulted in a negative cash flow movement of £660 million in the quarter.

I'd say that the working capital movement I would expect to be a seasonal related factor in principle, as those vehicles work through the pipeline. In Q4 we should see that working capital turn positive in Q4 for that reason and the other normal seasonal factors that tend to cause the working capital to be positive in Q4, which should improve the cumulative negative cash flow picture that we've had over the last nine months.

The investment spending was basically on track, with our expectation to be north of £4 billion of investment spending this year between the research and development spending and also the capital investment in physical tools, equipment, capacity, including the implementation of the factory in Slovakia that is proceeding well.

Slide 11 has the debt maturity profile, basically illustrating that despite the negative cash flow we've seen over the last nine months, the positive thing is we do have very strong liquidity and we do maintain that of course to be able to cope with the ebb and flow of the business and product cycle, as well as the seasonal cycle that we have. And we do have those maturities profiled over the next six years, so in principle providing a manageable refinancing challenge for us over that time.

In terms of slide 12, just a little bit more detail on the year-on-year movement in foreign exchange. Actually this quarter we saw sterling strengthen a bit compared to the last quarter a year ago. So, for example, pound against the dollar averaged about £1.35 in the quarter compare to £1.23 in the same quarter a year ago, around about. That factor, together with the associated impact of other movements on operating rates, actually gave us bad news operating exchange of around £130 million compared to the same quarter a year ago, but that's actually offset with a positive movement on realized hedges of about £150 million. So, basically the hedge program continuing to work to balance out the operating movements.

Then the one other factor that we've got is mostly a non-recurrence of a prior period FX revaluation loss. Hence, the £102 million explanation of what was in our profit waterfall.

I've got a few slides here, just changing gears a little, if you like, from the quarter itself to just a couple of reflections on our strategy and steps going forward. Amongst, of course, the ebb and flow of our quarterly financial results that we talk to here, of course, we're very much focused in the auto business on long-term investments intended to address the long-term trends that we see in the automotive sector. From that point of view, our strategy is, and remains, to continue to invest in fantastic products that we hope and believe our customers will love for life. That's what we're organised around, putting our customer at the heart of our business in the belief that that's a good long-term track to sustainable, profitable growth.

Of course we don't do it in a vacuum, so slide 15 highlights a number of the challenges—I'll try not to read them all out—along the top of the chart. All of these things, whether it's electrification, or market forces I've talked a bit about already, or Brexit, that I haven't really laboured, we see all of those challenges. And of course we are seeking to respond to them through, in particular, investment in hybrid and battery electric technology, in the fantastic new products that I talked about, in new technologies, and not forgetting we're very focused in the business on driving cost-efficiency in order to offset some of the cost of the investment in all of the technologies and capacities and electrification that we've been talking about.

Just to move on to slide 16. I think I've talked about the recent trends in industry volumes already, which clearly provides some more nearer term challenges that I've described. Slide 17 suggests that in principle we should continue to see growth in the premium car industry and markets over the next four or five years.

And in principle that gives us a couple of opportunities: A) these segments are large and we remain relatively more modestly sized; and B) these segments in principle should continue to grow, and therefore, we, as a business, have the opportunity, assuming we make the right choices about the investments and get our products absolutely spot-on, give us the opportunity to both grow our market share within large segments, but also grow as those segments themselves grow. And that certainly underpins our business plan.

On slide 18 we highlight some of those new models that I'm really alluding to, together with some of the awards that we've won, not just to make us feel good about ourselves, but also just to evidence that our product lines really are very competitive with the best in the business. And that's really showcasing a couple of new editions: the E-Pace, I already mentioned, in the middle of the page; the Jaguar I-Pace, electric vehicle, on sale in 2018; and something for the future, the Land Rover Defender, where the replacement is in development right now, so that's quite an exciting thing to be talking about in future meetings.

Slide 19 talks to some of the things that we're doing to address the autonomous connected electric-shared future, the shared-trends that we see for the automotive sector in the next decade. And the positive thing is here basically we are investing in all of these pillars on this chart in order to be ready for that future, including, as we've shown on slide 20, electrification, which I've talked about already.

But I think the nice thing about it is we did announce in October that all of our vehicles from 2020 would offer electric options, be that either a plug-in hybrid, a mild hybrid, or be themselves full-battery electric vehicles. I think what's nice about it is we've been working on that for a number of years, so it's nice to be able to talk about it now, and you see the first plug-in hybrids on Range Rover and Range Rover Sport coming into the marketplace, and of course on the I-Pace we'll be talking more about that in future calls, but intended for release mid-2018, as the slide says.

Which really brings me to my last slide before we have a chance for a bit of Q&A. Yes, we see a relatively more challenging global environment, including some of the pressures in the US and the UK and Brexit and diesel, uncertainties that I've talked about. Those more challenging markets do tend to bring more competitive pricing, which we're having to face up to; all of those things of course also having the challenge of electrification and other technological change happening. From the point of view of our business, we continue to invest in those new products, technology and capacity in the belief that that is the best way to drive profitable growth for this business.

For Q4 in FY'18 we would expect to see a stronger performance driven by some seasonal factors that obviously I've talked about on prior calls, but also the new models that we've launched starting to produce some volume in the quarter. In the longer term we still plan towards our EBIT margin targets really seeking to continue to drive operating leverage and focus on the cost efficiencies as two of the enablers to help us get there.
And then one other point is, and this is a point that Balaji of Tata Motors made in the call yesterday, we always keep our asset base, our investment priorities, our policies under review, and that's something we do every year. It is something that we're going through that sort of annual process, and if we have anything to announce on that then we'd likely do so in three to six months.

But all and all, that's the quarter. Thanks for bearing with me as I step through a slightly longer presentation than normal, but I appreciate your forbearance on that and happy to take questions.

Coordinator

Thank you very much, Mr. Gregor. Ladies and gentlemen, we will now begin the question and answer session. [Operator instructions]. Please standby for your first question. Thank you.

Our first question is from the line of Christopher Bolanga from Barclays. Christopher, please go ahead. Your line is now open.

C. Bolanga Thank you. I will have two questions. The first question is around Brexit, and the second one is around your investments.

Around the Brexit question, the first one is, can you share with us what is the level of your dealer inventories in the UK at the end of Q3, and how does it compare to last year?

And also with regard to the retail sales and subsequent production schedule, how do you see those two developing the next two quarters, especially following Brexit?

And for investment, really, we're looking into fiscal year '19, the main question is, do you see auto investments going down, or being up year-over-year. Thank you.

K. Gregor A couple of good questions. I actually don't have at my fingertips the specific level of dealer inventory in the UK, so that might be one for a little bit of a follow up offline.

But I think in general terms we have seen the UK market, as the figures show, continuing to be challenging through the course of the last nine months, basically since we started to see it going into reverse, in April, May, following the vehicle excise duty changes that took place and then sort of gathered pace a bit, with added diesel uncertainty. You know it's difficult to know exactly what the causal factors are because the UK market did have a peak last year, so there's a certain seasonality that one would expect to see that may be reinforced by general UK economic conditions being weaker, that may be reinforced by Brexit factors.

So, it's a little bit hard to know all of the underlying drivers, except for the fact that we certainly see sales being weaker. And although I don't have the data at my fingertips to answer you, I suspect that our inventory at the end of December is a little bit higher than might have been the case for December a year ago, because sales have been a bit slower and it takes a bit of time for the pipeline to adjust.

But it is the case that we do take steps to manage the pipeline, and we've been very focused, as we've seen sales patterns changing through the course of the year, to manage our production processes in order to align production with demand. That's something that I'm particularly focused on a week-in week out, in order to make sure that we keep inventory levels as best we can in line with where we would like them to be despite changing demand patterns.

And looking forward, you know what, I think it's difficult to say exactly how we see the UK market. I think we have seen a reduction this year. I'd hoped that we'd see some stabilisation in 2018 calendar year for the UK market, but very much, I would say, we probably need to get March under our belts first before being able to have a better sense of how the year as a whole would continue.

For investment, a fair question on investment, we actually didn't plan to give specific guidance on investment outlook for the next fiscal year in this call today. Actually one of the things that my CFO counterpart at Tata Motors announced yesterday was the intention to have an Investor Day in India in June and also for Jaguar Land Rover in June. And I think at that time, it might be a better time to be talking about how we see the investment plans for 2018 and beyond, that would be a better time at that point, so we weren't going to give guidance today on that.

C. Bolanga — Okay. Just maybe a follow up on the Brexit one.

K. Gregor — Sure.

C. Bolanga — Do you see, actually, other regions offsetting for the decline in whole sales in UK for the next two quarters?

K. Gregor — In principle, one of the positive things about our business is we do have a geographic spread that has 20% volume in each of the five regions that I talk about, so that possibility is certainly there, yes. And the other thing I'd say is that we also do have all the models that I've been talking about, Discovery, Velar, E-Pace, and '18 model year Range Rover and Range Rover Sport, plus I-Pace coming, but all of those models now being launched does give us good opportunity to grow our sales, despite the relatively more challenging market conditions. So, that's in front of us, but that possibility is there.

C. Bolanga — Thank you.

Coordinator — Thank you very much for your questions. We have a next question from the line of James Maxwell from Henderson. Please go ahead, James. Your line is now open.

K. Gregor — Hi, James.

J. Maxwell — Hi, there. Good afternoon. Can you hear me?

K. Gregor — Yes.

J. Maxwell — Cool. Brilliant, okay. A few questions, if I may. What you're seeing in diesel obviously is tougher. I'm wondering to what extent you have any indication that by offering plug-ins now that is enough to offset the decline there? That's the first question.

Secondly, you mentioned particularly Range Rover, Range Rover Sport how important it is from a margin perspective. Are the plug-ins margin dilutive, presumably there's more technology being offered there, and I'm not sure whether it's being recovered in the price. How do you see that evolving? Because it looks like this trend against diesel seems pretty relentless, to be honest with you, regardless of the facts, so just some more colour around that.

Second question, just looking further out, getting to this 8% to 10% margin target you talked about operating leverage and cost. How far in the future do you think that is? Do you need to be selling a million cars by then? And I'm wondering, you've obviously done quite a lot of launches of late, some of what I would expect to be the higher margin products, whether it be Discovery, or now the Velar, and of course the refreshes on the Range Rover product. I'm wondering whether you think you've done enough, or what you need to do to get towards those targets.

And then thirdly, just specifically on the working capital, can you remind me what it is, the outflow for the year-to-date figure? Are you saying you expect that to all correct in the final quarter? Thank you.

K. Gregor

Those are a good couple of challenging questions in there. On the working capital for the nine months the working capital movement is £700 million negative for the nine months in round numbers. And that's caused by, primarily, partly an expected growth in inventory related to the new models that we've launched, in particular, Velar, which because we're adding a new model into the pipeline has caused more inventory to be in the pipeline, so some of that is with us. But I would still expect a sizable part of that £700 million year-to-date working capital movement to reverse in Q4, would be my short answer on that one.

Just going back, your question immediately prior to that related to diesel plug-in and diesel and plug-in hybrids. The short answer is on the plug-in margins, yes, a plug-in hybrid, as you rightly say, does have more technology, and in particular it has not just an engine, and a fuel tank and a gear box, but it also has an electric motor and modest battery pack, and those extra bits add more cost.

Overall, therefore, margins on plug-in hybrids tend to be a bit more challenging than margins on regular products, but we do price them at a somewhat higher level to seek to recover some of that cost. They tend to be priced more like V8 engine cars.

I think what I would say is overall the volumes of plug-ins are expected to be relatively modest in our overall scheme, at least in the shorter term. Therefore, I think even if there is a slightly dilutive effect of the vehicle itself, our challenge is to find cost efficiencies and other actions to make the overall business work, would be what I'd say.

Is it enough to offset diesel? I think diesel is an interesting question. We believe diesel has an important part to continue to play in our product line-up, and in that of the car business going forward. Therefore, we are and have been investing in modern EU6 technology diesels, and we're investing in the next phase of clean diesel.

Those diesel cars are as clean as petrol cars. I think there is more work to do, clearly, to convince customers, and regulators, politicians of those facts, but they are facts. But one of the positives is we do have a flexible engine facility, so we have our engine manufacturing at Wolverhampton was deliberately designed to be flexible between petrol and diesel engine assembly. So, to the extent that we see mixes change, we are able to respond by changing the balance between petrol and diesel engine production over time.

The other thing you asked a question on, just to pick up your fourth question, was on our long-term margin target. To be honest, I think the time to talk a bit more about that would be in our Q4 call, but at the end of the day we do need to continue to grow the volume in the business. We have some fantastic nameplates, but of course we'd like to sell somewhat more of each of those vehicles, so long as we can do that profitably.

We don't believe in chasing volume at any price, because ultimately that doesn't produce sustainable volume growth, and what we want is that profitable volume growth. But assuming we do continue to grow that volume, it should provide the operating leverage I've been describing.

On the cost efficiency side, we kicked off our project internally that we call Leap, in the face of seeing the challenge of CO_2 related cost and a certain new normal emerging in China. We kicked this off over two years ago, and we continue to press forward with it. The focus areas for that are in material cost efficiencies. So of course, us, just like every other auto OEM, very focused on driving down the level of material costs in our products in order to offset of the cost of the increasing technology, such as plug-in hybrids, that we're putting into the cars, and that includes a couple good examples.

The reason we're building a manufacturing plant in Slovakia is not just to access a lower cost manufacturing footprint in Slovakia, it also enables us, for the vehicles that we produce there, to access a supplier base that's further east in Europe and somewhat lower cost than the supply base in the UK, for example. So, that's an important part of that. And another example is the pension changes that we made at the beginning of the year that produced a one-time benefit in Q1, this was part of an action to reduce the ongoing cost of our defined benefit pension scheme that also is part of our focus on cost efficiency.

I mention those things just to provide two examples, one on the material cost and one on the operating cost side of the business, just to give a couple of examples of the sort of things that we've been working on, those things and everything in between, in order to drive cost efficiency. Over time, we do hope to see the benefit of that more in the numbers than perhaps we see right now, but that we remain very much focused on.

J. Maxwell | Thank you. Just on the diesel specific, is there any danger because of what's happening investments that you've made that are on the balance sheet you might have to reappraise and potentially write-off?

K. Gregor | That's a good question. Obviously, that's something that we keep very much under review. I think right now I'd say that we do see a continued future for diesel as part of our product line-up into the foreseeable future.

The second thing I'd say is that our engine facilities are flexible between petrol and diesel, and therefore, to the extent we did see diesel reduce, we'd be able to move those facilities more into petrol engine production. Which doesn't mean that there isn't any risk of what you describe, but just a couple factors that might mitigate that risk.

J. Maxwell | Great. Thanks very much.

Coordinator | Thank you, James. There will be no further questions

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K. Gregor | In which case, I'd just like to say to all, thank you to everyone who's joined us today and also people who joined us yesterday. We really appreciate the engagement, appreciate your support for the new approach. We were doing it yesterday and also today just to provide two opportunities, if you like, for the bond holders, who may not want to join the full Tata Motors investors call, we're sensitive to that.

We'll talk again next quarter. In the meantime, thank you very much.

Coordinator | Thank you to the speakers. Ladies and gentlemen, that concludes your call. On behalf of Jaguar Land Rover, thank you for joining. Have a great day ahead.

[END OF CALL]