"Jaguar Land Rover Q2 FY14 Earnings Conference Call"

November 8, 2013

MANAGEMENT: **MR. KENNETH GREGOR – CFO, JAGUAR LAND ROVER**
MR. BEN BIRGBAUER – TREASURER, JAGUAR LAND ROVER

MODERATOR: **MR. LIOR JASSUR – HIGH YIELD RESEARCH, HSBC**

Moderator: Ladies and gentlemen, good day and welcome to the Jaguar Land Rover Q2 FY14 Earnings Conference Call hosted by HSBC. As a reminder, for the duration of this conference all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr**.** Lior Jassur from HSBC. Thank you. And over to you Sir.

Lior Jassur: Thank you very much, and thanks again for joining Jaguar Land Rover fiscal year 2014 Q2 earnings call today. We are glad to have with us from the company, Mr. Kenneth Gregor – CFO of Jaguar Land Rover who will be your speaker today joined by Mr. Ben Birgbauer – Treasurer of Jaguar Land Rover; and Mr. C Ramakrishnan CFO of Tata Motors. Mr. Gregor will now walk you through the presentation. Sir, over to you for further proceedings.

Kenneth Gregor: Thank you. Good morning, good afternoon everyone on the call. Hopefully, you have all got the presentation of the Q2 results for the quarter-ended 30th September in front of you. I am going to walk through relatively quickly, try and leave some time for questions as normal at the end.

I am on Slide #5 of the presentation. A great quarter for the Jaguar Land Rover business; this was a record quarter in terms of financial results in the quarter, we have really a number of things in our favour with record sales, revenue, and profits in the quarter. The Retail volume over 100,000 units, almost 20% up from the prior year, really driven, of course, by the strength of having a full quarter of the new Range Rover, and also the launch of the Range Rover Sport in the quarter. Revenue £4.6 billion. EBITDA very strong; a couple of specific factors in there, it is stronger perhaps this quarter than it might be other quarters, but just under 18% and headline PBT supported by the high EBITDA also some positive foreign exchange revaluations, £668m. Nice cash flow for the quarter basically bringing to a position where the free cash flow after the investment book for the interest is positive for the six months today, which is good. And all combined leaving us with a continued healthy liquidity position at the end of the quarter.

Slide #6 has some of the key metrics there. You can see obviously the strong EBITDA that I will talk about in a bit being about 3 points higher than the same quarter a year ago and for the six months of the year running cumulatively about 17%. The profit after tax growth clearly driven by the profit before tax growth, and on it you can see the positive cash flow for the six months ended 30th September of £89m which I called out. A bit lower than the positive cash flow for the six months last year, but that is the higher products investment which will come on to really driving that. So, overall, really pleased with all of the metrics on this page.

Slide #7, a little bit more texture on some of those details that the Land Rover volume growth in Retail terms about 15% – new Range Rover and Evoque sales growth. On the Jaguar side it was the F-Type, Sportbrake, all-wheel drive, smaller engine options, really all combining to year-on-year give us over 50% volume growth which is pretty good and gives us some confidence in the future volumes of Jaguar that when we get the products execution rights and market positioning and message is right we are able to grow the volume of the Jaguar brand. EBITDA of £823 million with margin of 17.8%. It is supported by strong Wholesale volume increase obviously on the back of the Retails, quite a rich product mix with the launch of the new Range Rover Sport, new Range Rover and Jaguar F-Type, also continued strong geographic mix that you can see from the volume chart that I will come to. It does include about £79 million of local incentives in a couple of markets, those are a bit of one-time feature in this quarter compared to other quarters. It is about double the number in the same quarter a year ago. PBT, I think you see when you get to the detailed income statement is obviously the EBITDA within the PBT is higher for the reasons I just described and there is also in the PBT of £679 million as well as the local market incentives. There are also £73 million of foreign exchange gain primarily reval. Within that headline £668 million, there are those two one-offs if you like, the local incentives and also the reval. But, clearly even without those numbers this would have been a strong quarter. Some change in UK tax rate in Q2, causing a change in the deferred tax balances giving us a slightly lower than normal effective tax rates in the quarter at 24%.

Following Slides #8 and #9 have the volume picture. I think I have covered really slide 8, which is the volume slide carline, you can see the growth in Range Rover and you can see the introduction of the new Range Rover Sport making the total Range Rover Sport volumes to about equal year-on-year. That will be an area to look for in the subsequent quarter. I think you are seeing it in growth and you can see year-on-year growth in Evoque, Discovery and Freelander. Quite pleasing I think on the Land Rover side to have continued momentum on those products as well as the new Range Rover and Range Rover Sport.

On the geographical picture you can see a similar pattern related to prior quarters, in this quarter compared to same quarter a year ago with growth in every market. A little more muted in Europe which I think probably you all understand although stabilized, I think the continued weaker economic picture in Europe than in other major places with continued strong growth in China.

Detailed Income Statement on Page #10. Here you can see the foreign exchange gain in the quarter, actually probably enough we had a gain this quarter a year ago, but as you all know this depends very much on the balance sheet foreign exchange rate at the end of the quarter, so it can swing around a bit, but a positive this quarter like the same quarter a year ago. For those of you who are wondering, the local incentives are in the other expenses line, netted those positive numbers are in the other expenses line, so above the EBITDA line. Do not really think that there is anything else to add there. On the cash flow, as I said in the prior quarter's call I did expect to have a working capital related inflow this quarter, which we did have to the tune of £240 million in the quarter, so the EBITDA of 823 broadly being mirrored in the cash from operating activities is the same number supported then by positive cash inflow from working capital, which is a bit of reduction in inventory and a little bit of growth in payables and other short term liabilities really reflecting the higher volumes in the quarter in September month in particular. Driving strong cash flow from operations, you can see the higher investments in the quarter, all consistent with what we talked about for the last 6 months, which is the overall product investment level including by the way the expense engineering but will be in the region, still in the region of £2.75 billion for the full year, for the first six months 1.1 billion although that does exclude the expensed engineering. And there you see the cash flow and the other changes in debt and finance expenses, etc. So strong cash flow picture helping to support that growing level of product investment.

The financial structure on Page #12. It has been our goal to continue for raising the product investment level to continue to have a solid balance sheet and financial picture, and I think you would all agree we still have that, that is what the metrics on Slide 12 say, compared to this time a year ago, of course we see the picture where you got the higher level of the revolving credit facility that we increased from just under £800 million to £1.25 billion as well as the higher level of cash on the balance sheet reflecting that cash inflow from operations. Also, of course the bond that we did in January supporting that higher cash position and higher debt position, but with healthy looking liquidity metrics.

Turning to what is coming up, we, at the Frankfurt Motor Show back in September I think we announced a range of family of Jaguar products that we have alluded to, it is fair to say on these calls previously that we will be introducing a smaller Sedan for Jaguar on an aluminium architecture, will go on sale in 2015, will be the first aluminium monocoque in that segment. We actually showed also Sports Crossover concept for Jaguar that would also be a part of that product family, and coming from the same architecture with that architecture helping us to deliver really good CO_2 numbers combined with engine from our new engine factory, which by the way progresses really well.

In other developments, we have confirmed the launch of diesel SUV hybrids in Range Rover, Range Rover Sport. A couple of other non-financial things. Nice award actually, quite an important award in the UK by getting named "Responsible Business of the Year" by Business in the Community and we are the lead partner in the National Automotive Innovation campus which is being set up nearby at Warwick University and we will invest £50 million in that collaborative research centre with other partners and government.

We got a rating upgrade from Moody's to support the similar update we already got from S&P. All of which you will know.

Basically Slide #16, just a summary, really solid performance in the first half of the year, really quite pleased with the results. Of course not complacent, there are lots of challenges out there and we have got a challenging cycle planned at new products to deliver. We will monitor economic trends closely to continue to balance sales and production and make sure we have got those balances, one of the keys to supporting strong net revenue performance that we have seen so far, and we will work to continue to generate those strong cash flows to support the investment that I have talked about of 2.75 billion in this fiscal year. With that I will hand over the call to the moderator to start any questions you may have.

Moderator: Thank you very much Sir. We will now begin the question-and-answer session. The first question is from the line of Aditya Makharia from JP Morgan, please go ahead.

Aditya Makharia: I was just wondering FY14 is a year when we were spending aggressively on CAPEX, both on product development as well as on building new facilities. How do we see the CAPEX going into FY15 and beyond, directionally will it be flat or higher, or do you see it stabilizing at these levels.

Kenneth Gregor: I am actually not going to give specific guidance for CAPEX for FY15. I think that is a matter for a future earnings call supported by internally development of our business plan within Jaguar Land Rover which we are doing over about the next three to six months, so I think I will hold on confirming a specific number right now. Clearly, what I will say is, what you can see is we have got no shortage of good ideas to invest in growing our business and we certainly plan to continue to invest in new products, facilities, capacities, infrastructure to support that growth, but that goes a specific direction on the number, it is not my intention to confirm that today.

Moderator: Thank you. The next question is from the line Richard Smith from Citi Group, please go ahead.

Richard Smith: We have seen the EBITDA margin improve considerably in the quarter, actually in the last quarter as well. To what extent are you benefiting from sort of operational leverage through that number and to what extent do you expect any kind of step up in fixed costs as volumes continue to grow?

Kenneth Gregor: That is a good question. I think the first thing I ought to say is of course, I have called this out already, those incentives in the market, a couple of markets that I alluded to, £79 something million, those are worth about 1.5 points of EBITDA margin in this quarter. So I think it is fair to say the underlying EBITDA margin in the quarter more like 16 to 16.5% somewhere in that range rather than 17.8 that you see this quarter. I think it is the case that we are seeing that operational leverage in the quarter. I do not know if I can split it for you though sort of financially. In the quarter relative to prior quarters, I think you have got mixture of effects with the EBITDA margin that we have seen in the first six months of this year, has been running at sort 16 to 16.5% excluding that one-off. I think the mix of effects that you have got is, we do have a very strong product and market mix with the launch a full six months of that new Range Rover that we did not have this time last year and then the launch of the Range Rover Sport in the first six months of the year, and on the Jaguar side, the first deliveries of the F-Type in the six months of the year also has quite strong margins. So those strong margin products, higher proportion of those in the first six months of the year definitely supporting the EBITDA margin. We also have positive market mix in the first six months of the year and in this quarter continue to be generated by faster sales growth in China for the first six months of the year than any other markets and that has also supported our EBITDA margin. I think it is the case that we do see so-called fixed cost growth of course. So, we have got growth in manufacturing cost, which may not be a classic definition of fixed cost I suppose because of course it grows in line with the volume growth and we are working 3-shift operations in Solihull and Halewood, which does come with some cost in order to be able to support the volumes that we are delivering, so there is growth in that manufacturing cost. There is growth in head count cost also, in employee cost partly because of that manufacturing, almost 70% of the manufacturing cost is people cost, but also in terms of the growth in products engineering cost, some of which gets capitalized of course, so when you look at the income statement, you can see that, but that growth in engineering supporting that future product growth is also causing growth and internally that engineering cost is a fixed cost, but we are clearly choosing to grow it to invest in those new products. Maybe some of the more back office areas that you are thinking of. Marketing cost, I call it fixed marketing, but it is not fixed, because to grow the volumes you do find yourselves spending more on advertising and sort of marketing campaigns that broadly grows in line with the volume and revenue growth in order to generate the sales I am sure you would understand and in the other areas there is cost growth to support the investment in manufacturing, to support the investment in R&D, to support the investment in new IT facilities, new IT systems in process, for example. So yes, you are seeing operational leverage, yes, we have got strong products and geographical mix, yes, there is also growth in the cost base, and of course the challenge for us in the business is to continue to drive the revenues and the product mix to keep the margin as strong as we can.

Moderator: The next question is from the line of Maggie O'Neill from Deutsche Bank, please go ahead.

Maggie O'Neill: I have a few questions. First of all you have had very strong volume growth in the first half. Do you expect that to continue in the back half of the year? And my second question is would you consider calling your bonds when they become due and aim to get lower costs there?

Kenneth Gregor: Thank you for your question. I think on the bonds, that's a decision that we take at a time depending on the exact market conditions in the financing markets, but obviously we are well aware of the opportunity. I think that is what I would say of the present interest rates, and the present rate at which we could offer at relative to the coupon on the bonds that are outstanding. So, obviously we are looking at that and we will keep it well under review but that is not something we are taking a decision on at this point in time, that is for the market conditions at the time. Your other question is on volume outlook. Try not to get on the hook of giving specific forecasts, I think it is fair to say, but for the second half of the fiscal year we have got a still fresh Range Rover and we have got a very fresh Range Rover Sport, which we have been in a launch phase for the first six months of the year. So all of the things actually on Range Rover Sport, one could expect to see higher volumes in the second half of the year driven by higher available production levels and in the first half of the year and supported by continued volume demand on Freelander and Evoque and on some of those Jaguar product lines. All of those things would add up to us being cautiously optimistic, but still optimistic volume outlook in the second half of the year, but I guess the Range Rover Sport probably being the thing that would give us the opportunity to grow the volumes in the second half of the year relative to first. There are the challenging market positions in various places and there are some product lines that are getting older plus that one becomes fresh. So I think there is an opportunity to grow the volumes in the second half of the year. Whether we do or not, time will tell.

Moderator: The next question is from the line of Raza Karim from HSBC. Please go ahead.

Raza Karim: Two questions if I may. What is the current capacity utilization of your factories? And what are your plans to expand production capacity, for example, how much are you trying to spend on it and when is it likely to happen?

Kenneth Gregor: I think at Solihull and Halewood on the Land Rover Range Rover side of the business, it is fair to say at the present time, we are running a pretty much to full capacity utilization on those car lines as of today, so I am talking about Freelander, Evoque, Range Rover Sport, and Discovery. As I said we have been in a launch phase on Range Rover Sport in the last six months which constrained volumes a bit, so that the opportunity of slightly higher volumes in the second six months of the year on the Range Rover Sport just because you past that launch phase, but basically, you know we are running 24 hours a day, 5 days a week, plus a bit of overtime in the weekend, so that is about as full as you can run. On the Jaguar side of the business, not quite the same picture, but we are running two shifts on F-Type, and presently two shifts also on XF, and I think one shift on XJ. So there is a little bit of upside on the Jaguar side of the capacity utilization depending on market demand. We are working to increase capacity. It is mostly associated with new models. So on the Jaguar side, we have got the family of new aluminium small vehicles, which as we said the first vehicle 2015 Retail sale being a small Sedan, and we talked about headline figure of about 1.5 billion of investment in products, capacity, engineering in terms of delivering the first vehicles of that platform, and that investment is taking place now and will continue through 2015, and will increase the capacity of the overall business to support those new products, and with substantial amount of investment going into both Solihull and Castle Bromwich in order to enable that capacity growth. So, simple pictures, on the Range Rover, Land Rover side running high capacity utilization because at the moment Jaguar side but yes, we are investing in new products, and those new products you have to invest in capacity in order to deliver them.

Moderator: Thank you. The next question is from the line of Teo Lasarte from Merrill Lynch, please go ahead.

Teo Lasarte: Hi, this is Lasarte, I wanted to take your comment here, the 1.5 billion that you announced today regarding the investment in the new architecture that is within the previous, currents of CAPEX, there is nothing new there in the 1.5 billion investment?

Kenneth Gregor: Totally, that finally is vehicle market, and capacity investments has been within our plan for some time, so it was the time at the Frankfurt Auto Show where we showing those products, so we start talking about the headline figures, the investment is spread over a number of years, and by and large, is already in our financial plans, but to get to a bit of headline because of the associated vehicle launch we did.

Moderator: Thank you. The next question is from the line of Yogesh Agarwal from HSBC Securities. Please go ahead.

Yogesh Agarwal: Just a couple of questions. Firstly on Jaguar, your volume growth has been pretty good in the past few months now. Even though the discounts have been pretty high in geographies like U.S., so it seems like you really have to push hard even now to sell Jaguar versus Land Rover. So just wanted to get your sense for the next one to two years, you expect discounts to come down, more importantly, before the smaller Jaguars hit the market, and then just have a small follow-up after that?

Kenneth Gregor: I think the key to incentive levels on all brands is there is an element of brand strength, which is also quite a strong element of how fresh the products are, and on the Land Rover Range Rover side, we do have very low incentive discount levels because the products of the Range Rover, Range Rover Sport and Evoque still very fresh. On the Jaguar side of the story, it is not quite the same picture, the brand is relatively small up against some very strong German competition in the Sedan segments, and in some of those segments, it is competing against, there are high levels of incentives being in the U.S. for example, or in Europe, being spent by the German competition in order to drive volumes and you do find yourself needing to broadly match, if you like, to sort of incentive spending levels on the Jaguar side of the business in order to be able to generate the same price points on a lease, for example, in the U.S. relative to for an XF Vs. F-Type series been doubly so. Substantially the pricing that we have is competitive pricing level driven by those competitors, so where they do find themselves competing for market share, sometimes we have to follow, and that does result in higher levels of incentives. So for the next couple of years before those new family of products comes on, broadly I expect that picture to continue. It has the launch of a new F-Type has helped on the Jaguar side, give us a product that is fresh and new with good strong margins, we were getting good market shares and it helped grow the volumes significantly. So it does give me some confidence that when the product is fresh, and really helps hits the right price points in terms of relative to the facing competition we can drive some good margins, and that is of course a continued challenge on the Jaguar brand, but we are in capacity segments, and you cannot ignore the competitive price points.

Yogesh Agarwal: Just to be clear, incentives of 79 million this quarter we should just assume one off when we model, right?

Kenneth Gregor: When you model quarter-by-quarter, yes, you should assume that is one off. So you would not see that again in the December quarter, for example. You may ask a follow up in "What should you expect in the same quarter next year?" I think there will be incentives in the same quarter next year, but the nature of them means that they can vary, and actually my present expectation is that they would be lower in the same quarter next year than they are in this quarter this year.

Moderator: Thank you. Ladies and gentlemen, due to time constraints, only one final question can be taken. Final question will be from the line of Sandeep Pandya from Goldman Sachs. Please go ahead.

Sandeep Pandya: My first question if you could share the pension unfunded status at the end of Q2 which I think was about £600 million after the first quarter. As the detail interim report is still not on your website, I think there is an item in the consolidated accounts of Tata Motors parent, where there is some pension item there, so which is why if you could share some detail on that?

Kenneth Gregor: I am actually asking Ben Birgbauer, our group treasurer just to cover off the pension liability position?

Ben Birgbauer: At the end of the second quarter 30th of September, the pension deficit was £943 million, at the end of June it was £785 million. That basically reflects on the discount rate that we apply to the liability. We apply 'AA' corporate bond discount rate to which is kind of standard, and that discount rates have moved in the quarter and that basically reflects the difference, so it moves about 20 basis points.

Sandeep Pandya: Second is the new CX-17 concept, there is one slide there and a detailed release on your website as well which was published earlier, it claims that it will bring down emissions for the Jaguar below 100 grams. Now that sounds like a very sharp improvement compared to the existing Jaguars. I just wanted to ask if that is a function of better engines and the aluminium architecture being developed, or is this claim based on some hybrid powertrain variant of Jaguar, if you could share something on that it will be very useful?

Kenneth Gregor: The headline figure is, yes, it is based on the aluminium architecture, and yes, it is based on the new AJ-200 installation in our smaller sedan. To be honest, I cannot quite remember if that includes a hybrid figure, or whether the hybrid figure will be lower or not. To be honest I will just check my facts rather than give you a misleading answer now, I need to double check on that.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I would now like to hand the floor back to the management for closing comments.

Kenneth Gregor: No closing comments from me, other than just to say, as always look, I appreciate you guys taken the time to join us on the call. I am sorry we do not have the time for so many questions as I am sure you have, so it was a bit tight. But thanks for your continued support for our business, it is appreciated.

Moderator: Thank you. On behalf of HSBC that concludes this conference. Thank you for joining us and you may now disconnect your lines.