Jaguar Land Rover Automotive plc

Ticker: TTMTIN

Isin	Issue Size	Rating M / S&P	Coupon	Min Piece	Maturity	Next Call	Offer	YTW	Spread
XS1195502031	£400m	B1 / B	3.875%	£100k	Mar 2023	Bullet	101.75	2.62%	+248
XS1551347393	€650m	B1 / B	2.20%	€100k	Jan 2024	Bullet	99.35	2.51%	+326
USG5002FAM89	$500m	B1 / B	4.50%	$200k	Oct 2027	July 2027 @ 100	98.25	4.83%	+396
XS2364593579	€500m	B1 / B	4.50%	€100k	Jul 2028	July 2024 @ 102.25	100	4.55%	+504
USG5002FAV88	$500m	- / B	5.50%	$200k	Jul 2029	July 2024 @ 102.75	99.5	5.58%	+425

Jaguar Land Rover (JLR) has come out of the first year of the pandemic better than it went in: costs are lower, margins are trending up, inventory is down, and operating profit returned. Leverage elimination is firmly in management's medium-term sights. There is an ambitious programme of margin enhancement, capacity reduction, technological advances, and brand investment to come as the group transitions to an all-electric future and a more tightly focused, valuable proposition. Although in the short term semiconductor supply shortages are a serious problem, they are mitigated by the order backlog and associated full price sales. Risks come with the development and execution of the new Reimagine strategy, but JLR's £6.6bn liquidity, plus reliable cash flow, provide good headroom to support its ambition.

Bonds

- General, unsecured, senior obligations. Guarantees from intermediate holding companies capture c.85% of total assets and roughly 29% of revenue.
- Fairly standard clauses for change of control (needs to also trigger a rating downgrade); limits on liens, mergers and sales of assets; and reporting.
- Events of default include a 30d grace period to cure non payment of interest. Covenants on other lending are providing some extra protection, e.g. restricting dividends to 25% of prior year's PAT. Cross default triggers if the original default causes acceleration, is not rectified within 30 days, and has a chunky £250m threshold in order to trigger, so plenty of leeway there. In addition, once the group achieves investment grade the cross default clause ceases to be in force and will not be reinstated in the event that JLR again falls below investment grade.
- Permitted liens can be the greater of £1.7bn or 15% of total consolidated assets (≈ £3.48bn as at YE March 2021).

Business

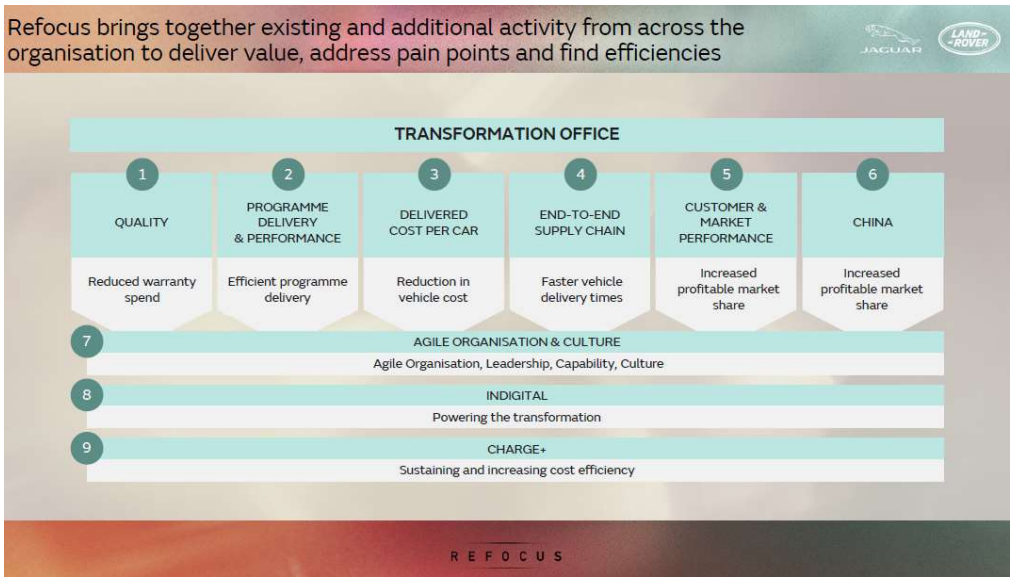
Jaguar and Land Rover are two of the most recognisable car brands in the world and have been part of the Tata Motors group since 2008. Enthusiastic expansion in the 2010s doubled production in six years, peaking with 614k units in FY 2018. Sales are currently spread across the UK (19%), North America (25%), Europe (18%), China (25%) and the rest of the world (13%). Management has done substantial work to address production issues, with considerable success to date:

Share of Revenue	2015	2016	2017	2018	2019	2020	2021
Employment	9.04%	10.61%	11.39%	12.45%	12.90%	11.74%	9.79%
Engineering costs capitalised	5.30%	5.68%	6.52%	7.36%	7.21%	6.26%	3.32%
Warranty	2.48%	2.67%	3.76%	3.19%	4.65%	5.17%	3.23%
Publicity	3.62%	3.71%	4.05%	4.35%	3.91%	3.35%	1.82%
Works, operation, other	8.27%	9.44%	10.61%	12.24%	11.79%	11.30%	7.84%

Expenses shown above peaked in FY 2018 and FY 2019, with the exception being warranty costs that lag production. They subsequently dropped back toward a more normal level in FY 2021, when unit sales were down below 440k, partly thanks to covid and semi-conductor shortages. Manufacturing utilisation is currently around 70% and group capacity will be reduced by 25% over the next five years. Non-manufacturing facilities are also being rationalised.

JLR's *Refocus* programme is dealing with tricky areas such as quality/warranties. To find efficiencies they have a new Chief Transformation Officer, who together with his team is working across functions and gearing up to deliver across key areas of the business. 35 workstreams are already up and running.

Goals for Refocus include 3% incremental EBIT by FY 2026 and £2bn of value found within three years rising to £4bn within five years.



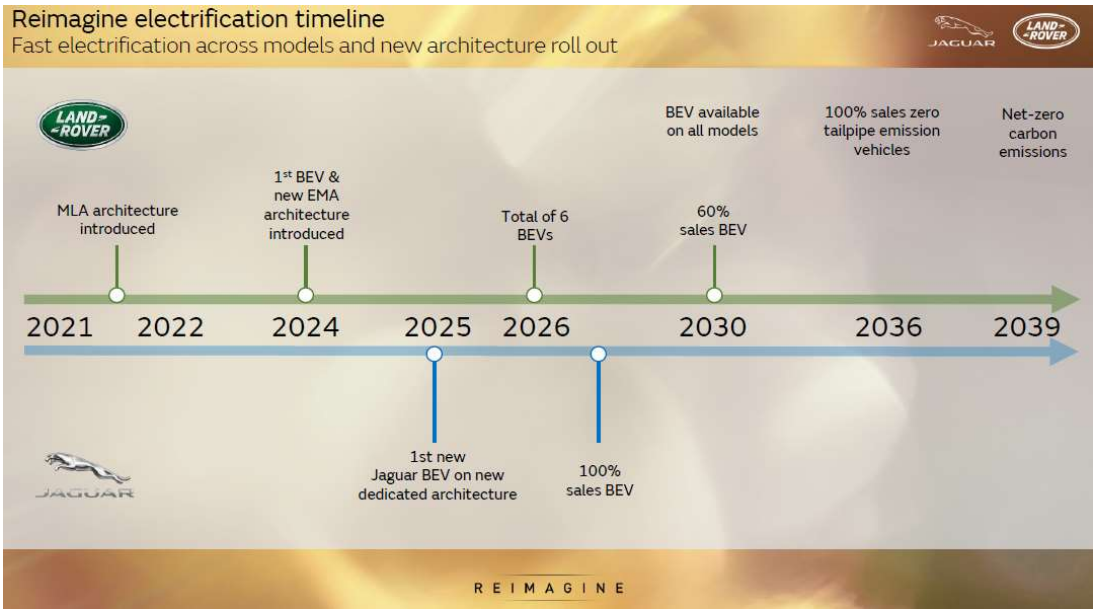
Strategy

In the midst of cleaning up production, CEO Ralf Speth retired and Thierry Bolloré replaced him in October 2020, having been CEO of Renault for ten months[1]. In February 2021 Bolloré presented a comprehensive new vision, *modern luxury by design*, to really crank up desirability and performance. To deliver this vision there is a new strategy: *Reimagine*.

Reimagine's aim is to propel JLR into a leading position by reimagining modern luxury, quality, unique customer experience and sustainability. The latter two include electrification and increasing connectivity and digitalisation. Quality and profit will be prioritised over volume and will involve increased collaboration with the Tata group and external partners.

[1] He was ousted by the board in the aftermath of Carlos Ghosn's arrest. There are conflicting reports as to Bolloré's management style possibly being a factor, and it seems clear he and the Nissan CEO at the time did not get along. With no official reason given by the board, it seems to be an effort to start fresh given the Ghosn scandal.

This has meant some tough decisions, including writing off almost £1bn development costs, in an effort to leap further ahead in electrification. Model updates from this fiscal year on will include more autonomous driving features and increasing electrified options (plug-in hybrid, mild hybrid, battery electric vehicles). All-electric vehicles will arrive within five years, with six variants starting 2024. Jaguar will be a purely electric brand from 2025 and the entire range across both Jaguar and Land Rover will be electric in FY 2026. Full-BEV powertrains should represent the majority of JLR sales by the end of the 2020s. Net zero carbon emissions are targeted by 2039 across the supply chain, product portfolio and operations. There will be a rationalisation down to three vehicle architectures, one solely for Jaguar, and the group will employ modular construction methods. JLR will be moving its models up to higher pricing segments and providing a lot more ancillary and flexible services for customers. All the buzzwords are here.



JLR is hoping to grow from a more sensible base by focusing on segments that are forecast to grow 2.8% between FY 2019-2027 versus 0.5% for the total vehicle industry. Growth will be skewed toward strong profitability products, and with increased market share outside the UK. At the same time, the group is resetting to be break even at 400k unit sales p.a., down from 600k a few years ago. They cannot let costs run away from them again while they do this, and having taken considerable costs out already, the Refocus transformation programme is about creating an agile and efficient design and production process.

The Reimagine strategy envisages £2.5bn of investment per annum, the cost being the one-off £1bn non-cash writedown in FY March 2021 plus £500m for restructuring in cash. It is supposed to deliver:

- Positive cash flow from FY 2023.
- Net cash instead of net debt as of FY 2023.
- Double-digit EBIT by FY 2026.

Ultimately, success will hinge on JLR's ability to come up with designs that are truly seductive and technology that is cutting edge. There is uncertainty on both fronts. JLR is a relatively small player compared to major OEMs that churn out as many vehicles in a month as JLR does in a year, spreading their costs widely. Neither is JLR at the super luxury or sports car end that provides exceptional exclusivity. Tata is a decent partner, and there is potential for that connection to be more lucrative for both of them, but its stable is full of workhorses, not thoroughbreds. That said, the success of the Jaguar iPace all electric SUV, delivered well before rivals, shows they can do it. Financial targets look doable given the already steady operating cash flow and improving cost base. That 13% EBIT margin was achieved in 2015, so the capability is there and it provides a firm base to really go after the aspirational side of the strategy.

Financials **YE 31 March 2021**

There have been good signs of a turnaround from FY 2019, with operating profit recovering despite the disruption of Covid that lined up fairly neatly with the 2021 financial year. JLR works with an underlying EBIT measure currently sitting around 4.00% c.f. our calculation of 3.10%. Exceptionals have done most of the damage, with £3.1bn in FY 2019 reflecting the writedown of capitalised investments prompted by the drop in demand, together with restructuring costs in both FY 2019 and FY 2020. The £1.5bn charge in FY 2021 included £952m for discontinued programmes

(non-cash) and a further £534m for restructuring. Operating cash flow has been steady at around £2.3bn for the past three years as they worked through the immediate issues, which included slimming inventory by around £700m along with the tighter cost control.

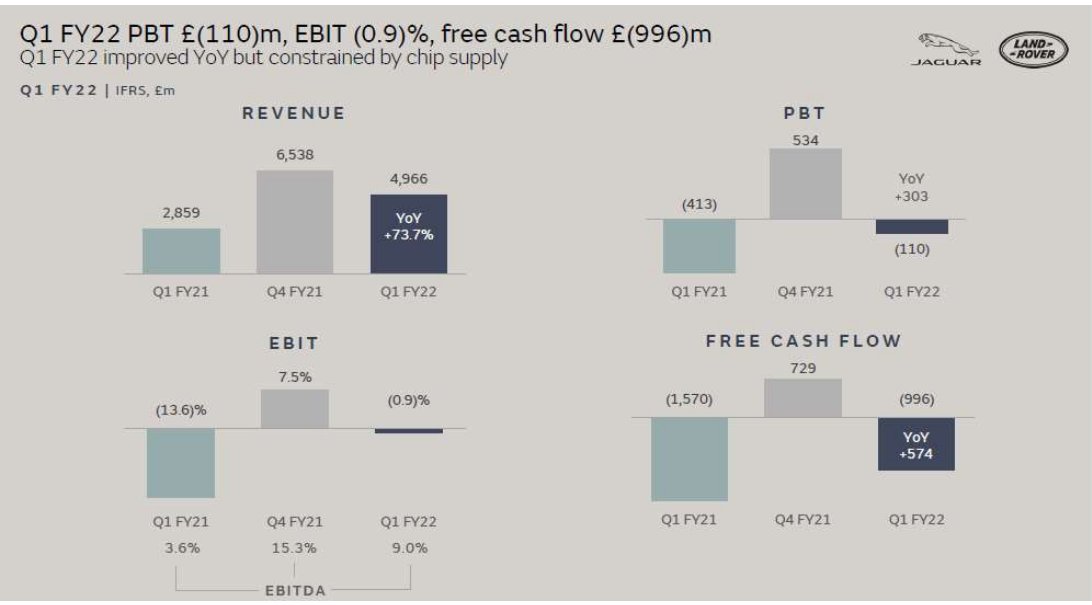
Jaguar Land Rover KEY METRICS	31-Mar-15	31-Mar-16	31-Mar-17	31-Mar-18	31-Mar-19	31-Mar-20	31-Mar-21
Revenue	21,866.0	22,208.0	24,339.0	25,786.0	24,214.0	22,984.0	19,731.0
EBITDA	3,896.0	3,280.0	3,358.0	3,358.0	1,938.0	2,037.0	2,588.0
Operating Profit	2,845.0	1,862.0	1,702.0	1,283.0	(226.0)	127.0	612.0
Exceptionals	0.0	0.0	0.0	0.0	(3,271.0)	(29.0)	(1,523.0)
NPBT	2,614.0	1,557.0	1,610.0	1,536.0	(3,629.0)	(422.0)	(861.0)
Operating Cashflow	3,627.0	3,560.0	3,160.0	2,958.0	2,253.0	2,314.0	2,326.0
Operating Cash Interest Cover (x)	21.6	29.3	26.1	22.5	16.6	11.0	12.3
Cash & Equivalents	3,208.0	3,399.0	2,878.0	2,626.0	2,747.0	2,271.0	3,778.0
Total Debt	2,551.0	2,502.0	3,584.0	3,739.0	4,512.0	5,884.0	6,697.0
Total Available Liquidity	5,592.0	6,405.0	7,178.0	5,940.0	4,074.0	3,834.0	4,474.0
Tangible Net Worth	1,088.0	2,117.0	414.0	3,225.0	323.0	270.0	(133.0)
Leverage	(0.2)	(0.3)	0.2	0.3	0.9	1.8	1.1

The balance sheet holds £23.2bn in total assets, including £6.5bn of fixed assets (largely property, plant and equipment) and £5.4bn of intangibles (overwhelmingly product development: capitalised and in progress). Liabilities are dominated by debt (£6.7bn) and operational payables (£6.3bn). Net debt was down £300mn at just under £1.9bn and included cash, equivalents and short term investments totalling £4.8bn. Together with the undrawn revolver of £1.9bn, liquidity was up £900mn to £6.7bn. The balance sheet was strong enough to absorb the difficulties of the past few years and enough resilience remains to see it through until it can be rebuilt.

Q1 30 June FY 2021-22

This fiscal year started with a 68% increase in retail sales across all regions and all model families (Jaguar, Range Rover, Defender, and Discovery) despite chip supply constraints that kept production around 30k units behind wholesale demand. The semiconductor shortage is being felt across the industry (and others) and is expected to worsen in Q2 before starting a gradual recovery over the following year or so. The vehicle order bank is now up to 110k units, so roughly a quarter's worth of deliveries. The silver lining to this is that marketing and other costs will remain suppressed and discounts are not necessary to shift stock. JLR is prioritising higher margin production and calibrating features in its models to what can be confidently delivered with the chips available.

Figures are brief for the first and third quarters, but Q1 saw revenue up almost 74% year-on-year to £5bn, the reported EBITDA margin was up from 3.6% to 9.0%, EBIT margin improved by almost 13ppts to negative 0.9, and the loss before tax was down by £303mn to £110mn.



As flagged to the market, the semiconductor supply issue contributed to a £1bn free cash outflow for the quarter, but that was still a £574mn improvement on Q1 last year and as usual reflects the seasonal reduction in deliveries after the March Q4 peak in cash inflows. Cash stood at £3.7bn with total liquidity of £5.7bn. Management expects another £1bn free cash outflow in Q2, so cash will drop, but as chip supply gradually improves and deliveries feed through in the back half, most of the cash will flow back as it did last year. The revolver was increased and extended, and new bonds were issued just after the quarter end (€500mn 4.50% 2028 and $500mn 5.50% 2029). Together they brought pro forma liquidity back up to £6.6bn.

Funding

Facility	Amount £mn	Maturity	Interest	Features
Revolving Credit Facility	2,015	July 2022	L + 1.65%	Accordion up to £2.5bn. £1bn minimum group liquidity covenant. Unsecured.
Forward Start Agreement (RCF)	1,500	March 2024	SONIA + 3.10%	Commences when RCF matures; retains accordion to £2.5bn and liquidity covenant.
Bonds	5,100	Various	Various	Spread across GBP (£400mn), EUR (£2.26bn), and USD (£2.07bn).
Term Loan	1,000	2022 & 2025	L + 1.90%	First tranche of 20% matures October 2022; remainder in January 2025. No financial covenants. Unsecured.
UKEF + Commercial Loan	625	October 2024	L + 2.75%	Syndicated. £500mn loan guaranteed by UK Export Finance + £125mn commercial loan. Must maintain 80:20 ratio. Amortising with £417mn outstanding. Restricts certain restricted payments such as dividends to 25% of group PAT and when total available liquidity is >£1.9bn. Total available liquidity £1.9bn is a covenant; breach is a mandatory repayment event. Unsecured.
China Revolving Facility	554	June 2023	1yr LPR -0.05%	RMB 5bn, fully drawn. Yes that is a minus margin. Reprices annually and may be +/- 0.05% margin. Financial targets of positive operating profit and debt/total assets to be <60%. Unsecured.
Fleet Financing Facility	113	December 2021	B + 2.75%	Working capital for buybacks of vehicles sold to rental companies. £70mn drawn. Drawings may not exceed 80% of vehicles secured by floating charge over "inactive own-use vehicles"..
Leasing	519	Various	Various	
Off Balance Sheet Invoice Discounting	500			Non-recourse; utilisation c.£278mn

The group revolver, term loan facilities, UKEF & Commercial loan facilities, and fleet financing all attract 1% penalty interest on top of the normal margin on overdue amounts. The China Revolving Facility can attract penalty interest of 150% of the normal rate for late payment, or up to 200% of the of the normal rate if the loan is both overdue and misappropriated. Naturally, bank debt ranks ahead of the bonds despite being unsecured.

Parent Company – Tata Motors Limited

Tata Motors (TM) was founded in 1945 and is a Nifty 50 listed company with a market cap of c.£10bn. It is 46% owned by Tata Sons Pvt Ltd (Tata Sons), parts of which date back to 1868. It's India's largest automobile manufacturer, producing cars, SUVs, trucks, buses, and defence vehicles. It employs almost 79k people and manufactures in the UK (via JLR), South Korea, Thailand, South Africa, Indonesia, Austria, and Slovakia. It has strategic JVs with Fiat and Marcopolo. TM vehicles are sold in 125 countries.

JLR represented around 75% of revenue over the past three years. As a result TM's health waxes and wanes with JLR. Despite JLR's losses in FY 2020 and FY 2021, the remainder of the group was able to buffer the impact. In FY 2021 TM's £25.5bn revenue led to £571m of operating profit and a loss before tax of £693m (JLR's LBT was £861m). The balance sheet is heavily weighted toward JLR, which carries around 85% of TM's £3.6bn inventory, 70% of its £9.4bn fixed assets, and 58% of its £6.5bn cash, but less than half of TM's £14.5bn debt. A lot of TM's tangible and intangible worth is tied up in JLR, but outside of JLR, TM is more highly levered (2.7x) and has lower cash interest cover (3.6x). JLR has sent regular dividends of £150m up to TM in accordance with a dividend policy of paying out 25% of after tax profit, although after an increase to £225m in FY 2019, dividends from JLR were suspended. TM does not guarantee JLR's bonds or any of the bonds' guarantors. Bondholders have no recourse to TM.

S&P announced on 20th August that Tata Group companies are on credit watch positive, which may have implications for TM (rated B) and JLR (debt also B). Although Tata Sons is unrated, S&P views it as "strongly investment grade". The agency will consider potential for extraordinary support from Tata Sons in the event of liquidity stress; the evolving, closer interrelationships; and Tata Sons' increased influence on financial policy (generally delevering). Tata Sons ownership of TM is up from c.35% in 2019 to 46%. The potential for support for TM and JLR should it be required is good, although at this point we think JLR will be able to delever on its own. Any upgrade that filters through would have the added benefit of shaving the forward start revolver interest rate from 3.10% to 2.85%. The credit watch will be resolved either way in the coming weeks.

View

Short term risks are led by the semiconductor shortages that will see production at around 50% of plan in Q2. Higher demand for chips, rolling covid impacts in chip producing Asian countries, and other supply chain difficulties could all impact longer than expected. The flipside for JLR is its 110k unit backlog and a product mix will likely support margin improvement through to resolution around the end of 2022. In the meantime, its competitors are in the same boat.

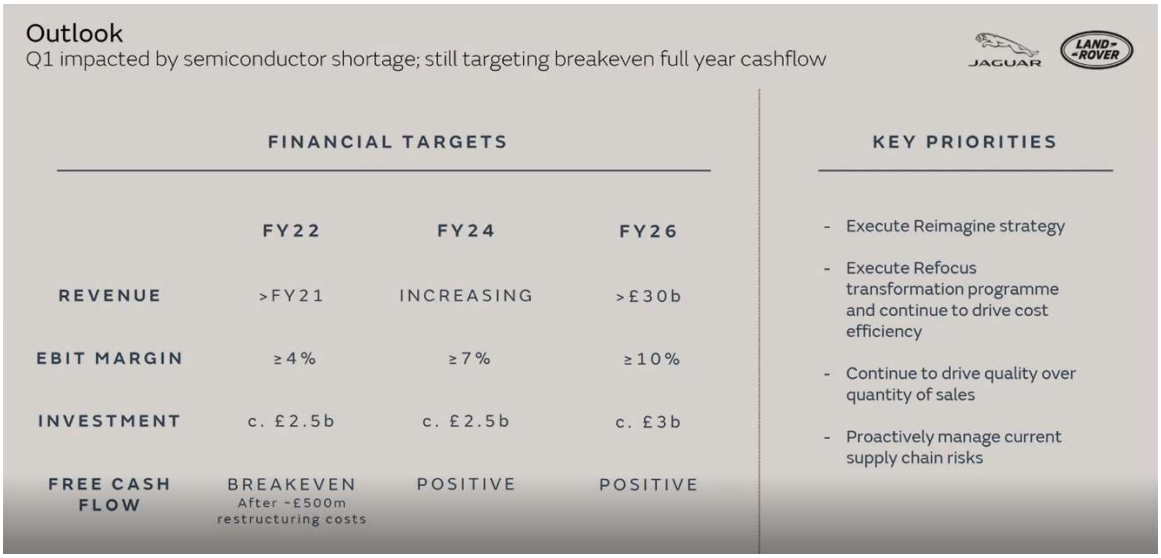
Clearly there is some risk with the strategy, both for the brands themselves and operationally. Going for technological advantage with the all new electric model portfolio comes with the uncertainty of not knowing how those new technologies, particularly batteries, will impact on warranty and other costs. There simply isn't the track record yet in the industry to model provision estimates. Either way, waiting and seeing is no strategy at all.

Balancing these uncertainties we have a timetable for new models and tangible financial targets to monitor progress based on break even at 400k units (see outlook slide below). Even if it takes a while for deliveries to come through this year, the cash follows quickly. We see the short term difficulties as surmountable, and JLR has ample liquidity to absorb the immediate and medium term challenges, even if semiconductor supply problems stretch further. Overall we think JLR has the ability to perform profitably and a good shot at hitting its strategic objectives.

Please contact the desk if you have wish to discuss.

Penelope Fitzherbert

23 September 2021



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