
S&P Global

Ratings

(/en_US/web/guest/home)

Jaguar Land Rover Automotive PLC Downgraded To 'BB'; Outlook Stable

26-Jul-2018 09:45 EDT

[View Analyst Contact Information](#)

The U.K.'s underperforming auto market, an unexpectedly strong market aversion to diesel in Europe, and high investments continue to weigh on Jaguar Land Rover Automotive PLC's (JLR's) margins, which have decreased by more than half since 2015.

JLR's lower resilience than peers to an increasingly complex environment and higher exposure to event risks (like Brexit and emerging trade wars) threaten to delay its targeted recovery of profitability.

We are lowering our long-term ratings on JLR to 'BB' from 'BB+'.

The stable outlook continues to mirror that on JLR's sole shareholder Tata Motors, which reflects improving adjusted funds from operations (FFO) to debt.

MILAN (S&P Global Ratings) July 26, 2018--S&P Global Ratings today lowered its long-term issuer credit rating on U.K.-based premium auto manufacturer Jaguar Land Rover Automotive PLC (JLR) to 'BB' from 'BB+'. The outlook is stable.

At the same time, we lowered our issue ratings on JLR's senior unsecured notes to 'BB' from 'BB+'. The '3' recovery rating is unchanged.

A combination of headwinds hit U.K.-based premium auto manufacturer JLR in the fiscal year ended March 31, 2018. Despite the sound performance of global auto markets during 2017 and in 2018 to date, volumes at JLR, including units sold at its Chinese joint venture (JV), were up only 1.7% (614,000 versus 604,000) compared with our initial projections of 10%-20% growth. The group's underperformance resulted from a 13% drop in sales in the U.K. market, which declined 15.7% in March 2018 versus previous years, according to LMC Automotive. This came alongside decreasing sales in other European markets, where JLR suffered from the accelerated decline of diesel sales, which decreased 5%. All this happened at a time of heavy investments in JLR's production facility in Slovakia and in electrification of its product offering; research and development (R&D), and capital expenditure (capex) represent 15% of sales. JLR's profits took a hit as adjusted EBITDA margins (which include dividends paid out by JLR's Chinese JV) fell below 6% from 7% in fiscal year 2017 and 9% in fiscal year 2016. We conclude that the company's lack of scale and diversification, which the group has been trying to address, only provides modest resilience to JLR's profitability from market-specific risks. We are thus revising our assessment of JLR's business risk profile to fair from satisfactory.

Volumes (including the Chinese JV) in the first quarter of fiscal year 2019 (ended June 30, 2018) are up 5.9%, mainly as a result of the recovery of the U.K. market from historical lows in the same period of the previous fiscal year. Still, the group's sales elsewhere in Europe are down 7%, which we believe is partly because of the difficulty of adapting to the shift in consumer preferences away from diesel to hybrids. Although the company maintains a strong commitment to extend electrification options to the entire product line-up from 2020, we believe that, beyond the I-PACE first battery SUV, having only a limited set of models with mild and plug-in hybrid features could weigh on volumes in a market that has been more dynamic in terms of consumer demand than expected.

Although we do not yet factor this into our base case, we believe event risk is higher for JLR than for its peers. We believe that an escalation in the trade war between the U.S. and Europe enveloping tariffs on cars imported into the U.S. is a high risk. This would have a negative impact on JLR, since its lack of production facilities in North America (which accounts for a little less than 20% of group sales), coupled with the highly competitive conditions in the U.S. market in terms of new products and competitive pricing, would make it challenging for the group to pass on tariffs to consumers.

While the outcome of the Brexit negotiations remains highly uncertain, we believe this is a unique risk for JLR compared with its main peers', owing to the group's reliance on the U.K. market for approximately one-fifth of its

sales. To mitigate the risks attached to Brexit, we anticipate some additional near-term costs for JLR in adjusting the supply chain and inventory levels. In the event of a disruption related to Brexit, the financial impact would be material--up to £1.2 billion in extra annual costs for the group--according to a statement by JLR's CEO.

The materialization of either of these events would jeopardize the planned recovery of profitability at JLR in the medium term (public target: long-term reported EBIT margin of 7%-9% compared with 3.8% in fiscal year 2018).

In our base-case scenario, we expect a gradual recovery of EBITDA margins, owing substantially to the fallout of some supply chain issues that affected the group's performance in fiscal year 2018, costs linked to the new production plant in Slovakia, and the gradual move to modular longitudinal vehicle architecture. Nonetheless, we project our adjusted EBITDA margin would recover to 2016 levels (9.0%) only in 2020. Because of persistently high capex needs, we expect negative free operating cash flows (FOCF) until 2020, which could be detrimental to the rating in the absence of relatively comfortable headroom in the credit metrics.

The stable outlook on JLR reflects the consolidated outlook on India-based Tata Motors, which reflects our expectation that the company's modest volume growth, and improving profitability at JLR from a shift in production to low-cost Slovakia facilities and controlled capital spending, would lift its ratio of FFO to debt to 30%-40% over the next 12-18 months. A continued turnaround in Tata Motors' commercial vehicles (CV) business should also support the recovery.

We may lower the rating on JLR if we lower the rating on Tata Motors, which could occur if the ratio of FFO to debt fails to recover to more than 25% over the next 12 months. This could happen if the company's operating performance remains weak while its capital spending stays elevated. Reported EBITDA margins of less than 11.0% would indicate weak operating performance. Brexit-related trade restrictions, U.S. import tariffs, reduced volumes, or profit margin at JLR due to competition or changing consumer preferences, and a wavering Indian CV business could result in such a scenario.

We are unlikely to upgrade JLR and Tata Motors over the next 12 to 24 months, unless the consolidated ratio of FFO to debt were to well exceed 45% on a sustainable basis, and the company is close to breakeven on FOCF. JLR's improved performance, without a commensurate increase in capital spending; reduced Brexit and U.S.-tariff risks; and a sustained recovery in Tata Motors' India operations could indicate such a scenario.

RELATED CRITERIA

Criteria – Corporates – General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers (/en_US/web/guest/article/-/view/sourceld/9831306), Dec. 7, 2016
Criteria – Corporates – Recovery: Methodology: Jurisdiction Ranking Assessments (/en_US/web/guest/article/-/view/sourceld/9478732), Jan. 20, 2016
Criteria – Corporates – General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers (/en_US/web/guest/article/-/view/sourceld/8956570), Dec. 16, 2014
Criteria – Corporates – Industrials: Key Credit Factors For The Auto And Commercial Vehicle Manufacturing Industry (/en_US/web/guest/article/-/view/sourceld/8336222), Nov. 19, 2013
Criteria – Corporates – General: Corporate Methodology (/en_US/web/guest/article/-/view/sourceld/8314109), Nov. 19, 2013
General Criteria: Country Risk Assessment Methodology And Assumptions (/en_US/web/guest/article/-/view/sourceld/8313032), Nov. 19, 2013
General Criteria: Methodology: Industry Risk (/en_US/web/guest/article/-/view/sourceld/8304862), Nov. 19, 2013
Criteria – Corporates – General: Corporate Methodology: Ratios And Adjustments (/en_US/web/guest/article/-/view/sourceld/8330212), Nov. 19, 2013
General Criteria: Group Rating Methodology (/en_US/web/guest/article/-/view/sourceld/8336067), Nov. 19, 2013
General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers (/en_US/web/guest/article/-/view/sourceld/7629699), Nov. 13, 2012
General Criteria: Use Of CreditWatch And Outlooks (/en_US/web/guest/article/-/view/sourceld/5612636), Sept. 14, 2009

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

Primary Credit Analyst: Vittoria Ferraris, Milan (39) 02-72111-207;
vittoria.ferraris@spglobal.com (<mailto:vittoria.ferraris@spglobal.com>)

Secondary Contact: Alex P Herbert, London (44) 20-7176-3616;
alex.herbert@spglobal.com (<mailto:alex.herbert@spglobal.com>)

Additional Contact: Industrial Ratings Europe;
Corporate_Admin_London@spglobal.com (mailto:Corporate_Admin_London@spglobal.com)

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory,

punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (<http://www.standardandpoors.com>) (free of charge), and www.ratingsdirect.com (<http://www.ratingsdirect.com>) and www.globalcreditportal.com (<http://www.globalcreditportal.com>) (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees (<http://www.standardandpoors.com/usratingsfees>).

Any Passwords/user IDs issued by S&P to users are single user-dedicated and may ONLY be used by the individual to whom they have been assigned. No sharing of passwords/user IDs and no simultaneous access via the same password/user ID is permitted. To reprint, translate, or use the data or information other than as provided herein, contact S&P Global Ratings, Client Services, 55 Water Street, New York, NY 10041; (1) 212-438-7280 or by e-mail to: research_request@spglobal.com (mailto:research_request@spglobal.com).

[Legal Disclaimers \(/en_US/web/guest/regulatory/legal-disclaimers\)](#)

[Careers at S&P Global Ratings \(http://www.spglobal.com/careers\)](http://www.spglobal.com/careers)

[Terms of Use \(/en_US/web/guest/regulatory/termsfuse\)](#)

[Privacy and Cookie Notice \(/en_US/web/guest/regulatory/privacy-notice\)](#)

Copyright © 2018 Standard & Poor's Financial Services LLC. All rights reserved.

Reproduction and distribution of this information in any form is prohibited except with the prior written permission of Standard & Poor's Financial Services LLC and its affiliates (together, "S&P"). S&P does not guarantee the accuracy, completeness, timeliness or availability of any information, including ratings, and is not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such information. S&P GIVES NO EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. S&P shall not be liable for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including lost income or profits and opportunity costs) in connection with any use of this information, including ratings. S&P ratings are statements of opinions and are not statements of fact or recommendations to purchase hold or sell securities. They do not address the market value of securities or the suitability of securities for investment purposes, and should not be relied on as investment advice. Please read our complete disclaimer here. ([/en_US/web/guest/regulatory/legal-disclaimers](#))