MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Jaguar Land Rover's ratings to B1; outlook negative

20 Jun 2019

London, 20 June 2019 -- Moody's Investors Service has downgraded today the corporate family rating (CFR) of Jaguar Land Rover Automotive Plc (company, Jaguar Land Rover or JLR) to B1 from Ba3 and the probability of default rating (PDR) to B1-PD from Ba3-PD. Concurrently, Moody's has also downgraded the instrument ratings on the bonds to B1 from Ba3. The outlook remains negative.

"The downgrade reflects Moody's expectation that leverage will remain elevated and free cash flow negative for fiscal years 2020 and 2021 as Jaguar Land Rover seeks to turn around performance in China, executes its restructuring program and continues to invest in its future model line-up including electrification", said Tobias Wagner, Vice-President and Senior Analyst at Moody's. "The negative outlook further reflects the challenge to turn around financial performance in a subdued market environment and as other manufacturers also prepare to launch electric vehicles. Risks regarding a potential "no-deal Brexit" or potential US tariffs also remain."

RATINGS RATIONALE

The downgrades reflect Moody's expectation that Moody's-adjusted debt/EBITDA is likely to remain above 5.0x for fiscal 2020 and 2021 while free cash flow is likely to remain materially negative. Both factors are not commensurate with a Ba3 rating and reflect the need to continue to invest in the future model line-up including electrification, the ongoing volume decline in China and related efforts to strengthen the sales operations and network in the region, balanced by overall cost reduction efforts such as project Charge and Accelerate, the company's restructuring programs, that will gradually benefit profitability.

While JLR's profitability, measured by Moody's-adjusted EBITA margin has declined over the last several years, notably also because the metric deducts research & development expenses that the company capitalizes, overall performance in fiscal 2019 was particularly weak with a negative margin (-3.4%), Moody's leverage at 14.0x and a negative free cash flow of GBP1.4 billion.

The Chinese market remains a major challenge for JLR as retail sales continue to decline. Moody's believes that China was a major profit contributor and hence the decline substantially contributed to the decline in profitability in the last quarters. After years of good growth JLR's retail volume growth in China turned negative in May 2018 (year-on-year) and has remained at high double-digit negative rates since July 2018. This can be partly attributed to an overall weaker market in China, with the segments JLR focuses on such as certain premium SUV segments declining more than the overall market average. However, the impact on JLR was further amplified by sales organization and network issues in the region. While May 2019 retail sales, year-on-year, demonstrated a reduced volume decline than in previous months, a sustained turnaround is so far not evident despite the company's ongoing active focus on the region.

In addition, ongoing trends such as electrification and the need to invest in hybrid and full electric vehicle options alongside investments to support the overall model line-up require continued significant ongoing investments in the next years, resulting in continued pressure on profitability and free cash flow. The investments include the launch of the Defender in 2019, the investment in a flexible architecture to enable all models to be offered with hybrid or increasingly full battery electric powertrain options from 2020 but also investments into the core product range.

Meeting regional emission requirements, particularly those relating to CO_2, is one of the most pressing and challenging objectives facing the auto industry over the medium to long term. Continued tightening of emissions standards and regulations across most major markets, driven by environmental concerns, also require investments into greater efficiency and electrification to maintain compliance and avoid fines or additional costs. Accordingly, environmental considerations are an important driver of this rating action, because these trends restrict the company's ability to reduce certain investments. The varying pace of adoption for hybrid and electric vehicles among different consumers also presents a challenge.

However, Moody's also expects the company's restructuring program, project Charge and Accelerate, to support profitability improvements in fiscal 2020 and beyond not the least from the significant and already executed headcount reduction. Project Charge has also already led to additional working capital inflows, combined with a seasonally positive working capital profile in January to March and ongoing inventory reductions in China. Efforts also include the reduction in investments in fiscal 2019 and going forward, which includes a reduction in non-product and non-core engineering spend, efforts to reduced powertrain complexity where possible and cooperation such as the June 2019 announced electronic drive unit collaboration with BMW. This has led to overall strong cash flow generation in the last quarter to March 2019.

JLR ratings continue to positively reflect (1) the company's strong brand names with a track record of successfully launching new models; (2) the broad consumer acceptance of its core models including the Range Rover, Range Rover Sport, Evoque, Velar, Jaguar F-PACE, E-Pace, Land Rover Discovery and Discovery Sport; (3) broad geographic profile in terms of sales including emerging markets and China; and (4) the commitment of its parent Tata Motors Ltd. (TML) to support JLR's product strategy, capex plan and financial strategy, in line with previous practice.

However, JLR's ratings also additionally reflect (1) the cyclical nature of the automotive industry, albeit less so for premium car manufacturers, which can be exposed to big swings in performance combined with high fixed costs; (2) its large focus on the SUV segment and degree of dependency on a range of successful models; (3) given its predominantly UK-based production footprint, exposure and uncertainty related to "no-deal Brexit" or tariffs, for example regarding the US market; and (4) high foreign exchange rate exposure although JLR has an established FX hedging programme.

RATING OUTLOOK

The negative outlook reflects the challenge to turn around financial performance in a subdued market environment as other manufacturers also prepare to launch electric vehicles. Risks regarding a potential "no-deal Brexit" or potential US tariffs also remain..

STRUCTURAL CONSIDERATIONS

The downgrade of the instrument ratings on the bonds follow the downgrade of the CFR. The instrument ratings remain aligned with the CFR given the essentially all unsecured, guaranteed and pari passu capital structure of the company.

LIQUIDITY PROFILE

JLR's liquidity profile remains adequate notwithstanding the ongoing sizeable cash consumption. As of March 2019, the company had GBP3.8 billion of cash on the balance sheet and access to the fully undrawn and committed GBP1.9 billion revolving credit facility due July 2022 with no financial covenants. However, Moody's also expects the company to remain materially free cash flow negative in fiscal 2020 and 2021 while meaningful working capital volatility, particularly between Q4 (January to March) and Q1 (April to June) due to higher seasonal sales and manufacturing activity in Q4 require meaningful ongoing cash. While the company's debt maturity profile is generally well balanced, there are also two $500 million bonds becoming due in November 2019 and March 2020, respectively. The company has also announced that it is exploring further funding options.

WHAT COULD CHANGE THE RATING UP/DOWN

JLR's ratings could come under further negative pressure in case of (1) failure to demonstrate material improvements in profitability in the next 12 to 24 months; (2) Moody's-adjusted debt/EBITDA to consistently exceed 6.0x; or (3) a deterioration in JLR's liquidity position as a result of continued high negative free cash flows. Conversely, positive pressure could arise should JLR be able to (1) reduce leverage (Debt/EBITDA) to below 5.0x; (2) improve Moody's-adjusted EBITA margin sustainably to above 2% and (3) materially reduce negative free cash flow.

The principal methodology used in these ratings was Automobile Manufacturer Industry published in June 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Downgrades:

..Issuer: Jaguar Land Rover Automotive Plc

.... Corporate Family Rating, Downgraded to B1 from Ba3

.... Probability of Default Rating, Downgraded to B1-PD from Ba3-PD

....Senior Unsecured Regular Bond/Debenture, Downgraded to B1 from Ba3

Outlook Actions:

..Issuer: Jaguar Land Rover Automotive Plc

....Outlook, Remains Negative

JLR is a UK manufacturer of premium passenger cars and all-terrain vehicles under the Jaguar and Land Rover brands. JLR operates six sites in the UK, one in Slovakia and has a joint venture (JV) in China. The company generated 42% of fiscal 2019 unit (retail) sales in Europe (of which 20% in the UK), 24% in North America, 17% in China (including JV) and 16% in other overseas markets, resulting in total revenue of GBP24.2 billion for fiscal 2019.

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