

August 25, 2017

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Survey Structure

- ▶ 10 interviews with JLR dealerships Regional: 2 East China; 1 South China; 2 Central China; 3 North China; 2 West China.
- ▶ Interviews covered differing regions and Tier 1 and 2 cities in China. Interviews spanned Beijing, Shanghai, Hunan, Jiangsu, Hubei, and Guangdong provinces.
- ▶ Interviews were conducted August 3-11 by phone and in person.

Objectives

- ▶ To understand growth, inventory, and discount trends for JLR in China

Tata Motors (TTM US)

JLR's China Dealerships Squeezed

- ▶ China carries growth: With JLR's ex-China growth stagnating, all eyes are on China in FY 2018. So far, China is delivering: at the retail level, China sales are up 31% YTD through July, FY 2018.
- ▶ Narrow miss: Dealers surveyed indicated growth in the mid-teens for the current calendar year. Four of the 10 dealers we surveyed believed they would narrowly miss their sales target for the year
- ▶ Pushing too hard: China dealerships feel increasingly pressured to take inventory. They say that pressure from JLR is forcing them to increase discounts, which in turn are squeezing margins.
- ▶ H2 is key: With discounts on the new 2017 Discovery still increasing, dealers are highly anticipating the arrival of the Velar and hoping this vehicle will help them restore profitability.

Low- to mid-teens

Dealers indicated that they expected growth on a weighted average basis of about 13% in CY 2017. While mid-teens growth in China is probably on the lower end of investor expectations, four of the 10 dealers we spoke with felt that they were likely to narrowly miss their targets provided by JLR. But we think odds of a substantial miss on top line are low for JLR. Sales tend to accelerate in the second half.

Only one dealer expected negative growth this year, in mid-single digits.

Growth Expectations

Geography	Hunan	Jiangsu	Sichuan	Hubei	Shanghai
2017	13%	-7%	14%	13%	1%
Estimated Growth (YoY)					

August 25, 2017

"In order to hit our targets, every large distributor is taking on lots of inventory and continuously discounting prices to dump cars..."

Geography	Beijing	Jiangsu	Guangdong	Guangdong	Guangdong
2017	22%	2%	33%	0%	24%
Estimated Growth (YoY)					

Source: J Capital interviews

Inventories

Dealers almost universally complained about high inventories, but we found the average inventory levels were about 1.8 months of sales, up from about 1.5 months at this time a year ago. Inventory levels appeared particularly acute in Jiangsu province. Inventory levels are typically lowest after the spring festival and peak in June, July and August. The second half of the year is typically the busy selling season.

Some interviewees noted that due to high growth targets (particularly in southern China) that dealerships were being forced to take on unhealthy levels of inventory. In order to move cars off the lot, dealers are selling cars at increased discounts, which is eating into dealer margins.

"... Mercedes, BMW, Audi are all getting stronger. If JLR doesn't make large scale changes on their product line and market operations, it will soon be surpassed by Lexus, Cadillac, and other brands. We have 10 dealerships in our operation. My dealership is ranked second of those 10, so the inventory levels at my store are healthy. But inventory pressure is a trend that is common across our dealers this year. JLR is targeting 35% growth for South China this year, in other regions it is aiming for 18% growth. In order to hit our targets, every large distributor is taking on lots of inventory and continuously discounting prices to dump cars..."

JLR Dealer, Hunan Province

"... Even with after-service sales, we made a loss in Q2. The overall situation is deteriorating. JLR is adjusting the variable rebates. In Q2 these rebates increased 2-3% and trying to avoid conflicts with dealers. If JLR continues to force inventory on dealers, there is a high probability that JLR will get backlash from dealers, similar to what BMW experienced [the USD 820 mln payment BMW provided to its China dealerships in 2015].

. For mid to high end brands only Mercedes and Lincoln are profitable for dealers. All other brands are loss making for dealers..."

JLR Dealer, Hubei Province

August 25, 2017

Table 1: Inventory Levels

Geography	Hunan	Jiangsu	Sichuan	Hubei	Shanghai
What are inventory levels now? Is this high or low in a historical context	Normal inventories currently	Inventory currently high. We have a system that tracks inventory across all our stores. Inventory is high system wide, but our individual location is doing OK	High level of inventory	High inventory	High inventory
When were inventories highest?	In June 2017. Inventories have come down since	This is the highest inventory level we have ever had	Inventory levels were highest in the low season in March and April. This year and last year are about the same	June last year was the peak. Usually inventories are highest in the middle of the year (around end of Q2 and early Q3)	We've had higher inventory levels before, but shortly after sales hit a peak. Inventories are also quite high today
Months of inventory (current)	1.3	1.0	1.2	2.5	1.3
Months of inventory (last year this season)	1.2	.09	1.3	1.7	1.1
Geography	Beijing	Jiangsu	Guangdong	Guangdong	Guangdong
What are inventory levels now? Is this high or low in a historical context	We have a healthy amount of inventory	This is the first time we've had so many cars. All of Jiangsu province is full of inventory	High about 2.1 months of inventory vs. a more normal 1.2 months	High level, a normal level would be about half of what we have now, but August is usually a seasonal high.	2.1 months, vs 1.5 months a year ago. Peak sales are in September and October, and generally throughout H2
When were inventories highest?	This year the highest due to sales targets	June, July, and August is usually the seasonal high. This is the first year with unusually high inventories however	Inventories are a bit higher now than they were at this time last year	Last year around this time inventories were 2.5x. Inventory is lowest right after the spring festival and builds during H1. Sales usually come in H2	Current inventory is highest ever.
Months of inventory (current)	1.7	2.6	2.1	2	2.1
Months of inventory (last year this season)	1.5	1.2	1.8	2.5	1.5

Source: J Capital interviews

August 25, 2017

Discounts

Most dealerships reported increasing discounts on JLR vehicles, particularly on models manufactured in China. Most dealers cite inventory pressure and high sales targets as the contributing factor to increased discounting. Discounts on the new Discovery are low, at 3-5% and increasing. Considering this is a brand-new vehicle, dealers would like to see it sell a few months around sticker price before having to offer these kinds of discounts.

Table 2: Discounts

Geography	Hunan	Jiangsu	Sichuan	Hubei	Shanghai
How have discounts changed between 2017 Q1 and 2017 Q2 (Calendar year)?	Discounts increased by 3-5% in Q2	Discounts are higher in Q2	There hasn't been much change in discounts	Discounts increased in Q2 by 2-3%	Discounts increased in Q2
Which cars have experienced the biggest change in discounts?	The new Discovery is selling poorly. Discounts of RMB 100,000.	For imported cars, the RR has the highest discount. Other than the RR, domestic produced cars typically have the highest discounts. Sales targets are too high, which is resulting in higher discounts	Jaguar F-Pace has highest discounts now because it's getting a model upgrade and we are clearing inventory. The new model is already on the market. The old model is selling about 30% off	Domestically produced cars have the highest discounts due to JLR forcing pressuring dealers to move higher volumes.	Domestically produced cars are selling at discounts of RMB ~10,000. The new discovery is selling with a discount of RMB 80,000 to 100,000. JLR is putting high targets on selling domestic cars which is resulting in discounts. The new Discovery isn't selling well, which is why it's discounted.

August 25, 2017

Geography	Beijing	Jiangsu	Guangdong	Guangdong	Guangdong
How have discounts changed between 2017 Q1 and 2017 Q2?	Discounts increased by 1% in Q2	From January to April 2017 there was virtually no inventory on the market for the new Discovery. The old model was still selling at its set price, or above that. The new model is selling poorly, and discounts are about 13% currently. In Q1 and Q2 there wasn't much change in discounts, but since June discounts have increased due to JLR pressuring dealers to take more inventory. Dealers have increased discounts overall for vehicles from 12-13% in H1 to 15% on average in Q3 calendar year		Discounts on average are about 20% on most cars he sells. Discounts have generally increased compared to last year, which is crimping his cash flow.	Discounts have been about steady
When were inventories highest?	This year the highest due to sales targets	June, July, and August is usually the seasonal high. This is the first year with unusually high inventories however	Inventories are a bit higher now than they were at this time last year	Last year around this time inventories were 2.5x. Inventory is lowest right after the spring festival and builds during H1. Sales usually come in H2	Current inventory is highest ever.

Source: J Capital interview

Sales to Second-Tier Dealers Not a Big Problem

Despite high inventory pressure and sales targets, the proportion of sales made to secondary dealers in our survey declined YoY. Dealers on average reported that 13% of units went to dealers this year vs 15% last year. Some dealers mentioned that JLR was more closely monitoring local license registrations to track how many vehicles primary dealers are selling to secondary dealerships.

Table 3: Second-Tier Dealer Sales

August 25, 2017

Geography	Hunan	Jiangsu	Sichuan	Hubei	Shanghai
In 2017, what portion of your sales went to secondary dealers?	12%	22%	18%	10%	5%
In 2016, what portion of your sales went to secondary dealers?	18%	31%	18%	15%	6%
Reason?	Sales have been optimized and volumes increased, so they are selling less to secondary dealers	JLR looks at the rate of local registrations for license plates for its cars and rewards dealerships where license registrations are growing in line with dealership sales. If we meet targets, we get RMB 1,000-3,000 per car. We are also reducing sales to secondary distributors to boost after service sales, where profits are high. Some distributors will sell to the secondary market whenever inventories get too high.	Not much change in the proportion going to secondary dealers. The secondary market is messy, dealers can even exchange cars between other dealerships. Before we even sent cars to Shanghai (from Sichuan)	We are reducing exposure to the secondary market and maintain the rate of local vehicle registrations. We're also looking to keep profit from aftersales of vehicles.	JLR assesses its dealers for sales to secondary dealers, and is requiring dealers to reduce indirect sales

Geography	Beijing	Jiangsu	Guangdong	Guangdong	Guangdong
In 2017, what portion of your sales went to secondary dealers?	25%	10%	0%	25%	5%

August 25, 2017

Geography	Beijing	Jiangsu	Guangdong	Guangdong	Guangdong
In 2016, what portion of your sales went to secondary dealers?	23%	20%	0%	10%	5%
Reason?	Beijing is different from most other regions in China in that Beijing dealerships frequently need to supply cars to Tianjin and Hebei province. Sales targets are high this year, so there's a mild uptick in the amount of sales going to secondary dealers	This year we are principally trying to maintain market share in our city, if we have market share we will maintain profit for after sales service. So we are reducing sales to secondary dealers. JLR also assesses our performance, and market share is one of the criteria. But JLR isn't strictly limiting the ratio of our sales to secondary dealers.	Never sells to secondary dealers. His dealership manages its inventory well and after sales service is a profit maker.	Even though selling more units this year, his profits are falling because cars are being discounted more heavily. Selling inventory to second tier dealers is terrible for business because it means selling at a loss.	His dealership let any more than 10% of cars go to secondary dealerships. His dealership has access to financing and probably sells less cars to the secondary market than the average dealer.

Source: J Capital interview

New Discovery Land Rover

Most dealers were pessimistic on sales of the new Discovery. Dealers felt that consumers don't like the new exterior look of the vehicle. Other dealers said that customers were waiting for discounts to stop falling before making a purchase.

Table 4: Discovery

Geography	Hunan	Jiangsu	Sichuan	Hubei	Shanghai
How many units per month for the old Discovery model?	4	3 to 4	We sold out of the old model in May. When it was announced that the old model was going to stop, we were selling 12 units on average per month	We started clearing inventory for the old Disco model in March, and we've been selling about 5 per month	When we were clearing inventory of the old model in the beginning of the year, we were selling 5 to 8 cars per month

August 25, 2017

Geography	Hunan	Jiangsu	Sichuan	Hubei	Shanghai
How many units per month can you sell for the new Discovery model?	2 units -- the new model isn't well accepted in the market. The price is high, and the exterior is ugly	5 units per month. Sales of the new model are selling well in a nearby city where there's no dealership yet	We sold 3 units in July. There have been some issues with the vehicles, on one the A pillar fell off. There's been a problem with the ordering system and we haven't been able to get new vehicles. We need after sales support or parts	2 units. There is decreased interest in the market, and JLR has set prices high. Dealers are only selling after lots of haggling on price	2 units. The exterior looks like the Disco Sport, and most people don't like it. More people end up choosing the Range Rover sport over this model.

Geography	Beijing	Jiangsu	Guangdong	Guangdong	Guangdong
How many units per month for the old Discovery model?	Last year and the end of the year we ran out of stock and had no inventory. We used to be able to sell 16 units per month	5 to 8	0	3	5 to 8

How many units per month can you sell for the new Discovery model?	The exterior changed a lot, you basically can't even see the outlines of the previous model in the new vehicle. We can probably sell about 12 unit per month. People who like to go off roading will purchase this model	2 units per month. People don't like the exterior of the new model. We've been cutting the price, but the units still aren't moving. Another problem is that the factory has only given us units with high specs, and no vehicles with only basic options. At this price level, most consumers will buy the Range Rover Sport instead	The new Discovery isn't selling well. The first car arrived on his lot 90 days ago, and he hasn't sold one yet. Usually cars don't sit on his lot for more than 40 days. Discounts on the new Discovery are about 10%, and this will continue to drop. He thinks buyers will wait for discounts to bottom, and then will step in and buy. Currently that are about 10 units in inventory	The new Disco started selling in May, and the dealership has sold 10 in 3 months, which is about consistent with the old model. The Discovery is a niche vehicle that appeals to 30-40 year olds who like to go off-roading. The new version might be selling slow today, but buyers will get over the new exterior looks and come back to the model. If you are serious about off-roading there isn't much of an alternative	5 to 8, but as discounts increase this will trend up. If discounts get to 15-20% of sticker price, he might be able to sell 13 per month. Clients are waiting for higher discounts before they by now. The new model should sell better than the old one once consumers get used to the looks
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Source: J Capital interview

August 25, 2017

New Velar Land Rover

Dealers universally had high praise for the Velar’s looks, its quiet cabin, and attractive interior. At the time of survey, most dealers were unclear on pricing. Still, most felt that the Velar is likely to be a high-volume model – in many instances, dealers felt that it is likely to outsell the new Discovery. If the Velar is a high margin vehicle for JLR, this vehicle could drive substantial EBITDA growth in H2 FY 2018.

Table 5: Velar

Geography	Hunan	Jiangsu	Sichuan	Hubei	Shanghai
What is the market reaction to the new Velar?	Market response is good. We've already had about 30 people come to the dealership for inquiries about the new model and 5 put in pre-orders	Market reaction is good. The design and interior are well done, but it probably won't be long for discounts start appearing from the sticker price	The Velar has a good reputation in the market, after all it has an attractive exterior and 3 LCD entertainment displays. The key is on price. It's rumored to be an expensive car coming in between the price of Range Rover and Discovery models -- probably somewhere around RMB 700,000. If the price is too high, the Velar won't be as competitive as the Range Rover	The new Velar is well received by the market, mainly because JLR has done a good job with promoting the vehicle. But I think discounts from the sticker price will probably start appearing on the car about 3 months after we start selling it. In recent years, new models from Land Rover haven't sold well. Only the Evoque managed to sell at its sticker price for about half a year after it was introduced of the market	Market reception is good, and a few customers have already placed pre-orders. The better the price, the more units we will sell on this vehicle. This year I think the factory may not have enough supply to keep up with sales
By calendar year Q4, how many units per month do you estimate you can sell of the new Velar?	5	4 to 6	From our present perspective, we think we can sell about 5 Velar's per month. The factory is currently short on production for the Velar, and in general there isn't much supply at dealerships	5	7

August 25, 2017

Geography	Beijing	Jiangsu	Guangdong	Guangdong	Guangdong
What is the market reaction to the new Velar?	Market reception is good. The price will be in the range of RMB 800,000 to RMB 1,000,000. There's a lot of technology in this car, and it fills the gap in the mid-large size category for Land Rover. It's bigger than the Evoque and smaller than the Range Rover Sport. It should be popular with female customers.	We think that sales price should be RMB 600,000 to 900,000. This is a mid-large size SUV, and the price isn't too high. JLR is requiring us to take on 2 units of inventory, and we can start selling in September. In recent years Jaguar and Land Rover have put out a lot of new models, but we still haven't had a very good seller	The velar should be a higher volume car than the Discovery. The interior is fancy and comfortable, and the car is good looking. Pricing is rumored to be around RMB 1 Mln for a high spec car.	High expectations for the Velar. It gives a quiet ride, which Chinese people will like. It's the same size as the F-Pace, and the interior is very high tech. Hot seller, maybe in the magnitude of 10 units per month. This competes somewhat with Porsche's Macan.	Positive reaction. The Velar should sell well in China

By calendar year Q4, how many units per month do you estimate you can sell of the new Velar?	15 to 20	2 to 3	10	10	10-15 per month if the price is RMB 500-600k for a low spec vehicle
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Source: J Capital interview

Notable Quotes

One dealer said it is deliberately holding back on sales to avoid making losses:

“... Sales are loss making [before after-sales service income], so we won't sell any more than what we need to get our volume rebates...”

JLR Dealership, Jiangsu Province

Dealers frequently described Mercedes, Lincoln, and BMW as the leading brands in China in terms of growth and maintaining firm pricing for dealerships:

“... JLR is placing more emphasis on sales of domestically produced cars. Currently domestically produced cars are over half of sales at this dealership. Going forward they will represent an increasing share. In the mid- and high-end segment we can't compare with Mercedes and BMW -- we can only compare ourselves to Cadillac. This year Cadillac's growth should be higher than Land Rover's...”

JLR Dealership, Sichuan Province

“... For mid- to high-end brands, only Mercedes and Lincoln are profitable for dealers. All other brands are loss making for dealers...”

JLR Dealership, Hubei Province

“... In the luxury segment, only Lincoln, Mercedes, and Lexus make money for dealers. Pricing for other brands is all trending toward localization. Average prices will continue to fall. For JLR, after localization with its local partner, it is targeting a customer level in the RMB 200,000 to 300,000 range...”

JLR Dealership, Shanghai

“... In the mid to high end market, Mercedes, BMW, and Porsche dealers are making money. Land Rover and Audi dealerships are making losses. If JLR doesn't a new model that can help dealers earn money, there will be obvious conflicts that appear between dealers and JLR. Mid end models and Japanese cars are selling relatively well. Dealers are making substantial losses on selling Korean cars...”

JLR Dealership, Jiangsu

“... Mercedes is probably the best brand a dealer can carry today. Mercedes are selling with no discounts. Discounts on BMW are similar to JLR – in the 20% range. Audi probably has

August 25, 2017

higher discounts than JLR. Audi has probably been in the China market too long and too many people own them, so they are no longer seen as special...”

JLR Dealership, Guangdong

“... Mercedes is selling the best right now, with low discounts for dealers. BMW is probably next best. Audi ranks third, Cadillac 4th, JLR 5th, Lexus 6th, and Volvo 7th...”

JLR Dealership, Guangdong

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