

MarketGauge

See what stocks and sectors are moving today's markets.

FREE Markets Tools

- Stock & Fund Listings
- Futures
- Options
- Annuities
- Economic Calendar
- Markets Calendar

Help

Contact Us

Log Out



MONDAY, MAY 2, 2005

The Next Toyota?

Hyundai's auto-making future appears solid, but hold off on buying its shares

ROBERT COSMAI, THE CHIEF OF Hyundai Motor America, can hardly wait for May 20 to arrive. That's the date of the official opening of Hyundai's Montgomery, Ala., plant -- the ambitious South Korean car maker's first production facility in the States and the key beachhead in the next stage of its assault on North America's vast light-vehicle market.

Seven months after the opening, Hyundai hopes to be pumping out 150,000 'Bama-built Sonatas a year. The car, redesigned for 2006, will go head-to-head with the two leaders in the U.S. midsize-auto sector, the [Honda](#) (ticker: HMC) Accord and [Toyota](#) (TM) Camry. If all goes as planned, production of Santa Fe sports utility vehicles will begin in January, bringing the plant to its full capacity of 300,000 vehicles a year.



Jeffrey Sauger/Bloomberg News

Under Robert Cosmai, Hyundai Motor America plans to take "some big steps over the next few years."

Hyundai already has a design center in Irvine, a proving ground in the Mojave Desert and an engineering center in Superior Township, Mich., investments totaling \$1.3 billion. But the plant has a deep psychological significance for Korea's largest car maker. Its opening will mark a triumphant manufacturing return to a continent where it ignominiously abandoned a Canadian plant in the mid-'Nineties, amid crashing sales brought on by its cars' terrible reliability.

"We're poised to really develop our infrastructure to take some of the big steps over the next few years," Cosmai says. Among those steps: To become one of the world's five largest carmakers in 2010. (With sister company Kia Motor, it's No. 7, just ahead of Japan's [Nissan Motor](#) (NSANY) and behind France's PSA Peugeot.)

Already, sales have surged, helped by steep gains in quality rankings from J.D. Power & Associates and Consumer Reports. Business Week rated Cosmai's boss, Hyundai Chairman and Chief Executive Chung Mong Koo, one of Asia's best executives. Cosmai expects a robust 16% increase in Hyundai's U.S. unit sales, to 485,000 vehicles this year, even while he sees the overall market staying "relatively flat." And Hyundai's sales also are climbing in Europe and in Asia. Since 2000, Hyundai/Kia's western European sales grew 67.4% to 452,892 units in 2004, according to

© 2005 The Vanguard Group Inc., All rights reserved. Patents Pending Vanguard Marketing Corp., Distributor.

Three new VIPERs® ETFs from Vanguard.

Vanguard® European VIPERs®

VGK

Vanguard® Pacific VIPERs®

VPL

Vanguard® Emerging Markets VIPERs®

VWO

Click here to learn more.

Vanguard®

BARRON'S SERVICES

Subscribe

Digital Delivery

Advertise

Automotive News Europe, a trade publication. In the first quarter alone, the company sold 583,463 vehicles worldwide, up 19% from a year earlier. Exports rose 20%, while sales fell 6% in Korea, where consumers have been squeezed by a credit crunch.

In the U.S., Hyundai's ascent will put more pressure on the Big Three, which are struggling with lackluster volume and soaring costs. In China, the world's biggest emerging car market, the company doubled sales in the first quarter. And in India, it has become the third biggest auto maker. But Hyundai has a larger target in sight. It wants to be the new Toyota, which is likely to surpass GM as the world's largest vehicle maker within a few years. And it's not just targeting sales in its pursuit of the Japanese giant. Thursday, without any provocation, it declared that it would surpass Toyota in quality by 2008. If nothing else, Hyundai isn't humble.

What's driving the company's global surge? "The quality of Hyundai's cars has improved dramatically and they have a distinct price advantage, feature for feature, quality for quality," says Henry Seggerman of International Investment Advisers, which runs the Korea International Investment Fund, the oldest hedge fund invested in the Korean market. "What Samsung Electronics did to Japanese electronics companies, Hyundai could be doing to Toyota Motor in the not-too-distant future." Hyundai has already said it wants to match Toyota's quality and appeal by 2007.



Middleweight Contender: Hyundai officials think their 2006 Sonata, which comes with some standard features that are optional on rival midsize cars, will be a formidable competitor to Honda's Accord and Toyota's Camry.

For investors, there's a caveat in the Hyundai story. For all that its auto-making future looks bright, its stock price may not keep pace immediately. (Although Hyundai has shares that trade in the U.S. pink sheets, the primary trading is done in the Korean market.) That's because raw-material costs are soaring, the Korean won is gaining against both the dollar and the euro, and short-term labor trouble could be looming.

In fact, first-quarter results were sharply lower than analysts expected. Operating profit, which under Korean accounting covers only the domestic market, fell a staggering 30%, to 322.7 billion Korean won (\$322 million) as margins contracted. Net income, however, rose 14%, to KRW 509.8 billion, as profit from overseas affiliates almost doubled. The won's gain made Korean exports much less competitive, cutting the value of Hyundai's overseas earnings. And raw-material costs hit 67% of revenue from 59% a year earlier. (Kia Motor, which is 38% owned by Hyundai, had an 89% drop in operating profit.)

More weakness may lie ahead for the shares, if margins keep contracting. During the quarter, the operating margin fell to 4.7%, down from 12.5% in 2002. Hyundai officials, speaking with investors and analysts, said that they (like every other auto maker in the world) are trying to get their parts suppliers to trim costs. Losses at two affiliates, Hyundai Card and Hyundai Capital, have started to reverse. But the won remains strong, and a turnaround in Korea's domestic auto

FRIENDS.
GOOD
OR BAD
THING.
DISCUSS.



THE MACALLAN® SINGLE MALT SCOTCH WHISKY
43% ALC/VOL (86 PROOF) RARE AMERICAN, INC., NEW YORK, NEW YORK ©2004 THE MACALLAN DISTILLERS LTD. PLEASE SAVOR RESPONSIBLY.

COMPANIES

Dow Jones, Reuters

[Honda Motor Co. Ltd. ADS \(HMC\)](#)

PRICE 24.02

CHANGE -0.08

U.S. dollars 4:03p.m.

[Customer Service](#)

[Reprints](#)

[Corporate Reports](#)

[Classified Ads](#)

[Other Sites from Dow Jones](#)

[MarketWatch](#)

[CareerJournal](#)

[CollegeJournal](#)

[OpinionJournal](#)

[Personal Technology](#)

[RealEstateJournal](#)

[StartupJournal](#)

[MORE](#)

market, which accounts for a third of the company's total sales, shows no signs of materializing.

Since December, Hyundai stock has been supported by a \$650 million buyback. But that program expires soon, Hyundai is entering a season of labor disputes at home, and the Montgomery plant probably won't break even until year-end. "You will still get a better chance to buy this stock," says Todd McClone, an analyst at William Blair International Growth Fund, which until December was a major Hyundai shareholder.

That's good news, for the stock's inherent value is considerable. The shares, which carry an annual dividend of KRW 1,150 (about \$1.15), traded last week at KRW 53,900 (\$54.06). "It's very cheap, and at six to seven times earnings, the promise has almost never been better," says Wendy Trevisani, a portfolio manager at Thornburg Investment Management and a value investor. "They should close the year with decent margins, a better mix domestically, higher-end products and price increases. We're optimistic," says Trevisani, who thinks the stock is worth at least eight times earnings.

Another fan is Christopher Smart, who runs the Pioneer Emerging Markets mutual fund. Hyundai trades at 2.5 times cash flow, versus a long-term average of three times, he observes. "Given the diversification of businesses, it should get back there which would put it at a target price of KRW 68,000. Or if you look at I/B/E/S estimates for '06 of 8,900 won per share, and give that a market multiple of 7.5 times, you get to KRW 66,000." True, earnings assumptions these days are subject to risk. Still, says Smart, "I think a 3% dividend yield is pretty good protection."

Trevisani and Smart are just two of the foreigners who own 50% of Hyundai's outstanding stock today. Quite a change from the depths of the Asian currency crisis, when the Hyundai business group teetered under an enormous debt that forced it to restructure.

To get back on its feet, it introduced a 10-year, 100,000-mile warranty in 1999, when Hyundai's cars weren't exactly paragons of reliability. But Hyundai stepped up its focus on quality, and its vehicles' low prices drew customers. In addition, Hyundai protected itself by making the warranty nontransferable. In other words, only the original owner (or, in some cases, that owner and his family members, if he sold the vehicle to them) were covered. Subsequent buyers weren't, and most cars change hands at least once before they're 10 years old.

Hyundai and Kia together have 4.1% of the U.S. car and light-truck market. Hyundai buyers are loyal to the brand -- two-thirds who trade in one buy another. And, as quality improves, Hyundai is paying less on its warranties. "The warranty situation has decreased by 35% over the last three years," says Cosmai.

Much depends on a successful startup in Montgomery. The worst thing for Hyundai would be to follow up the Sonata launch with a series of recalls, but this is Hyundai's first Sonata in some years, and the company's engineers have had plenty of time to work out any kinks. Still, [Nissan Motor](#) recently stumbled rolling out models at its Canton, Miss., plant. Michael Stalker, a global automotive analyst for Credit Suisse Asset Management, says "Hyundai is really coming into a phase where it has to show good progress in car sales and

[Toys "R" Us Inc. \(TOY\)](#)

PRICE	25.70
CHANGE	0.35
U.S. dollars	4:01p.m.

[Nissan Motor Co. Ltd. ADS \(NSANY\)](#)

PRICE	19.64
CHANGE	-0.01
U.S. dollars	4:00p.m.

[Nissan Motor Co. Ltd. ADS \(NSANY\)](#)

PRICE	19.64
CHANGE	-0.01
U.S. dollars	4:00p.m.

* At Market Close



2005 Santa Fe



2005 Tiburon



2005 Tucson

Beefing Up: A broader lineup of products, ranging from sport coupes to SUVs, has helped Hyundai gain fans in Europe, China and the U.S., bolstering its share price.

the ability to offset some of these cost headwinds. A successful startup on the new plant is key."

But more depends on the success of Hyundai's aggressive "24/7" strategy, in which it unveils seven new cars in 24 months. Hyundai launched the Tucson, its second SUV, in the fourth quarter. Then there's the new Sonata midsize sedan. The Accent, an entry-level car, debuts in the summer. The Azera, Hyundai's first luxury car, arrives in the fall. Then there's a new minivan, the second-generation Santa Fe and a new Elantra sedan.

Hyundai is spending 25% more to market the Sonata than its spend on the current model last year. Margins should widen, given that the new Sonata is listed at \$18,495, narrowing its price gap with the Camry and Accord to 5% to 6%, versus 10% to 12% for the 2005 model. Such price increases are one reason Hagju Kim, an analyst at Samsung Securities in Seoul, recently upgraded Hyundai to Buy.

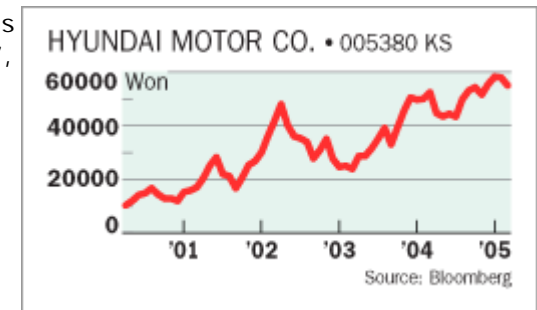
"I now consider Hyundai a growth stock," says Kim. "The Alabama plant will be successful, it will be fully utilized by 2005, and sales volumes for the Sonata will increase." Kim predicts that Hyundai also will improve vehicle durability, raising its cars' resale value. This, in turn, should allow it to charge more for new vehicles. A 10% increase in durability leads to a 2.7% increase in used-car prices, says Kim. That means Hyundai can raise new-car prices 6.5%.

How long will Hyundai price at a discount? As long as it's "closely aligned" to Japanese manufacturers, it can raise prices, says Cosmai. "We want to get beyond being the value brand with the long warranty. As our product becomes more aspirational in nature, then we can price up accordingly. I want people talking about Hyundai at cocktail parties." That could happen as Hyundai introduces its luxury vehicle. And once Hyundai starts selling, say, 800,000 cars a year in the U.S., it can quit discounting, Cosmai reckons. U.S. sales totaled 418,615 last year, nearly five times 1998 sales.

Much of the sales effort will rely on an overhauled dealer system. Just 38% of Hyundai's network is exclusive. Cosmai wants to raise that to 44% by year end and 50% by 2007, with an emphasis on Sunbelt states. "Exclusive dealers sell more cars," he says.

One challenge: To differentiate Hyundai from Kia, which is also moving up the quality chain. The Hyundai Tucson and Kia Sportage are look-alikes, as are the current Sonata and Kia Optima. Says Cosmai: "Kia's driver is a little younger, more exciting. Ours is refined and confident."

Confidence is something Cosmai doesn't lack, either. This year, he says, Hyundai's U.S. share will hit at least 2.8%, versus 2.5% in '04. The scary thing for rivals: His estimate looks conservative.



E-mail comments to editors@barrons.com

 [EMAIL THIS](#)

 [FORMAT FOR PRINTING](#)

 [ORDER REPRINTS](#)

[Return To Top](#)

Copyright © 2005 Dow Jones & Company, Inc. All Rights Reserved

[Copyright Information.](#)

DOWJONES