CASE STUDY

VALUATION MASTER CLASS

by

A. Stotz INVESTMENT RESEARCH

Is this carmaker's parallel strategy a potent value play?

Valuation Master Class

This video is for learning purposes only.

This is not investment advice or a recommendation.

Ask Ajarn Andrew

Hyundai sees the future in hydrogen, unlike other carmakers

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HYUNDAI

Our estimate:

KWR280,000

(Upside 28.4%)

BUY

3 things to know about this company

- ★ Contrarian bet on hydrogen could be a winning strategy
- ★ Long-awaited margin rebound could justify re-rating
- ★ Reducing reliance on global supply chains

Key statistics

Analyst consensus (33)	PB ratio	Dividend yield
KRW300,000 (Upside 38.9%) BUY	**0.8x**	**2.1%**

Sources: A. Stotz Investment Research, Refinitiv

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Price signal unclear, but volume supports bullish signal

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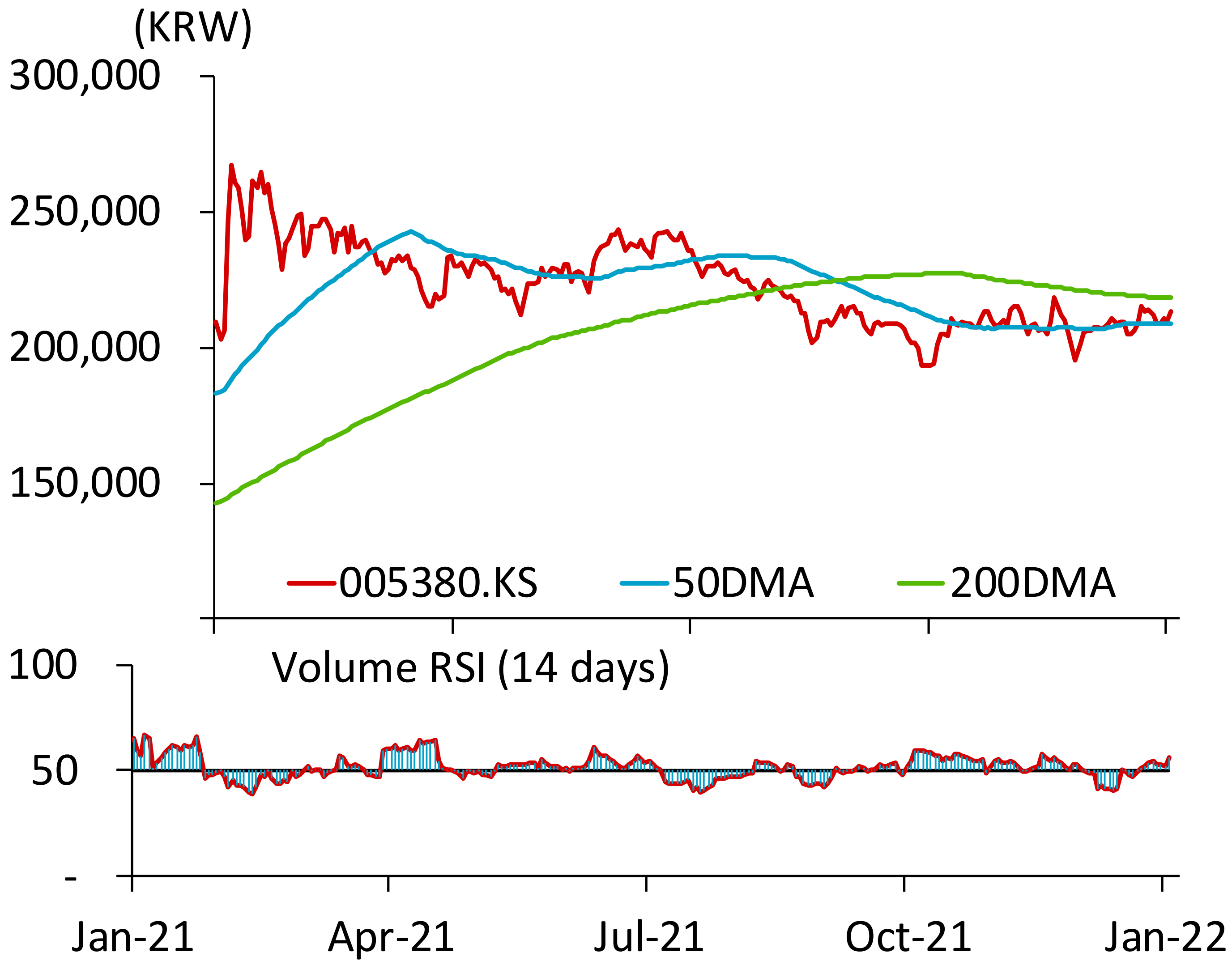

- ★ Recently, the 50 DMA closed the gap to the 200 DMA line
  - **It appears that the 50 DMA could soon cross the 200 DMA again, which we would consider a good signal**
- ★ The Volume RSI currently has stayed above the 50%-line which indicates a bullish trend

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Revenue breakdown 2020 (other 6%)

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Vehicles 78%

Top 1 Korean car
Hyundai Grandeur

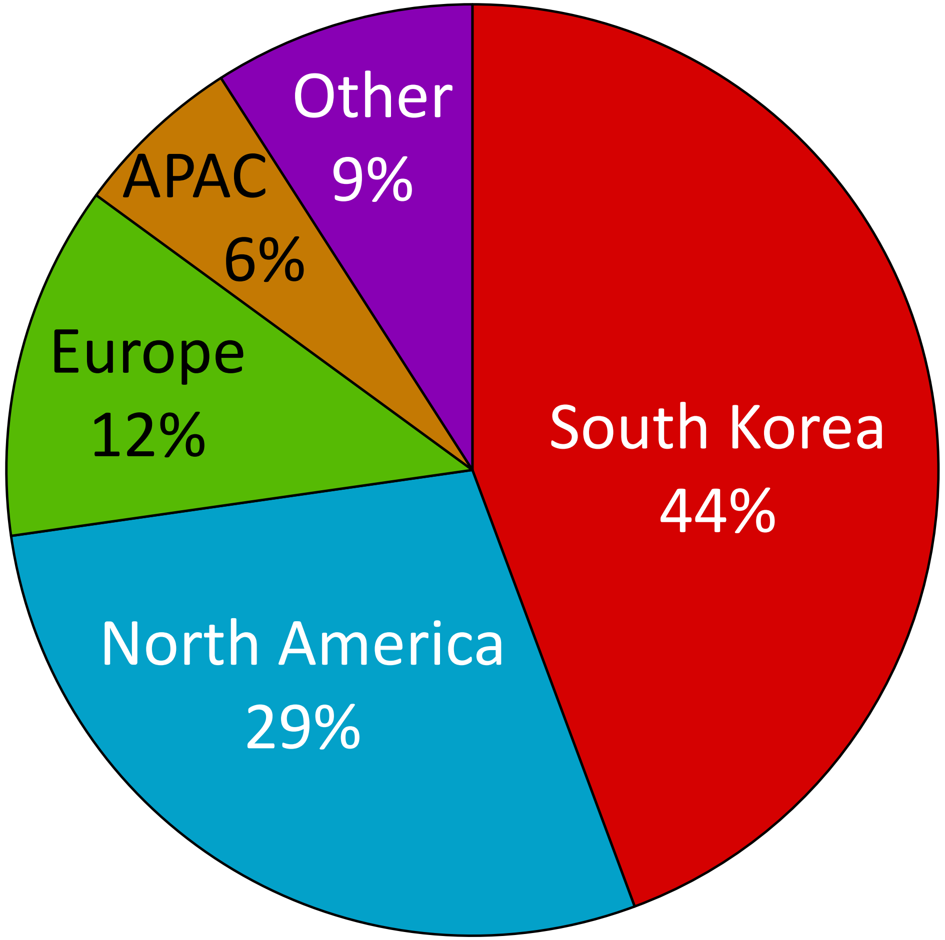
Top 2 Korean car
Hyundai Porter Truck

Most famous model in US
Hyundai Tucson

Financing 16%

HYUNDAI FINANCE

Breakdown by region



Sources: A. Stotz Investment Research, company data

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1 Contrarian bet on hydrogen could be a winning strategy

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★ Hyundai and Toyota are the only large car producers that are sticking with fuel cell electric vehicles (FCEV)

- **They have 90% market share of in FCEV**

★ Hyundai has allocated 2022 CAPEX of US$1.1bn, roughly 15% of its total CAPEX budget, to develop two further fuel cell plants

- **This brings annual production to 100,000**
- **A bold move considering that almost all car makers exited from hydrogen to focus on EV**

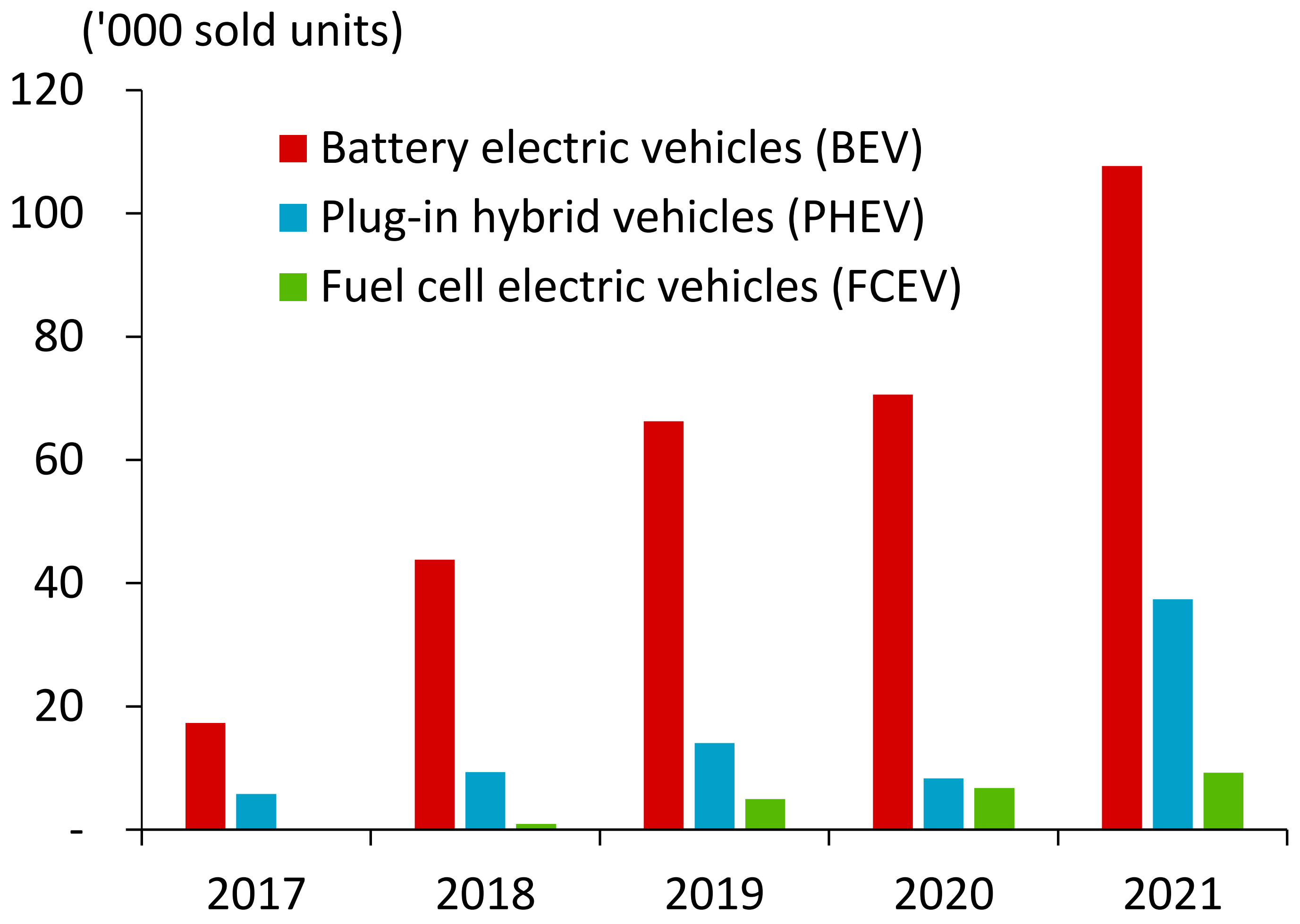
Sources: A. Stotz Investment Research, company data

What are the differences among the electric vehicles?

- **Battery electric vehicles (BEV)**
  - Pure electric vehicles that use rechargeable batteries
  - Tesla’s main approach, followed by most other car makers
- **Plug-in hybrid vehicles (PHEV)**
  - Hybrid models that use both an electric motor and a gas engine, Toyota has been a leader in hybrids
- **Fuel cell electric vehicles (FCEV)**
  - Instead of a battery, it uses fuel cells that generate electricity through hydrogen

Ask Ajarn Andrew

Still, Hyundai is also well-prepared for EV roll-out



- A top 5 largest EV producer
  - **In 2021, it sold more than 100,000 battery electric vehicles (BEV)**
  - **This gives it a market share of 5%, compared to Tesla's 14.6%**
- The company continues to give equal priority to EV and hydrogen
  - **If hydrogen turns out to be a more feasible solution, then Hyundai could be a big winner**

Sources: A. Stotz Investment Research, company data

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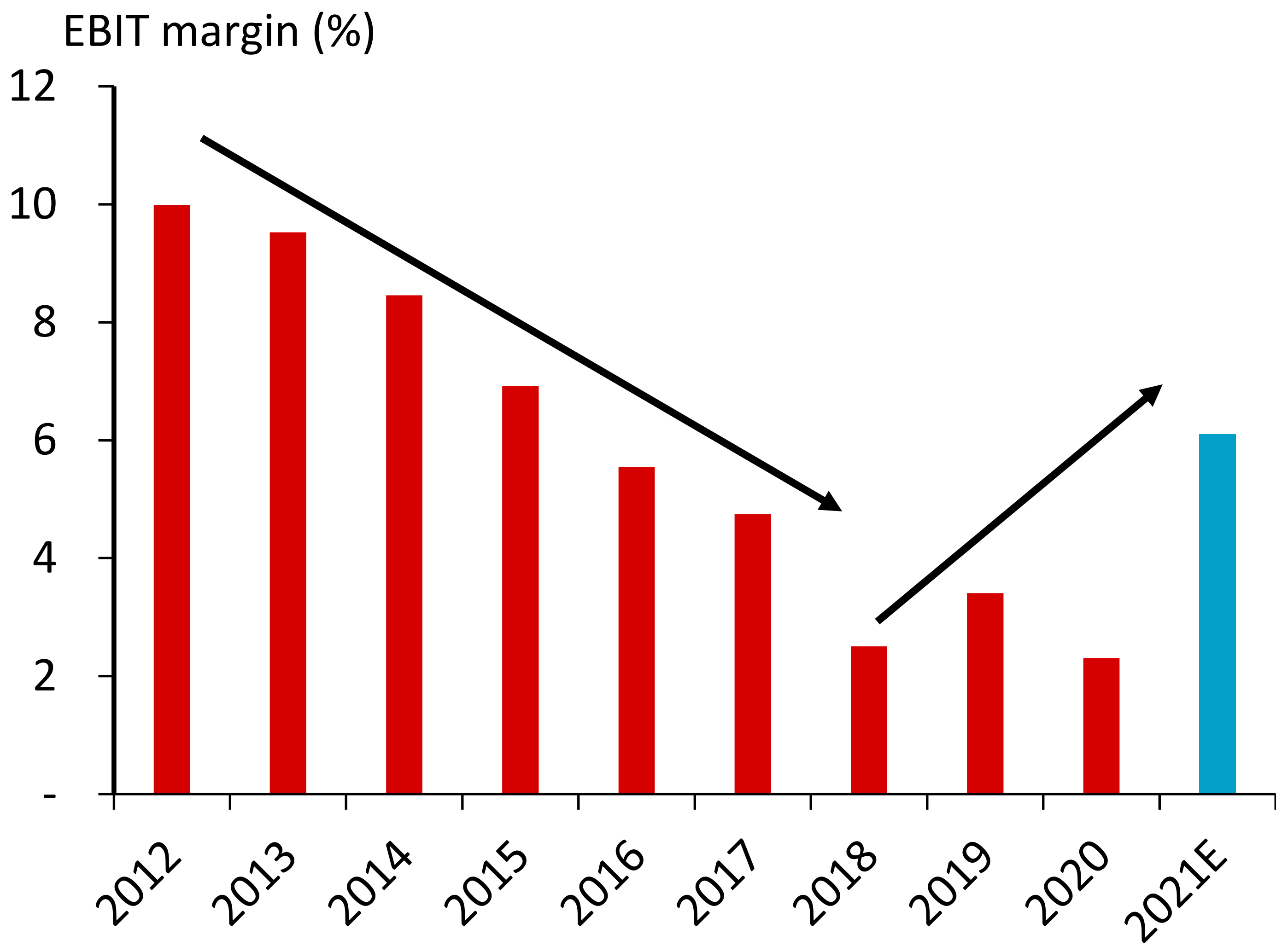
Long-awaited margin rebound could justify re-rating



- Hyundai has fallen from one of the most profitable car makers to below average profitability in 2020
  - **Mainly from fierce price competition, higher labor costs and the recent chip shortage**
- However, company's efforts to focus on higher margin car models and reducing SG&A is starting to pay off
  - **If it can maintain a 6-7% EBIT margin it change the market's assessment of the company**

Sources: A. Stotz Investment Research, company data

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3 Reducing reliance on global supply chains

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- Sales
- **Story**
- FVMR
- Value
- WCB
- Risks

★ The company missed its 2021 sales target by 4% amid the chip crisis

- **Still, it was among only 3 car makers that were able to increase sales volume YoY**

★ Through its affiliate Hyundai Mobis, the Korean car maker plans to produce its own chips in the future to reduce its reliance on third-party suppliers

- **The further integration along the supply chain could lead to long-term cost reductions**

HYUNDAI MOBIS

Sources: A. Stotz Investment Research, company data

FVMR Scorecard

- Measures a stock's attractiveness relative to all other companies
- Attractiveness is based on four elements
  - Fundamentals, Valuation, Momentum, and Risk
- Scale from 1 (Best) to 10 (Worst)

Strong fundamental improvement for a good price

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	Worst				Neutral					Best
Rank relative to all other companies*					■					

Fundamentals

W			■						B

(%)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**
Operating profit margin	4.4	2.2	2.8	2.3	5.1
Recurring net margin	5.0	1.8	2.8	1.7	4.6
Asset turnover	54.0	54.0	56.4	51.5	52.9
Return on assets	2.7	1.0	1.6	0.9	2.4
Recurring return on equity	7.1	2.6	4.2	2.5	7.4

Valuation

W						■			B

(x)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**
Price-to-sales	0.4	0.3	0.2	0.5	0.5
Price-to-earnings	8.0	18.0	8.0	32.6	10.0
Price-to-book	0.6	0.5	0.3	0.8	0.7
PE-to-EPS growth (PEG)	nm	nm	0.1	nm	0.0
EV/EBIT	18.2	30.6	24.4	50.3	18.3

Momentum

W							■		B

(%)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**
Revenue growth	2.9	0.5	9.2	(1.7)	12.9
Recurring EPS growth	(11.4)	(62.9)	66.3	(39.6)	267.6
Operating profit margin chg. (bps)	(75)	(218)	59	(50)	286
	6mth	3mth	1mth	3wk	1wk
Price change	(14.7)	(4.0)	(3.7)	(1.0)	0.2

Risk

W			■						B

(x)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**
Current ratio	1.7	1.5	1.4	1.4	1.5
Net debt-to-equity (%)	69.9	77.1	90.0	99.6	100.6
Times-interest-earned	12.7	7.0	9.4	6.6	17.4
	5yr	3yr	1yr	6mth	3mth
Beta	1.3	1.4	1.7	1.2	1.0

Note: Benchmarking against 770 non-financial companies in South Korea.

Sources: A. Stotz Investment Research, Refinitiv. Notes: *Bars are decile rankings of the most recent period. **Past 12 months of published data. na = not available, nm = not meaningful. Valuation is based on historical prices.

Trading below a PB of 1x

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Valuation

W									B

(x)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**
Price-to-sales	0.4	0.3	0.2	0.5	0.5
Price-to-earnings	8.0	18.0	8.0	32.6	10.0
Price-to-book	0.6	0.5	0.3	0.8	0.7
PE-to-EPS growth (PEG)	nm	nm	0.1	nm	0.0
EV/EBIT	18.2	30.6	24.4	50.3	18.3

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What does a PB-ratio of less than 1x indicate?

- Book value is the value attributable to shareholders in case the company sells all its assets and repays its liabilities (also called liquidation value)
- A price-to-book ratio of less than 1x indicates that the market values the net assets less than the balance sheet suggests
- If a company trades at a very low PB, it could be either a cheap opportunity to BUY or a sign that something seriously wrong with the company

Ask Ajarn Andrew

Recently, I created a short online course explaining my FVMR investing approach

Get $97 value for FREE

(limited offer)

Consensus remains optimistic regarding profitability turnaround

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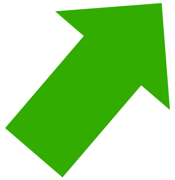
Analyst consensus valuation

Recommendation	Oct-21	Nov-21	Dec-21	Current
Strong buy	11	10	10	10
Buy	20	20	20	20
Hold	1	1	1	2
Sell	1	1	1	1
Strong sell	-	-	-	-
Average score	1.8	1.8	1.8	1.8

Price target	Aug-21	Sep-21	Oct-21	Current
Median	305,000	300,000	300,000	300,000
Mean	302,241	291,667	292,037	291,016

33 analysts



Upside: 38.9%

Analyst consensus 3-year forecast

(%)	18	19	20	21E	22E	23E
Revenue growth	2.5	9.2	(1.7)	12.9	7.0	4.6
Gross margin	15.6	16.7	17.8	18.7	18.9	19.2
EBIT margin	2.5	3.4	2.3	6.0	6.3	6.4
Net margin	1.6	2.8	1.4	5.1	5.3	5.5

- Analysts are more positive about Hyundai than the market
- They are optimistic that Hyundai can achieve a higher level of profitability which would close the gap with its peers
  - **If it can maintain a 6-7% EBIT margin, then this could be a catalyst for share price performance**

Sources: A. Stotz Investment Research, Refinitiv

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Profit & loss statement

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(YE Dec, Won bn)	2019A	2020A	2021E	2022E
Revenue	105,746	103,998	117,517	125,743
Cost of goods & services	(88,091)	(85,516)	(95,542)	(101,852)
Gross profit	**17,655**	**18,482**	**21,976**	**23,891**
SG&A	(14,050)	(16,087)	(14,337)	(15,089)
Other operating (exp)/inc	(0)	0	-	-
EBIT	**3,606**	**2,395**	**7,639**	**8,802**
Interest expense (net)	196	39	56	90
Other non-operating inc/(exp)	(362)	(70)	-	-
Earnings before taxes (EBT)	**3,439**	**2,364**	**7,694**	**8,892**
Income tax	(978)	(169)	(1,693)	(1,956)
Earnings after taxes (EAT)	**2,461**	**2,195**	**6,002**	**6,936**
Equity income/Minority interest	365	(396)	(112)	(794)
Earnings from cont. operations	**2,826**	**1,799**	**5,889**	**6,142**
Forex/Exceptionals before tax	154	(374)	-	-
Net profit	**2,980**	**1,424**	**5,889**	**6,142**

- ★ Hyundai is likely to recognize a record profit in 2021E
  - **Due to strong car sales and increased cost-cutting**
  - **9M21 net profit already stood at 4,159**
- ★ If achieved, it could be the starting point of turning around the profitability to industry-average

Sources: A. Stotz Investment Research, Refinitiv

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Balance sheet - assets

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Risks

(YE Dec, Won bn)	2019A	2020A	2021E	2022E
Cash & short-term investments	25,375	29,854	30,623	34,507
Accounts receivable	37,401	40,203	38,193	40,517
Inventories	11,664	11,334	10,616	11,317
Other current assets	1,643	2,296	2,350	2,515
Total current assets	**76,083**	**83,686**	**81,782**	**88,856**
Long-term investments	22,104	22,670	24,710	26,193
Net fixed assets	54,806	55,591	58,218	61,030
Intangible assets	5,005	5,336	5,442	5,554
Goodwill	262	341	341	341
Other long-term assets	36,253	41,719	42,137	42,558
Total assets	**194,512**	**209,344**	**212,631**	**224,531**

- The company has a solid cash position, holding around 14% of its assets in cash as of 2020
- Strategic partnerships and fixed assets investments necessary to maintain leading role in climate neutral car development

Sources: A. Stotz Investment Research, Refinitiv

Balance sheet - liabilities

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(YE Dec, Won bn)	2019A	2020A	2021E	2022E
Overdrafts & short-term loans	28,482	30,026	18,028	18,930
Accounts payable	10,520	11,751	11,943	12,732
Other current liabilities	14,313	17,683	16,452	17,604
Total current liabilities	**53,314**	**59,460**	**46,423**	**49,265**
Long-term debt	53,658	62,138	72,112	75,718
Other long-term liabilities	11,174	11,406	11,634	11,867
Total liabilities	**118,146**	**133,003**	**130,170**	**136,850**
Minority interest	**6,300**	**6,860**	**8,333**	**9,868**
Paid-up capital - Common shares	5,355	5,348	5,348	5,348
Paid-up capital - Preferred shares	-	-	-	-
Retained earnings	68,250	68,912	72,445	76,130
Revaluation/Forex/Others	(3,539)	(4,779)	(3,665)	(3,665)
Total equity	**70,066**	**69,481**	**74,128**	**77,813**
Total liab & shareholders' equity	**194,512**	**209,344**	**212,631**	**224,531**

- ★ Hyundai has moderately high leverage
  - **Liabilities-to-assets ratio stood at 64% in 2020**
- ★ Higher jumps in retained earnings would come from increased profitability

Sources: A. Stotz Investment Research, Refinitiv

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Ratios

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(YE Dec)	2019A	2020A	2021E	2022E
General growth (YoY, %)				
Revenue	9.2	(1.7)	13.0	7.0
Assets	7.7	7.6	1.6	5.6
Gross profit	16.6	4.7	18.9	8.7
Operating profit	48.9	(33.6)	219.0	15.2
Attributable profit	97.6	(52.2)	313.5	4.3
EPS	100.1	(51.8)	314.7	4.3
Recurring EPS	67.0	(37.7)	233.4	4.3
Du Pont analysis (%)				
Net profit margin	2.8	1.4	5.0	4.9
Revenue per Won100 of assets	56.4	51.5	55.7	57.5
Assets/equity (x)	2.7	2.9	2.9	2.9
Return on equity	4.3	2.0	8.2	8.1
Others (%)				
Effective tax rate	27.2	8.5	22.0	22.0
Dividend payout ratio	36.7	44.2	40.0	40.0

- ★ Revenue is expected to rebound over the next two years in line with heightened global demand for sales
- ★ Shareholders should expect higher return on equity

Sources: A. Stotz Investment Research, Refinitiv

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Ratios (cont.)

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(YE Dec)	2019A	2020A	2021E	2022E
Internal liquidity (x)				
Current ratio	1.4	1.4	1.8	1.8
Quick, or acid test ratio	1.2	1.2	1.5	1.6
Working cap. mgmt (Days)				
Inventory conversion period	46	48	41	39
Receivables collection period	120	134	120	113
Days from raw mat to coll	166	183	161	151
Payables deferral period	43	47	45	44
Cash conversion cycle	123	136	117	108
Profitability ratios (%)				
Gross profit margin	16.7	17.8	18.7	19.0
EBIT margin	3.4	2.3	6.5	7.0
EBIT return on avg assets	1.9	1.2	3.6	4.0
Return on average assets	1.6	0.7	2.8	2.8
Financial risk (x)				
Liabilities-to-assets (%)	60.7	63.5	61.2	60.9
Debt-to-equity	1.2	1.3	1.2	1.2
Net debt-to-equity	0.8	0.9	0.8	0.8
Times-interest-earned	23.5	18.2	28.6	34.2
Effective interest rate (%)	0.4	0.4	0.4	0.4

- Hyundai has been among the least profitable car companies in the past years
  - **However, 2021 proved its capability to bring profits to industry average**
  - **This was evidenced by its 2Q21 and 3Q21 gross margin of 6.4% and 6.2%, respectively**

Sources: A. Stotz Investment Research, Refinitiv

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Free cash flow

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- **Value**
- WCB
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(YE Dec, Won bn)	2019A	2020A	2021E	2022E
EBIT	3,605.5	2,394.7	7,638.6	8,802.0
Est tax rate (%)	*27.2*	*8.5*	*22.0*	*22.0*
NOPAT	**2,624.0**	**2,191.6**	**5,958.1**	**6,865.6**
Add: Depre & amort	3,831.9	4,185.4	3,580.1	3,824.3
Cash NOPAT	**6,455.9**	**6,377.0**	**9,538.2**	**10,689.9**
Chg in A/R	(4,362.1)	(2,801.1)	2,009.4	(2,324.2)
Chg in inventory	(949.0)	330.1	718.0	(701.2)
Chg in oth curr assets	810.0	(653.4)	(53.8)	(164.5)
Chg in A/P	194.6	1,231.1	192.1	788.8
Chg in oth curr liabs	1,554.3	3,369.8	(1,230.4)	1,151.7
Less: Chg in working cap	**(2,752.3)**	**1,476.5**	**1,635.3**	**(1,249.4)**
Less: CAPEX	(3,500.8)	(4,553.9)	(5,566.9)	(5,956.6)
Free cash flow to firm	**202.8**	**3,299.7**	**5,606.6**	**3,483.9**

- ★ FCFF expected to be strong in near term future
- ★ CAPEX is likely to increase as heavy R&D investments are necessary related to hydrogen-technology, development of chips, and batteries

Sources: A. Stotz Investment Research, Refinitiv

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Value estimate

Forecast assumptions

3-year average	Consensus	My assumptions
Revenue growth (CAGR)	8.1	9.6
Gross margin	18.9	18.8
EBIT margin	6.2	6.7
Net margin	5.3	4.9

My valuation method

Market: Korea	
Market risk-free rate	2.5
Market equity risk premium	7.0
Market return	**9.5**
Company beta (x)	1.3
COE	**11.3**
WACC	5.0
Terminal growth rate	2.0

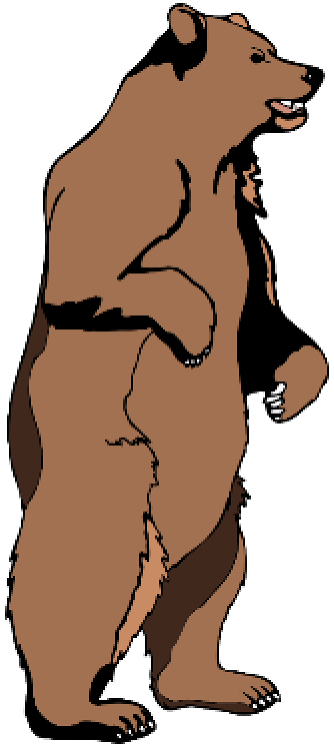
Valuation Method: FCFF

- ★ Global car sales likely to see strong rebound as chip shortage eases and demand remains robust
- ★ Hyundai started to turnaround the declining margin trend
  - **The key challenge is to maintain such a margin over the long run**
  - **We think that the market has not fully acknowledged the strong efforts yet**

Sources: A. Stotz Investment Research, Refinitiv

Value estimate

Bear
KRW263,500
(Upside 20.1%)



Base
KWR280,000
(Upside 28.4%)

Bull
KWR298,000
(Upside 36.7%)

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World Class Benchmarking Scorecard

- Identifies a company's competitive position relative to global peers
- Combined, composite rank of profitability and growth, called "Profitable Growth"
- Scale from 1 (Best) to 10 (Worst)

Ranked among the worst in the world

Profitable Growth

'17	'18	'19	'20	PTM
8	9	8	8	7

Benchmarked against 1,040 large Cons. Disc. companies worldwide.

Sources: A. Stotz Investment Research, Refinitiv

Bad profitability drags score

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- Risks

Room for improvement in profitability

Recent growth rebound

Profitable Growth

'17	'18	'19	'20	PTM
8	9	8	8	7

Profitability

'17	'18	'19	'20	PTM
8	9	8	8	7

Growth

'17	'18	'19	'20	PTM
8	10	2	7	2

Benchmarked against 1,040 large Cons. Disc. companies worldwide.

Sources: A. Stotz Investment Research, Refinitiv

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Key risk is ongoing supply chain disruptions

Sales

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Risks

- ★ Ongoing supply chain disruptions create shortages that could lead to lower sales
- ★ Failure to maintain higher level of profitability
- ★ Hydrogen strategy might not pay off leading to wasted R&D investments

Sources: A. Stotz Investment Research, company data

Hyundai sees the future in hydrogen, unlike other carmakers

VALUATION MASTER CLASS

HYUNDAI

3 things to know about this company

- ★ Contrarian bet on hydrogen could be a winning strategy
- ★ Long-awaited margin rebound could justify re-rating
- ★ Reducing reliance on global supply chains

Our estimate:

KWR276,000

(Upside 28.4%)

BUY

Key statistics

Analyst consensus (30)	PB ratio	Dividend yield
KRW300,000 (Upside 38.9%) **BUY**	**0.8x**	**2.1%**

Sources: A. Stotz Investment Research, Refinitiv

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CONCLUSION

- Parallel strategy of hydrogen and EV gives it a unique edge
- Maintaining a higher margin could be sufficient for a re-rating by the market
- Low PB multiple of 0.8x makes it an interesting value play