ELLIOTT

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ELLIOTT'S LETTER TO THE DIRECTORS OF HYUNDAI MOTOR GROUP

Your attention is drawn to the important information set out in <u>Appendix C</u> to this Letter[1]

13 November 2018

Dear Directors of Hyundai Motor Group:

We are writing to you in our capacity as shareholders of Hyundai Mobis Co., Ltd. ("Mobis" 012330:KS), Hyundai Motor Company ("HMC" 005380:KS), and Kia Motors Corporation ("Kia" 000270:KS),[2] collectively referred to herein as "Hyundai Motor Group" or "HMG."

Background

Since HMG's withdrawal of its original restructuring plan earlier this year, we along with many of our fellow shareholders have both publicly and privately expressed the need for a more comprehensive restructuring plan that addresses the capital and governance issues that are responsible for HMG shares' chronic underperformance. However, despite specific commitments from HMG's leaders – including its Chief Vice Chairman, Chung Eui-sun – communication on the much-needed reform has been neither proactive nor transparent.[3]

In fact, nearly half a year has passed since the withdrawal of the original plan without any genuine engagement from HMG, despite multiple good-faith attempts by Elliott to share constructive views and move the restructuring forward. Given this muted response as well as HMG's ongoing valuation discounts and lack of improvement in the area of corporate governance, we believe it is imperative for the respective boards of HMG to take bold and decisive action to remedy HMG's underperformance.

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1 This Letter is from and is prepared solely by Elliott Advisors (HK) Limited, which advises various Elliott-affiliated funds including Elliott Associates, L.P. ("EALP") and Potter Capital LLC ("Potter"). Founded in 1977, Elliott manages two funds, EALP and Elliott International, L.P., with assets under management of approximately US $35 billion as at the date of this Letter. Copies of this Letter and the accompanying report can be found at: http://www.acceleratehyundai.com.

2 EALP and Potter currently hold, in aggregate, more than 2.5% of common stock in Mobis, 3% in HMC, and 2.1% in Kia. Elliott affiliates may now have and/or at any time in the future may, without notice to any person (other than as required by, and in accordance with, applicable laws and regulations), establish long positions (other than the current shareholdings described) or short positions and/or may increase and/or decrease, whether fractionally or fully, the size of any long and/or short positions, in each case in respect of or related to any shares or other equity or debt securities (including securities and derivative products directly or indirectly related to such securities including KOSPI 200 Index) of any member of the Hyundai Motor Group. *See* the important information contained in **<u>Appendix C</u>** to this Letter.

3 "We will humbly and thoroughly review the feedback we received on the group's restructuring plan . . . We will continue to communicate with our stakeholders in a transparent and proactive manner." - Letter to HMC Shareholders, dated 21 May 2018.

Independent Analysis Confirms Extreme Overcapitalization at HMG

From the outset, Elliott has consistently emphasized to HMG the need for a comprehensive restructuring, with a focus on improving capital management and corporate governance as much as severing the circular shareholding and addressing the risks associated with certain intra-group transactions. **Today, we are moving the debate forward by providing you and all other HMG stakeholders with a full and independent analysis of HMG's capital structure.**

For this task, Elliott engaged **Conway MacKenzie**, a global automotive consulting firm. Conway MacKenzie was commissioned to independently assess the particular challenges facing HMG's balance sheets and to offer constructive solutions where appropriate. A copy of the report (the "**Independent Analysis**") is enclosed with this letter and available to download at www.acceleratehyundai.com.

The Independent Analysis identified the following concerns in the Group's capital structure:

- The Group is **grossly overcapitalized** with excess capital ranging from **KRW 8 to 10 trillion** for HMC and from **KRW 4 to 6 trillion** for Mobis

- A history of questionable use of cash flow has resulted in non-operating assets tying up valuable capital while R&D and capex remain below industry average

- Shareholder returns continue to lag behind industry standards

- Non-conforming reporting of cash flows distorts and hides HMC's true cash flow from operations

The concerns highlighted by Conway MacKenzie are summarized in greater detail in Appendix A to this Letter, along with a matching set of recommendations. In addition to these summary points, we encourage you to read the Conway MacKenzie report in its entirety.

In our view, the conclusions to be drawn from this analysis are clear: **HMG must take action by committing to:**

- **Return excess capital on its balance sheets**, meaning up to KRW 8 trillion at HMC (or 31% of its market capitalization[4]) and KRW 4 trillion at Mobis (or 22% of its market capitalization)**;**

- **Conduct a strategic review of any and all non-core assets that have depressed shareholder returns,** including but not limited to the land in Gangnam purchased in 2014 and remaining undeveloped to this day; and

- Engage with shareholders to improve its corporate governance structure and bring it into line with current international best practices, **including by adding new independent directors to its respective boards.**

[4] Including preference shares.

Conway MacKenzie's independent findings unfortunately reinforce Elliott's view that the boards and the management of HMG have failed to deliver value to shareholders for years and are continuing this failure with no end in sight. To be sure, HMG faces a number of industry-wide and macroeconomic headwinds, such as ongoing trade disputes and protectionist sentiments around the world.

These challenges are not unique to HMG and should not preclude it from honouring its commitment to engage with its shareholders. In fact, such dynamics only further underline the need for improved capital management and a well-governed and accountable board capable of providing the oversight needed to steward HMG into this uncertain future. Further, lest management claim that weak quarterly results indicate a need to retain its unnecessary excess cash balance, Conway MacKenzie has confirmed that provisioning announced in conjunction with the Group's Q3 earnings is excessive, one-off, and in no way diminishes the Group's need to optimize its inappropriately bloated balance sheet.

Corporate Governance Reform Can No Longer Wait

More broadly, corporate reform remains a priority in Korea. While HMG's reform efforts have stalled, founding families of other large corporate groups have taken decisive steps to reform their corporate structures and shareholder return policies. **HMG is now the <u>only</u> major corporate group in Korea with an unreformed legacy shareholder structure and no plan to address it.**

The case of Samsung Electronics provides an instructive guide for what is possible. In October of 2016, we wrote a letter to the board of Samsung Electronics calling for reforms long sought by domestic and international shareholders for Samsung Electronics to streamline its structure, return excess capital to shareholders and enhance oversight by adding new directors to its board. With shareholders firmly united on these measures, the board responded with action: over the past two years, Samsung Electronics has taken steps to diversify its board and set targets for maximum cash on balance sheets. It has also improved shareholder returns and group transparency, including steps in recent weeks to finally remedy its own circular shareholding. <u>This progress points the way for HMG to take similar steps to act in the best interests of all shareholders by pursuing reform</u>.

Next Steps

When HMG announced that it would scrap its shareholder-unfriendly restructuring in May 2018, we and other shareholders were hopeful that this action – and the statements that immediately followed – reflected a new era for management-shareholder relations. This fresh start could have marked an opportunity to begin rectifying poor long-term shareholder returns, putting in place corporate governance enhancements fit for a global group of HMG's size and stature, and addressing debilitating intra-group shareholdings. <u>Yet key leaders of HMG have not acted on their commitment to engage shareholders and address HMG's bloated balance sheets.</u> Meanwhile, return metrics continue to drift downwards at significant cost to shareholders who have long suffered from HMG's mismanagement of capital. Make no mistake: doing nothing has been doing harm.

It is therefore not surprising to us that HMG continues to underperform, with HMC share price underperforming the KOSPI index by -16% YTD and their peers by -19%. This is a continuation of a trend from which HMG shareholders have suffered for more than five years, which culminates in over -60% underperformance versus other automotive manufacturers during that period. Mobis shareholders have suffered similarly, with -11% underperformance YTD as compared to KOSPI index. Kia remains the only HMG affiliate without excess capital and has performed in line with peers and KOSPI YTD, although longer term trends still show significant underperformance.[5]

All the while, valuation and discounts remain at historical lows with HMC and Kia trading at 0.3x and 0.7x ex-cash P/E, a discount of 89% and 71% versus peers and 94% and 84% versus KOSPI index. Mobis now trades at 3.6x ex-cash P/E, representing a discount of 52% as compared to peers and 20% as compared to KOSPI index.[6] These valuation levels further confirm Conway MacKenzie's views that the market attributes little to no value to the excess capital sitting on HMC's and Mobis' balance sheets.

Given the tremendous value to be unlocked at HMG and despite its history of capital mismanagement, we call on the boards of HMG to **publicly commit** to:

- **Engage with Elliott and other shareholders** on governance improvements, including the addition to HMG's respective boards of new independent directors who bring strong international corporate backgrounds, enhance the diversity of HMG's boards, and enable HMG to tap into a broader range of experiences in relevant industries outside Korea;

- **Return excess capital** to HMC and Mobis shareholders, preferably in the form of share buybacks given the deep valuation discounts; and

- **Conduct a strategic review of any and all non-core assets** acquired over the past five years, with an eye toward divesting assets that are either underutilized or contribute low returns.

Our interest is to see HMG thriving in the long term and creating value for all its shareholders. To that end, we encourage you to carefully review and consider the recommendations put forth by Conway MacKenzie.

Given the cost of delay and the lack of progress made thus far by the Group, we reserve the right to put forward the various Conway MacKenzie recommendations, among other ideas, as shareholder resolutions in the next general meeting absent an appropriate response from HMG. However, the most efficient and effective way forward would be for HMG to take the long-overdue step of engaging constructively in discussions to implement these measures without delay. We remain hopeful that HMG will take this approach and would be willing to make ourselves available to discuss at your convenience.

Sincerely,

James Smith, Managing Director

Elliott Advisors (HK) Limited

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[5] Relative performance in dollarized total shareholder returns. *See* **Appendix B** for more detailed comparison of relative performance.

[6] *See* **Appendix B** for more detailed valuation discount charts.

APPENDIX A: FINDINGS OF THE INDEPENDENT ANALYSIS

Significant and excessive capital remains trapped on balance sheet with excess capital ranging from <u>KRW 8 to 10 trillion</u> for HMC and <u>KRW 4 to 6 trillion</u> for Mobis

- Half of HMC and nearly a quarter of Mobis' market capitalization is in cash, implying investors lack confidence in those two companies' ability to create value from its cash holdings (*see* slides 14 and 16 of the Independent Analysis)

- Excess cash on balance sheets of HMC and Mobis is based on multiple metrics and is relative to peer averages, making clear that its overcapitalization problem is in excess of what other auto manufacturers and auto part suppliers have on their balance sheets (*see* slide 29)

- Both HMC and Mobis' excess cash balances are far above and beyond what is necessary to withstand a downturn similar to the global financial crisis and are despite warranty provisions included in the latest filings (*see* slides 30 to 32)

While R&D and capital expenditures remain below industry average, HMG has made multiple and massive non-core capital investments that lack strategic rationale, which have depressed return metrics

- HMG's history of capital mismanagement is well-documented and well-known among market participants, who can readily identify the misallocation of billions of dollars in land and property, financial companies and other non-core investments (*see* slides 24 to 26)

- As a result, HMC's Return on Invested Capital (ROIC) stands at 4% in 2017 as compared to peers' average of 13% and Mobis' ROIC is at 7% as compared to peers' average of 10%

- In addition to its shortfall versus peers, the steep nature of this decline is notable, as both HMC and Mobis' returns were well above peers five years ago at 14% and 13%, respectively (*see* slides 13 and 15)

Shareholder returns are well below industry standards

- Where most peers have meaningfully increased returns to shareholders in the form of buybacks in the past six years, HMG has made little progress to improve its historically low capital returns (*see* slides 20 to 22)

Nonconforming reporting of cash flows distort and hide HMC's true cash flow from operations

- Unlike most other auto manufacturers, HMC does not segment its financing business and reports working capital changes from financing business as cash flow from operations

- Adjusting for the distortion, Conway MacKenzie calculates the true cash flow from operations to be KRW 6.6 trillion for HMC in 2017 versus the reported figure of KRW 3.9 trillion (*see* slide 18)

Conway MacKenzie has also offered a number of sensible – and in our view necessary – recommendations for consideration by HMG's stakeholders, including:

- Right-size balance sheets by returning excess capital to shareholders through buybacks

- Adjust go-forward capital return policy to return at least 50% of free cash flow to shareholders

- Consider divestiture of non-core assets with proceeds returned to shareholders

- Focus future investment strategy on accretive acquisitions

- Improve cash flow reporting, which would involve standardizing cash flow from operation

APPENDIX B: RELATIVE PERFORMANCE

Table 1:
Relative performance in dollarized total shareholder returns of Hyundai Mobis vs. peers and KOSPI

	YTD	2 Year	3 Year	4 Year	5 Year
Mobis vs. Peers' average	**2%**	**(19%)**	**(16%)**	**(26%)**	**(61%)**
Mobis vs. Mando	23%	12%	(27%)	0%	
Mobis vs. Hanon	(5%)	(31%)	(44%)	(41%)	(78%)
Mobis vs. Denso	(10%)	(45%)	(24%)	(28%)	(48%)
Mobis vs. Aisin Seiki	(1%)	(21%)	(20%)	(43%)	(50%)
Mobis vs. Continental	11%	(12%)	9%	(4%)	(26%)
Mobis vs. Brembo	(1%)	(14%)	(47%)	(93%)	(164%)
Mobis vs. Valeo	29%	21%	18%	(2%)	(35%)
Mobis vs. Magna	(19%)	(60%)	(31%)	(22%)	(66%)
Mobis vs. Autoliv	(21%)	(49%)	(15%)	(49%)	(76%)
Mobis vs. Tenneco	11%	11%	18%	18%	(2%)
Mobis vs. KOSPI	**(11%)**	**(36%)**	**(31%)**	**(28%)**	**(44%)**

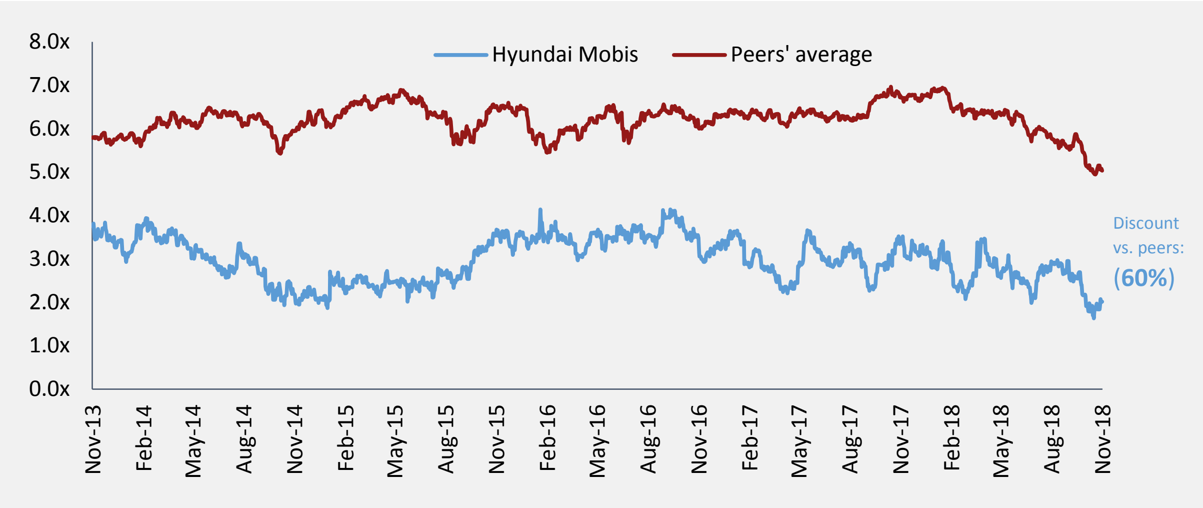
Table 2:
Relative performance in dollarized total shareholder returns of HMC vs. peers and KOSPI

	YTD	2 Year	3 Year	4 Year	5 Year
HMC vs. Peers' average	**(19%)**	**(22%)**	**(26%)**	**(38%)**	**(61%)**
HMC vs. Toyota	(31%)	(36%)	(34%)	(43%)	(65%)
HMC vs. Nissan	(31%)	(23%)	(28%)	(48%)	(79%)
HMC vs. Daimler	(7%)	(7%)	(9%)	(20%)	(45%)
HMC vs. BMW	(19%)	(23%)	(21%)	(24%)	(47%)
HMC vs. Volkswagen	(18%)	(38%)	(60%)	(12%)	(27%)
HMC vs. Renault	(12%)	(13%)	(15%)	(45%)	(61%)
HMC vs. Peugeot	(54%)	(81%)	(71%)	(149%)	(181%)
HMC vs. GM	(25%)	(41%)	(43%)	(64%)	(73%)
HMC vs. Ford	(16%)	(7%)	(8%)	(14%)	(28%)
HMC vs. Tata	24%	51%	27%	38%	(0%)
HMC vs. KOSPI	**(16%)**	**(29%)**	**(41%)**	**(42%)**	**(63%)**

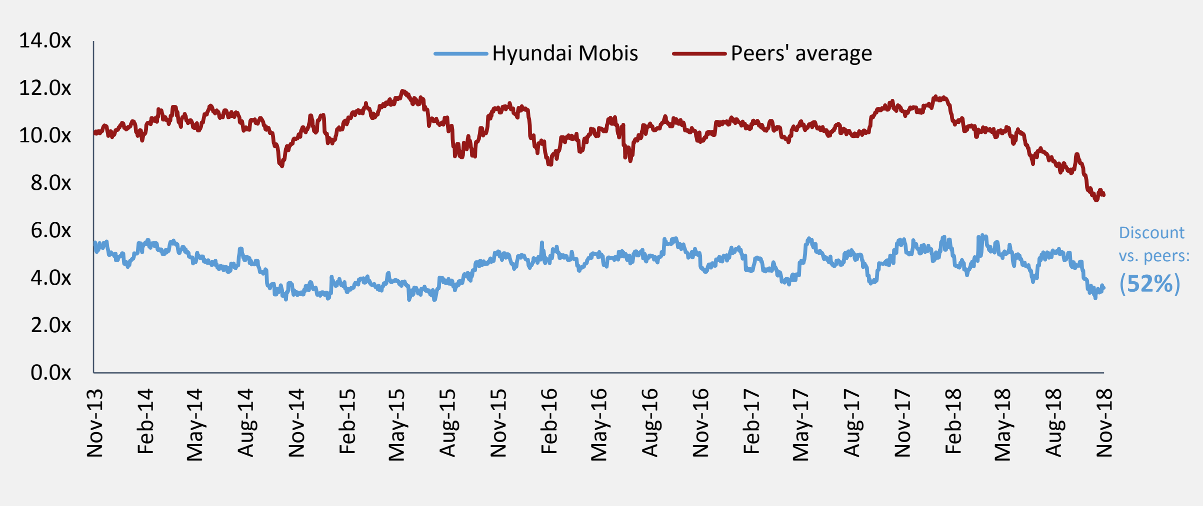
Table 3:
Relative performance in dollarized total shareholder returns of Kia vs. peers and KOSPI

	YTD	2 Year	3 Year	4 Year	5 Year
Kia vs. Peers' average	**(2%)**	**(28%)**	**(42%)**	**(51%)**	**(57%)**
Kia vs. Toyota	(13%)	(42%)	(50%)	(56%)	(62%)
Kia vs. Nissan	(14%)	(30%)	(44%)	(61%)	(76%)
Kia vs. Daimler	10%	(13%)	(25%)	(32%)	(42%)
Kia vs. BMW	(2%)	(30%)	(37%)	(37%)	(43%)
Kia vs. Volkswagen	(0%)	(44%)	(75%)	(24%)	(23%)
Kia vs. Renault	5%	(19%)	(30%)	(58%)	(58%)
Kia vs. Peugeot	(36%)	(88%)	(87%)	(161%)	(178%)
Kia vs. GM	(8%)	(47%)	(59%)	(77%)	(70%)
Kia vs. Ford	1%	(14%)	(24%)	(27%)	(24%)
Kia vs. Tata	41%	44%	11%	26%	3%
Kia vs. KOSPI	**1%**	**(35%)**	**(57%)**	**(54%)**	**(60%)**

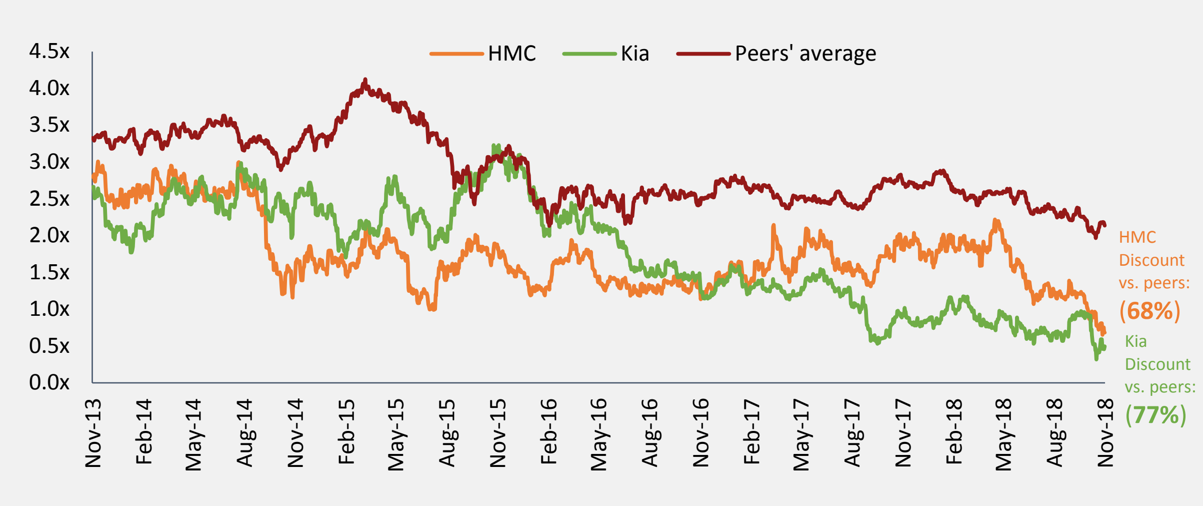
Mobis vs. Peers forward EV/EBITDA



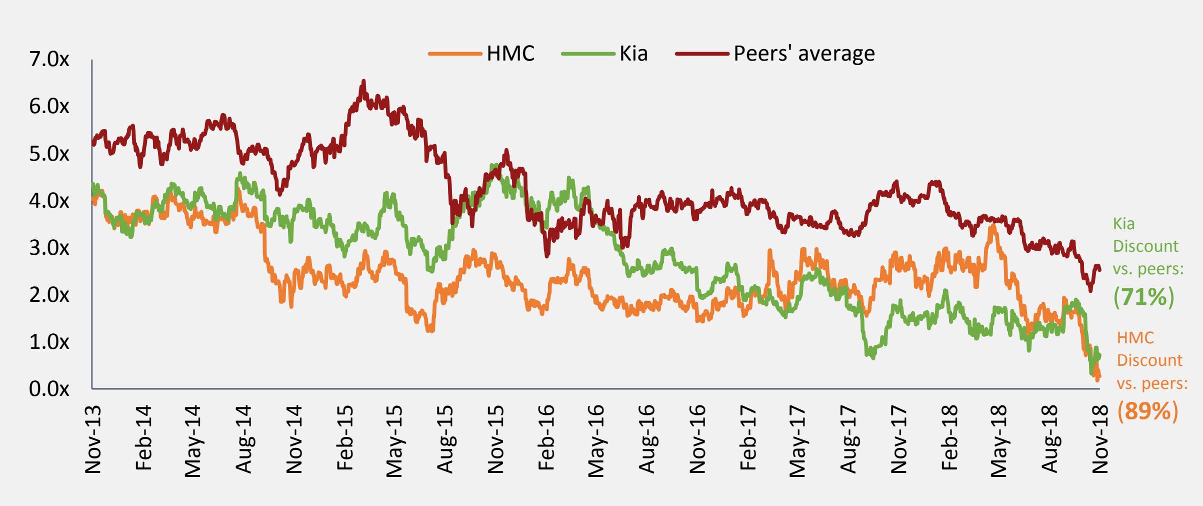
Mobis vs. Peers forward PE (ex-cash)



HMC & Kia vs. peers forward EV/EBITDA



HMC & Kia vs. peers forward P/E (ex-cash)



APPENDIX C: IMPORTANT INFORMATION

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