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BARRON'S COVER

Lexus' Next Act

New models, new markets

By JAY PALMER

IN THE BEGINNING, THERE WERE FIVE POSSIBLE names, including Vectre, Verone, Calibere and Chaparel. **Toyota Motor**, in a meeting in October of 1986, chose the fifth name, Alexis, but pointedly dropped the "a" and changed the "i" to a "u" -- to distance the new cars from the scheming, conniving Alexis of the then-popular soap opera *Dynasty*. And so was born a brand that would change the luxury auto market forever.

From the launch of the first LS400 four-door sedan and its smaller brother, the ES250, in the fall of 1989, Lexus was a sensational hit. Today, it is America's top-selling luxury light-vehicle brand. It out-sells not only such domestic titans as Lincoln and Cadillac and its two Japanese competitors, **Honda's** Acura and **Nissan's** Infiniti, but also the two European names it has always considered its real top rivals, **BMW** and Mercedes-Benz.

In its rise to the top, Lexus has forced competing auto makers around the world to rethink their own models, especially by the key measure of reliability. Lexus, which largely eschews bold styling and tire-searing acceleration, has demonstrated that legions of luxury-car buyers value reliability above all else. In survey after survey, Lexuses have been shown to have fewer mechanical breakdowns than all other cars in all price ranges.

At the same time, the brand has become a vital part of Toyota and a key component of the company's push to match the world market-share of No. 1-ranked **General Motors**. Though Lexus' finances are a closely guarded secret, the brand is thought to have contributed anywhere from one-quarter to one-third of the Japanese car maker's nearly \$11 billion in '04 earnings. After all, the average Lexus probably pulls in as much profit as two Toyota Camrys. That financial horsepower, in turn, has helped Toyota's stock to far outperform those of rivals. The American depository receipts (ticker: TM), at a recent 87, are up some 45% in the past two years.



Lexus is planning a slew of new models, including the IS350 sports sedan shown above.

But for all its past successes, Lexus is now facing some of its greatest challenges ever. More than half its U.S. sales are of SUVs, with a single model, the popular RX 300/330, accounting for a third of all Lexus sales -- and this at a time when rising fuel prices are seriously diminishing the appeal of SUVs in general.

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Aware of the danger, Lexus is looking elsewhere for new growth -- to hybrid fuel-efficient vehicles and a wider range of U.S. mass-market luxury. For instance, it's planning a beefed-up sports sedan, the IS350, to better compete with BMW, and might make a foray into the super-luxury, \$100,000 segment.

But the U.S. luxury market, ferociously competitive for the past several years, is only getting more so. Cadillac has been making a huge comeback with new, more energetic models -- all to the soundtrack of Led Zepplin. Acura has overhauled its flagship RL sedan after years of neglect, giving it high tech and more style. Even Hyundai, once the very picture of down-market, plans to launch a luxury car in the U.S. in '06

Little wonder, then, that Lexus is increasingly looking beyond America. Earlier this month, the brand was offered for the first time in Toyota's home country of Japan. Toyota had to work hard to overcome the fears of its existing dealers, who argued the market was already too crowded. But Lexus is now proceeding in Japan with its usual style: Dealerships gleam with marble floors, leather sofas and giant plasma TVs, and an army of 2,000 salespeople and staff have attended a new Lexus training college. The estimated cost of the launch: about \$1.8 billion.

Lexus, however, is clearly late to the game in Japan and now must play catch-up. While the company is also targeting Europe, that is home to the those top two German luxury brands, BMW and Daimler-Chrysler's Mercedes, both have their own plans for expansion.

The upshot: There are no guarantees Lexus will be able to continue its past growth and profitability. And just how well it handles the new challenges could have important implications for both Toyota and the luxury-auto sector as a whole.



2006 Lexus GS 430

FOR NOW, AT LEAST, LEXUS REMAINS the clear pacesetter of the U.S. luxury market. Starting with the entry-level IS300 sedan at about \$30,000, prices move up through the \$43,000 GS300 sedan, the \$52,000 GS430 sedan, the \$57,000 LS430 sedan to the \$66,000 SC430 convertible. The SUV line starts with the popular \$37,000 RX330 and includes the \$47,000 GX470, the hot new \$49,000 hybrid RX400h and the giant \$67,000 LX470, a luxury version of the Toyota Land Cruiser.

In all, Lexus has been the top-selling luxury-auto brand in the U.S. for each of the past five years. Its sales in 2004 (not including the hybrid, which only launched last spring) rose more than 10% over '03 to 288,000 vehicles, roughly 14% of the total U.S. luxury market as measured by brand. Sales were ahead of BMW (260,000) and Mercedes (221,000), as well as Acura (198,000) and Infiniti (118,000). They also topped Cadillac (234,000), Lincoln (139,000) and the collective total of Volvo, Jaguar, Land Rover and Aston Martin, the four brands that make up **Ford Motor's** Premier Auto Group (221,000).

Some of those brands, such as Cadillac and Mercedes, sell more cars than Lexus in the higher price ranges. And Mercedes may pull in more revenues from the U.S., owing to the generally higher prices of its cars. But Lexus is the undisputed volume leader. The numbers for the first eight months of this year strongly suggest Lexus will continue to lead the pack for all of '05, selling perhaps 300,000 vehicles in total.

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