

Asian Daily

Hon Hai Precision (2317.TW)

Defensive, but earnings growth acceleration the key for re-rating

Maintain NEUTRAL

Previous Rating: NEUTRAL

Target price (NT\$): 116.00

Previous target price (NT\$): 121.00

- Hon Hai reported a better 1Q22 operating result (owing to above-seasonal revenue and a better mix), but softer EPS (hurt by mark-to-market revaluation losses). However, the deviation vs consensus is much smaller than Pegatron's. This is supported by Hon Hai's more diversified business model and better vertical integration capability.
- April sales pulled back by 3% YoY/4% MoM, much milder than Pegatron's/Quanta's. Hon Hai revised up its computing outlook from flat to YoY growth, reflecting its share gains supported by its diversified production footprint and better supply chain management. The trend is in line with our expectations.
- EV remains the top focus, which Hon Hai targets to reach 5% market share and 40% vertical integration opportunity in 2025. Assembly will be the top priority, as it provides the base to its module and components business. It still targets GM improvement in FY22.
- We fine-tune FY22-23E EPS within 1%, but lower TP from NT\$121 (12x) to NT\$116 (11x), reflecting market multiple contraction. Introduce FY24E. We maintain our relative preference of Hon Hai over Pegatron, but expect the stock to trade sideways before earnings growth acceleration.

Price (12-May-22, NT\$)	102.00	Est. pot. % chg. to TP	13.7	
Mkt cap (NT\$/US\$ mn)	1,414,025 / 47,377	Blue sky scenario (NT\$)	145.0	
Number of shares (mn)	13,863	Grey sky scenario (NT\$)	80.0	
Free float (%)	90.0	Performance	1M 3M 12M	
52-wk range (NT\$)	120 - 98.20	Absolute (%)	0.0 (3.8) 0.0	
ADTO-6M (US\$ mn)	92.9	Relative (%)	8.1 10.9 1.8	
Year	12/21A	12/22E	12/23E	12/24E
Revenue (NT\$ mn)	5,994,174	6,222,575	6,481,203	6,772,459
EBITDA (NT\$ mn)	224,441	255,195	282,050	304,689
EBIT (NT\$ mn)	148,959	173,168	195,223	214,044
Net profit (NT\$ mn)	139,320	144,820	161,126	173,679
EPS (CS adj.) (NT\$)	10.05	10.45	11.62	12.53
Chg. from prev. EPS (%)	n.a.	0.1	0.3	n.a.
Consensus EPS (NT\$)	n.a.	10.57	11.8	12.43
EPS growth (%)	36.9	3.9	11.3	7.8
P/E (x)	10.1	9.8	8.8	8.1
Dividend yield (%)	5.1	5.2	5.6	5.6
EV/EBITDA (x)	5.4	3.7	3.6	2.9
P/B (x)	1.02	0.96	0.9	0.84
ROE (%)	10.4	10.2	10.6	10.7
Net debt/equity (%)	(12.6)	(27.7)	(22.7)	(27.9)

Source: Company data, Refinitiv, Credit Suisse estimates

1Q22 result—operationally above, EPS below.

Similar to Pegatron, Hon Hai also reported a better 1Q22 operating result (owing to above-seasonal revenue that -26% QoQ and a richer product mix), but a softer EPS (NT\$2.12 vs our estimate of NT\$2.29, hurt by mark-to-market revaluation losses). However, the deviation vs consensus is much smaller than Pegatron's. This is supported by Hon Hai's more diversified business model (in terms of mix/global footprint) and better vertical integration capability.

2Q22 outlook better than peers. April revenue pulled back by 3% YoY/4% MoM, much milder than Pegatron's (-40%/-48%) and Quanta's (-21%/-40%). Hon Hai also revised up its computing outlook from flattish to YoY growth, reflecting its share gains supported by its diversified production footprint and better supply chain management. The trend is in line with our expectations.

Figure 1: Hon Hai 1Q22 result and 2Q22/2022 outlook

(NT\$ mn)	1Q22E				2Q22E				2022E						
	Actual	CS Old	%Diff	Street	%Diff	CS New	CS Old	%Diff	Street	%Diff	CS New	CS Old	%Diff	Street	%Diff
Revenues	\$1,407,553	\$1,400,303	0.5	\$1,369,378	2.8	\$1,411,408	\$1,409,498	0.1	\$1,358,892	4.2	\$6,222,575	\$6,206,325	0.8	\$6,137,474	1.4
Gross profit	84,786	83,351	1.7	82,163	3.2	86,089	88,543	-2.8	84,207	2.2	392,663	394,322	-1.2	386,924	1.7
Operating profit	36,689	29,543	24.1	30,784	19.1	37,315	35,872	4.0	33,715	10.7	173,168	166,842	2.7	167,176	3.0
Non-op income/exp	258	14,203	-98.2			8,865	10,429	-14.8			34,167	46,193	-26.1		
Pre-tax income	36,947	43,746	-15.6	29,200	4.1	46,200	46,301	-0.2			207,334	212,946	0.1		
Net income	29,450	31,935	-7.1	29,200	4.1	29,926	29,723	0.3	29,670	0.5	144,820	144,696	0.3	147,222	-1.6
EPS (NT\$)	\$2.12	\$2.29	-7.1	\$2.04	4.1	\$2.15	\$2.14	0.3	\$2.14	0.5	\$10.45	\$10.44	0.3	\$10.92	-1.6
YoY % sales change	4%	4%		2%		4%	4%		0%		4%	4%		4%	
QoQ % sales change	-26%	-26%		-26%		0%	1%		-1%		6.31%	6.35%		6.29%	
GM%	6.02%	6.00%		6.00%		6.10%	6.29%		6.22%		6.31%	6.35%		6.29%	
OPM%	2.61%	2.11%		2.25%		2.64%	2.54%		2.49%		2.78%	2.69%		2.72%	
NPM%	2.09%	2.28%		2.07%		2.11%	2.11%		2.19%		2.33%	2.33%		2.40%	

Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse estimates, Company data

Commitment to EV investments. EPS maximisation remains the target, given uncertainties from pandemic, inflation and geographic conflicts. It expects a stable revenue outlook, off a higher base, but mix improvement (with higher-margin components and cloud outgrowing) to mitigate higher pass-through revenue. Overall it expects GM to improve YoY in FY22.

EV remains the top focus, which Hon Hai targets to reach 5% market share and 40% vertical integration opportunity in 2025. Then timeline: (1) 2022—E-bus/Gogoro/Lordstown; (2) 2023—Stellantis (software);

(3) 2024—Fisker (PEAR)/PTT (production)/Stellantis (auto IC). It will provide more details on the investments in Indonesia and Saudi Arabia once available. Assembly will be the top priority, as it provides the base to its module and components business.

Stay NEUTRAL. We fine-tune FY22-23E EPS within 1%, but lower TP from NT\$121 (12x) to NT\$116 (11x), reflecting market multiple contraction. We maintain our relative preference of Hon Hai over Pegatron, given its more diversified business model, better vertical integration capability, and higher commitment to new business/ESG, but expect the stock to trade sideways before earnings growth acceleration. Stay NEUTRAL.

Figure 2: HHP & Pegatron fwd P/E



Source: Credit Suisse estimates

Figure 3: HHP's EV strategy



Source: Credit Suisse estimates

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Valuation Methodology and Risks

Target Price and Rating

Valuation Methodology and Risks: (12 months) for Hon Hai Precision (2317.TW)

Method: We have a NEUTRAL rating on Hon Hai Precision. We believe it is well positioned in cloud and 5G, but the stock has rallied significantly on EV – an encouraging movement with trivial earnings contribution. Our NT\$116 target price is based on 11x FY22E EPS (earnings per share), vs. its historical average trading P/E (price-to-earnings) of 13x.

Risk: Risks to our NEUTRAL rating and NT\$116 target price for Hon Hai Precision include: (1) the impact from rising China labour costs being bigger than expected; (2) the potential of key clients cutting orders due to labour events, or potential orders being stronger than expected due to PC product cycles and devices, including tablets and smartphones; (3) a change in Hon Hai's relationship with Apple, its largest customer in revenue contribution terms; (4) slowdown in 5G infrastructure build and 5G smartphone launch; and (5) slower or stronger demand due to escalating or less trade war tension.

Companies Mentioned (Price as of 12-May-2022)

Apple Inc (AAPL.OQ, \$146.5)

Compal Electronics (2324.TW, NT\$23.0)

Fisker Inc. (FSR.N, \$8.29)

Hon Hai Precision (2317.TW, NT\$102.0, NEUTRAL, TP NT\$116.0)

Lordstown Motors (RIDE.OQ, \$1.51)

PTT Public Company Limited (PTT.BK, Bt36.5)

Pegatron (4938.TW, NT\$67.7)

Quanta Computer (2382.TW, NT\$82.1)

Stellantis (STLA.MI, €13.254)

Disclosure Appendix

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3-Year Price and Rating History for Hon Hai Precision (2317.TW)

2317.TW	Closing Price	Target Price	
Date	(NT\$)	(NT\$)	Rating
22-May-19	74.00	73.00	N
04-Jun-19	71.80		*
10-Jun-19	72.10	77.00	N
17-Jan-20	92.30	104.00	O
02-Apr-20	70.00	91.00	
04-Feb-21	114.00	123.00	N
14-May-21	104.50	119.00	
12-Aug-21	109.00	123.00	
04-Jan-22	103.50	118.00	
24-Mar-22	106.50	121.00	



* Asterisk signifies initiation or assumption of coverage.

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