

## First Read

# Key Call: Hon Hai Precision

## Q122 OPM beat; 2022 PC outlook revised upward

### Q: How did the results compare vs expectations?

Hon Hai reported Q122 results and held an analyst meeting after the market close on 12 May. Net profits were NT\$29.5bn (-34% QoQ; +5% YoY), 3% above our estimates (due to better sales and OPM) but in line with market expectation with better operating margins offset by lower investment income. Revenue reached NT\$1.4trn (-26% QoQ; +4% YoY). Gross margin was 6.02% vs 6.03% in Q421 and 5.80% in Q121, roughly in line with our/consensus forecast of 6.1%/6.0%. On the positive side, OPM rose to 2.61% (vs. 2.05% in Q121) better than consensus and our forecast at 2.3%-2.4% on efficiency improvements. Operating profits rose 33% YoY, 13% above our forecasts.

### Q: What were the most noteworthy areas in the results?

Hon Hai saw small impact from the lockdowns in China due to diversified manufacturing footprints, which also led to share gains. Inventory days came in at 50 days, up from 35 days in 4Q21. The company strategically held more inventories on hand to support strong demand and mitigate component shortage and logistics risks. As relates to its EV efforts, today it announced the completion of Ohio's EV plant acquisition for US\$230mn from Lordstown, which will become its EV manufacturing hub for North America. Hon Hai and Lordstown have signed contract manufacturing agreement and joint venture agreement to co-design and develop vehicle programs on the MIH open EV platform. Hon Hai invests US\$55mn in the new JV and owns 55% of holdings.

### Q: Has the company's outlook/guidance changed?

Hon Hai guided 2Q sales to be flat QoQ and YoY with cloud, computing and component sales up QoQ and smartphone down QoQ due to seasonality. Thus it expects 2Q GM will be up QoQ, but OPM will depend on extra expenses due to lockdowns and new business. It maintains 2022 sales guidance at roughly flat YoY but surprisingly revised up computing sales guidance to up YoY from flat YoY due to share gains in desktop PCs, tablets and NBs. It also guided 1H GM and 2022 GM will be up YoY on improved product mix driven by strong growth in cloud as well as components. It is not immune to potential risks from inflation and geopolitical risks that may weigh on consumer demand, but management noted mid to high-end products demand remain stable while low-end segments are already seeing some slowdown.

### Valuation: maintain Buy; PT NT\$160 (unchanged)

Our 2022E EPS remains largely unchanged. Our positive view is based on 1) resilient core business outlook with stable iPhone business and share gains in servers, components and PCs; 2) steady progress in EVs to drive long-term growth; and 3) attractive valuation - the stock now trades at ~10.0x our 202E EPS forecasts vs. 8-13x historically.

## Equities

Taiwan

Electric Components &amp; Equipment

12-month rating

Buy

12m price target

NT\$160.00

Price (12 May 2022)

NT\$102.00

RIC: 2317.TW BBG: 2317 TT

### Trading data and key metrics

|                             |                      |
|-----------------------------|----------------------|
| 52-wk range                 | NT\$119.50-98.20     |
| Market cap.                 | NT\$1,414b/US\$47.3b |
| Shares o/s                  | 13,861m (ORD)        |
| Free float                  | 80%                  |
| Avg. daily volume ('000)    | 26,070               |
| Avg. daily value (m)        | NT\$2,700.2          |
| Common s/h equity (12/22E)  | NT\$1431b            |
| P/BV (12/22E)               | 1.0x                 |
| Net debt to EBITDA (12/22E) | NM                   |

### EPS (UBS, diluted) (NT\$)

|        | From  | To    | % ch | Cons. |
|--------|-------|-------|------|-------|
| 12/22E | 10.61 | 10.26 | -3   | 10.57 |
| 12/23E | 11.56 | 11.48 | -1   | 11.80 |
| 12/24E | 12.32 | 12.17 | -1   | 12.43 |

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| Highlights (NT\$m)        | 12/19     | 12/20     | 12/21     | 12/22E    | 12/23E    | 12/24E    | 12/25E    | 12/26E    |
|---------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Revenues                  | 5,342,811 | 5,358,023 | 5,994,174 | 6,093,242 | 6,169,413 | 6,319,636 | 6,703,598 | 6,834,921 |
| EBIT (UBS)                | 114,897   | 110,827   | 148,959   | 163,770   | 178,890   | 190,138   | 213,162   | 219,377   |
| Net earnings (UBS)        | 115,309   | 101,795   | 139,320   | 142,274   | 159,194   | 168,756   | 185,523   | 180,616   |
| EPS (UBS, diluted) (NT\$) | 8.32      | 7.34      | 10.05     | 10.26     | 11.48     | 12.17     | 13.38     | 13.03     |
| DPS (net) (NT\$)          | 4.00      | 4.20      | 4.00      | 5.47      | 5.59      | 6.26      | 6.63      | 7.29      |
| Net (debt) / cash         | 259,917   | 553,087   | 237,445   | 306,626   | 171,196   | 175,763   | 100,842   | 152,149   |
| Profitability/valuation   | 12/19     | 12/20     | 12/21     | 12/22E    | 12/23E    | 12/24E    | 12/25E    | 12/26E    |
| EBIT (UBS) margin %       | 2.2       | 2.1       | 2.5       | 2.7       | 2.9       | 3.0       | 3.2       | 3.2       |
| ROIC (EBIT) %             | 14.0      | 17.6      | 21.6      | 19.0      | 18.6      | 17.1      | 17.3      | 16.3      |
| EV/EBITDA (UBS core) x    | 3.8       | 2.7       | 3.9       | 3.7       | 3.6       | 3.6       | 3.4       | 3.3       |
| P/E (UBS, diluted) x      | 9.4       | 10.9      | 11.1      | 9.9       | 8.9       | 8.4       | 7.6       | 7.8       |
| Equity FCF (UBS) yield %  | 15.7      | 28.1      | (12.3)    | 11.5      | (4.1)     | 6.4       | 1.2       | 26.6      |
| Dividend yield (net) %    | 5.1       | 5.2       | 3.6       | 5.4       | 5.5       | 6.1       | 6.5       | 7.1       |

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of NT\$ 102.00 on 12-May-2022 19:55:30 CST

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Figure 1: Hon Hai - Q122 results comparison

| (NT\$mn)           | Q122      | Q122E     | Diff. (%) | Q421      | Q/Q (%) | Q121      | Y/Y(%) | VA Q122   | Diff. (%) |
|--------------------|-----------|-----------|-----------|-----------|---------|-----------|--------|-----------|-----------|
| Net sales          | 1,407,553 | 1,351,296 | 4%        | 1,889,826 | -26%    | 1,347,113 | 4%     | 1,380,377 | 2%        |
| Gross profit       | 84,766    | 82,389    | 3%        | 113,866   | -26%    | 78,133    | 8%     | 82,764    | 2%        |
| Operating income   | 36,669    | 32,431    | 13%       | 52,720    | -30%    | 27,570    | 33%    | 31,567    | 16%       |
| Pre-tax income     | 36,927    | 39,993    | -8%       | 62,208    | -41%    | 39,189    | -6%    | 40,389    | -9%       |
| Net income         | 29,450    | 28,594    | 3%        | 44,395    | -34%    | 28,162    | 5%     | 29,456    | 0%        |
| EPS (NT\$)         | 2.12      | 2.06      | 3%        | 3.20      | -34%    | 2.03      | 4%     | 2.12      | 0%        |
| <b>Margins (%)</b> |           |           |           |           |         |           |        |           |           |
| Gross margin       | 6.0%      | 6.1%      |           | 6.0%      |         | 5.8%      |        | 6.0%      |           |
| Operating margin   | 2.6%      | 2.4%      |           | 2.8%      |         | 2.0%      |        | 2.3%      |           |
| Pre-tax margin     | 2.6%      | 3.0%      |           | 3.3%      |         | 2.9%      |        | 2.9%      |           |
| Net margin         | 2.1%      | 2.1%      |           | 2.3%      |         | 2.1%      |        | 2.1%      |           |

Source: Company data, Visible Alpha, UBS estimates

Figure 2: Hon Hai - Quarterly P&amp;L

| (NT\$ mn)          | 1Q21      | 2Q21      | 3Q21      | 4Q21      | 1Q22E     | 2Q22E     | 3Q22E     | 4Q22E     |
|--------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Net sales          | 1,347,113 | 1,351,467 | 1,405,768 | 1,889,826 | 1,407,553 | 1,383,983 | 1,504,624 | 1,797,081 |
| Gross profit       | 78,133    | 81,542    | 88,586    | 113,866   | 84,766    | 83,587    | 98,121    | 113,604   |
| Operating income   | 27,570    | 32,477    | 36,193    | 52,720    | 36,669    | 32,934    | 40,406    | 53,761    |
| Pre-tax income     | 39,189    | 44,229    | 47,946    | 62,208    | 36,927    | 42,039    | 51,206    | 64,561    |
| Net income         | 28,162    | 29,780    | 36,984    | 44,395    | 29,450    | 30,210    | 37,965    | 44,649    |
| EPS (NT\$)         | 2.03      | 2.15      | 2.67      | 3.20      | 2.12      | 2.18      | 2.74      | 3.22      |
| <b>Margins (%)</b> |           |           |           |           |           |           |           |           |
| Gross margin       | 5.8%      | 6.0%      | 6.3%      | 6.0%      | 6.0%      | 6.0%      | 6.5%      | 6.3%      |
| Operating margin   | 2.0%      | 2.4%      | 2.6%      | 2.8%      | 2.6%      | 2.4%      | 2.7%      | 3.0%      |
| Pre-tax margin     | 2.9%      | 3.3%      | 3.4%      | 3.3%      | 2.6%      | 3.0%      | 3.4%      | 3.6%      |
| Net margin         | 2.1%      | 2.2%      | 2.6%      | 2.3%      | 2.1%      | 2.2%      | 2.5%      | 2.5%      |

Source: Company data, UBS estimates

## Forecast returns

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|                             |        |
|-----------------------------|--------|
| Forecast price appreciation | +56.9% |
| Forecast dividend yield     | 5.4%   |
| Forecast stock return       | +62.2% |
| Market return assumption    | 5.7%   |
| Forecast excess return      | +56.5% |

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## Company Description

Hon Hai is the world's largest contract electronics manufacturer (also known by its trade name, Foxconn). It started connector production in 1981 and has established a strong tooling fabrication foundation. It diversified into PC enclosures in 1996 and, as a natural extension, began to offer surface-mount technology assembly/printed circuit board assembly (PCBA) services in the late 1990s. It moved into electronic manufacturing service PCBA and box-build in 2000. Its major customers include Apple, Hewlett-Packard, Sony and Dell. Founder and CEO Terry Gou is the largest shareholder, with a 12.2% stake.

## Valuation Method and Risk Statement

Our price target is based on DCF methodology and supported by PE multiple.

Downside risks for Hon Hai include: 1) a lower-than-expected market share gain for the iPhone business; 2) weaker-than-expected growth in the consumer electronic market; and 3) unfavourable FX movement.

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|-------------------|---|-----------------------|--------------------------|
| <b>Buy</b>        | FSR is > 6% above the MRA.  | 56%                   | 32%                      |
| <b>Neutral</b>    | FSR is between -6% and 6% of the MRA.   | 35%                   | 28%                      |
| <b>Sell</b>       | FSR is > 6% below the MRA.  | 8%                    | 22%                      |
| Short-Term Rating | Definition  | Coverage <sup>3</sup> | IB Services <sup>4</sup> |
| <b>Buy</b>        | Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event. | <1%                   | <1%                      |
| <b>Sell</b>       | Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event. | <1%                   | <1%                      |

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| Company Name                         | Reuters | 12-month rating | Price      | Price date  |
|--------------------------------------|---------|-----------------|------------|-------------|
| <b>Hon Hai Precision<sup>5</sup></b> | 2317.TW | Buy             | NT\$103.00 | 11 May 2022 |

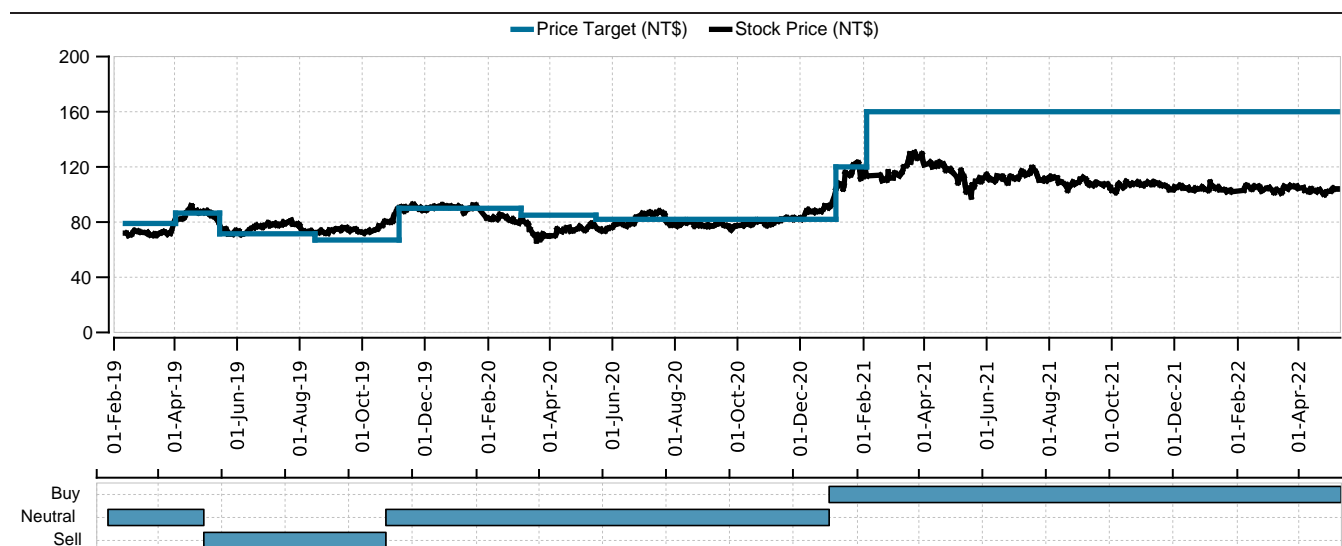
Source: UBS. All prices as of local market close.

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## Hon Hai Precision (NT\$)



| Date       | Stock Price (NT\$) | Price Target (NT\$) | Rating  |
|------------|--------------------|---------------------|---------|
| 2019-02-11 | 69.90              | 79.00               | Neutral |
| 2019-04-01 | 80.80              | 86.50               | Neutral |
| 2019-05-14 | 79.70              | 71.50               | Sell    |
| 2019-08-15 | 71.60              | 67.00               | Sell    |
| 2019-11-05 | 90.00              | 90.00               | Neutral |
| 2020-03-03 | 81.00              | 85.00               | Neutral |
| 2020-05-15 | 77.10              | 82.00               | Neutral |
| 2021-01-04 | 99.90              | 120.00              | Buy     |
| 2021-02-03 | 116.50             | 160.00              | Buy     |

Source: UBS; as of 11-May-2022

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