

November 20, 2008

Stock Rating  
Equal-weight

Industry View  
In-Line

## Hon Hai Precision

### Growing Deleverage Pains

#### What's Changed

Rating	Overweight to Equal-weight
Price Target	NT\$100.00 to NT\$65.00
09e/10e Earnings	Down 12%/Down 16%

**Downgrade to Equal-weight:** We lower our earnings estimates by 12% and 16% for 2009 and 2010, respectively, to discount deteriorating end demand across the board that would affect Hon Hai's top-line momentum despite incremental new project wins. Slower revenues would cap OM expansion even if Hon Hai could quickly streamline its cost structure, and thereby hurt bottom-line performance. We cut our price target to NT\$65 to reflect our reduced earnings forecasts and mid-term growth rate. The stock trades below 1x 2009e P/B, vs. 0.5x P/B average for other EMS peers. Our SOP analysis shows its core business still trades at 10x P/E for 2009e. We believe the stock is unlikely to perform until signs of OM bottoming emerge.

**Why not Underweight?** While we think the Street might have not cut earnings estimates aggressively enough, we believe below book valuations should have already priced in most negatives. In this report, we also review Hon Hai's outstanding debt and simulate its cash flow status for next year – and conclude that market fears over its cash flow status are likely overdone unless Hon Hai fails to secure its funding needs, which in our view seem unlikely given its low gearing and good reputation among local banks. Long-term, we believe Hon Hai will survive the downturn in light of its competitive cost structure and solid position in EMS plus component that is need in a highly competitive environment.

**What's next:** We would monitor closely the following potential catalysts that could lead us to turn bullish again: 1) more aggressive OPEX and capex cuts than we project; 2) earlier-than-expected industry consolidation that allows Hon Hai to increase market share; 3) raise cash dividend payout; 4) potential M&A activities that would be net positive to the bottom-line; and 5) increasing transparency on the company – a potential re-rating catalyst.

#### Key Ratios and Statistics

Reuters: 2317.TW Bloomberg: 2317 TT  
Taiwan System & PC Hardware

Price target	NT\$65.00
Upside to price target (%)	12
Shr price, close (Nov 19, 2008)	NT\$58.00
52-Week Range	NT\$183.04-56.80
Sh out, dil, curr (mn)	7,415
Mkt cap, curr (mn)	US\$12,942
EV, curr (mn)	US\$12,904
Avg daily trading volume (mn)	US\$136

Fiscal Year ending	12/07	12/08e	12/09e	12/10e
ModelWare EPS (NT\$)	8.72	9.11	7.15	7.43
Prior ModelWare EPS (NT\$)	-	8.92	8.13	8.82
EPS, basic (NT\$)*	12.35	9.87	7.61	7.81
Consensus EPS (NT\$)§	10.05	9.18	9.47	10.81
Revenue, net (NT\$ bn)	1,703	2,057	2,049	2,184
EBITDA (NT\$ bn)	97	113	105	112
ModelWare net inc (NT\$ bn)	55	68	53	55
P/E	20.1	6.4	8.1	7.8
P/BV	2.9	1.0	0.9	0.8
RNOA (%)	20.3	17.2	12.7	13.7
ROE (%)	19.2	17.6	12.1	11.6
EV/EBITDA	11.4	4.0	3.8	3.7
Div yld (%)	1.4	4.4	5.2	3.2
FCF yld ratio (%)	(1.3)	(2.5)	17.4	(2.4)
Leverage (EOP) (%)	(3.2)	3.4	(8.8)	(4.4)

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

§ = Consensus data is provided by FactSet Estimates.

\* = GAAP or approximated based on GAAP

e = Morgan Stanley Research estimates

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## Hon Hai Precision: Financial Summary

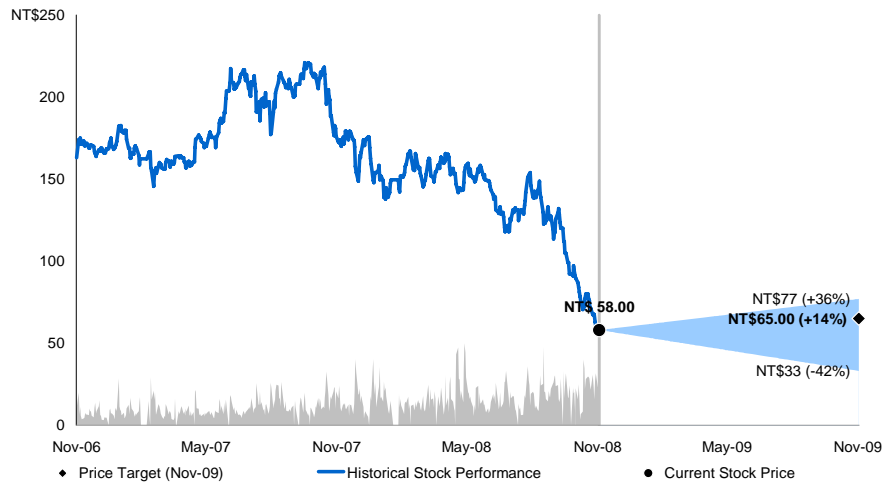
NT\$ million; Years Ending December

Consolidated Income Statements					Consolidated Cash Flow Statements				
	2007*	2008E	2009E	2010E		2007*	2008E	2009E	2010E
<b>Net sales</b>	<b>1,702,663</b>	<b>2,057,439</b>	<b>2,048,886</b>	<b>2,184,244</b>	<b>Cashflow from operations</b>	<b>102,466</b>	<b>55,724</b>	<b>124,527</b>	<b>35,483</b>
COGS	-1,535,140	-1,878,446	-1,889,282	-2,019,421	Net Profits	77,690	73,150	56,427	57,930
<b>Gross profit</b>	<b>167,523</b>	<b>178,994</b>	<b>159,604</b>	<b>164,823</b>	Depreciation \$ Amortization	26,168	27,472	32,557	37,077
Operating expenses	-74,059	-87,960	-83,486	-87,389	Equity investment losses (income)	-3,643	-1,371	0	0
<b>Operating income</b>	<b>93,464</b>	<b>91,033</b>	<b>76,118</b>	<b>77,434</b>	Disposal of Investment	-562	0	0	0
Non-operating income	7,674	3,733	-4,366	-3,166	Working Capital Change	-3,719	-39,694	35,451	-58,061
Interest income	-2,753	-2,405	-3,566	-3,566	Other adjustments	6,532	-3,834	92	-1,463
Investment income	3,856	1,371	0	0	<b>Cashflow from Investing</b>	<b>-97,991</b>	<b>-62,065</b>	<b>-45,000</b>	<b>-40,000</b>
Disposal of investment	597	0	0	0	(Purchases) Sale of fixed asset / (capex)	-82,517	-60,000	-45,000	-40,000
Disposal of fixed asset	-31	0	0	0	(Purchases) Sale of LT investment	-2,695	-2,065	0	0
Exchange gain	6,520	6,078	0	0	(Purchases) Sale of ST investment	-1,065	0	0	0
Other	-515	-1,310	-800	400	Other adjustments	-11,714	0	0	0
Pre-tax income	101,138	94,767	71,752	74,268	<b>Cashflow from financing</b>	<b>52,010</b>	<b>22,211</b>	<b>-25,814</b>	<b>-16,461</b>
Income tax	-16,449	-20,267	-12,915	-13,368	Increase in L-T debt	-66	27,955	12,000	0
Minorities	-6,999	-1,350	-2,409	-2,969	Increase in S-T debt	63,851	16,919	-12,000	0
Net income	77,690	73,150	56,427	57,930	Cash Dividend Paid	-15,503	-18,872	-22,244	-13,707
Modelware Net Income	54,871	67,568	53,046	55,126	Dir& Emp Bonus Paid	-1,356	-3,791	-3,570	-2,754
EPS (NT\$)	12.35	9.87	7.61	7.81	Other adjustments	5,084	0	0	0
Modelware EPS (NT\$)	8.72	9.11	7.15	7.43	Others	99	0	0	0
					Exchange rate adjustment	1,622	1,814	1,814	1,814
					<b>Net change in cash</b>	<b>58,206</b>	<b>17,684</b>	<b>55,527</b>	<b>-19,163</b>
					<b>Consolidated Financial Ratios</b>				
						2007*	2008E	2009E	2010E
					<b>Margins</b>				
					Gross margin	9.8%	8.7%	7.8%	7.5%
					Operating margin	5.5%	4.4%	3.7%	3.5%
					Pretax margin	5.9%	4.6%	3.5%	3.4%
					Net margin	4.6%	3.6%	2.8%	2.7%
					<b>YoY growth</b>				
					Sales	29.0%	20.8%	-0.4%	6.6%
					Operating profits	24.0%	-2.6%	-16.4%	1.7%
					Pretax profits	24.6%	-6.3%	-24.3%	3.5%
					Net profits (pre-bonus)	29.8%	-5.8%	-22.9%	2.7%
					EPS (pre-bonus)	6.6%	-20.1%	-22.9%	2.7%
					Cash dividend payout ratio	27%	27%	27%	27%
					Adjusted cash dividend (NT\$)	3.0	3.0	1.8	1.9
					Yield	1%	4%	5%	3%
					Net Debt/Equity (Net of mkt secs.)	-3%	3%	-9%	-4%
					Net Debt/Equity	-3%	4%	-8%	-4%
					Liabilities/Equity	126%	123%	113%	111%
					Liabilities/Assets	56%	55%	53%	53%
					ROAE	23%	18%	12%	12%
					ROAA	10%	8%	6%	6%
					AR/NR Turnover (days)	51.2	44.1	45.3	45.3
					AP/NP Turnover (days)	57.3	54.3	54.7	54.4
					Inventory Turnover (days)	33.9	37.4	37.1	37.0
					Cash conversion cycle (days)	27.7	27.2	27.8	27.9

E = Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research; \* 07 is actual number

## Risk-Reward Snapshot: Hon Hai Precision (2317.TW, NT\$56.8, EW, NT\$65.0)

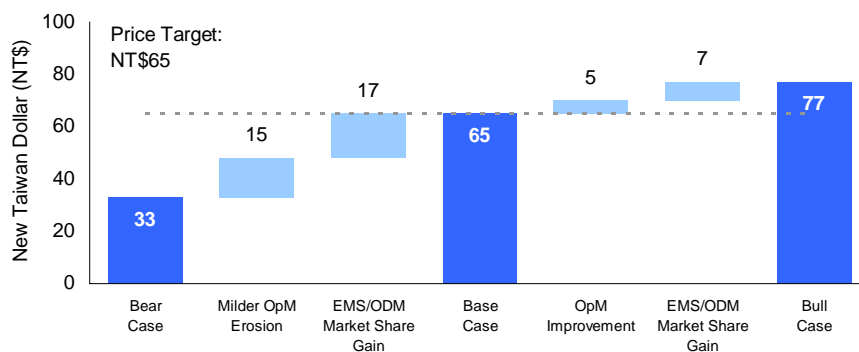
### Balanced Risk-Reward Profile



Source: Company data, Morgan Stanley Research

Price Target NT\$65		Based on our base-case scenario	
<b>Bull Case</b> NT\$77	11x Base Case 09e EPS	1.	Top-line remains flat YoY to up slightly; and GM remains resilient
		2.	OPEX cut faster than expected to boost operating margin
<b>Base Case</b> NT\$65	9x Base Case 09e EPS	1.	Top-line flat YoY; but GM drops on lower loading and full-system mix increases
		2.	Cutting back OPEX slightly by 0.2 ppt to 4.1% in 2009
<b>Bear Case</b> NT\$33	8x Base Case 09e EPS	1.	Top-line falls 30% YoY on deteriorating demand
		2.	OPEX goes up YoY; leading to lower operating margin

### Base Case Driven Primarily by Market Share and Resultant Pricing



Source: Morgan Stanley, FactSet

### Why Downgrade to EW?

- We believe Hon Hai's top-line momentum will likely stall in 2009 in response to customers falling COGS due to shrinking demand.
- Slower revenues would cap OM expansion even if Hon Hai could quickly streamline its cost structure, and thereby hurt bottom-line performance.
- Below book valuations should have already priced in most negatives and market concerns on insolvency risks are likely overdone.

### Key Value Drivers

- New contract wins from leading global OEMs in 3C space.
- Injection of new business through several aggressive acquisitions to enhance vertical integration.
- Lower employee bonus dilution, key to sustaining long-term competitiveness

### Potential Catalysts

- Accelerating order gains within current global OEMs
- More aggressive OPEX and capex cuts than we project
- Earlier-than-expected industry consolidation
- Raise cash dividend payout
- Potential M&A activities
- Increasing transparency on the company

### Risks

- Uncertainty associated with underlying demand.
- Changes in the competitive landscape.
- Management reshuffles that could lead to order allocation changes between parent company and subsidiaries.

## Investment Case

### Summary & Conclusions

**We are downgrading Hon Hai to Equal-weight** from Overweight as we have become more cautious over likely worse-than-expected bottom-line in 1Q09 onwards due to accelerating slowdown on products across the board that should lead to larger than expected deleverage pains. We lower our earnings estimates by 12% and 16% for 2009 and 2010, respectively, to discount reduced top-line despite our lower OPEX assumptions. Our new price target of NT\$65 is based on our RI valuation model in which we also apply a lower mid-term growth rate of 6.5% from 9.5% previously, and implies a P/E of 9x on our US GAAP 2009e earnings, a below trough valuation, which we think as justified in view of its likely deterioration in ROE to 12-18% in 2008-10e vs. 24-30% in the past five years. Trading at close to 1x 2009e P/B, we believe Hon Hai's share price might have some valuation support, but we think it's unlikely to perform, at least in the next two quarters, until signs of OM bottoming emerge.

**Why not Underweight?** Although we admit it's a late downgrade, our analysis shows that market worries over potential tightness in cash flow are overstated. Based on its working capital needs, maintenance capex requirement, cash dividend paid, cash on hand and maturity of debt outstanding, we conclude cash flow risk is low unless Hon Hai fails to secure its funding needs via debt. In our view, this would seem unlikely given Hon Hai's low gearing position as of 3Q, and good reputation among commercial banks even though we forecast around 23% YoY decline in the bottom-line in 2009. Additionally, we believe Hon Hai has streamlined its cost structure, i.e. reduced headcount, disposed of unutilized facilities and lowered capex. We view Hon Hai as a long-term survivor that should benefit from accelerating outsourcing given its solid position in EMS plus components that are in need in a highly competitive environment.

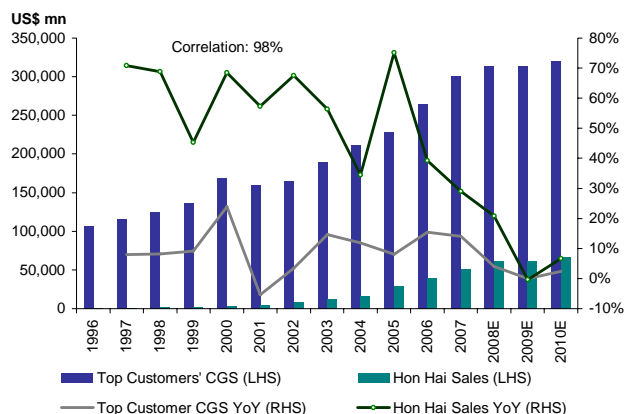
### Stagnant top-line momentum owing to shrinking

**end-demand:** Based on MS forecasts (our US PC analyst Katy Huberty), we expect global PC sales to grow only 2% YoY in 2009, in which we forecast NB to grow 9% and desktop to drop 5% YoY. For handsets, Nokia recently cut its 4Q forecasts and believes industry growth might show volume decline in 2009. Hon Hai currently still has roughly 50% of its total top-line coming from the PC space, of which the majority is desktops; and around 21% from handsets via FIH. As such, we believe top-line momentum will likely stall in 2009 even if we assume Hon Hai's share gains were to continue. Other than the server business from Sanmina-SCI for IBM, iPhone and Macbook

from Apple, full desktop assembly from Dell, LCD TV from Sony, NB OEM assembly from HP and Dell that we estimate can bring in incremental revenues of NT\$107 billion (5% of 09 top line) in 2009, revenue from other businesses might fall in response to clients' falling COGS owing to shrinking demand. We believe it could be a challenge for Hon Hai to deliver double digit YoY top-line growth as it used to and our calculation below shows a scenario of flat to slight fall YoY is more likely.

Exhibit 1

### Hon Hai's Revenue Trend vs. Top Customers' CGS: 98% correlation



Note: Our top customers CGS include the figures of HP, Dell, Apple, Sony, Cisco, EMC, Nokia, and Motorola. E=Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

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Hon Hai Precision

Exhibit 2

## Hon Hai: Global Mkt Share by Applications, 06-10E

US\$bn	2006	2007	2008E	2009E	2010E	CAGR 07-10E
<b>HH PC Sales</b>	19.2	26.0	30.3	31.3	33.9	9%
<b>*WW PC Rev.</b>	106.9	127.6	144.3	135.8	138.5	3%
<b>HH Global Share</b>	18%	20%	21%	23%	24%	
<b>HH Consumer Sales</b>	4.2	6.8	8.5	7.3	8.0	6%
<b>*WW Consumer Rev.</b>	35.7	37.2	38.4	31.6	34.5	-2%
<b>HH Global Share</b>	12%	18%	22%	23%	23%	
<b>HH Networking Sales</b>	6.4	7.9	9.8	9.7	10.7	11%
<b>*WW Networking Rev.</b>	28.0	30.7	34.4	34.4	38.3	8%
<b>HH Global Share</b>	23%	26%	28%	28%	28%	
<b>HH Handset Sales</b>	10.1	10.6	13.0	13.0	12.8	6%
<b>*WW Handset Rev.</b>	42.4	52.3	61.7	59.8	56.6	3%
<b>HH Global Share</b>	24%	20%	21%	22%	23%	
<b>HH Others Sales</b>	0.1	0.2	0.6	0.6	0.6	52%
<b>*WW Others Rev.</b>	27.2	32.0	37.5	44.7	52.9	18%
<b>HH Global Share</b>	0%	1%	2%	1%	1%	
<b>HH Total Sales</b>	40.0	51.5	62.3	62.0	66.1	9%
<b>YoY Growth</b>	39%	29%	21%	0%	7%	
<b>Total</b>	40.0	51.5	62.3	62.0	66.1	21%
<b>Global EMS market</b>	240.1	279.7	316.3	306.3	320.8	5%
<b>% Market Share</b>	17%	18%	20%	20%	21%	

E=IDC, Morgan Stanley Research

Note: WW revenues are defined as CGS of WW global OEMs in different application

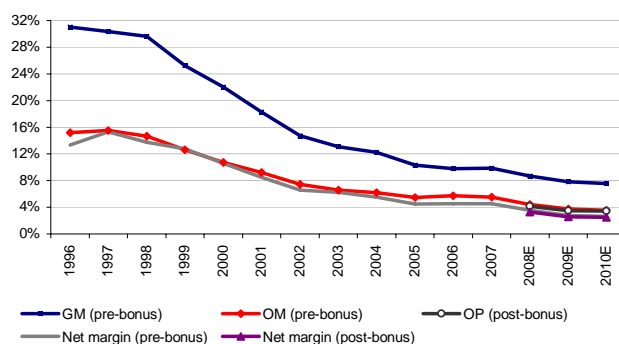
Source: IDC, Company data, Morgan Stanley Research

**OM likely to bottom in 2Q09:** Hon Hai's OM has been on a downward trend since 1998, while its OPEX ratio has risen to 4.3% in 2007 from 4.1% in 2006, which we believe is a result of the duplication in its workforce in line with ongoing site expansion since 2007, especially in inner China (Exhibit 5), on top of overseas expansion. Additionally, R&D expenses have also risen rapidly in the past two years given the company aims to land more ODM projects across all applications. Given the current macro environment, we believe Hon Hai also needs to cut its costs rapidly to defend its OM ahead of potentially slowing top-line momentum. Positive to note that its mega site expansion that drove up capex in the past few years should gradually come to an end in 2009. After completion of site expansions, overall cost savings should come from deduction in redundancy in workforce, tax benefits and lower wages. In

our model, we assume that Hon Hai controls its SG&A expenses despite increasing R&D expenses so that overall OPEX comes down in 2009 – which we believe could defend its overall OM even though we project GM will still be trending down owing to changes in product mix. In the mid-term, although we are modeling ROE to trend down owing to falling profitability, it might recover again should Hon Hai cut back its expenses faster than anticipated to drive up operating leverage again.

Exhibit 3

## Hon Hai: Margin Trend

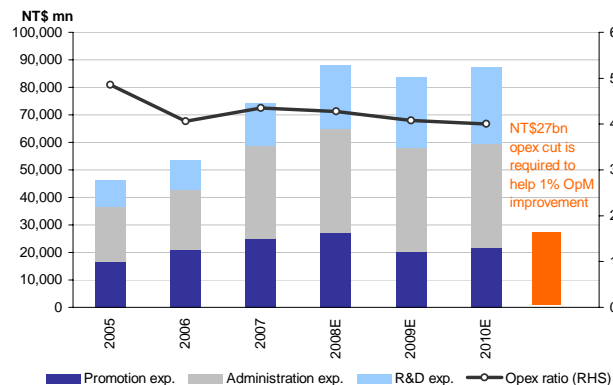


E = Morgan Stanley Research estimates.

Source: Company data, Morgan Stanley Research

Exhibit 4

## Hon Hai: Operating Expenses Trend



E = Morgan Stanley Research estimates.

Source: Company data, Morgan Stanley Research

Exhibit 5

## Hon Hai: Manufacturing Site Expansion, 2006-2009

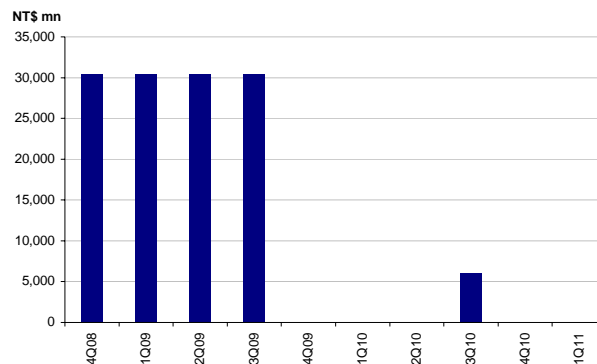
Nation	Area	Location	2006	2007	2008*	2009*	Item	Note
China	Shenzhen	Southeast	•	•	•		Component, Wireless Communications	
	Beijing	Northeast	•	•	•		Wireless Communications	
	Hangzhou	East	•	•	•		Router, Wireless Communications	
	Kunshan	East	•	•	•		Connector	
	Yantai	Northeast	•	•	•		Wireless Communications	
Taiwan	Jincheng	Northeast	•	•	•		Casing, Metal Stamping, Car	
	Kaohsiung	South				•		
	Nanjing	East		•	•		Software	R&D Team around 200 engineers
	Taiyuan	Northeast		•	•		Casing, Metal Stamping, Car	
	Shenyang	Northeast		•	•			
	Yingkou	Northeast		•	•		PCB	Around 50k employees
	<b>Langfang</b>	<b>Northeast</b>		•	•		<b>Wireless Communications, Handset component, PCB</b>	<b>Key focus</b>
	Qinhuangdao	Northeast		•	•		Electronics, Software	
	<b>Wuhan</b>	<b>Northeast</b>		•	•		<b>Casing, PC, Automobile, DSC</b>	<b>Key focus</b>
	Huainan	Northeast		•	•		TBC	Around 100k employees
	Nanning	Southwest		•	•			
	Hohhot	Northeast		•	•		3C Assembling	
<b>Vietnam</b>	<b>Vietnam</b>			•	•	<b>Camera module, PC MB, Connector</b>	<b>Key focus beyond 08e</b>	
India	India			•				
Russia	St. Petersburg			•		PC		
Czech			•	•		• PC		
US			•	•		• PC		
Mexico			•	•		• Wireless Communication/PC	Motorola	
Brazil			•	•		Wireless Communication	Nokia	
Ireland			•	•		PC		
Scotland			•	•		PC		
Finland			•	•		Wireless Communications	Nokia	
Denmark			•	•				
<b>Capex</b>			NT\$50 bn	NT\$83 bn	NT\$60 bn			↓

Source: Company data, Morgan Stanley Research \* Based on YTD announcement

**Concerns over cash flow tightness are overdone:** Hon Hai's debt (only interest-bearing) to asset ratio stood at 17% as of 3Q08, down from 20% in 2Q08. Among total interest-bearing debt, Hon Hai reduced its ST debt but increased LT debt to secure long-term funding. We also believe this is to reduce its exposure to USD loan in view of USD appreciation. Based on its cash on hand, Hon Hai's gearing remains low, in our view. We note, however, that Hon Hai's 3Q cash flow from operation was negative NT\$15bn, despite even though the company managed to control its A/R, A/P and inventory to shorten its cash conversion cycle (CCC) to 3Q's 27 days from 2Q's 31 days owing to falling profitability and preparation for high season in 4Q. In the face of the challenging environment next year, Hon Hai recently gained approval from the board to issue NT\$12bn corporate bond (straight bond), which we believe is also part of its effort to improve its debt structure and more importantly, in preparation for its working capital requirements and maintenance capex needs. Based on Exhibits 6 and 7, we believe that Hon Hai's cash requirements are well covered; the cash coverage analysis is based on a worst-case scenario that net profit falls 30% YoY in 2009e.

Exhibit 6

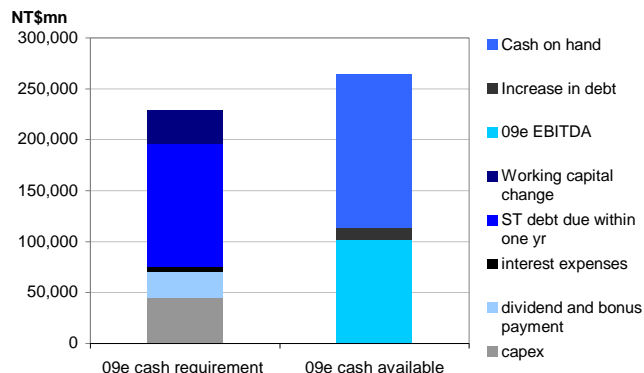
## Hon Hai: Maturity of Outstanding Debt



Note: We assume Hon Hai will payback its short-term debt in the next four quarters equally.  
Source: Company data, Morgan Stanley Research

Exhibit 7

## Hon Hai: Cash Requirement Is Well-covered



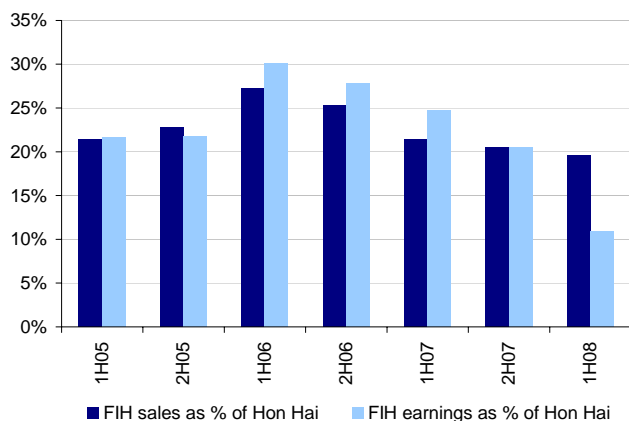
Note: The cash coverage analysis is based on a worst-case scenario that its net profit falls 30% YoY in 09e. Source: Company data, Morgan Stanley Research

### FIH remains an earnings drag; but impact is lessening:

Based on Hon Hai's 3Q minority interests, we believe this implies FIH's 3Q bottom-line further contracted from 1Q's level. We believe FIH (2038.HK, HK\$2.03, EW) could remain under pressure owing to sluggish recovery in MOTO, Nokia and Sony-Ericsson's saturated market share and likely delays in outsourcing opportunities from Korean brands including Samsung and LG due to local currency depreciation. However, despite the earnings drag, FIH's contribution to Hon Hai has dropped to about 10% of Hon Hai's bottom-line since 1H08, from 20-29% in the past three years. We expect the impact to Hon Hai to further reduce beyond 2008.

Exhibit 8

## FIH Contribution to Hon Hai



Source: Company data, Morgan Stanley Research

Exhibit 9

## Hon Hai: Sum-of-the-Parts Analysis

NT\$m	Stake	Sotp Value
Hon Hai (2317.TW)	Parent	430,048
Less:		
FIH	72%	41,284
Foxconn Technology	31%	17,637
Pan International	27%	2,103
Foxsemiconn	21%	173
SIMPLO TECHNOLOGY	9%	1,239
CyberTAN	11%	512
Innolux Display Corp.	6%	3,063
Foxconn Advanced Tech	43%	4,005
G-TECH Optoelectronics	42%	700
Advanced Optoelectronic	20%	229
UGOBE INC.	30%	330
ALLIANCE FIBER OPTIC	20%	6
Ways Technical Corp.	24%	678
Diabell	20%	404
UVAL Technology Corp.	22%	224
Others	-	1,964
Global Strategic Investment	-	206
Entire Technology		221
Infinia Corporation		161
Others	-	868
Security Holdings		1,008

	2008E	2009E
Hon Hai Core Market Value	353,032	353,032
Hon Hai Core Profit	47,620	34,848
<b>Hon Hai Core PE</b>	<b>7x</b>	<b>10x</b>

E = Morgan Stanley Research estimates for covered companies (Hon Hai, FIH, Foxconn Tech, Innolux Display) and Factset consensus for the others.  
Source: Company data, Morgan Stanley Research, Factset.

### Long-term survivor; likely to get stronger throughout the

**downcycle:** We view Hon Hai as a long-term survivor that should benefit from accelerating outsourcing opportunities, aided by customers' layoffs in R&D and closure of manufacturing sites (evidenced by Dell's closure of Austin plant) given its solid position in EMS plus components that are in need in a highly competitive environment. If we look at other EMS peers' balance sheet, Hon Hai still has a strong cash position relative to its peers with high gearing levels (see Exhibits 10 & 11). Site expansions moving to lower cost areas might help Hon Hai to rationalize its cost structure and expand its operating leverage as the cycle turns, in our view.

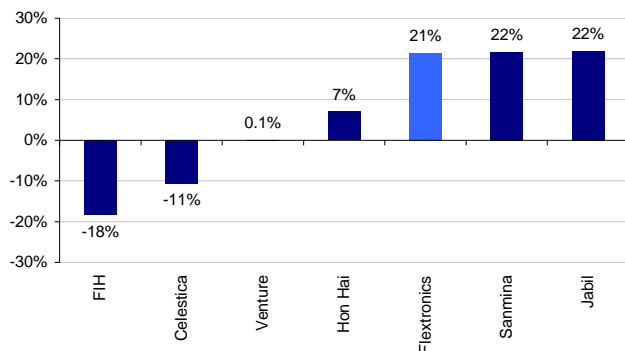
**Earnings revision & risks to price target:** We lower our earnings estimates by 12% and 16% for 2009 and 2010,

respectively, to discount reduced top-line despite our lower OPEX assumptions (down 0.2ppt YoY). Our new price target of NT\$65 is based on our RI valuation model (see Exhibit 14) in which we also apply a lower mid-term growth rate of 6.5% from 9.5% previously, and implies a P/E of 9x on our US GAAP 2009e earnings, a below trough valuation, which we think as justified in view of its likely deterioration in ROE to 12-18% in 2008-10e vs. 24-30% in the past five years. Trading at close to 1x 2009e P/B, we believe Hon Hai's share price might have some valuation support, but we think it's unlikely to perform, at least in the next two quarters, until signs of OM bottoming emerge.

Risks to our price target include: 1) uncertainty associated with underlying demand, especially if macro outlook darkens more than fear; 2) changes in the competitive landscape; 3) management reshuffles that may lead to a change in order allocation between subsidiaries and Hon Hai and sustainability of solid execution, and 4) margin risks in the midst of product mix shift or resulting from raw material price hikes, labor cost increase, and FX movement.

Exhibit 10

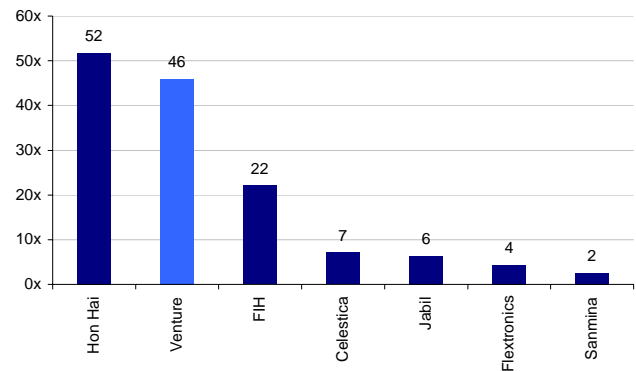
### EMS Players: Rank in Net Debt/Equity



Note: The figures are based on 3Q08 and 1H08 (FIH) actual financial statements  
Source: Company data, Morgan Stanley Research

Exhibit 11

### EMS Players: Rank in Interest Coverage Ratio, 08E



Note: 08e EBITDA is based on Morgan Stanley Research estimates for Hon Hai and FIH, and the others are based on Factset consensus.  
Source: Company data, Morgan Stanley Research, Factset

#### Company Description

Hon Hai Precision Industry Co. Ltd. is largest EMS in the world. Main products include connectors and barebone assembly. The company is expanding its products/services into networking, telecom and consumer electronic devices.

#### Taiwan System & PC Hardware

Industry View: In-Line

#### MSCI Country: Taiwan

Asia Strategist's Recommended Weight: 11.8%  
MSCI Asia/Pac All Country Ex Jp Weight: 12.0%

November 20, 2008

Hon Hai Precision

Exhibit 12

**Hon Hai Precision: Key Assumptions 2006-2010E**

<i>NT\$ m</i>	2006	2007	2008E	2009E	2010E
<b>Sales (NT\$ m)</b>					
PC	634,197	859,376	1,002,775	1,034,544	1,120,647
Consumer	139,967	223,671	281,264	241,233	264,680
Networking	210,194	261,730	322,215	321,922	353,822
Handset	332,200	351,885	430,242	430,242	424,151
Others	3,819	6,001	20,944	20,944	20,944
<b>Total</b>	<b>1,320,376</b>	<b>1,702,663</b>	<b>2,057,439</b>	<b>2,048,886</b>	<b>2,184,244</b>
<b>YoY growth (%)</b>					
PC	44%	36%	17%	3%	8%
Consumer	42%	60%	26%	-14%	10%
Networking	40%	25%	23%	0%	10%
Handset	40%	6%	22%	0%	-1%
<b>Sales breakdown</b>					
PC	46.5%	50.5%	48.7%	50.5%	51.3%
Consumer	10.4%	13.1%	13.7%	11.8%	12.1%
Networking	15.9%	15.4%	15.7%	15.7%	16.2%
Handset	25.0%	20.7%	20.9%	21.0%	19.4%
Others	2.2%	0.4%	1.0%	1.0%	1.0%
<b>Gross Margins</b>					
Connector	32.9%	31.8%	29.3%	29.0%	29.0%
PC System / Enclosure	8.1%	7.6%	7.6%	6.4%	6.0%
Consumer Products	5.9%	7.4%	6.7%	5.9%	5.8%
Handset-FIH	11.8%	9.3%	6.6%	6.4%	6.3%
Networking	12.3%	12.8%	12.3%	11.3%	10.8%
<b>Overall Margin</b>	<b>9.8%</b>	<b>9.8%</b>	<b>8.7%</b>	<b>7.8%</b>	<b>7.5%</b>

E= Morgan Stanley Research Estimates

Source: Company data, Morgan Stanley Research

November 20, 2008

Hon Hai Precision

Exhibit 13

## Hon Hai Precision: Earnings Summary, 2007-2009E (Consolidated)

NT\$ m	1Q08	2Q08	3Q08	4Q08E	1Q09E	2Q09E	3Q09E	4Q09E	2007*	2008E	2009E
<b>Sales</b>	<b>415,196</b>	<b>395,838</b>	<b>573,588</b>	<b>672,817</b>	<b>449,176</b>	<b>423,695</b>	<b>566,352</b>	<b>609,663</b>	<b>1,702,663</b>	<b>2,057,439</b>	<b>2,048,886</b>
COGS	-377,396	-363,110	-520,338	-617,602	-413,939	-390,421	-522,413	-562,509	-1,535,140	-1,878,446	-1,889,282
<b>Gross profit</b>	<b>37,800</b>	<b>32,728</b>	<b>53,250</b>	<b>55,216</b>	<b>35,237</b>	<b>33,274</b>	<b>43,939</b>	<b>47,154</b>	<b>167,523</b>	<b>178,994</b>	<b>159,604</b>
Operating Exp.	-18,282	-18,174	-25,795	-25,710	-16,997	-18,415	-23,564	-24,510	-74,059	-87,960	-83,486
<b>Operating profit</b>	<b>19,519</b>	<b>14,554</b>	<b>27,455</b>	<b>29,506</b>	<b>18,240</b>	<b>14,859</b>	<b>20,375</b>	<b>22,644</b>	<b>93,464</b>	<b>91,033</b>	<b>76,118</b>
Total non-operating Inc.	3,315	4,264	-3,403	-442	-1,092	-1,092	-1,092	-1,092	7,674	3,733	-4,366
Net Interest Inc.	-982	-612	-161	-650	-892	-892	-892	-892	-2,753	-2,405	-3,566
Net Investment Inc.	0	658	56	658	0	0	0	0	3,856	1,371	0
Disposal of Investment	0	1	-1	0	0	0	0	0	597	0	0
Disposal of Fixed Asset	52	-52	0	0	0	0	0	0	-31	0	0
Exchange Gain (Loss)	4,237	3,717	-1,476	-400	0	0	0	0	6,520	6,078	0
Others Income (Loss)	7	553	-1,821	-50	-200	-200	-200	-200	-515	-1,310	-800
Pre-tax profit	22,833	18,817	24,053	29,063	17,149	13,767	19,283	21,553	101,138	94,767	71,752
Income Tax	-4,972	-5,480	-4,607	-5,208	-3,087	-2,478	-3,471	-3,879	-16,449	-20,267	-12,915
Minorities	-851	849	-599	-749	-482	-482	-723	-723	-6,999	-1,350	-2,409
<b>Net Profit - Pre-EB</b>	<b>17,011</b>	<b>14,186</b>	<b>18,847</b>	<b>23,107</b>	<b>13,580</b>	<b>10,807</b>	<b>15,089</b>	<b>16,950</b>	<b>77,690</b>	<b>73,150</b>	<b>56,427</b>
<b>Net Profit - Post-EB</b>	<b>16,074</b>	<b>11,934</b>	<b>17,820</b>	<b>21,740</b>	<b>12,771</b>	<b>10,158</b>	<b>14,184</b>	<b>15,933</b>	<b>54,871</b>	<b>67,568</b>	<b>53,046</b>
<b>EPS (NT\$) - Pre-EB</b>	<b>2.29</b>	<b>1.91</b>	<b>2.54</b>	<b>3.12</b>	<b>1.83</b>	<b>1.46</b>	<b>2.04</b>	<b>2.29</b>	<b>12.35</b>	<b>9.87</b>	<b>7.61</b>
<b>EPS (NT\$) - Post-EB</b>	<b>2.17</b>	<b>1.61</b>	<b>2.40</b>	<b>2.93</b>	<b>1.72</b>	<b>1.37</b>	<b>1.91</b>	<b>2.15</b>	<b>8.72</b>	<b>9.11</b>	<b>7.15</b>
<b>Margins- Pre-EB</b>											
Gross margin	9.1%	8.3%	9.3%	8.2%	7.8%	7.9%	7.8%	7.7%	9.8%	8.7%	7.8%
Operating margin	4.7%	3.7%	4.8%	4.4%	4.1%	3.5%	3.6%	3.7%	5.5%	4.4%	3.7%
Pre-tax margin	5.5%	4.8%	4.2%	4.3%	3.8%	3.2%	3.4%	3.5%	5.9%	4.6%	3.5%
Net margin	4.1%	3.6%	3.3%	3.4%	3.0%	2.6%	2.7%	2.8%	4.6%	3.6%	2.8%
<b>Margins- Post-EB</b>											
Gross margin	9.1%	8.3%	9.3%	8.2%	7.8%	7.9%	7.8%	7.7%	9.8%	8.7%	7.8%
Operating margin	4.4%	3.4%	4.3%	4.1%	3.8%	3.3%	3.4%	3.5%	3.6%	4.1%	3.5%
Pre-tax margin	5.2%	4.5%	4.1%	4.1%	3.6%	3.1%	3.2%	3.3%	4.0%	4.4%	3.3%
Net margin	3.9%	3.0%	3.1%	3.2%	2.8%	2.4%	2.5%	2.6%	3.2%	3.3%	2.6%
<b>% QoQ (YoY)</b>											
Sales	-24.0%	-4.7%	44.9%	17.3%	-33.2%	-5.7%	33.7%	7.6%	29.0%	20.8%	-0.4%
Gross profit	-30.2%	-13.4%	62.7%	3.7%	-36.2%	-5.6%	32.1%	7.3%	29.9%	6.8%	-10.8%
Operating profit	-30.7%	-25.4%	88.7%	7.5%	-38.2%	-18.5%	37.1%	11.1%	24.0%	-2.6%	-16.4%
Pre-tax profit	-32.0%	-17.6%	27.8%	20.8%	-41.0%	-19.7%	40.1%	11.8%	24.6%	-6.3%	-24.3%
Net Profit - Pre-EB	-36.0%	-16.6%	32.9%	22.6%	-41.2%	-20.4%	39.6%	12.3%	29.8%	-5.8%	-22.9%
Net Profit - Post-EB	-12.5%	-25.8%	49.3%	22.0%	-41.3%	-20.5%	39.6%	12.3%	-	23.1%	-21.5%
EPS - Pre-EB	-45.7%	-16.6%	32.9%	22.6%	-41.2%	-20.4%	39.6%	12.3%	6.6%	-20.1%	-22.9%
EPS - Post-EB	-25.7%	-25.8%	49.3%	22.0%	-41.3%	-20.5%	39.6%	12.3%	-	4.5%	-21.5%

E = Morgan Stanley Research Estimates; Source: Company data, Morgan Stanley Research; \*Note that '07 numbers exclude the impact of Employee Bonus.

Exhibit 14

## Hon Hai Precision: US GAAP-Adjusted Residual Income Valuation

NT\$ m; Y/E Dec 31	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Total Equity	473,888	518,306	580,002	645,708	715,685	790,211	869,581	954,109	1,044,133	1,140,007	1,239,238
Core Net Profit	56,427	57,930	61,696	65,706	69,977	74,526	79,370	84,529	90,023	95,875	99,230
Total Equity (NT\$ bn)	474	518	580	646	716	790	870	954	1,044	1,140	1,239
Core Net Profit (NT\$ bn)	56	58	62	66	70	75	79	85	90	96	99
Return on Equity	12.4%	11.7%	11.2%	10.7%	10.3%	9.9%	9.6%	9.3%	9.0%	8.8%	8.3%
Beta (Last 60 Mths)	1										
Equity Risk Premium (Rm-Rf)	6%										
Risk Free Rate (Rf)	3%										
Cost of Equity	9%										
Terminal Growth Rate	4%										
Continuing Value Spread	0%										
2008-2018 growth rate	6.5%										
Residual Income (NT\$ mn)	16,918	15,028	14,143	12,849	11,456	9,961	8,359	6,644	4,811	2,852	(1,877)
Spread	3.8%	3.2%	2.7%	2.2%	1.8%	1.4%	1.1%	0.8%	0.5%	0.3%	-0.2%
Beginning Equity Capital	439,518										
PV of Forecast Period	62,724										
PV of Continuing Value	(17,157)										
Equity Value	485,085										
No. of Shares	7,415										
Projected Price (EoY)	65										
P/E 08	7.2										
P/E 09	9.1										

Source: Morgan Stanley Research estimates

Exhibit 15

## Valuation Comparison – US GAAP

Ticker	Company	Closing Price		Price Target	Market Cap (US\$ m)	EPS (Local Dollar)		P/E (X)		PEG	P/S (X)		P/B (X)		EV/EBITDA		ROAA (%)		ROAE (%)	
		11/20/2008	Rating			08E	09E	08E	09E		08E	09E	08E	09E	08E	09E	08E	09E	08E	09E
VENM.SI	Venture	4.3	NR	--	765	0.84	0.94	5.1	4.5	0.4	0.3	0.3	0.6	0.6	3.7	3.5	7.3	8.5	12.2	13.0
2317.TW	Hon Hai	58.0	E	65	12,944	9.11	7.15	6.4	8.1	-0.3	0.2	0.2	1.0	0.9	3.9	3.9	7.3	5.3	16.4	11.6
BHE.N	Benchmark	11.3	NR	--	733	1.29	1.18	8.7	9.6	-1.0	0.3	0.3	0.6	0.6	2.9	3.1	5.1	4.4	7.1	5.9
CLS.N	Celestica	5.02	NR	--	1,151	0.87	0.80	5.7	6.3	-0.6	0.1	0.1	0.4	0.4	1.9	2.0	3.1	2.9	7.3	6.1
FLEX.O	Flextronics	2.56	NR	--	2,145	0.88	0.83	2.9	3.1	-0.5	0.1	0.1	0.3	0.2	3.2	3.4	3.3	3.1	8.8	7.6
2038.HK	FIH	2.02	E	3.7	1,816	0.07	0.06	3.6	4.0	-0.4	0.1	0.1	0.5	0.4	1.9	1.8	6.9	5.4	14.1	11.0
SANM.O	Sanmina	0.44	NR	--	235	0.10	0.09	4.3	4.7	-0.5	0.0	0.0	0.2	0.2	2.8	3.5	0.7	1.5	5.1	4.3
2353.TW	Acer	42.7	O	60	3,230	4.90	5.12	8.7	8.3	1.9	0.2	0.2	1.3	1.3	6.5	5.6	4.7	4.7	15.3	15.8
2357.TW	Asustek	34.6	O	68	3,883	6.35	6.51	5.5	5.3	2.1	0.5	0.4	0.9	0.8	2.4	1.9	7.4	8.3	16.9	15.5
2382.TW	Quanta	35.4	E	39	3,819	5.84	5.48	6.1	6.5	-1.0	0.2	0.1	1.3	1.2	4.2	4.8	6.2	5.5	22.4	20.0
2324.TW	Compal	16.9	E	23	2,114	3.18	3.18	5.3	5.3	-37.6	0.2	0.2	0.8	0.7	4.4	4.6	7.8	7.4	16.5	15.4
2321.TW	Wistron	17.5	O	32	728	5.01	5.26	3.5	3.3	0.7	0.1	0.0	0.7	0.6	3.4	3.1	5.4	4.8	20.6	19.7
2308.TW	Delta Electronics	60.4	O	81	3,829	5.10	5.24	11.8	11.5	4.3	0.8	0.8	1.7	1.6	5.5	5.1	9.2	9.2	15.3	15.6

E=Morgan Stanley Research estimates for covered companies and Factset consensus for non-covered (NR) companies.

Source: Company data, Morgan Stanley Research, Factset.



**Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations.** For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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(as of October 31, 2008)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	Total IBC	% of Rating Category
<b>Overweight/Buy</b>	<b>869</b>	<b>39%</b>	<b>275</b>	<b>42%</b>	<b>32%</b>
<b>Equal-weight/Hold</b>	<b>983</b>	<b>44%</b>	<b>286</b>	<b>44%</b>	<b>29%</b>
<b>Not-Rated/Hold</b>	<b>22</b>	<b>1.0%</b>	<b>6</b>	<b>0.9%</b>	<b>27.3%</b>
<b>Underweight/Sell</b>	<b>403</b>	<b>18%</b>	<b>89</b>	<b>14%</b>	<b>22%</b>
<b>Total</b>	<b>2,277</b>		<b>656</b>		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

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**Overweight (O or Over)** - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

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**Not-Rated/Hold (NA or NAV)** - Currently the analyst does not have adequate conviction about the stock's total return relative to the relevant country MSCI Index, on a risk-adjusted basis, over the next 12-18 months. Please note that NA or NAV may also be used to designate stocks where a rating is not currently available for policy reasons. For the current list of Not-Rated/Hold stocks as counted above in the Global Stock Ratings Distribution Table, please email [morganstanley.research@morganstanley.com](mailto:morganstanley.research@morganstanley.com).

**Underweight (U or Under)** - The stock's total return is expected to be below the total return of the relevant country MSCI Index, on a risk-adjusted basis, over the next 12-18 months.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

### Analyst Industry Views

**Attractive (A)**: The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

**In-Line (I)**: The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

**Cautious (C)**: The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

### Other Important Disclosures

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For a discussion, if applicable, of the valuation methods used to determine the price targets included in this summary and the risks related to achieving these targets, please refer to the latest relevant published research on these stocks.

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November 20, 2008

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### Industry Coverage: Taiwan System & PC Hardware

Company (Ticker)	Rating (as of)	Price (11/19/2008)
<b>Grace Chen</b>		
Acer Inc. (2353.TW)	O (07/11/2007)	NT\$42.7
Asustek Computer Inc. (2357.TW)	O (02/26/2008)	NT\$34.6
Compal Electronics (2324.TW)	E (02/26/2008)	NT\$16.9
Delta Electronics Inc. (2308.TW)	O (04/30/2007)	NT\$60.4
Mitac International Corp. (2315.TW)	E (07/30/2007)	NT\$10.7
Paragon Tech. (3518.TW)	O (11/28/2007)	NT\$48.8
Quanta Computer Inc. (2382.TW)	E (04/30/2007)	NT\$35.4
Wistron Corporation (3231.TW)	O (07/21/2008)	NT\$17.5
<b>Jasmine Lu</b>		
HTC Corporation (2498.TW)	O (05/21/2007)	NT\$295
Hon Hai Precision (2317.TW)	E (11/20/2008)	NT\$58

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