

TAIWAN

# Hon Hai Precision

19 January 2009

2317 TT **Outperform**

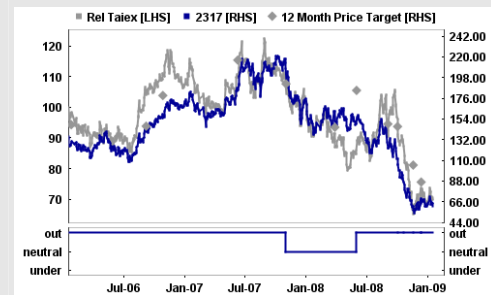
Stock price as of 16 Jan 09	NT\$	62.20
12-month target	NT\$	80.00
Upside/downside	%	+28.6
Valuation	NT\$	72.00-88.00
- ROE-g/COE-g		

GICS sector	technology hardware & equipment		
Market cap	NT\$m	461,189	
30-day avg turnover	NT\$m	2,227.6	
Market cap	US\$m	13,827	
Number shares on issue	m	7,415	

## Investment fundamentals

Year end 31 Dec	2007A	2008E	2009E	2010E
Total revenue	bn 1,702.7	1,906.8	1,812.2	1,934.3
Reported profit	bn 77.7	63.0	58.9	74.9
Profit bonus exp	bn 61.4	63.0	58.9	74.9
Bon exp/rep prof	% 21.0	0.0	0.0	0.0
Adjusted profit	bn 79.3	64.0	61.5	77.5
EPS rep	NT\$ 10.82	8.60	7.95	10.10
EPS rep growth	% 24.2	-20.5	-7.6	27.1
EPS bonus exp	NT\$ 8.55	8.60	7.95	10.10
EPS bonus growth	% 41.4	0.6	-7.6	27.1
PE rep	x 5.7	7.2	7.8	6.2
PE bonus exp	x 7.3	7.2	7.8	6.2
Total DPS	NT\$ 2.68	2.11	1.99	2.53
Total div yield	% 4.3	3.4	3.2	4.1
ROA	% 12.5	8.5	7.3	8.1
ROE	% 25.8	16.8	14.2	15.9
EV/EBITDA	x 3.8	3.8	3.7	3.2
Net debt/equity	% -3.2	0.2	-9.2	-21.6
Price/book	x 1.3	1.1	1.0	0.9

## 2317 TT rel Taiex performance, & rec history



Source: FactSet, Macquarie Research, January 2009 (all figures in NT\$ unless noted)

## Analysts

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## Why you should pick me

### Event

- We maintain our Outperform rating on Hon Hai (HHP) but lower our TP slightly from NT\$87 to NT\$80 based on our recently lowered handset (FIH) assumptions. Hon Hai should begin to outperform the index and most blue-chips on its attractive valuation and potential share gains during this downturn.

### Impact

- Macquarie vs consensus** – The street remains negative on HHP's business outlook due to its exposure to desktops and handsets. We agree, but believe most of the concerns should already be in the price. In fact, HHP should continue to gain market share during this downturn on its cost leadership. We believe the market is under-estimating HHP's market share gains potential.
- Handset business weaker but no longer a big deal** – Birdy Lu, our handset analyst, recently lowered his FIH forecasts due to poor orders from Motorola and slow Nokia outsourcing. While FIH weakness is a negative factor to HHP, we think the impact is now much smaller. FIH's earnings contribution to HHP has dropped from 25-30% in 2006 to 2H08's 8%, and will be even lower in 09.
- Market share winner during downturn** – HHP is already a well-known cost leader for most 3C customers. When customers are suffering from rapidly falling ASP/margins, they will seek the cost leader. The logic is simple here. HHP should further consolidate market share from smaller companies due to its stronger balance sheet and scale, even in its mature products.

### Earnings revision

- We lower our 09 earnings by 5% due to lower handset assumptions.

### Price catalyst

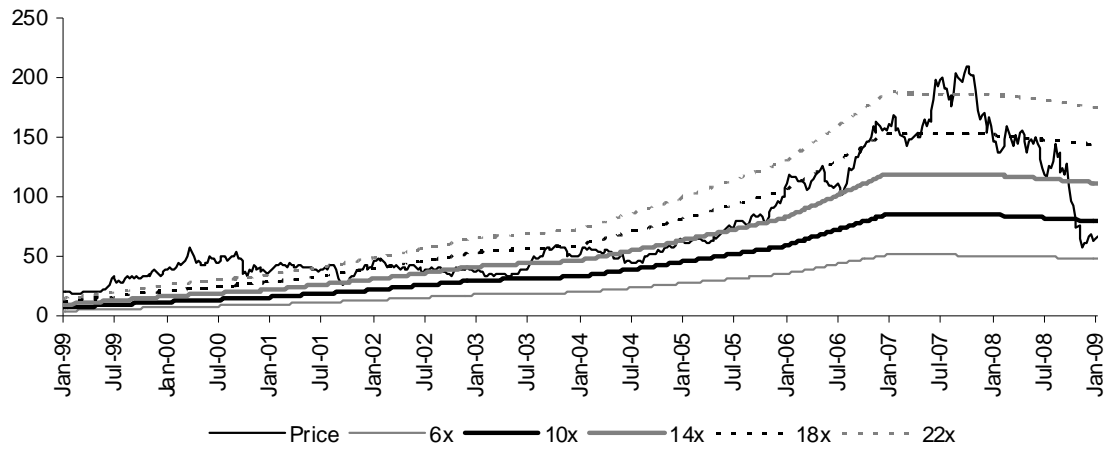
- 12-month price target: NT\$80.00 based on a PER methodology.
- Catalyst: Attractive valuation and relative stable earnings performance.

### Action and recommendation

- We recommend HHP over TSMC.** Although TSMC (2330 TT, NT\$41, UP, TP: NT\$35) has superior leadership and management in the foundry sector, we believe HHP will begin to outperform TSMC due to its strong downside support and stronger upside potential than TSMC.
- Given its solid profitability, we do not think HHP will trade below its 09 book, which implies the stock has less than 10% downside from here. However, TSMC's downside could be much greater given its outlook for losses, shrinking ROE performance and stretched P/BV valuation. Even if the cycle turns positive, HHP should outperform TSMC. HHP is trading at 7-8x 09E PER (its historical low) and 1-1.1x P/BV with ROE of 14-15%, while TSMC is at 2.5-2.6x P/BV with ROE of only 3%. There is more scope for HHP to rise by 50% in an upcycle as the stock would trade at only 11-12x PER, which is still at the low end of its trading range. Based on the same portfolio performance, TSMC would have to trade up to 3.5-4x P/BV, which we see as highly unlikely.

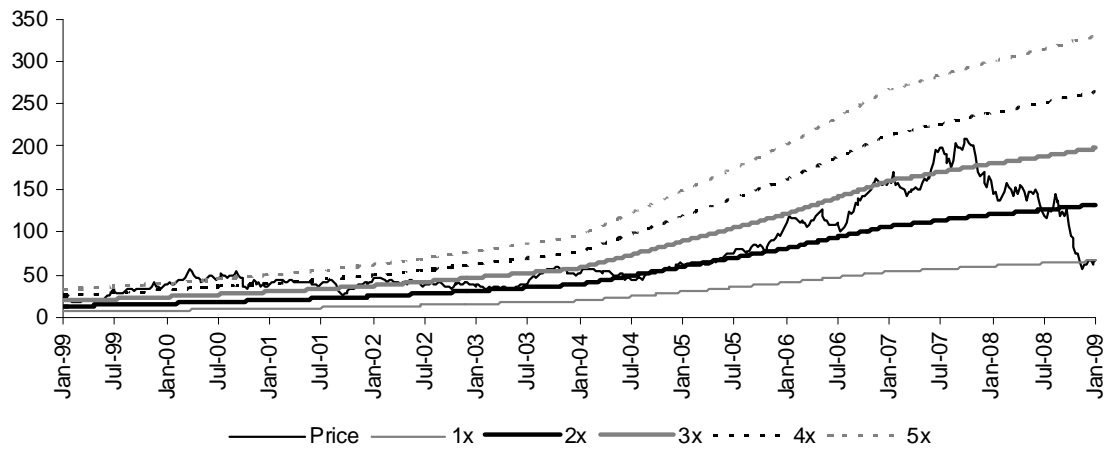
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**Fig 1 Hon Hai one year forward PER**



Source: Macquarie Research, January 2009

**Fig 2 Hon Hai one year forward PBR**



Source: Macquarie Research, January 2009

**Hon Hai Precision (2317 TT, Outperform, Target price: NT\$80.00)**

Quarterly Results					Profit & Loss						
		3Q/08A	4Q/08E	1Q/09E	2Q/09E		2007A	2008E	2009E	2010E	
Revenue	m	573,828	521,926	425,012	403,798	Revenue	m	1,702,663	1,906,788	1,812,220	1,934,258
Gross Profit	m	53,249	47,525	38,932	36,998	Gross Profit	m	167,523	171,302	167,272	181,892
Operating Expenses	m	-26,562	-24,620	-21,296	-19,854	Operating Expenses	m	-74,059	-89,789	-87,907	-87,873
Operating Income	m	26,687	22,904	17,636	17,144	Operating Income	m	93,464	81,512	79,364	94,019
Net Non-operating income	m	-3,404	-2,546	-1,196	-1,271	Net Non-operating income	m	7,674	1,629	-4,728	-2,174
Pre-Tax Income	m	23,283	20,358	16,440	15,873	Pre-Tax Income	m	101,137	83,141	74,637	91,844
Tax Expense	m	-4,364	-3,054	-2,466	-3,968	Tax Expense	m	-16,449	-17,332	-12,783	-13,777
Exceptionals	m	-650	-650	-650	-650	Exceptionals	m	-1,642	-1,017	-2,600	-2,600
Minority Interests	m	-600	-646	-622	-544	Minority Interests	m	-6,999	-2,824	-2,939	-3,170
<b>Reported Earnings</b>	<b>m</b>	<b>18,319</b>	<b>16,659</b>	<b>13,352</b>	<b>11,360</b>	<b>Reported Earnings</b>	<b>m</b>	<b>77,690</b>	<b>62,986</b>	<b>58,915</b>	<b>74,897</b>
Reported Earnings (bonus exp)	m	18,319	16,659	13,352	11,360	Reported Earnings (bonus exp)	m	61,375	62,986	58,915	74,897
Bonus exp / Reported Earnings	%	0.0	0.0	0.0	0.0	Bonus exp / Reported Earnings	%	21.0	0.0	0.0	0.0
<b>Adjusted Earnings</b>	<b>m</b>	<b>18,969</b>	<b>17,309</b>	<b>14,002</b>	<b>12,010</b>	<b>Adjusted Earnings</b>	<b>m</b>	<b>79,332</b>	<b>64,003</b>	<b>61,515</b>	<b>77,497</b>
<b>EBITDA</b>	<b>m</b>	<b>36,727</b>	<b>33,208</b>	<b>28,431</b>	<b>28,473</b>	<b>EBITDA</b>	<b>m</b>	<b>115,459</b>	<b>120,620</b>	<b>125,066</b>	<b>144,718</b>
EPS (rep)	NT\$	2.47	2.25	1.80	1.53	EPS (rep)	NT\$	10.82	8.60	7.95	10.10
EPS pcg growth (rep)	%	-10.1	-38.8	-19.0	-7.1	EPS growth (rep)	%	24.2	-20.5	-7.6	27.1
EPS (rep bonus exp)	NT\$	2.47	2.25	1.80	1.53	EPS (rep bonus exp)	NT\$	8.55	8.60	7.95	10.10
EPS pcg growth (rep bonus exp)	%	13.8	-22.5	-19.0	-7.1	EPS growth (rep bonus exp)	%	41.4	0.6	-7.6	27.1
EPS (adj)	NT\$	2.56	2.33	1.89	1.62	EPS (adj)	NT\$	11.03	8.73	8.30	10.45
EPS pcg growth (adj)	%	-8.2	-37.1	-13.7	-1.4	EPS growth (adj)	%	25.4	-20.9	-4.9	26.0
Revenue pcg growth	%	30.9	-5.6	2.4	2.0	PE (rep)	x	5.7	7.2	7.8	6.2
Operating Income pcg growth	%	10.5	-22.2	-3.7	26.1	PE (rep bonus adj)	x	7.3	7.2	7.8	6.2
Reported Earnings pcg growth	%	-7.8	-37.3	-16.9	-4.8	PE (adj)	x	5.6	7.1	7.5	6.0
Gross Profit Margin	%	9.3	9.1	9.2	9.2	Total DPS	NT\$	2.68	2.11	1.99	2.53
Operating Income Margin	%	4.7	4.4	4.1	4.2	Total Div Yield	%	4.3	3.4	3.2	4.1
Reported Earnings Margin	%	3.2	3.2	3.1	2.8	Weighted Average Shares	m	7,182	7,324	7,415	7,415
EBITDA Margin	%	6.4	6.4	6.7	7.1	Period End Shares	m	7,234	7,415	7,415	7,415
<b>Profit and Loss Ratios</b>		<b>2007A</b>	<b>2008E</b>	<b>2009E</b>	<b>2010E</b>	<b>Cashflow Analysis</b>		<b>2007A</b>	<b>2008E</b>	<b>2009E</b>	<b>2010E</b>
Revenue Growth	%	29.0	12.0	-5.0	6.7	<b>Reported Earnings</b>	<b>m</b>	<b>77,690</b>	<b>62,986</b>	<b>58,915</b>	<b>74,897</b>
Gross Profit Growth	%	29.9	2.3	-2.4	8.7	Depreciation & Amortisation	m	21,996	39,107	45,701	50,699
Operating Income Growth	%	24.0	-12.8	-2.6	18.5	Chgs in Working Cap	m	-3,719	-59,827	-5,272	-10,411
Reported Earnings Growth	%	29.8	-18.9	-6.5	27.1	Other	m	1,740	13,629	18,262	13,066
EBITDA Growth	%	27.7	4.5	3.7	15.7	<b>Operating Cashflow</b>	<b>m</b>	<b>97,706</b>	<b>55,895</b>	<b>117,607</b>	<b>128,252</b>
Gross Profit Margin	%	9.8	9.0	9.2	9.4	Acquisitions	m	2,420	-2,000	-2,000	-2,000
Operating Income Margin	%	5.5	4.3	4.4	4.9	Capex	m	-87,634	-60,000	-48,000	-36,000
Reported Earnings Margin	%	4.6	3.3	3.3	3.9	Asset Sales	m	0	0	0	0
EBITDA Margin	%	6.8	6.3	6.9	7.5	Other	m	1,066	0	0	0
Payout Ratio	%	24.3	24.1	23.9	24.2	<b>Investing Cashflow</b>	<b>m</b>	<b>-84,148</b>	<b>-62,000</b>	<b>-50,000</b>	<b>-38,000</b>
EV/EBITDA	x	3.8	3.8	3.7	3.2	Dividend (Ordinary)	m	-15,504	-19,422	-15,621	-14,729
EV/EBIT	x	4.6	5.6	5.8	4.8	Equity Raised	m	0	0	0	0
<b>Balance Sheet Ratios</b>						Debt Movements	m	63,784	18,000	14,400	10,800
ROE	%	25.8	16.8	14.2	15.9	Other	m	-7,981	-9,492	-7,595	-5,696
ROA	%	12.5	8.5	7.3	8.1	<b>Financing Cashflow</b>	<b>m</b>	<b>40,298</b>	<b>-10,915</b>	<b>-8,816</b>	<b>-9,625</b>
ROIC	%	29.6	17.4	14.8	18.0	<b>Net Chg in Cash/Debt</b>	<b>m</b>	<b>55,478</b>	<b>-17,020</b>	<b>58,791</b>	<b>80,628</b>
Net Debt/Equity	%	-3.2	0.2	-9.2	-21.6	Free Cashflow	m	10,072	-4,105	69,607	92,252
Interest Cover	x	33.9	42.1	88.2	104.5	FCF per Share	NT\$	1.40	-0.56	9.39	12.44
Price/Book	x	1.3	1.1	1.0	0.9	P/FCF	x	44.4	-111.0	6.6	5.0
Book Value per Share	NT\$	48.5	55.5	61.6	70.2	<b>Balance Sheet</b>		<b>2007A</b>	<b>2008E</b>	<b>2009E</b>	<b>2010E</b>
						Cash	m	145,776	180,655	235,845	317,617
						Receivables	m	268,381	322,687	320,623	334,775
						Inventories	m	158,403	222,663	209,987	224,303
						Investments	m	64,534	63,369	61,969	61,123
						Fixed Assets	m	203,149	231,394	239,575	229,288
						Intangibles	m	0	0	0	0
						Other Assets	m	27,054	33,763	39,131	43,156
						<b>Total Assets</b>	<b>m</b>	<b>867,297</b>	<b>1,054,532</b>	<b>1,107,132</b>	<b>1,210,263</b>
						Payables	m	273,990	333,747	316,336	336,994
						Short Term Debt	m	104,645	123,845	128,645	132,245
						Long Term Debt	m	28,792	57,592	62,392	65,992
						Provisions	m	0	0	0	0
						Other Liabilities	m	76,365	95,303	110,454	121,817
						<b>Total Liabilities</b>	<b>m</b>	<b>483,792</b>	<b>610,488</b>	<b>617,827</b>	<b>657,048</b>
						<b>Total S/H Equity</b>	<b>m</b>	<b>383,505</b>	<b>444,044</b>	<b>489,305</b>	<b>553,215</b>
						<b>Total Liab &amp; S/H Funds</b>	<b>m</b>	<b>867,297</b>	<b>1,054,532</b>	<b>1,107,132</b>	<b>1,210,263</b>

All figures in NT\$ unless noted.

Source: Company data, Macquarie Research, January 2009

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Recommendation definitions	Volatility index definition*	Financial definitions
<p><b>Macquarie - Australia/New Zealand</b>            Outperform – return &gt;5% in excess of benchmark return            Neutral – return within 5% of benchmark return            Underperform – return &gt;5% below benchmark return</p> <p><b>Macquarie – Asia/Europe</b>            Outperform – expected return &gt;+10%            Neutral – expected return from -10% to +10%            Underperform – expected return &lt;-10%</p> <p><b>Macquarie First South – South Africa</b>            Outperform – expected return &gt;+10%            Neutral – expected return from -10% to +10%            Underperform – expected return &lt;-10%</p> <p><b>Macquarie – Canada</b>            Outperform – return &gt;5% in excess of benchmark return            Neutral – return within 5% of benchmark return            Underperform – return &gt;5% below benchmark return</p> <p><b>Macquarie – USA</b>            Outperform (Buy) – return &gt;5% in excess of benchmark return            Neutral (Hold) – return within 5% of benchmark return            Underperform (Sell) – return &gt;5% below benchmark return</p> <p><b>Recommendations</b> – 12 months  <b>Note:</b> Quant recommendations may differ from Fundamental Analyst recommendations</p>	<p>This is calculated from the volatility of historical price movements.</p> <p><b>Very high–highest risk</b> – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.</p> <p><b>High</b> – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.</p> <p><b>Medium</b> – stock should be expected to move up or down at least 30–40% in a year.</p> <p><b>Low–medium</b> – stock should be expected to move up or down at least 25–30% in a year.</p> <p><b>Low</b> – stock should be expected to move up or down at least 15–25% in a year.</p> <p>* Applicable to Australian/NZ/Canada stocks only</p>	<p>All "Adjusted" data items have had the following adjustments made:            Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives &amp; hedging, IFRS impairments &amp; IFRS interest expense            Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends &amp; minority interests</p> <p><b>EPS</b> = adjusted net profit / <math>efpowa^*</math>  <b>ROA</b> = adjusted ebit / average total assets  <b>ROA Banks/Insurance</b> = adjusted net profit / average total assets  <b>ROE</b> = adjusted net profit / average shareholders funds  <b>Gross cashflow</b> = adjusted net profit + depreciation  <math>^*</math>equivalent fully paid ordinary weighted average number of shares</p> <p>All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).</p>

## Recommendation proportions – For quarter ending 31 December 2008

	AU/NZ	Asia	RSA	USA	CA	EUR
Outperform	38.55%	50.61%	64.52%	53.13%	65.55%	43.00%
Neutral	41.82%	15.92%	25.81%	40.63%	27.73%	48.00%
Underperform	19.64%	33.47%	9.68%	6.25%	6.72%	9.00%

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