How much more can the Taiwanese giant Hon Hai grow?









Valuation Master Class

This information is for learning purposes only.

This is not investment advice or a recommendation.



How much more can the Taiwanese giant Hon Hai grow?





Sector: Info Tech



World' largest contract assembler of consumer electronics with over 40% global market share (most famous for assembling iPhones)

My value estimate:

TWD135

(Upside 32%)

BUY



3 things to know about this company

- Smartphone market matures, focus on emerging countries
- EV market might turn into growth catalyst soon
- Attractive dividend yield could rise above 5%

Key statistics

Analyst consensus (20)

PE ratio

Dividend yield

TWD145

11x

3.9%

(Upside 42%)

BUY

Revenue breakdown 2020



Sales

Story

FVMR

Value

WCB

Risks

Consumer electronics 50%



Computing Products 21%



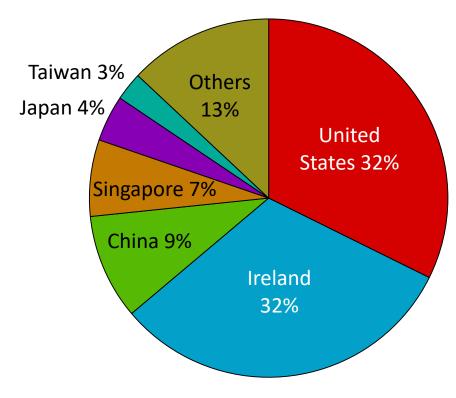
Cloud and Networking 23%



Components 6%



Breakdown by region



If you have one of the following products, you are supporting Hon Hai's revenue...



Sales

Story

FVMR

Value

WCB















Price remained stable over time, but volume grew recently





- During the past 12 months, the stock price mainly moved sideways
 - The 50DMA remained slightly below the 200 DMA
- Volume RSI stayed above the 50%line since the end of 2021
 - So, volume would provide good support for a turnaround



Smartphone market matures, focus on emerging countries



Sales

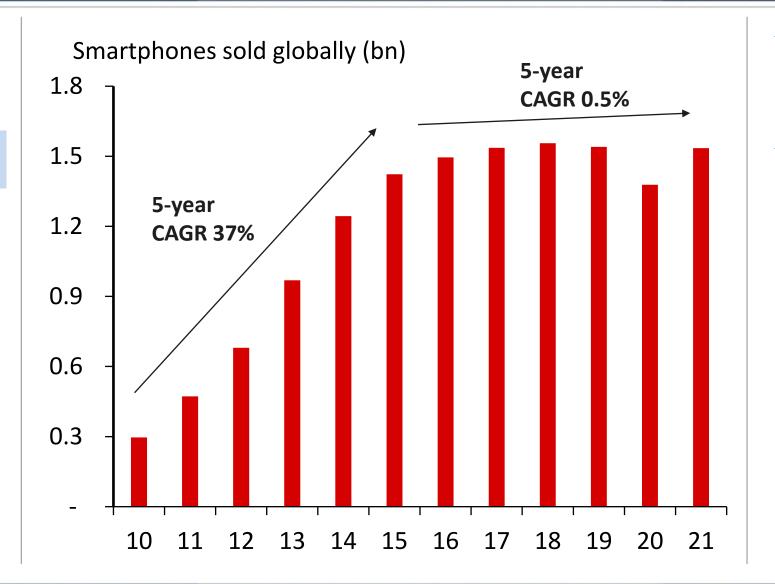
Story

FVMR

Value

WCB

Risks

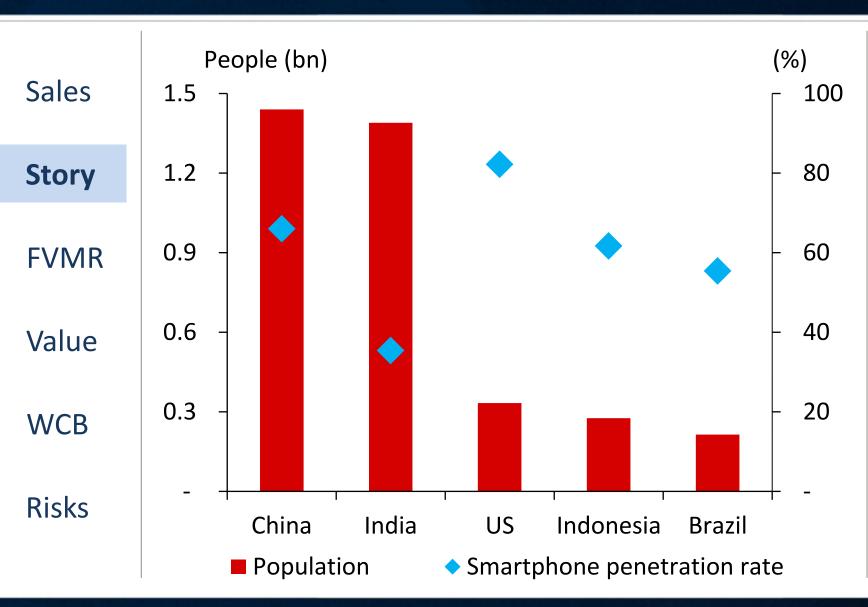


- The smartphone market has constituted the main growth driver for the company
- However, the demand for smartphones has matured, this is especially visible from slowing orders from Europe and US
 - While the assembling of smartphones still comprises an important business, it is unlikely to remain the No.1 growth catalyst for Hon Hai

Sources: A. Stotz Investment Research, company data

Still, China and India could deliver growth in the short run





- With 80% smartphone penetration, the US market is already mature
 - The same goes for most other developed countries
- However, China and India, the two largest countries in the world are still quite underpenetrated
 - **Especially India, which has** seen exceptional growth of smartphones over the past years, which could rise



EV market might turn into growth catalyst soon



Sales

Story

FVMR

Value

WCB

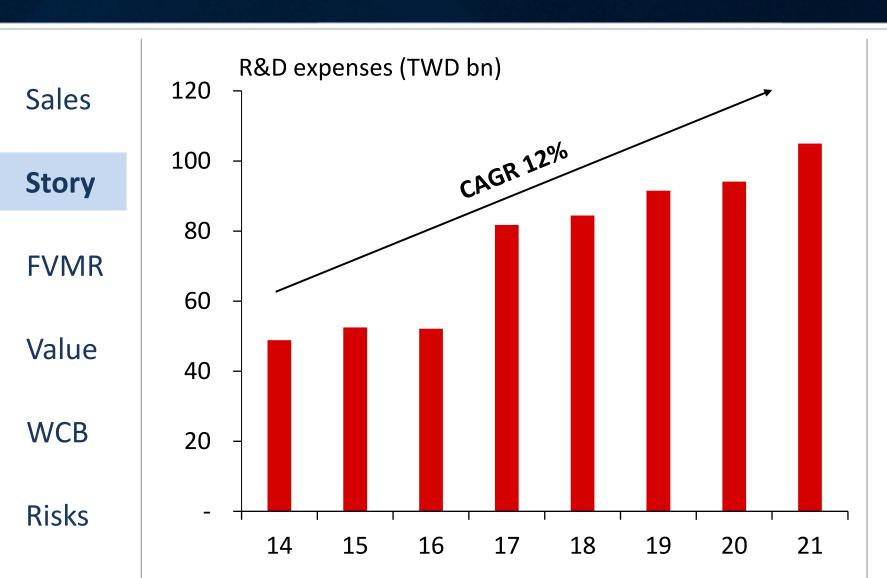
- ★ Hon Hai established strategic partnerships with global car manufacturers to develop and manufacture EVs on a mass basis
 - Its alliances include Stellantis (Fiat Chrysler), Geely, Yulon Motor, Fisker and Byton
- ★ The management expects to generate TWD1trn revenue from EVs by 2026
 - This equals around 20% of current revenue
 - Its manufacturing plants in the US and Thailand could start operations by 2023



In Nov 2021, the company presented its first 3 selfdeveloped EV car models

Investments in AI and semiconductor drive up costs

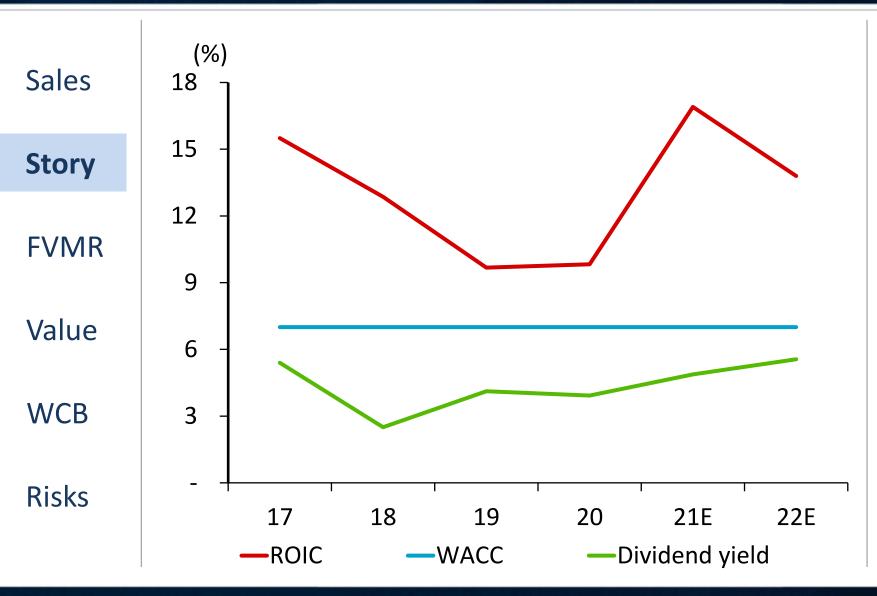




- Besides the assembling of cars, Hon Hai sees a great potential in the development of car components, motor and semiconductor
- The company is wellequipped to compensate for the slowing smartphone market
 - Over the past 10 years, the company generated a 5% CAGR and it could continue to see that stable growth

Attractive dividend yield could rise above 5%





- Overall, Hon Hai delivered strongly on ROIC, highlighting its value creation over time
- Also, the dividend yield might be worth a look from an investor perspective
 - Despite being in a growth stage, Hon Hai provided an attractive yield above 3%
 - In 22E, it could return to 5%+, which would be double compared to the Taiwanese average

Good on financial side, bad on ethics



Sales

Story

FVMR

Value

WCB

- ★ The company has been involved in several scandals over the years
 - Between 2010 and 2013, more than 20 workers committed suicide in its factories where iPhones were assembled
 - Several cases of students working overtime and illegal child labor
 - **Bribery and fraud scandals of executives**
 - In Dec 2021, 250 workers got food poisoning, leading to a closure of the factory for more a 1 week





Home

Student login

FAQ

5

Resources

Testimonials



What Is Going to Happen with Inflation?

By Valuation Master Class Student

Many forces at work impact inflation.
There are current trends that cause both inflationary and deflationary measures.
Whether we'll see inflation or deflation in the future depends on which of these forces dominate.

Read More



How to Value a Startup

By Andrew Stotz

This story started when Dan, a podcast listener, replied to my recent weekly email with this question, "How do you value a startup, especially if there is no revenue?"

Read More



How to Fight Back When Your Dreams Are Crushed

By Andrew Stotz

The trouble you face is not your fault, and I'm gonna show you how you can fight back. I challenge you to recommit to your dreams today!

Read More

ValuationMasterClass.com



What Does It Mean to Be

Financially World Class?





Scan this QR code to go to the ValuationMasterClass.com blog to download all full Case Study reports for free.

*It's usually up within 24h.



FVMR Scorecard

- Measures a stock's
 attractiveness relative to all
 other companies
- * Attractiveness is based on four elements
 - Fundamentals, Valuation,
 Momentum, and Risk
- *Scale from 1 (Best) to 10 (Worst)



Strong fundamentals and favorable valuation



В

PTM**

(17.1)

1.5

4.8 3mth

0.8

Dec-20

(22.2)

1.5

1.5

6mth 0.9

Sales

Story

FVMR

Value

WCB

Risks



Risk

(%)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**
Operating profit margin	1.2	1.7	0.8	1.1	2.0
Recurring net margin	2.9	2.5	2.2	2.0	2.4
Asset turnover	156.9	156.0	159.4	153.2	174.8
Return on assets	4.6	4.0	3.6	3.1	4.2
Recurring return on equity	12.7	11.7	9.7	8.6	11.7

(x)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**
Price-to-sales	0.3	0.2	0.2	0.3	0.2
Price-to-earnings	11.3	8.9	8.2	15.9	9.9
Price-to-book	1.4	0.8	0.8	1.3	1.1
PE-to-EPS growth (PEG)	nm	nm	2.8	nm	0.2
EV/EBIT	21.8	9.9	14.7	21.5	9.2

W

Momentum	w					В	

/1**	(x)	Dec-17	Dec-18	Dec-19	
0.1	Current ratio	1.4	1.5	1.6	
1.9	Net debt-to-equity (%)	(2.8)	2.5	(3.3)	
98	Times-interest-earned	1.5	1.6	0.7	
.wk		5yr	3yr	1yr	
1.4	Beta	1.0	1.0	1.0	

(%)	Dec-17	Dec-18	Dec-19	Dec-20	PTM**
Revenue growth	8.0	12.5	0.9	0.3	20.1
Recurring EPS growth	(4.5)	(15.9)	2.9	(8.4)	41.9
Operating profit margin chg. (bps)	(178)	46	(88)	28	98
	6mth	3mth	1mth	3wk	1wk
Price change	(6.3)	(6.7)	(2.8)	(3.7)	1.4

Note: Benchmarking against 1,080 non-financial companies in Taiwan.

Recently, I created a short online course explaining my FVMR investing approach

I usually sell it for \$97 but for a limited time I am offering it for FREE





Analysts see a right time to buy

Sources: A. Stotz Investment Research, Refinitiv



Sales

Story

FVMR

Value

WCB

Risks

Analyst consensus valuation								
Recommendation	Oct-21	Nov-21	Dec-21	Current				
Strong buy	7	6	6	6				
Buy	8	9	9	8				
Hold	5	7	7	6				
Sell	-	-	-	-				
Strong sell	-	-	-	-				
Average score	1.9	2.0	2.0	2.0				

20 analysts



Upside: 42%

- Most analysts have a BUY recommendation, while 6 analysts recommend HOLD
- Consensus expects robust revenue growth over the next few years
 - Also, they believe that the company can expand its margin significantly

Analyst consensu	ıs 3-year fo	recast				
(%)	18	19	20	21E	22E	23E
Revenue growth	2.5	0.9	0.3	10.3	2.1	4.7
Gross margin	6.3	5.9	5.7	6.1	6.5	7.0
EBIT margin	2.6	2.2	2.1	2.5	2.8	3.1
Net margin	2.4	2.2	1.9	2.3	2.5	2.7

Profit & loss statement



Sales

Story

FVMR

Value

WCB

Revenue	5,342,811	5,358,023	F 000 000	
	(F 006 040)	0,000,000	5,909,899	6,039,917
Cost of goods & services	(5,026,943)	(5,055,104)	(5,549,396)	(5,653,363)
Gross profit	315,868	302,919	360,504	386,555
SG&A	(200,972)	(192,091)	(218,666)	(223,477)
Other operating (exp)/inc	0	(0)	-	-
EBIT	114,897	110,827	141,838	163,078
Interest expense (net)	9,711	7,785	13,825	6,001
Other non-operating inc/(exp)	13,541	7,937	14,684	13,216
Earnings before taxes (EBT)	138,148	126,550	170,346	182,294
Income tax	(31,693)	(31,147)	(41,000)	(43,930)
Earnings after taxes (EAT)	106,456	95,404	129,346	138,364
Equity income/Minority interest	2,758	(4,705)	3,010	4,027
Earnings from cont. operations	109,213	90,698	132,356	142,390
Forex/Exceptionals before tax	6.095	11.097	7.916	8.708
Net profit	115,309	101,795	140,272	151,098

- ★ The company is likely to benefit from the consumer demand rebound in 2021
 - Most of its products could continue to ride the demand wave providing short-term strength

Balance sheet - assets



Sales

Story

FVMR

Value

WCB

(YE Dec, NT\$ m)	2019A	2020A	2021E	2022E
Cash & short-term investments	910,247	1,269,582	1,152,430	1,026,786
Accounts receivable	1,068,253	962,231	984,983	1,073,763
Inventories	515,772	582,114	647,429	659,559
Other current assets	79,421	70,722	76,829	78,519
Total current assets	2,573,693	2,884,649	2,861,672	2,838,627
Long-term investments	326,258	363,691	390,604	415,993
Net fixed assets	339,408	346,192	361,884	387,342
Intangible assets	28,687	32,213	30,981	30,832
Goodwill	15,407	14,917	16,110	16,432
Other long-term assets	37,489	32,613	37,179	38,295
Total assets	3,320,942	3,674,276	3,698,430	3,727,521

- ★ A core part of Hon Hai's strategy is to develop strategic partnerships for the joint development and manufacturing of products
 - Alliances with the EV car industry are likely to lead to a rise in LT-investments

Balance sheet - liabilities



Sales

Story

FVMR

Value

WCB

(YE Dec, NT\$ m)	2019A	2020A	2021E	2022E
Overdrafts & short-term loans	471,626	551,532	597,511	477,084
Accounts payable	1,002,460	1,169,361	1,017,389	1,036,450
Other current liabilities	183,376	195,363	195,027	211,397
Total current liabilities	1,657,461	1,916,257	1,809,927	1,724,931
Long-term debt	237,957	253,676	298,905	328,795
Other long-term liabilities	25,898	30,196	32,612	34,569
Total liabilities	1,921,316	2,200,129	2,141,444	2,088,295
Minority interest	159,641	176,869	188,407	198,051
Paid-up capital - Common shares	338,013	341,276	341,276	341,276
Paid-up capital - Preferred shares	-	-	-	-
Retained earnings	1,004,438	1,043,332	1,114,635	1,187,230
Revaluation/Forex/Others	(102,467)	(87,330)	(87,330)	(87,330)
Total equity	1,239,984	1,297,277	1,368,580	1,441,176
Total liab & shareholders' equity	3,320,942	3,674,276	3,698,430	3,727,521

- Despite having TWD800bn in debt, Hon Hai is net cash
 - The company holds 1/3 of its assets in cash



Sales

Story

FVMR

Value

WCB

(YE Dec)	2019A	2020A	2021E	2022E
General growth (YoY, %)				
Revenue	0.9	0.3	10.3	2.2
Assets	(1.8)	10.6	0.7	0.8
Gross profit	(4.9)	(4.1)	19.0	7.2
Operating profit	(15.6)	(3.5)	28.0	15.0
Attributable profit	(10.7)	(11.7)	37.8	7.7
EPS	(10.7)	(11.7)	37.8	7.7
Recurring EPS	(1.4)	(15.5)	43.6	7.6
Du Pont analysis (%)				
Net profit margin	2.2	1.9	2.4	2.5
Revenue per NT\$100 of assets	159.4	153.2	160.3	162.7
Assets/equity (x)	2.7	2.8	2.8	2.6
Return on equity	9.4	8.0	10.5	10.8
Others (%)				
Effective tax rate	22.0	22.6	23.0	23.0
Dividend payout ratio	53.3	60.1	51.9	55.0

- The company is characterized by a remarkable efficiency
 - This could lead revenue to grow faster than fixed assets over time

Ratios (cont.)



Sales

Story

FVMR

Value

WCB

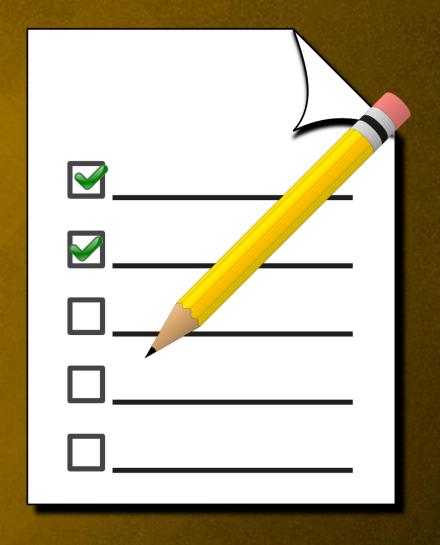
Risks

(YE Dec)	2019A	2020A	2021E	2022E
Internal liquidity (x)				
Current ratio	1.6	1.5	1.6	1.6
Quick, or acid test ratio	1.2	1.2	1.2	1.3
Working cap. mgmt (Days)				
Inventory conversion period	41	39	40	42
Receivables collection period	74	68	59	61
Days from raw mat to coll	115	107	99	103
Payables deferral period	74	77	71	65
Cash conversion cycle	41	30	28	38
Profitability ratios (%)				
Gross profit margin	5.9	5.7	6.1	6.4
EBIT margin	2.2	2.1	2.4	2.7
EBIT return on avg assets	3.4	3.2	3.8	4.4
Return on average assets	3.4	2.9	3.8	4.1
Financial risk (x)				
Liabilities-to-assets (%)	57.9	59.9	57.9	56.0
Debt-to-equity	0.6	0.6	0.7	0.6
Net debt-to-equity	(0.2)	(0.4)	(0.2)	(0.2)
Times-interest-earned	2.8	4.4	9.3	8.8
Effective interest rate (%)	8.9	5.3	2.7	3.2

★ With the increased focus on producing higher-margin complex components such as semiconductor, I expect an expansion of gross margin over time A. Stotz Investment Research
Stock Picking Checklist

★ Inspired by Peter Lynch's ten baggers (A stock that has gone up 10x)

- * Based on our extensive research
- * 9 factors that drive long-term share price performance



Long-term share price performance potential



Sales

Story

FVMR

WCB

Ratios

Value

A. Stotz Investment Research		G	
Stock Picking Checklist	Potential	Comment	
 Management – Management has a proven commitment to growth 	Good	The management puts a high emphasis on growth Revenue CAGR accumulated to 5% over past 10 years.	
2. Growth – Product and industry can support a decade of 10%+ annual growth	Moderate	Expanding presence in EV market could lead to mid single-digit growth	
3. Sustainable – Competitive strategy creates sustainably high gross margin	Good	The company has a dominant market share of 40% and developed long-lasting partnerships (e.g. Apple)	
4. Quality – Good earnings quality, non-core items are small or non-existent	Moderate	Earnings grew at a much slower path compared to revenue (due to extraordinary items)	
5. Efficiency – In the long run sales grow faster than assets	Good	The company is characterized by a high efficiency; asset turnover is around 150%+	
6. Tight – Relatively low cash conversion cycle, negative is best	Moderate	Cash conversion is moderately high and stood at 3 days in 2020	
7. Cash flow – Operating cash flow is consistently positive	Weak	Operating cash flows fluctuated a lot and were sometimes negative due to changes in working cap	
8. Capacity – Company has access to capital to fund growth	Good	The company is net cash (net debt-to-equity ratio stood at -0.3x in 2020	
9. Inexpensive – Valuation is reasonable, avoid very expensive stocks	Good	Cheap on both 21E PE and PB compared to US Info Tech companies, but low on ROE	

Free cash flow



Sales

Story

FVMR

Value

WCB

(YE Dec, NT\$ m)	2019A	2020A	2021E	2022E
EBIT	114,897	110,827	141,838	163,078
Est tax rate (%)	22	23	23	23
NOPAT	89,652	85,749	109,215	125,570
Add: Depre & amort	67,009	65,114	71,308	78,488
Less: CAPEX	(71,421)	(60,493)	(80,978)	(97,615)
Chg in A/R	53,696	106,022	(22,752)	(88,780)
Chg in inventory	109,254	(66,342)	(65,316)	(12,129)
Chg in oth curr assets	10,487	8,698	(6,106)	(1,690)
Chg in A/P	(49,108)	166,902	(151,972)	19,061
Chg in oth curr liabs	(12,002)	11,988	(337)	16,370
Less: Chg in working cap	112,327	227,268	(246,483)	(67,169)
Less: Chg in invest cap				
Free cash flow to firm	197,567	317,638	(146,938)	39,275

- ★ FCFF might turn negative in 21E due to significant changes in working cap
 - However, 22E onward, Hon Hai should be able to deliver consistent positive FCFF

Value estimate



Sales

Story

FVMR

Value

WCB

Forecast assumptions			
3-year average	Consensus	My assur	nptions
Revenue growth (CAGR)	5	5.6	5.5
Gross margin	ϵ	5.5	6.4
EBIT margin	2	2.8	2.6
Net margin	2	2.5	2.5

My valuation method			
Market: Taiwan			
Market risk-free rate	1.0		
Market equity risk premium	9.0		
Market return	10.0		
Company beta (x)	1.0	Valuation Method:	
COE	10.0	FCFF	
WACC	7.0		
Terminal growth rate	2.0		

- I expect a similar revenue growth and margin expansion compared to the consensus
- However, my terminal growth rate of 2% is rather conservative

Value estimate



Sales

Story

FVMR

WCB

Ratios

Value

Risks

Bear **TWD123**



Base **TWD135** (Upside 32%)



Bull **TWD147**

(Upside 44%)



World Class Benchmarking Scorecard

- We identify a company's competitive position relative to global peers
- * We use a composite rank of profitability and growth, called "Profitable Growth"
- Scale from 1 (Best) to 10 (Worst)



Poor profitability and average growth rate



Sales

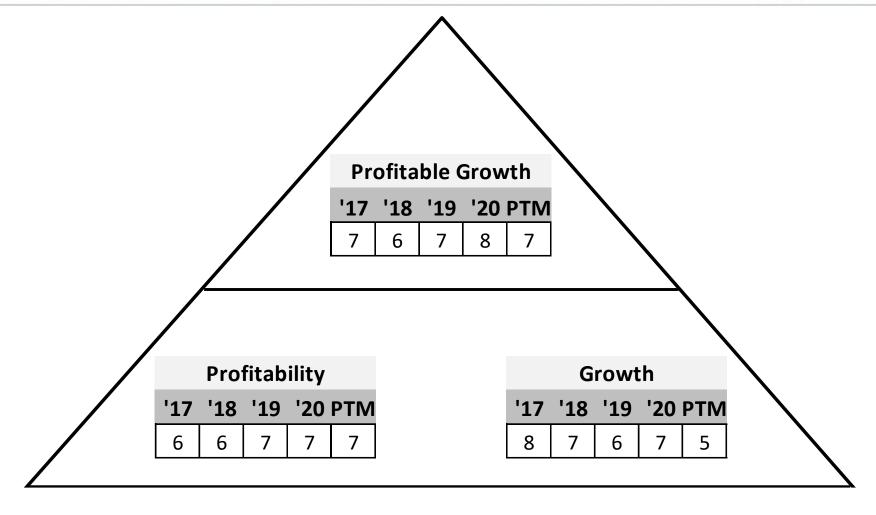
Story

FVMR

Value

WCB

Risks



Benchmarked against 700 large Info Tech companies worldwide.

Key risk is failure to keep up with technological trends

Sources: A. Stotz Investment Research, company data



Sales

Story

FVMR

Value

WCB

- ★ Underestimating competition in the global EV market
- ★ Lagging technological developments
- * Reputation damage (e.g., child labor, working conditions, suicides in its factories already got media attention in the past)

CONCLUSION

- Management has a proven commitment to growth
- Expansion in EV market offers attractive opportunities to scale
- Valuation is attractive; dividend yield adds some good return on top of upside

