

Equities

31 March 2011 | 6 pages

Hon Hai Precision (2317.TW)

Alert: Smaller FIH OP Loss Should Help Hon Hai's Margin

4Q10 net loss came down sharply for FIH — FIH released its 2010 full year results last night with a net loss of US\$218M, implying a 2H10 net loss of US\$77M, much lower than the US\$144M net loss in 1H10. Moreover, FIH delivered a small 0.6% operating margin in 2H10, much better than the -2.2% OPM FIH delivered in 1H10. FIH does not publish quarterly results. However, based on Hon Hai's 3Q10 loss on minority interest of NT\$614M, we estimate that FIH's 3Q10 net loss was around US\$68M (Hon Hai owns 71% of FIH). This suggests FIH's net loss in 4Q10 was only US\$8M, down sharply from the US\$68M in 3Q10.

FIH result positive for Hon Hai — Some market watchers have been expecting FIH's net loss to widen in 2H10, which likely led to Hon Hai's share price weakness yesterday. The fact that FIH delivered operating profit in 2H10, and narrowed its net loss sharply in 4Q10 may force some market watchers to raise their Hon Hai estimates. From Hon Hai's perspective, FIH's net loss likely went down by US\$60M Q/Q in 4Q10, which should improve Hon Hai's OPM by 20bps. Given Hon Hai only made 2.5% OPM in 3Q10, a 20bps improvement would be positive for the company. Hon Hai remains our top pick in the downstream sector. We expect the company to deliver 30% revenue growth and start to improve its OPM in 2Q11. We believe Hon Hai's normalized OPM should be around 3.5% and we expect Hon Hai to deliver such margin when they complete the relocation to inland China in 2H11. We note that Hon Hai has raised prices aggressively with multiple clients, including Apple, Nokia, Microsoft, HPQ and Sony Ericsson over the past few months. With better pricing and smaller losses from FIH, we expect Hon Hai's OPM to stay around 2% in 4Q10 / 1Q11, which should be regarded as very strong results given that some market watchers have been providing scenarios of around sub-1% or even zero OPM.

Hon Hai Precision (2317.TW; NT\$104.50; 1L)

■ Company Update

Kevin Chang

+852-2501-2739 +886-2-8726-9084
kevin.chang@citi.com

Jonathan Gu

jonathan.gu@citi.com

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Hon Hai Precision

Valuation

Our target price of NT\$148 is based on a target PE multiple of 14x 2011E EPS to reflect the contribution of Apple and Sony products' growth momentum. The target PE multiple of 14x is slightly below Hon Hai's five-year trading average of 16x given our expectation of lower-than-expected earnings growth momentum for Hon Hai than historical.

Risks

We rate Hon Hai shares Low Risk, in line with our quantitative risk-rating system, which tracks 260-day historical share price volatility. Downside risks that could prevent the stock from reaching our target price include: 1) any sharp rebound in raw-material costs; 2) further market-share losses from FIH; and 3) weaker-than-expected demand for 3C products. Upside risks include: 1) faster-than-expected progress in NB segment; 2) stronger-than-expected new product shipments; and 3) sharp cost reductions.

Appendix A-1

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Hon Hai Precision (2317.TW)

Ratings and Target Price History Fundamental Research

Analyst: Kevin Chang
Covered since September 5 2008

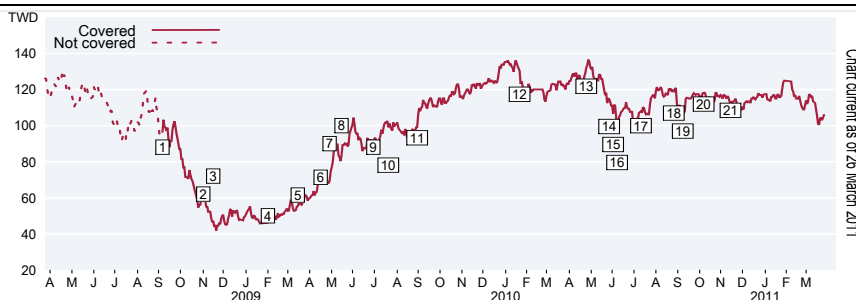


Chart current as of 26 March 2011

	Date	Rating	Target Price	Closing Price
1	5-Sep-08	*1M	*130.30	96.54
2	2-Nov-08	1M	*74.53	62.11
3	16-Nov-08	1M	*69.10	46.58
4	2-Feb-09	1M	*55.90	46.20
5	15-Mar-09	1M	*65.22	55.12
6	16-Apr-09	1M	*83.07	69.49
7	29-Apr-09	1M	*93.17	69.41

	Date	Rating	Target Price	Closing Price
8	15-May-09	1M	*118.79	83.46
9	30-Jun-09	1M	*118.75	90.62
10	21-Jul-09	1M	*127.68	99.11
11	31-Aug-09	1M	*133.93	99.11
12	21-Jan-10	*2L	133.93	130.36
13	26-Apr-10	2L	*139.29	132.14
14	27-May-10	2L	*117.86	114.73

	Date	Rating	Target Price	Closing Price
15	2-Jun-10	2L	*108.93	106.70
16	8-Jun-10	2L	*101.79	99.55
17	11-Jul-10	*1L	*147.32	107.59
18	26-Aug-10	1L	*150.00	119.00
19	8-Sep-10	1L	*140.00	108.00
20	7-Oct-10	1L	*154.00	118.00
21	14-Nov-10	1L	*148.00	113.50

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Hon Hai Precision (2317.TW)

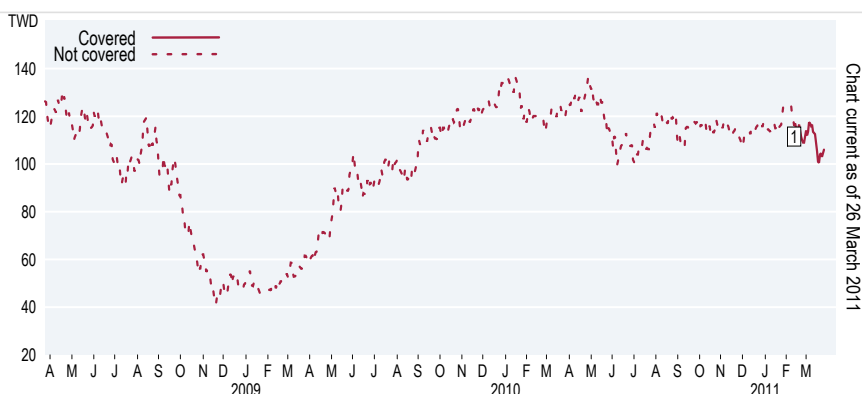
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Kevin Chang

Covered since September 5 2008



Date	Rating	Target Price	Closing Price
11-Feb-11	*ADD MP	-	116.00

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12 Month Rating			Relative Rating		
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