Bulletin:

Hon Hai's Rising Exposure To Electric Vehicle Business Is Credit Positive

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Taiwan Ratings Corp. said today that **Hon Hai Precision Industry Co. Ltd.'s** (twAA+/Stable/twA-1+) increasing diversification into electric vehicle (EV) business and growing revenue contribution from auto components is moderately positive for the company. Nonetheless, it will take time for this business line to bring significant benefit to Hon Hai's credit profile.

EV business could serve as a long-term growth avenue for Taiwan-based Hon Hai, given the diversification strategy of its key customer Apple Inc. and relatively low growth for the smartphone market in general. That's despite the likelihood of higher sales for Apple's iPhone models over the next few quarters, aided by growing demand for newer fifth generation (5G) devices as part of the sector's upgrade cycle. We believe it could take a few years for Hon Hai to bring meaningful improvement to its EV business scale and return solid profits from this sector. That's based on Hon Hai's current announced projects and order status. However, faster global EV adoption could accelerate Hon Hai's EV business expansion. The company plans to capture about 10% of the global EV market by 2025 through its MIH Alliance, joint ventures with traditional automotive companies and new entrants, and as-yet unannounced plans. Hon Hai estimates the total EV market could be worth US$600 billion by 2025.

Hon Hai's improving performance and tight working capital management could continue to sustain its strong operating cash flow and support the moderately higher capital expenditure (capex) needed for expansion into EVs and more advanced semiconductors over the next two years. Our current base case indicates Hon Hai will require new Taiwan dollar (NT$) 70 billion-NT$90 billion of capex annually in 2021 and 2022, compared with NT$65.5 billion in 2020. This would support equipment upgrades, geographic diversification, and new business expansion including EVs, robotics, AI, and semiconductors. We maintain our view that Hon Hai will maintain financial discipline over new investments, given that future joint ventures can share the capex required in these.

Hon Hai's performance in the first half of 2021 was in line with our base case; however, the company could achieve slightly higher sales growth in full year 2021, driven by stronger iPhone and server demand. Hon Hai is also likely to generate strong free operating cash flow and stay debt free on an adjusted basis in 2021-2022, with a limited impact from the current semiconductor shortage in some.

This report does not constitute a rating action.