Bulletin:

Hon Hai Is Overcoming Demand Weakness

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Hon Hai Precision Industry Co. Ltd. is showing operating resilience despite weak demand for most consumer electronics. Our view reflects an ongoing shift in Hon Hai's business strategy and product mix. As such, we expect its profitability to continue to improve over the next few quarters, with moderate growth in revenue. Longer term, investments in the electric vehicle (EV) space, should also support its performance.

Hon Hai (twAA+/Stable/twA-1+) is benefiting from a stronger product portfolio of premium smartphones and a greater ability to provide a time-to-market electronics manufacturing services amid supply-chain constraints. At the same time, it is experiencing robust demand from its cloud and networking clients in downstream segments.

In addition, Hon Hai is shifting its business focus away from cyclical consumer end markets. Instead, the company is increasing its exposure to growing enterprise revenue, mainly from servers, and new businesses that are focused on returns, including autos, semiconductors, and automation.

In our view, this shift supports Hon Hai's goal of a 10% gross profit margin in 2025. The company's revenue increased by 8% year on year in the second half of 2022, compared with our current base case of about 5% for the whole of 2022.

EV car assembly and component manufacturing are Hon Hai's main investment areas and could become its largest potential revenue drivers by 2025. The company has a growing pipeline with both traditional auto original equipment manufacturers (OEMs) and new entrants in the U.S., Europe, and Southeast Asia. EV software platforms are an additional growth area.

The company could maintain its record-high inventory level throughout the rest of 2022 to cope with supply-chain challenges due to COVID, particularly because its major assembly sites are located in China. This strategy would incur additional costs such as working capital needs. But we do not expect Hon Hai's relatively strong performance or very low financial leverage to be undermined, given the company's moderately improving profitability and expanded financial buffer over the past few years.

This report does not constitute a rating action.