

Bulletin:

# Hon Hai May Quicken Its Geographical Diversification Amid China's Strict COVID Policy

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Taiwan Ratings Corp. said today that the COVID-19 lockdown in Zhengzhou, China, is likely to hit **Hon Hai Precision Industry Co. Ltd.**'s iPhone shipments. In our view, Hon Hai faces downside risk in its revenue growth, particularly in 2023. This stems from the possibility that Apple could advance its effort to spread production-related risks for its high-end iPhones by diverting orders to other electronics manufacturing services providers, given China's zero-COVID policy is unlikely to change soon.

We believe it is difficult for Hon Hai (twAA+/Stable/twA-1+) to return capacity utilization in Zhengzhou to normal in a short period. This is despite the company's restrictions on the movement of workers at the plant during the pandemic. Hon Hai could also incur additional costs, such as overtime pay and incentive bonuses, to retain its workforce and support utilization rates. Its Zhengzhou plant has about 200,000 workers and is the major iPhone manufacturing base for Hon Hai.

Despite the challenges, we believe the impact to Hon Hai's iPhone shipments over the next few months should be limited, mainly due to its strong record in manufacturing and supply chain management with its assembly lines located in different places in China. The company's September 2022 sales hit a monthly record of 40% year-on-year increase, supported by iPhone's new product launch, and Hon Hai's rising allocation from Apple. We now expect Hon Hai's revenue expansion to be lower, but it could still grow by 11%-13% in 2022.

As U.S.-China tension intensifies, we believe Hon Hai will gradually increase its geographical footprint. The company assembles most of its networking and communications products outside of mainland China, such as in Taiwan and Mexico. However, about 75% of Hon Hai's overall capacity remains in China, particularly for iPhone manufacturing. We believe the company will gradually boost its production presence in Vietnam and India, given the improving infrastructure provided by their governments. Hon Hai's ambitious development of its electric vehicles business should also play an important role for geographical diversification because the majority of investments and projects are outside China.

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