

Bulletin:

Hon Hai's Electric Vehicle Business To Benefit From Partnership With ZF Group

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Hon Hai Precision Industry Co. Ltd.'s electric vehicle (EV) business looks set to grow following the company's announcement of a joint venture with German-based ZF Friedrichshafen AG.

Taiwan-based Hon Hai (twAA+/Stable/twA-1+) has announced its intention to acquire a 50% stake in ZF group's axle system assembly unit, ZF Chassis Modules GmbH, for about \$560 million euros. This will create a joint venture aimed at expanding supply chain opportunities for Hon Hai's EV segment. The transaction still requires regulatory approval but could be finalized in six to nine months. The investment is part of Hon Hai's strategy to achieve annual sales of new Taiwan dollar (NT\$) 1 trillion for its EV business by 2025. Hon Hai hopes to achieve this through continued investment in EV car assembly and component manufacturing, as well as increasing EV partnerships globally.

The joint venture could open access for Hon Hai to ZF's technology and expertise in areas such as electric drive, chassis, and safety systems. It could also help Hon Hai to increase its brand recognition and strengthen its global supply chain for the development and production of EVs. This could improve Hon Hai's access to existing large automotive original equipment manufacturers (OEMs) and accelerate the development of Hon Hai's EV business. ZF is the third-largest automotive supplier globally, behind Robert Bosch GmbH, and Denso Corp., and ahead of Continental AG.

We believe Hon Hai will spend significantly to support business development for new technologies and new markets, particularly for EVs. Our base case assumes NT\$140 billion capital expenditure plus long-term investment annually in 2023-2024. In our view, Hon Hai's relatively strong and stable profitability and cash flow generation can support such high capital spending and investments over the same period and keep the company debt free on an adjusted basis.

Hon Hai has positioned its EV business as a long-term growth source. This is because margins are narrowing in the mature smartphone market where Hon Hai earns the bulk of its revenue. Meanwhile, one of the company's top customers, Apple Inc., has implemented a supplier diversification strategy. This has forced Hon Hai and other electronics manufacturing services (EMS) providers to seek new revenue sources. However, we forecast the sales contribution from EVs will remain low in 2023 and 2024, based on Hon Hai's existing pipeline, which is mostly with EV start-ups. Intensifying competition from other EMS providers could limit new orders from established auto and EV OEMs and restrict Hon Hai's revenue growth over the next few years.

This report does not constitute a rating action.

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