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Hon Hai (2317.TW): Rising AI server on new platform ramp up; TP up to NT$227; Buy

Allen Chang
+852-2978-2930 | allen.k.chang@gs.com
Goldman Sachs (Asia) L.L.C.

Verena Jeng
+852-2978-1681 | verena.jeng@gs.com
Goldman Sachs (Asia) L.L.C.

Ting Song
+852-2978-6466 | ting.song@gs.com
Goldman Sachs (Asia) L.L.C.

We are positive on Hon Hai and further raise our target price for the company's shares to NT$227 (vs. previously at NT$201), reflecting the AI servers ramp up ahead. We see Hon Hai as well-positioned in the upcoming rack-level AI servers, given **(1) total solution:** computing tray, switch tray, liquid cooling, rack-level total solution, **(2) global manufacturing**, which is not only establishing production sites globally but strong capability in managing global supply chain, inventory, logistics, labour, etc. The company also has production site in the US (FII Wisconsin visits), and **(3) strong balance sheet**, supporting the company's build of high-price rack-level AI servers. Hon Hai is in a net cash position at US$11.3bn as of 2023. Moreover, Hon Hai's large scale underpins its strong bargaining position in the supply chain, as well as its long experience serving global-tier brand makers across various technology products. We expect Hon Hai's AI server revenue contribution to reach 10%/ 24%/ 28% in 2024/ 25/ 26E. Maintain Buy.

2Q24 to see accelerated growth in PC and Servers: Hon Hai's April revenues were better than our estimates, and we expect 2Q24 revenue growth to accelerate to 8% YoY (vs. -9% YoY in 1Q24 due to high base of last year), or YoY growth of 10%/ -6%/ 10% in May/ Jun/ Jul. The better-than-expected Apr revenues were mainly on strong AI server demand, general servers recovery and consumer electronics clients' pull-in—Hon Hai guided YoY and QoQ revenues growth in 2Q24, driven by growth of servers, networking products, and PC.

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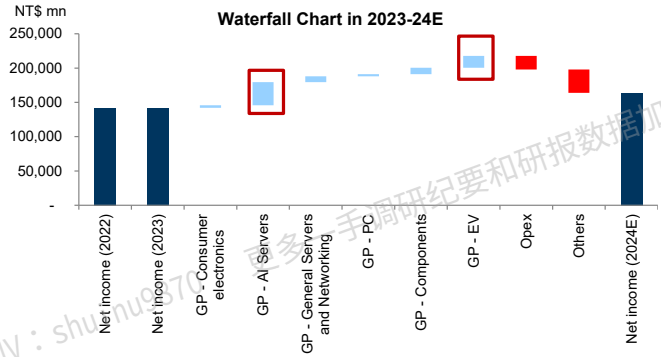
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Exhibit 1: We model Hon Hai May revenue growth at 10% YoY to NT$496bn
Hon Hai monthly revenues

	Feb 2024	Mar 2024	Apr 2024	May 2024E	Jun 2024E	Jul 2024E	1Q24	2Q24E
Revenues (NT$m)	352,481	447,541	510,896	495,798	396,279	516,158	1,323,992	1,402,973
YoY	-12%	12%	19%	10%	-6%	10%	-9%	8%
MoM/QoQ	-32%	27%	14%	-3%	-20%	30%	-29%	6%
GS estimates (NT$m)	377,913	540,845	459,265				1,415,467	
Actual vs. GS	-7%	-17%	11%				-6%	

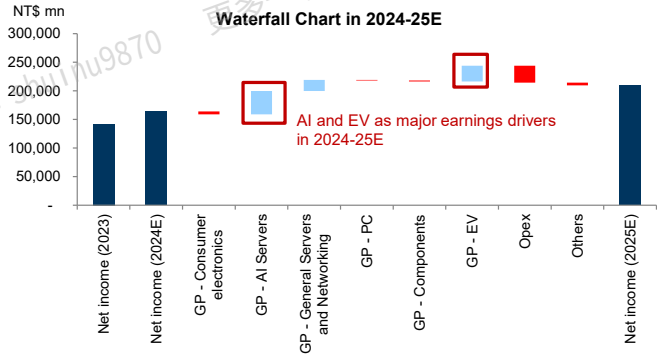
Source: Company data, Goldman Sachs Global Investment Research

Exhibit 2: Hon Hai waterfall chart in 2023-24E



Source: Company data, Goldman Sachs Global Investment Research

Exhibit 3: AI server and EV as key earnings driver
Hon Hai waterfall chart in 2024-25E



Source: Company data, Goldman Sachs Global Investment Research

Earnings revision: We revised up our Hon Hai earnings by 1%/ 2%/ 1%/ 0% in 2024-27E mainly on higher revenues driven by rack-level AI servers ramp up, while we lowered our GM by 2025-27E by 0.3ppts/ 0.2ppts/ 0.2ppts due to diluted GM on higher cost of GPUs.

Exhibit 4: Hon Hai earnings revision

	2024E			2025E			2026E			2027E		
NT m	Old	New	Chg	Old	New	Chg	Old	New	Chg	Old	New	Chg
Revenues	6,842,199	6,842,135	0%	7,879,477	8,328,644	6%	8,620,158	9,072,004	5%	8,934,018	9,385,863	5%
GP	453,327	456,815	1%	524,112	533,138	2%	581,588	588,730	1%	608,065	615,077	1%
OP	212,731	215,566	1%	257,326	262,099	2%	322,983	325,642	1%	363,273	368,041	1%
Net income	161,642	163,893	1%	205,783	209,572	2%	238,945	240,455	1%	264,518	265,703	0%
Margins												
GM	6.6%	6.7%		6.7%	6.4%		6.7%	6.5%		6.8%	6.6%	
OPM	3.1%	3.2%		3.3%	3.1%		3.7%	3.6%		4.1%	3.9%	
NM	2.4%	2.4%		2.6%	2.5%		2.8%	2.7%		3.0%	2.8%	

Source: Company data, Goldman Sachs Global Investment Research

GS estimates vs. consensus: Compared to Bloomberg consensus, our net income is 7%/ 7% higher in 2024/ 25E mainly on higher revenues, reflecting our positive view on Hon Hai's AI server business ramp up and leading position in consumer electronics, supported by its global footprint and strong execution. Our GM estimate for 2024E is higher than consensus by 0.3ppts, which reflects our positive view on company's product mix upgrade towards high margin products.

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Exhibit 5: GS vs. Bloomberg consensus

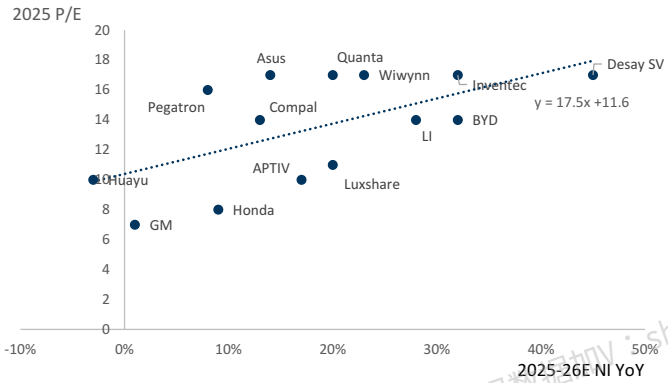
	2024E			2025E		
NT m	GS	BB	Diff %	GS	BB	Diff %
Revenues	6,842,135	6,547,000	5%	8,328,644	7,862,000	6%
GP	456,815	419,008	9%	533,138	500,809	6%
OP	215,566	192,087	12%	262,099	238,443	10%
Net income	163,893	153,837	7%	209,572	195,260	7%
Margins						
GM	6.7%	6.4%		6.4%	6.4%	
OPM	3.2%	2.9%		3.1%	3.0%	
NM	2.4%	2.3%		2.5%	2.5%	

Source: Goldman Sachs Global Investment Research, Bloomberg

Valuation: We continue to use near-term PE to derive our target price and use 2025E EPS. Our target PE multiple is updated to 15.3x from 13.8x, which is set in line with the regression of peers' 2025E P/E vs. 2025-26E earnings growth (Exhibit 6). We updated the comparables group with more of a focus on AI server peers (Inventec, Wiwynn) to reflect Hon Hai's growing exposure to AI servers in coming years. The higher target multiple reflects company's PE re-rating driven by AI server strong ramp up. Our new target price is thus at NT$227 (vs. previously at NT$201).

The target PE multiple of 15.3x is in line with company's recent trading range at 14-16x, and the PE to 2025-26E avg. NI YoY at 21% and 2025-26E avg. OPM at 3.4% ratio is at 0.6x, which is also consistent with its peers at 0.5-0.9x. Maintain Buy.

Exhibit 6: Hon Hai peers valuation scatter chart (2025 P/E vs. 2025-26E NI YoY)



Source: Company data, Goldman Sachs Global Investment Research

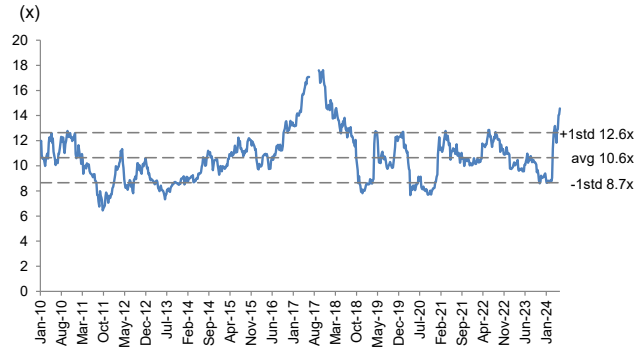
Exhibit 7: Hon Hai TP implied 2025E PE vs. 2025-26E earnings growth and OPM

Company	FII	Hon Hai	Luxshare	Quanta	Inventec	Wiwynn
Ticker	601138.SS	2317.TW	002475.SZ	2382.TW	2356.TW	6669.TW
Rating	Buy	Buy	Buy	Buy	Neutral	Buy
TP (lcy)	36.54	227.00	42.16	383.00	68.50	3,483.00
2025-26E NI YoY	25%	21%	32%	20%	33%	28%
2025-26E OPM	5%	3%	7%	4%	2%	6%
TP implied 2025E P/E	16	15.3	20	22	21	21
TP Implied PEG & M	**0.5**	**0.6**	**0.5**	**0.9**	**0.6**	**0.6**

Source: Company data, Goldman Sachs Global Investment Research

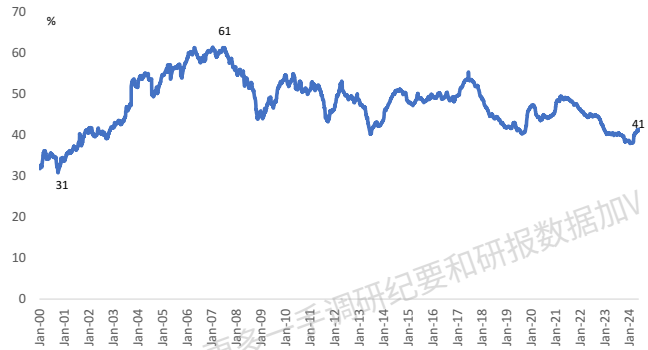
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Exhibit 8: Hon Hai 12M forward P/E



Source: Company data, Goldman Sachs Global Investment Research, Bloomberg

Exhibit 9: Hon Hai QFII holdings



Source: TEJ

Exhibit 10: Hon Hai P&L summary

Hon Hai (2317.TW) NTD bn	2020	2021	2022	2023	2024E	2025E	2026E	2027E	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24E	3Q24E	4Q24E
P&L																
Revenue	**5,358**	**5,994**	**6,627**	**6,162**	**6,842**	**8,329**	**9,072**	**9,386**	**1,462**	**1,305**	**1,543**	**1,852**	**1,324**	**1,403**	**1,908**	**2,208**
COGS	(5,055)	(5,632)	(6,227)	(5,774)	(6,385)	(7,796)	(8,483)	(8,771)	(1,374)	(1,221)	(1,440)	(1,739)	(1,240)	(1,318)	(1,771)	(2,056)
Gross profit	**303**	**362**	**400**	**388**	**457**	**533**	**589**	**615**	**88**	**84**	**103**	**113**	**84**	**85**	**136**	**152**
Operating expense	(192)	(213)	(226)	(221)	(241)	(271)	(263)	(247)	(48)	(53)	(57)	(64)	(47)	(50)	(67)	(77)
EBITDA	**176**	**224**	**250**	**251**	**306**	**360**	**426**	**472**	**60**	**52**	**69**	**70**	**59**	**57**	**92**	**98**
D&A	(65)	(75)	(76)	(84)	(90)	(98)	(101)	(104)	(20)	(21)	(22)	(21)	(23)	(23)	(23)	(23)
EBIT	**111**	**149**	**174**	**167**	**216**	**262**	**326**	**368**	**41**	**31**	**46**	**49**	**37**	**35**	**69**	**75**
Net interest income/(expense)	8	10	9	16	19	21	(1)	(12)	2	6	3	5	5	5	5	5
Disposal of assets (pre-tax)	(0)	4	4	15	0	0	0	0	0	8	1	6	0	0	0	0
Others	27	30	1	(5)	(9)	0	(0)	0	(22)	3	7	7	(9)	0	0	(0)
Pretax profit	**145**	**194**	**188**	**192**	**226**	**283**	**324**	**356**	**20**	**48**	**57**	**67**	**33**	**39**	**74**	**80**
Income tax	(31)	(40)	(36)	(37)	(46)	(58)	(69)	(76)	(7)	(12)	(10)	(9)	(7)	(8)	(15)	(16)
Minorities	(13)	(15)	(10)	(13)	(15)	(15)	(15)	(15)	(1)	(2)	(4)	(5)	(4)	(4)	(4)	(4)
Net income	**102**	**139**	**141**	**142**	**164**	**210**	**240**	**266**	**13**	**33**	**43**	**53**	**22**	**27**	**55**	**60**
EPS (NTD)	7.27	9.90	10.04	10.07	11.62	14.86	17.05	18.84	0.92	2.36	3.07	3.73	1.56	1.94	3.90	4.22
DPS (NTD)	3.96	5.12	5.22	5.31	6.12	7.83	8.98	9.92	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Dividend payout ratio	54%	52%	52%	53%	53%	53%	53%	53%	0%	0%	0%	0%	0%	0%	0%	0%
Growth & margins																
Revenue growth	0%	12%	11%	-7%	11%	22%	9%	3%	4%	-14%	-12%	-6%	-9%	8%	24%	19%
EBITDA growth	-3%	28%	11%	0%	22%	18%	18%	11%	11%	-23%	9%	7%	-1%	10%	34%	39%
EBIT growth	-4%	34%	17%	-4%	29%	22%	24%	13%	11%	-30%	-5%	11%	-9%	12%	50%	53%
Net income growth	-12%	37%	2%	0%	15%	28%	15%	11%	-56%	-1%	11%	33%	72%	-17%	27%	12%
EPS growth	-12%	36%	1%	0%	15%	28%	15%	11%	-56%	0%	11%	31%	70%	-18%	27%	13%
Gross margin	5.7%	6.0%	6.0%	6.3%	6.7%	6.4%	6.5%	6.6%	6.0%	6.4%	6.7%	6.1%	6.3%	6.1%	7.1%	6.9%
EBITDA margin	3.3%	3.7%	3.8%	4.1%	4.5%	4.3%	4.7%	5.0%	4.1%	4.0%	4.4%	3.8%	4.5%	4.1%	4.8%	4.4%
EBIT margin	2.1%	2.5%	2.6%	2.7%	3.2%	3.1%	3.6%	3.9%	2.8%	2.4%	3.0%	2.6%	2.8%	2.5%	3.6%	3.4%

Source: Company data, Goldman Sachs Global Investment Research

Price Target Risks and Methodology – Hon Hai

Valuation methodology: Our 12m target price of NT$227 is based on a 15.3x 2025E P/E multiple, which is set in line with the regression of peers' P/E vs. forward year earnings growth, and is also consistent with Hon Hai's avg. +1std P/E since 2010.

Key risks: Slower-than-expected ramp-up of the EV business; higher-than-expected opex ratio; weaker-than-expected technology products EMS; weaker-than-expected EV total solution performance across EV assembly, design, software and semis; a slower-than-expected ramp-up of EV capacity globally; and varying work-life culture and labor unions across its global workforce.

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2317.TW	12m Price Target: **NT$227.00**	Price: **NT$185.50**	Upside: **22.4%**

Buy

Market cap: NT$2.6tr / $80.8bn
Enterprise value: NT$2.5tr / $78.2bn
3m ADTV: NT$18.9bn / $588.8mn
Taiwan
Greater China Technology
M&A Rank: 3
Leases incl. in net debt & EV?: No

GS Forecast

	12/23	12/24E	12/25E	12/26E
Revenue (NT$ mn) New	**6,162,221.4**	**6,842,134.6**	**8,328,644.2**	**9,072,003.6**
Revenue (NT$ mn) Old	6,162,221.4	6,842,198.9	7,879,477.5	8,620,157.9
EBITDA (NT$ mn)	250,934.3	305,956.0	360,060.7	426,243.9
EPS (NT$) New	**10.07**	**11.62**	**14.86**	**17.05**
EPS (NT$) Old	10.07	11.46	14.59	16.94
P/E (X)	10.4	16.0	12.5	10.9
P/B (X)	1.0	1.7	1.6	1.5
Dividend yield (%)	5.1	3.3	4.2	4.8
CROCI (%)	9.8	14.1	15.3	16.4

	3/24	6/24E	9/24E	12/24E
EPS (NT$)	1.56	1.94	3.90	4.22

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 28 May 2024 close.

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Growth is based on a stock's forward-looking sales growth, EBITDA growth and EPS growth (for financial stocks, only EPS and sales growth), with a higher percentile indicating a higher growth company. **Financial Returns** is based on a stock's forward-looking ROE, ROCE and CROCI (for financial stocks, only ROE), with a higher percentile indicating a company with higher financial returns. **Multiple** is based on a stock's forward-looking P/E, P/B, price/dividend (P/D), EV/EBITDA, EV/FCF and EV/Debt Adjusted Cash Flow (DACF) (for financial stocks, only P/E, P/B and P/D), with a higher percentile indicating a stock trading at a higher multiple. The **Integrated** percentile is calculated as the average of the Growth percentile, Financial Returns percentile and (100% - Multiple percentile).

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Rating and pricing information

Foxconn Industrial Internet (Buy, Rmb24.12), Hon Hai (Buy, NT$185.50), Inventec (Neutral, NT$56.40), Luxshare (Buy, Rmb31.11), Quanta (Buy, NT$289.50) and Wiwynn (Buy, NT$2,685.00)

The rating(s) for Hon Hai is/are relative to the other companies in its/their coverage universe: AAC, ACM Research, AMEC, ASMPT, AVC, AccoTest, Anji Micro, Anlogic, Arcsoft, Asus, Auras, Awinic, BOE, BYDE, Bestechnic, CFME, CR Micro, Cambricon, China Mobile (HK), China Telecom, China Tower Corp., China Unicom, China United Network Comm, Chinasoft Intl, Compal, Dahua, Desay SV, E Ink, EHang, Empyrean, Eoptolink, Espressif, Etek, Everbright Photonics, Fiberhome, Fositek, Foxconn Industrial Internet, GalaxyCore, Gigabyte, Gigadevice, Glodon Co., Goodix, HG Tech, HTC Corp., Hengtong, Hikvision, Hirain, Hon Hai, Hua Hong, ISoftStone, Innolight, Inventec, JCET, Jingce, KFMI, King Slide, Kingdee, Kingsemi, Kingsoft Office, Largan, Lenovo, Longsys, Luxshare, Maxscend, Montage, NAURA, NSIG, Novosense, O-film, Pegatron, Primarius, Quanta, Ruijie, SG Micro, SICC, SMIC (A), SMIC (H), Sanan, Sangfor, Shennan Circuits, Silan, SinoWealth, StarPower, Sunny Optical, TFC Optical, Thundersoft, Thunisoft, Tongfu, Transsion, USI, Vanchip, Venustech, VeriSilicon, Will Semi, Wistron, Wiwynn, YJ Semitech, YJK, YOFC (A), YOFC (H), Yonyou, ZTE (A), ZTE (H), ZWSOFT, iFlytek

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Goldman Sachs had an investment banking services client relationship during the past 12 months with: Hon Hai (NT$185.50)

Goldman Sachs had a non-investment banking securities-related services client relationship during the past 12 months with: Hon Hai (NT$185.50)

Goldman Sachs had a non-securities services client relationship during the past 12 months with: Hon Hai (NT$185.50)

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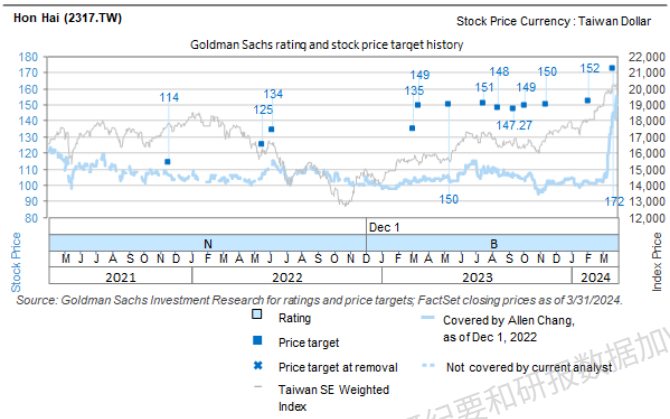
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