Flextronics International
(FLEX)

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Brief Description

- Formed in 1980
- Leading Electronic Manufacturing Services (EMS) providers
- End-to-End solutions provider
- Has operations in 27 countries
- CEO: Michael E. Marks

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Financial Overview

- Sales (ttm): $10,139 billion
- EPS (ttm): $0.83* (pro-forma $0.71)
- P/E (ttm): ~31
- Market Cap: $11,466 billion

* - According to Bloomberg (not pro-forma)

Industry Overview

Electronic Manufacturing Services

= "contract manufacturing" (for electronics)

- The companies that actually manufacture the products when OEMs outsource

- OEMS: Original Equipment Manufacturers i.e. Sony, IBM, Nokia, Microsoft
  - The companies that "create" the products

- Currently, EMS is a **HOT** sector

Industry Trends (1)

- EMS is a booming sector
- As technology companies become more cost conscious, they will stick to what they do best (core competencies):
  - Research & Development
  - Sales & Consulting
- AND cut the costs in the areas they have least expertise:
  - Manufacturing
  - Fulfillment

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Industry Trends (2)

- Outsourcing is quite common in many industries:
  - Laptops/ PCs/ Peripherals
  - Toys (Hasbro doesn't make most of their toys)
  - Apparel
- In the past, most product outsourcing came from relatively "simpler" products (i.e. apparel)
  - "Simple" products can be made in countries where labor is cheaper (LDCs)
- However, more technology companies are continuing to outsource
  - Countries like China, Taiwan, Malaysia and Mexico have greater technology infrastructure and personnel

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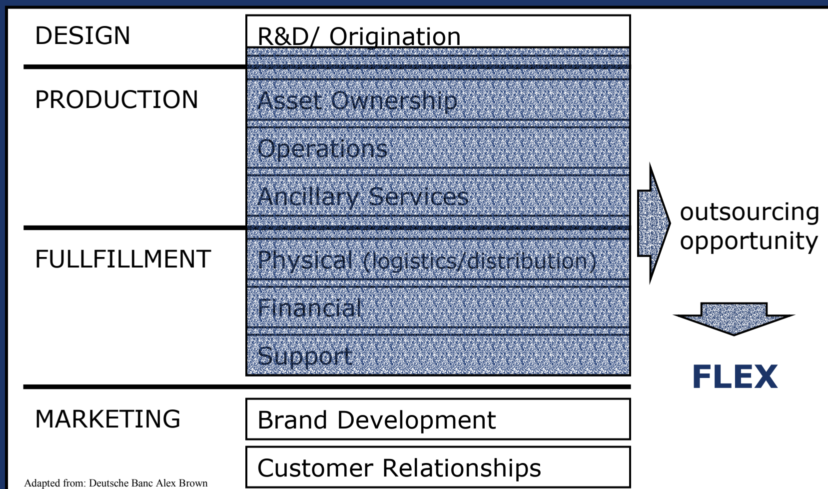
Outsourcing Opportunities



Industry Trends (3)

- Developments in Supply Chain Management:

Vertically Integrated	Disintegrated/ Outsourced	Virtually Integrated
PAST	**PRESENT**	**Future**

- Large OEMs want to outsource to companies that provide:
  - End-to-End solutions (better coordination)
  - Low-Cost Manufacturing capabilities (lower cost)
  - Exposure to fastest-growing end-markets (wider coverage)
  - Sufficient capacity (higher flexibility)

Industry Trends (4)

- Examples:
  - Ericsson announced the outsourcing of 100% of its handset business to Flextronics
  - Nokia plans to outsource 20% of its handset business
  - Motorola and CLS announce $1 billion supply agreement
  - Other companies who have recently announced plans for cost-cutting: Lucent, Microsoft, Sun Microsystems, Dell, Nortel
    - Most likely move: outsource as much production as possible
- Example of success: CISCO
  - 75% of Cost of Goods Sold outsourced
  - Second largest Flextronics customer (10% of revenues)

Company Capabilities

- Capabilities encompass a wide scope
- Divisions:
  - Flextronics Systems Assembly (assembly and manufacturing operations)
  - Multek (PCB and back panel fabrication)
  - Flextronics Enclosures (custom "cases")
  - Flextronics Semiconductors
  - Flextronics Design
    - 40% of revenues incorporate design aspects
  - Flextronics Plastics
  - Flextronics Network Services (installation)
  - Supply Chain Services (procurement, IT solutions)

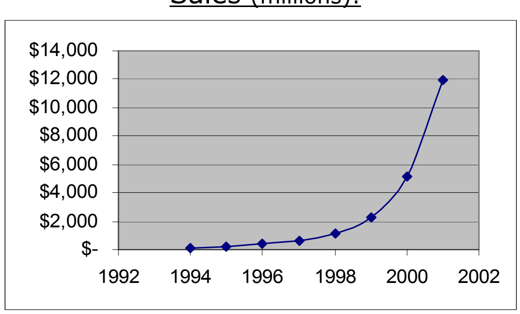
Corporate Clients

- 10 largest clients make up for about 50% of revenues
- Ericsson (10%)
  - Should increase significantly as a result of recent agreement to outsource handset operations
- Cisco (10%)
- Others include: Phillips, Microsoft, Motorola, Siemens, Alcatel, Compaq, Lucent, Nokia

Growth

- Phenomenal sales growth since 1994
- 7-year Sales CAGR: 92.21%!!!
- Consecutive quarter-to-quarter growth (2 exceptions)

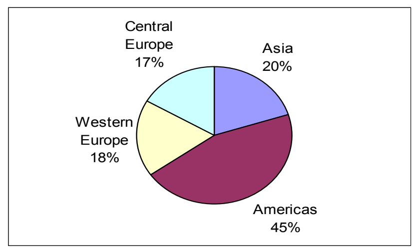
Sales (millions):



Sources of Revenue

- Flex is well-diversified geographically
- Main products:
  - Telecommunications equipment (25%+)
  - Mobile phones
  - Networking equipment (routers, switches)

Sales breakdown by region
(for 9 months ending Dec.2000):



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Opportunities

- Huge industry growth
  - OEMs currently have 0-25% outsourced compared with Cisco's 75%
- Industry growth expected to continue during any economic slowdown in the US
  - Sensitivity to cost structure increases i.e. Ericsson
- Flex is extremely well-positioned within industry
  - Reputation
  - Broad scope
- Recent acquisitions and deals will benefit Flex when economy regains strength
  - Buy low, sell high

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Valuation (1)

- Will not use cashflow model as cashflows from recent years have been fluctuating significantly:
  - Integration costs as a result of acquisitions
  - High capital expenditures
- Will value based on earnings

Valuation (2)

- Expected 5 yr sales growth of 30%
- Net margin should improve to 3.0% (currently 2.8%)
  - Asia is growing as a percentage of sales
- Shares outstanding increases to about 520 million

Net Margins	
Asia	4.858%
Americas	3.336%
Western Europe	1.580%
Central Europe	1.817%

Valuation (3)

- Based on EXTREMELY conservative estimates:

(millions except EPS)	Sales	Net Income	EPS	Shares Out.
FY 2001	$ 11,911	$ 357	$ 0.74	480
FY 2002	$ 15,484	$ 465	$ 0.93	500
FY 2003	$ 20,130	$ 604	$ 1.16	520
FY 2004	$ 26,168	$ 785	$ 1.51	520
FY 2005	$ 34,019	$ 1,021	$ 1.96	520

P/E	15	20	25	30	35	40
FY 2001	$ 11.26	$ 15.01	$ 18.77	$ 22.52	$ 26.27	$ 30.03
FY 2002	$ 14.05	$ 18.74	$ 23.42	$ 28.11	$ 32.79	$ 37.47
FY 2003	$ 17.57	$ 23.42	$ 29.28	$ 35.13	$ 40.99	$ 46.84
FY 2004	$ 22.84	$ 30.45	$ 38.06	$ 45.67	$ 53.28	$ 60.90
FY 2005	$ 29.69	$ 39.58	$ 49.48	$ 59.37	$ 69.27	$ 79.16

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Valuation (4)

P/E	15	20	25	30	35	40
FY 2001	$ 11.26	$ 15.01	$ 18.77	$ 22.52	$ 26.27	$ 30.03
FY 2002	$ 14.05	$ 18.74	$ 23.42	$ 28.11	$ 32.79	$ 37.47
FY 2003	$ 17.57	$ 23.42	$ 29.28	$ 35.13	$ 40.99	$ 46.84
FY 2004	$ 22.84	$ 30.45	$ 38.06	$ 45.67	$ 53.28	$ 60.90
FY 2005	$ 29.69	$ 39.58	$ 49.48	$ 59.37	$ 69.27	$ 79.16

- Price range should be between $18.77 to $30.03 during fiscal 2001 (ends March 31st 2001)
- Assumes that mid-large companies are generally given a P/E between 25-40 for 30% 5-year growth

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Valuation (5)

- However, don't forget about the market
- IBES:
  - 5 yr growth rate: 46.49%
- Zacks:
  - FY 2001 EPS: $0.92
  - FY 2002 EPS: $1.25
    - This compares with my estimates of $0.75 and $0.94 respectively
    - Discrepancy arises from:
      - Various M&A activity resulting in pro-forma statements (I used non-proforma statements provided by Edgar and Bloomberg)
      - Reporting discrepencies
- Wall Street:
  - Price Targets from $48-$55 in next 12 months
  - 22 STRONG BUYS, 1 Hold

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Valuation (6)

P/E	15	20	25	30	35	40
FY 2001	$ 13.80	$ 18.40	$ 23.00	$ 27.60	$ 32.20	$ 36.80
FY 2002	$ 18.75	$ 25.00	$ 31.25	$ 37.50	$ 43.75	$ 50.00
FY 2003	$ 23.44	$ 31.25	$ 39.06	$ 46.88	$ 54.69	$ 62.50
FY 2004	$ 29.30	$ 39.06	$ 48.83	$ 58.59	$ 68.36	$ 78.13
FY 2005	$ 36.62	$ 48.83	$ 61.04	$ 73.24	$ 85.45	$ 97.66

- P/E Range during 2000:
  - Hi – 85.75
  - Lo – 29.48
- Using my estimate of EPS $0.74, P/E of 35: $26.27
- Using estimate of EPS $0.92, P/E of 35: $32.20

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Recommendation

- LT STRONG BUY
- ST BUY under $26
- ST STRONG BUY under $22
- Minimum expected return (over 12 months):
  - ($32 - $26)/$26 = 23%
- Today's Closing: $26 $^{11}/_{16}$
- HOWEVER, I would recommend a BUY now since market is shifting towards profitable companies which do well in a bad economy = Flextronics International

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Key Concerns/Risks

- FLEX's ability to attract new clients
- Depression in stock price
- Low net margins
- Unstable and negative operating cashflows during these past 2 years

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