Flextronics International (FLEX)

Presented by:
Chris Lau

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
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

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
### Outsourcing Opportunities

<table>
<thead>
<tr>
<th>DESIGN</th>
<th>R&amp;D/ Origination</th>
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<tbody>
<tr>
<td>PRODUCTION</td>
<td>Asset Ownership</td>
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<tr>
<td></td>
<td>Operations</td>
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<td></td>
<td>Ancillary Services</td>
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<tr>
<td>FULLFILLMENT</td>
<td>Physical (logistics/distribution)</td>
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<td></td>
<td>Financial</td>
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<td></td>
<td>Support</td>
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<tr>
<td>MARKETING</td>
<td>Brand Development</td>
</tr>
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<td></td>
<td>Customer Relationships</td>
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</table>

Adapted from: Deutsche Banc Alex Brown

### Industry Trends (3)

- Developments in Supply Chain Management:
  - Vertically Integrated
  - Disintegrated/Outsourced
  - Virtually Integrated

- 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: Philips, 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):

![Pie chart showing revenue distribution by region.]

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
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

<table>
<thead>
<tr>
<th>Region</th>
<th>Net Margin</th>
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<tbody>
<tr>
<td>Asia</td>
<td>4.858%</td>
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<tr>
<td>Americas</td>
<td>3.336%</td>
</tr>
<tr>
<td>Western Europe</td>
<td>1.580%</td>
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<tr>
<td>Central Europe</td>
<td>1.817%</td>
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</table>
Valuation (3)

Based on EXTREMELY conservative estimates:

<table>
<thead>
<tr>
<th>FY</th>
<th>Sales (millions)</th>
<th>Net Income (millions)</th>
<th>EPS</th>
<th>Shares Outstanding</th>
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<tbody>
<tr>
<td>2001</td>
<td>$11,911</td>
<td>$357</td>
<td>$0.74</td>
<td>480</td>
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<td>2002</td>
<td>$15,484</td>
<td>$465</td>
<td>$0.93</td>
<td>500</td>
</tr>
<tr>
<td>2003</td>
<td>$20,130</td>
<td>$604</td>
<td>$1.16</td>
<td>520</td>
</tr>
<tr>
<td>2004</td>
<td>$26,168</td>
<td>$785</td>
<td>$1.51</td>
<td>520</td>
</tr>
<tr>
<td>2005</td>
<td>$34,019</td>
<td>$1,021</td>
<td>$1.96</td>
<td>520</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>P/E</th>
<th>15</th>
<th>20</th>
<th>25</th>
<th>30</th>
<th>35</th>
<th>40</th>
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</thead>
<tbody>
<tr>
<td>FY 2001</td>
<td>$11.26</td>
<td>$18.77</td>
<td>$22.52</td>
<td>$26.27</td>
<td>$30.03</td>
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<tr>
<td>FY 2002</td>
<td>$14.05</td>
<td>$23.42</td>
<td>$28.11</td>
<td>$32.79</td>
<td>$37.47</td>
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<tr>
<td>FY 2003</td>
<td>$17.57</td>
<td>$29.28</td>
<td>$35.13</td>
<td>$40.99</td>
<td>$46.84</td>
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<tr>
<td>FY 2004</td>
<td>$22.84</td>
<td>$38.00</td>
<td>$45.67</td>
<td>$53.28</td>
<td>$60.90</td>
<td></td>
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<tr>
<td>FY 2005</td>
<td>$29.69</td>
<td>$49.48</td>
<td>$59.37</td>
<td>$69.27</td>
<td>$79.16</td>
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</table>

Valuation (4)

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
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 discrepancies
- Wall Street:
  - Price Targets from $48-$55 in next 12 months
  - 22 STRONG BUYS, 1 Hold

Valuation (6)

- 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
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

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