

Flextronics International Ltd.

FLEX: NasdaqGS

Analyst: Peter Ostrowski
Sector: Information Technology

BUY

Price Target: \$16.01

Key Statistics as of 12/3/2015

Market Price: \$11.26
Industry: Software
Market Cap: \$6.2B
52-Week Range: \$9.55-12.86
Beta: .67

Thesis Points:

- Acquisition of Wink will give Flex a strategic position for the upcoming Internet of Things
- Capital Allocation will Continue to Create Shareholder Value
- Partnership with Nike

Company Description:

Flextronics International Ltd. provides electronics manufacturing services. The Company's customers include original equipment manufacturers in the telecommunications, networking, computer, consumer electronics, and medical device industries.



Thesis

Flextronics is currently the 2nd largest producer of electronics manufacturing systems. This is a shrinking industry as revenues have slowly been decreasing since 2011; so innovation is key to future growth and success. Flextronics is working towards becoming a big player in the Internet of Things through solutions and sales of sensors. The acquisition of Wink will be strategic for the expansion into the Internet of Things. It is also important to note that focus on capital allocation as well as a recent partnership with Nike will help create long term shareholder value.

Industry Outlook

The Internet of Things is happening and it is important to understand the magnitude and potential effects on the future market that exist. The increase of machine to machine devices is only part of the equation. Sensors are going to be incorporated in order to gather the data that will exist and make these machines more intelligent. The amount of data that will exist because of the Internet of Things is enormous. Cisco estimates there will be 50 billion connected devices by 2020. The technology sector must adapt accordingly to take advantage of this opportunity.

The Internet of Things will ultimately make the marketplace faster which will increase efficiency substantially through innovation. These devices will be able to pick up on trends and stop problems before they even occur. The goal is for everything to be connected to the internet. This brings up the potential for smart cities. Through the Internet of Things; devices and sensors will be able to do more than ever imagined. This includes smart traffic control which is exactly what it sounds like. Traffic lights will be able to detect when accidents occur transmit the data to a processor which will immediately be sent to people's GPS's and reroute them around the accident. Other problems that the Internet of Things will be able to pick up on include air pollution levels, forest fires, electromagnetic levels, water leakages and even item location. In the future if someone misplaces their keys and these keys are connected to the IoT; one can simply ask google where they are. That's innovation. Imagine the amount of time that will be saved.

The forecasts for Internet of Things are just as big as the hype. Janus Bryzek who is a VP at Fairchild semiconductor and known as "the father of sensors"; estimates that the Internet of Things will be responsible for the largest growth in the history of humans. GE even estimates that the IoT has the potential to add \$10 to \$15 trillion to global GDP over the next 20 years. Cisco believes that there will be \$19 trillion of economic value created by 2020.

This potential trillion dollar market is impossible to overlook as IoT product and service suppliers as projected to generate incremental revenue of over \$300 Billion in 2020. The amount of devices will continue to increase at exponential rates.

Wink Acquisition

Wink is a smart home platform that enables smart products to work together, and connect and communicate globally. This acquisition will drive Flextronics to become a top player in the Internet of Things. Flextronics already acted as a partner for Wink as their primary supplier.

This acquisition came about after the parent company of Wink filed for bankruptcy in September. This allowed Flextronics to acquire Wink at a discount of \$15 million.

Flextronics prides themselves in their Sketch to Scale platform. This platform allows customers to purchase solutions specifically tailored to their needs. This includes solutions which are not readily available. Flextronics has the capabilities to develop technologies to each specific need. The acquisition of Wink will improve Flex's ability to design and build devices with integrated connected intelligence. This will also provide customers to very intelligent cloud-based home automation platform. This acquisition will ultimately help Flex achieve their mission of making the smart home available to everyone.

Capital Allocation

In Flextronics most recent earnings call Flextronics announced that they will continue capital allocation to create shareholder value with a long-term commitment. This is directly correlated with their objective of returning over 50% of free cash flow to shareholder returns. Higher margins as well as mergers and acquisitions have also been noted in the past year and continue to generate value for the company.

Margins						
Gross Margin	5.43	5.57	5.17	5.86	5.74	5.91
EBITDA Margin	4.37	4.15	3.79	3.76	3.77	4.62
Operating Margin	1.43	2.49	2.01	1.36	1.99	2.56
Incremental Operating Margin	--	8.32	--	-4.69	7.88	378.95
Pretax Margin	-0.07	2.21	1.96	1.40	1.53	2.56
Income before XD Margin	0.08	2.13	1.77	1.28	1.40	2.30
Net Income Margin	0.08	2.09	1.67	1.18	1.40	2.30
Net Income to Common Margin	0.08	2.09	1.67	1.18	1.40	2.30

With decreasing revenues due to the current market for OEM Flex has been able to cut costs faster in order to boost margins which is shown especially with the EBITDA margin growth year over year.

By allocating funds into various projects; Flex has been able to increase profitability as a result which is shown below.

In Millions of USD except Per Share	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
12 Months Ending	03/31/2010	03/31/2011	03/31/2012	03/31/2013	03/31/2014	03/31/2015
Returns						
Return on Common Equity	0.97	27.87	21.35	12.23	16.58	26.56
Return on Assets	0.17	5.35	4.31	2.56	3.17	4.97
Return on Capital	2.65	15.28	11.60	7.48	9.80	15.24
Return on Invested Capital	5.63	15.69	11.91	6.81	11.48	14.33

Partnership with Nike

Nike and Flex recently partnered to boost innovation. Flex will now be Nike's manufacturing partner for the future. Flex has the ability to provide solutions which will increase product efficiency and bring products to customers at a much faster pace. This also grants Nike the possibility of bringing their products to the Internet of Things. This partnership is very strategic for both parties as Flex will be able to immediately boost revenues with an opportunity for an increased share of the Internet of Things market when it really begins to take off within the next 5 years.

Competitive Advantage

Flex's main competitors for the Electronic Manufacturing services industry include Avnet and Jabil Circuit. Jabil's main source of revenue and value is based on Apple's success as they are Apple's supplier for the iPhone casings. Jabil currently does work with other large name companies; however they do not have contracts with these companies and base their future growth on speculation that Apple will continue to use Jabil as their supplier. Jabil has not shown any signs of expanding into the Internet of Things which leaves a big piece of the market open for Flex.

Avnet also provides solutions but is not expanding into the IoT market at the moment. The problem with these companies avoiding this market opportunity is that technology becomes cheaper every year which is demonstrated in decreasing revenues as the competition increases which drives prices down. Innovation is Flex's competitive advantage and this innovation will be demonstrated through inorganic and organic growth allowing Flex to become a conglomerate with a large growth and market opportunity.

Companies are going to have to work together to fully conquer the Internet of Things and get it installed in devices around the world.

Conclusion

I recommend a buy on Flextronics. This is due to the extensive market opportunity that exists in the Internet of Things. The macroeconomic factors demonstrate significant growth potential for companies that are attempting to capitalize on this market. As Flextronics is more than capable of becoming one of the big players for the Internet of Things; it is a no brainer that this stock has a bullish future.

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Flextronics International Ltd.		Analyst Peter Ostrowski	Current Price \$11.33	Intrinsic Value \$14.58	Target Value \$16.01	Dividend Yield 0%	1-y Return: 41.31%	BULLISH	
General Info		Peers	Market Cap.	Management					
Sector	Information Technology	Jabil Circuit Inc.	\$4,907.86	Professional		Title			
Industry	Electronic Equipment, Instruments and Components	Avnet, Inc.	\$6,020.87	McNamara, Michael		Comp. FY2013	Comp. FY2014	Comp. FY2015	
Last Guidance	October 19, 2015	Samsara Corporation	\$1,760.97	Collier, Christopher		\$1,546,774	\$3,524,715	\$4,808,322	
Next earnings date	January 27, 2016	Plexus Corp.	\$1,253.58	Barbier, Francois		\$3,467,779	\$5,207,806	\$4,543,076	
Market Data		Benchmark Electronics Inc. \$1,083.89		Hoak, Jonathan		\$1,628,908	\$2,308,449	\$2,225,181	
Enterprise value	\$7,497.61			Humphries, Paul		\$3,007,380	\$4,816,539	\$4,535,985	
Market Capitalization	\$6,302.94			Bennett, David		\$0	\$0	\$0	
Daily volume	3.25			Past Earning Surprises					
Shares outstanding	556.31			Revenue		EBITDA	Norm. EPS	Standard Error of "Surprise"	
Diluted shares outstanding	578.91			Last Quarter		2.43%	8.00%	2.00%	
% shares held by institutions	84.08%			Last Quarter-1		-5.47%	-9.10%	2.64%	
% shares held by insiders	0.58%			Last Quarter-2		-4.89%	4.39%	3.84%	
Short interest	1.23%			Last Quarter-3		6.18%	14.45%	2.92%	
Days to cover short interest	1.46			Last Quarter-4		1.57%	10.90%	2.78%	
52 week high	\$12.86			Standard error		2.2%	4.1%	1.86%	
52-week low	\$9.55			Standard Error of Revenues prediction		2.2%			
5y Beta	0.97			Imputed Standard Error of Op. Cost prediction		3.4%			
6-month volatility	24.75%			Imputed Standard Error of Non Op. Cost prediction		NM			
Industry Outlook (Porter's Five Forces)									
Bargaining Power of Suppliers (75th Percentile), Bargaining Power of Customers (100th Percentile), Intensity of Existing Rivalry (67th Percentile), Threat of Substitutes (100th Percentile), Threat of New Competition (83th Percentile), and Overall (92th Percentile).									
Proforma Assumptions									
Convergence Assumptions		General Assumptions		Items' Forecast Assumptions			Other Assumptions		
All base year ratios linearly converge towards the Sub-industry ratios over an explicit period of 10 years		Money market rate (as of today)	0.38%	Base year (LTM)	Convergence period (Sub-industry)	Adjustment per year	Tobin's Q	80%	
		Risk-Free rate (long term estimate)	3.07%	Operating Cash/Rev.	0.00%	0.02%	Excess cash reinvestment	Money market rate	
		Annual increase (decrease) in interest rates	0.1%	NWV/Rev.	1.99%	2.00%	Other claims on the firm's assets	\$0.00	
		Marginal Tax Rate	20.0%	NPPE/Rev.	8.92%	17.94%	Capitalization		
		Country Risk Premium	6.0%	Dpx/NPPE	21.21%	19.33%	100% of all rent expenses are capitalized and amortized 'straightline' over 10 years		
				NOPAT MARGIN	2.55%	4.00%	100% of all R&D expenses are capitalized and amortized 'straightline' over 5 years		
				Op. Exp./Rev.	95.13%	90.00%	E&D expenses are not capitalized		
				SBC/Rev.	0.24%	0.87%	SG&A expenses are not capitalized		
				Rent Exp./Rev.	0.54%	1.00%	Valuation Focus		
				R&D/Rev.	0.00%	6.68%	DCF Valuation		
				E&D/Rev.	0.00%	0.00%	Relative valuation		
				SG&A/Rev.	3.24%	11.57%	Distress Valuation		
				ROIC	19%	14.47%	-0.46%		
				EV/Rev.	0.98x	0.07x	Monte Carlo Simulation Assumptions		
				EV/EBITA	8.42x	9.30x	Revenue Growth deviation		
				Debt/Equity	66%	44%	Normal (0%, 1%)		
				Unlevered beta	1.00	0.01	Operating expense deviation		
				Dividends/REV	0%	2%	Normal (0%, 1%)		
							Continuing Period growth		
							Triangular (5.82%, 6%, 6.18%)		
							Country risk premium		
							Triangular (2.91%, 3%, 3.09%)		
							Intrinsic value σ(e)		
							\$0.03		
							1-year target price σ(e)		
							\$0.04		
Valuation									
Forecast Year	ROIC	WACC	Invested Capital	Implied Enterprise Value	Net Claims on Assets and Dilution Costs	Shares Outstanding	Price per Share	Monte Carlo Simulation Results	
LTM	19.1%	7.9%	\$3,697.76	\$10,986.94	\$2,477.40	556.31	\$14.30		
FY2016	21.3%	8.0%	\$4,414.79	\$11,800.98	\$2,308.35	556.31	\$15.72		
FY2017	20.4%	7.7%	\$5,395.74	\$12,785.82	\$2,220.80	556.31	\$17.18		
FY2018	19.2%	8.1%	\$6,415.99	\$13,800.89	\$2,119.30	556.31	\$18.77		
FY2019	18.4%	8.4%	\$7,486.16	\$14,848.04	\$1,987.23	556.31	\$20.49		
FY2020	17.8%	8.6%	\$8,610.70	\$15,926.02	\$1,824.11	556.31	\$22.35		
FY2021	17.3%	8.9%	\$9,793.48	\$17,034.12	\$1,629.05	556.31	\$24.36		
FY2022	16.9%	9.1%	\$11,037.97	\$18,171.61	\$1,400.36	556.31	\$26.53		
FY2023	16.6%	9.3%	\$12,347.41	\$19,337.64	\$1,135.89	556.31	\$28.87		
FY2024	16.4%	9.5%	\$13,724.93	\$20,531.08	\$833.11	556.31	\$31.41		
FY2025	16.2%	9.7%	\$15,173.65	\$21,750.56	\$489.23	556.31	\$33.59		
Continuing Period	14.5%	9.8%	\$9,201.35						
Sensitivity Analysis									
Revenue growth variations account for 95.9% of total variance									
Risk premium's variations account for 2.5% of total variance									
Operating expenses' variations account for 1.4% of total variance									
Continuing period growth variations account for 0.2% of total variance									