Jabil Circuit Inc.

JBL: NYSE

Analyst: Peter Ostrowski
Sector: Information Technology

BUY

Price Target: $27.21

Key Statistics as of 11/17/2015

Market Price:	$23.98
Industry:	Hardware
Market Cap:	$4.5B
52-Week Range:	$16.9-$24.95
Beta:	1.13

Thesis Points:

- Parts supplier for Apple
- Strategic Acquisitions Combined with Organic Investment
- Financials- Increasing margins and Value Creation

Company Description:

Jabil Circuit, Inc. is an electronic manufacturing services provider for international electronics companies in the communications, personal computer, peripheral, consumer, and automotive markets. The Company offers circuit design, board design from schematic, prototype assembly, volume board assembly, system assembly, repair, and warranty services.

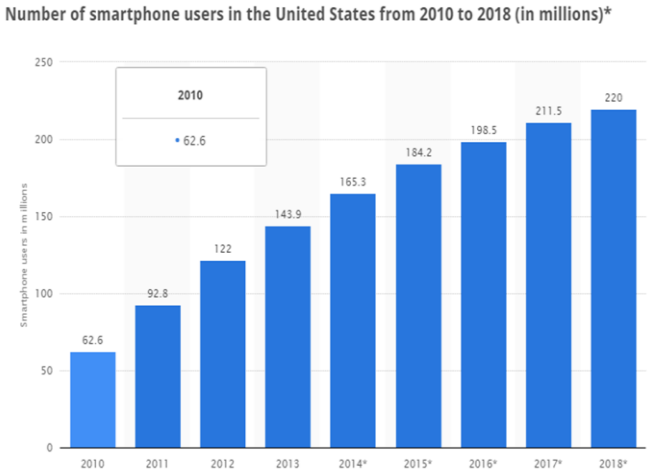
Thesis

Jabil is currently the 3rd largest producer of electronic components in the world. They currently are Apple's supplier for the iPhone casings which has led to substantial growth over the past five years. Apple's success with iPhones has directly translated to Jabil's. Jabil is extremely diversified in their product line ranging from packaging solutions to automobile technologies. This has allowed them to have stability in a volatile market. Jabil have acquired strategic companies to expand the market base of their products while simultaneously increasing investments in key areas to add organic growth to the company.

Macroeconomic Environment

The general macroeconomic environment for the technology sector is unpredictable and volatile. It is important for companies to have a strong customer pipeline as well as a diversified product line. Being a success in multiple sectors can give a company some security and stability.

Jabil is currently Apple's part supplier. The diversity of their product line ranges from industrial, automotive and packaging to the Internet of Things. These markets are emerging and show growth potential that Jabil can capitalize on.



The graph above shows that there will continue to be an increasing number of smartphone users until 2018. This number does not include individuals who upgrade their phones on a yearly basis. The demand for the newest and most attractive items is on part of basic human fundamentals. This is demonstrated in the recent success of the iPhone 6 and 6s. These two phones annihilated expectations as they sold 10 million units in first three days. Analysts' projections of demand for iPhone 6s were conservative and warned of lower numbers. This was completely false as shown. The iPhone 7 is not set to come out until September of 2016; however, Jabil and Apple must start preparing now for further growth in demand.

The automotive industry is rapidly changing and markets are emerging in demand for optics, wireless and electrification of the power train. The industry is quickly moving towards the Internet of Things where machines will be able to share data directly to other machines. This is a huge market that has yet to be capitalized on.

Parts Supplier for Apple

It's impossible to discuss Jabil without Apple. Apple is Jabil's biggest customer as it has contributed to 24% of Jabil's revenue in 2015 compared to 18% in 2014. This revenue boost is largely due to the success of the iPhone 6 and 6s as previously discussed.

Jabil makes the casings for iPhones and has been extremely successful this past quarter because of it. Jabil's Diversified Manufacturing Services segment grew 47% year over year to $1.92 Billion. This sector accounts for almost half of Jabil's revenue for the year. As successful as Apple has been for Jabil it is important to understand Jabil's other growth opportunities.

Although there is no written contract between Apple and Jabil; Jabil still has a competitive advantage in its industry due to the high cost of switching suppliers along with the high opportunity costs and potential risks Apple would face.

Acquisitions

Jabil's company Nypro Packaging aids companies such as Proctor and Gamble and Coca Cola in manufacturing and production solutions. These solutions include conventional packaging, hybrid packaging, active packaging, and intelligent packaging. Essentially these packaging solutions make this part of their customer's business more efficient. This is due to enhanced

capabilities that allow manufacturing companies to decrease costs, waiting times and increase production. This allows customers to distribute goods such as foods more effectively. If the product arrives at the grocery store damaged or spoiled no revenue can be made. Investing in smart packaging volumes can increase as well as decreased liability on the distribution channel. This ultimately makes consumers want to buy these products as the company was willing to invest more into the success of it.

Nypro Packaging has recently acquired Plasticos Castella for $110M. This company is headquartered in Spain with operations in Hungary as well. Plasticos Castella has been operating for 40 years as a successful manufacturer of high-volume plastic containers and packaging for food and beverage name brands.
This acquisition gives Nypro packaging a strong growth platform. This is due to the vast market expansion opportunities that exist in Europe.

Investments

Jabil prides itself on continued investments back into the company. The inorganic growth they receive from investments combined with their acquisition is the key to long-term growth as well as capital gains.

Fiscal 2016 Anticipated Capital Investments

Area of Investment	
Capacity / Infrastructure	$250M
DMS – Mobility	$150M
DMS – Nypro	$100M
DMS – Other	$200M
EMS	$150M
Capabilities	$50M

Investing in the infrastructure of Jabil is key. The point of this is to over time increase the volume of sales by increasing the size of current operations. This is due to the growing demand of current products and the future macroeconomic outlook. By producing more Jabil will be able to continue to operate at a high level.

Increasing investments in diversified manufacturing systems is essential due to the increasing sales shown

in 2015 as well as the expansion to Europe. With Apple reporting record sales on the iPhone 6; Jabil will have to prepare for the upcoming release of the iPhone 7 next September. This is the reasoning for the $150M investment into DMS-mobility.

The investment into Nypro is due to the acquisition of Plasticos Castella. The expansion into the European markets will require additional capital to get the business up and running.

Jabil also plans to invest in capabilities. These capabilities are the actions that the automotive sector products do. The latest investment in this area is in innovative technologies. These include optics, wireless and electrification of the power train. They offer data solutions in automotive design as well. These solutions primarily deals with battery management, power supply and general efficiency of the car.

Financials

Year over year Jabril has been very impressive. This is due to a revenue increase of 14% as well as an increasing EBITDA from $784.1M to $1.1B. Not only have sales increased; margins have also increased as shown below:

12 Months Ending	08/31/2013	08/31/2014	08/31/2015
Gross Margin	7.03	6.51	8.40
Operating Margin	2.62	1.29	3.10
EBITDA Margin	5.05	4.39	6.06
Profit Margin	2.15	1.53	1.59

Jabil has been able to increase sales while mitigating costs which shows increased efficiency as well as an effective use of resources.

Jabil's current ROIC according to capitalIQ is 20% compared to the WACC which is 8.33%. This shows an ROIC/WACC ratio of 2.33. This means that Jabil is creating value.

Porter's Five Forces

The bargaining power of suppliers is low. This is due to the fact that they have multiple suppliers for each product. This allows them to negotiate for the lowest price among the groups.

The bargaining power of customers is neutral to high. For the DMS sector Jabil has a small amount of customers that make up a large percentage of revenue. This leads to a high bargaining power of customers; however, there is a high cost for companies such as Apple to switch suppliers. In the electrical manufacturing sector Jabil has a large number of customers where the product is important to them.

The intensity of existing rivalry is high. There is constant competition among the industry to keep prices as low as possible. This is due to the large size of the industry.

The threat of new competition is low. This is due to the high cost of switching for customers. Strong brand names are important when selling to big name companies such as Apple, HP and GE. Advanced technologies are also required for the packaging industry as well as the electrical manufacturing sector.

The threat of substitutes is neutral. This is largely due to the diverse product line that Jabil is in. Certain sectors have a relatively large number of substitutes while certain have none.

Conclusion

I recommend a buy for Jabil. This is largely due to their partnership with Apple. Apple has consistently been responsible for the increases in Jabil's revenue due to the success the iPhone continues to bring. Jabil has also been largely investing in other sections of its business as well as acquiring strategic companies to hedge the risk of this dependence on Apple. Expanding the packaging market will increase growth for Jabil as well as increasing their presence in automobile technology. Increasing margins as well as value creation are also a key indicator of future stability.

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Jabil Circuit Inc.	jbl	Analyst	Current Price	Intrinsic Value	Target Value	Divident Yield	1-y Return: 15.06%	NEUTRAL
		Peter Ostrowski	$23.91	$24.22	$27.20	1%		

General Info	
Sector	Information Technology
Industry	lectronic Equipment, Instruments and Componen
Last Guidance	September 24, 2015
Next earnings date	December 17, 2015

Market Data	
Enterprise value	$5,302.11
Market Capitalization	$235.34
Daily volume	0.51
Shares outstanding	189.27
Diluted shares outstanding	196.01
% shares held by institutions	49.63%
% shares held by insiders	9.20%
Short interest	8.17%
Days to cover short interest	5.39
52 week high	$24.95
52-week low	$16.90
5y Beta	1.10
6-month volatility	32.26%

Peers	Market Cap.
Flextronics International Ltd.	$6,202.80
Plexus Corp.	$1,221.41
Sanmina Corporation	$1,871.41
Avnet, Inc.	$5,944.31
Benchmark Electronics Inc.	$1,020.73
KEMET Corp.	$129.55
Kimball Electronics, Inc.	$316.41
TE Connectivity Ltd.	$25,333.94

Current Capital Structure	
Total debt/Common Equity (LTM)	0.68
Cost of Borrowing (LTM)	7.64%
Estimated Cost of new Borrowing	6.92%
Altman's Z	2.65
Estimated Debt Rating	CC
Current levered Beta	1.28
LTM WACC	6.68%

Management

Professional	Title	Comp. FY2013	Comp. FY2014	Comp. FY2015
Mondello, Mark	Chief Executive Officer and Director	$4,684,062	$6,539,114	$0
Peters, William	President	$2,665,095	$2,926,551	$0
Alexander, Forbes	Chief Financial Officer	$2,486,468	$2,567,929	$0
Muir, William	Chief Operating Officer	$2,591,624	$2,927,921	$0
McGee, Joseph	Executive Vice President of Strategic Planning	$1,728,230	$1,745,833	$0
Brooks, Martha	Director and Member of Audit Committee	$222,600	$260,510	$0

Past Earning Surprises

	Revenue	EBITDA	Norm. EPS	Standard Error of "Surprise"
Last Quarter	2.83%	4.46%	20.45%	5.62%
Last Quarter-1	-2.16%	5.92%	0.00%	2.42%
Last Quarter -2	0.90%	10.60%	11.11%	3.32%
Last Quarter -3	5.32%	15.42%	17.02%	3.66%
Last Quarter -4	6.00%	10.84%	400.00%	130.54%
Standard error	1.5%	2.0%	77.6%	26.20%
Standard Error of Revenues prediction	1.5%			
Imputed Standard Error of Op. Cost prediction	1.3%			
Imputed Standard Error of Non Op. Cost predictio	77.6%			

Industry Outlook (Porter's Five Forces)

Bargaining Power of Suppliers (100th Percentile), Bargaining Power of Customers (43th Percentile), Intensity of Existing Rivalry (33th Percentile), Threat of Substitutes (67th Percentile), Threat of New Competition (100th Percentile), and Overall (87th Percentile).

Proforma Assumptions

Convergence Assumptions

All base year ratios linearly converge towards the Sub-industry ratios over an explicit period of 10 years

General Assumptions	
Money market rate (as of today)	0.45%
Risk-Free rate (long term estimate)	3.06%
Annual increase (decrease) in interest rates	0.1%
Marginal Tax Rate	30.0%
Country Risk Premium	6.0%

Forecast Year	Revenue Growth Forecast	Revenue ($) Forecast
LTM		$17,899.20
FY2016	11.2%	$19,906.51
FY2017	6.1%	$21,115.59
FY2018	7.6%	$22,730.40
FY2019	5.0%	$23,866.92
FY2020	4.0%	$24,821.60
FY2021	3.5%	$25,690.35
FY2022	3.3%	$26,525.29
FY2023	3.1%	$27,354.20
FY2024	3.1%	$28,191.93
FY2025	3.0%	$29,046.49
Continuing Period	3.0%	$29,917.89

Items' Forecast Assumptions

	Base year (LTM)	Convergence period (Sub-industry)	Adjustment per year
Operating Cash/Rev.	2.23%	2.23%	0.0%
NWV/Rev.	0.00%	2.00%	0.2%
NPPE/Rev.	15.67%	16.00%	0.0%
Dpr/NPPE	18.00%	18.00%	0.0%
NOPAT MARGIN	2.89%	5.00%	0.2%
Op. Exp./Rev.	93.41%	88.00%	-0.5%
SBC/Rev.	0.35%	0.87%	0.1%
Rent Exp./Rev.	0.59%	1.00%	0.0%
R&D/Rev.	0.15%	6.68%	0.7%
E&D/Rev.	0.00%	0.00%	0.0%
SG&A/Rev.	4.47%	4.50%	0.0%
ROC	11%	8.68%	-0.20%
EV/Rev.	0.25x	.5x	0.00x
EV/EBITA	6.40x	6.49x	0.01x
Debt/Equity	68%	44%	-2.4%
Unlevered beta	0.87	1.33	0.05
Dividends/REV	0%	2%	0.1%

Other Assumptions

Tobin's Q	80%
Excess cash reinvestment	Money market rate
Other claims on the firm's assets	$0.00

Capitalization

100% of all rent expenses are capitalized and amortized 'straightline' over 10 years
100% of all R&D expenses are capitalized and amortized 'straightline' over 5 years
E&P expenses are not capitalized
SG&A expenses are not capitalized

Valuation Focus

DCF Valuation	100%
Relative valuation	0%
Distress Valuation	0%

Monte Carlo Simulation Assumptions

Revenue Growth deviation	Normal (0%, 1%)
Operating expense deviation	Normal (0%, 1%)
Continuing Period growth	Triangular (5.82%, 6%, 6.18%)
Country risk premium	Triangular (2.91%, 3%, 3.09%)
Intrinsic value σ(ε)	$0.05
1-year target price σ(ε)	$0.06

Valuation

Forecast Year	ROC	WACC	Total Capital	Implied Enterprise Value	Other Claims on Assets and Dilution Costs	Shares Outstanding	Price per Share
LTM	10.7%	6.7%	$4,952.87	$5,491.69	$106.66	189.27	$23.60
FY2016	14.6%	7.0%	$5,866.57	$6,067.59	$119.98	189.27	$26.44
FY2017	14.9%	7.6%	$6,881.10	$6,671.32	$134.27	189.27	$29.91
FY2018	15.3%	8.2%	$8,103.04	$7,385.41	$161.20	189.27	$33.44
FY2019	15.2%	8.7%	$9,424.59	$8,123.06	$186.75	189.27	$37.08
FY2020	14.9%	9.2%	$10,859.99	$8,904.30	$212.40	189.27	$40.99
FY2021	14.6%	9.7%	$12,415.75	$9,740.48	$238.66	189.27	$45.29
FY2022	14.2%	10.1%	$14,099.68	$10,643.91	$265.86	189.27	$50.08
FY2023	13.9%	10.6%	$15,919.79	$11,627.72	$294.21	189.27	$55.48
FY2024	13.6%	11.0%	$17,884.01	$12,706.26	$0.00	189.27	$61.61
FY2025	13.3%	11.4%	$20,000.26	$13,895.70	$0.00	189.27	$65.50
Continuing Period	8.7%	11.5%	$17,237.20				

Monte Carlo Simulation Results

The 3σ(ε)-adjusted intrinsic value is $24.22; the 3σ(ε)-adjusted target price is $27.2; and the analysts' median target price is $25

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