

Lenovo (992 HK)

Not Rated



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Stock performance (HK\$)



Source: Bloomberg

Key data

May 22 close (HK\$)	12.90
Share in issue (m)	11,109
Major shareholder	Legend Holdings (30.6%)
Market cap (HK\$b)	143.3
3M avg. vol. (m)	41.7
52W high/low (HK\$)	13.85 / 9.26

Source: Bloomberg

Flattish outlook for next quarter

What's new? Lenovo's net profit for the three months ending Mar 31, 2015 (4QFY15) fell 37% YoY to US\$100m, broadly in line with Bloomberg consensus of US\$99m.

Profitability worsened with net profit margin down to below 1% The group's blended gross profit margin (GPM) rose to 15.7% (up from 14.9% the previous quarter) on the full-quarter consolidation of the high gross profit margin **Motorola** mobile (over 15%) and **IBM** server (over 20%) businesses, compared to just two months of results in the previous quarter. Nonetheless, the group's operating profit margin (OPM) worsened as the fiscal Jan-Mar quarter is the typical industry low season for its core PC business (63% of sales) and losses at Motorola mobile continue to weigh on the group earnings. Pre-tax losses at its Mobile and Enterprise divisions were US\$218m and US\$45m respectively. 4QFY15 net profit margin fell to 0.9%, down from 1.8% the previous quarter.

Management reiterates timeline to turnaround the Motorola business Management remains firm on its timeframe of turning around the Motorola business in four to six quarters from the acquisition (closed in Oct 2014), i.e. in late 2015 or early 2016, via cost savings from supply chain management and component procurement improvements after incorporating the Lenovo mobile business, and top line growth from launching products later in the fiscal year. For Jan-Mar 2015 period, Lenovo was ranked third in the global smartphone market with 18.8m units shipped (+49% YoY), and a 5.6% global market share, following **Samsung** (no.1 with a 24.5% market share) and **Apple** (no.2 with an 18.2% market share), according to IDC.

Flattish business outlook The company's core PC business has remained weak with a drop in YoY growth for PC shipments, from 15% in the Apr-Jun 2014 quarter to 3% YoY growth in the Jan-Mar 2015 quarter. IDC expects global PC shipments to decline by 4.9% in 2015. We expect Lenovo to continue to fare slightly better than market, driven by market share gains. We expect the company to deliver a low-single digit YoY increase (around 2%) in PC shipments in the Apr-Jun 2015 quarter.

Trading at a high-teen forward P/E Investors, in general, have lost interest in the ex-growth PC business. For instance, shares in **HP** (HPQ US, NR) have fallen 16% YTD and are now trading at 9.3x forward P/E. However, we see Lenovo as a unique case in the PC industry given its outlook for improved profitability, underpinned by a turnaround in its loss-making IBM server and Motorola mobile businesses. The stock is currently trading at 19.1x FY16 Bloomberg EPS estimate (FYE Mar 31, 2016). Its share price has risen 26% YTD.

Figure 1: Lenovo - 4QFY15 results summary

(US\$ m)	Three-month ended					YoY chg	Full year		YoY chg
	Mar 14	Jun 14	Sep 14	Dec 14	Mar 15		FY14	FY15	
PC	7,793	n.a	n.a	9,147	7,160	-8%	31,632	33,346	5%
Mobile	1,147	n.a	n.a	3,390	2,845	148%	5,353	9,142	71%
Enterprise	124	n.a	n.a	1,222	1,066	760%	505	2,627	420%
Others	293	n.a	n.a	333	263		1,217	1,180	-3%
Total revenue	9,357	10,395	10,475	14,092	11,334	21%	38,707	46,296	20%
Gross profit	1,245	1,349	1,457	2,097	1,779	43%	5,064	6,682	32%
<i>Gross margin(%)</i>	<i>13.3</i>	<i>13.0</i>	<i>13.9</i>	<i>14.9</i>	<i>15.7</i>		<i>13.1</i>	<i>14.4</i>	
Pre-tax income	213	264	329	274	103	-52%	1,014	970	-4%
Net profit	158	214	262	253	100	-37%	817	829	1%
<i>Net margin (%)</i>	<i>1.7</i>	<i>2.1</i>	<i>2.5</i>	<i>1.8</i>	<i>0.9</i>		<i>2.1</i>	<i>1.8</i>	
PC shipments (m units)	12.9	14.6	15.7	16.0	13.4		55.0	59.7	9%
<i>YoY chg</i>	<i>10%</i>	<i>15%</i>	<i>11%</i>	<i>5%</i>	<i>3%</i>				

Sources: Company data

Figure 2: Lenovo - Quarterly sales and margin trend

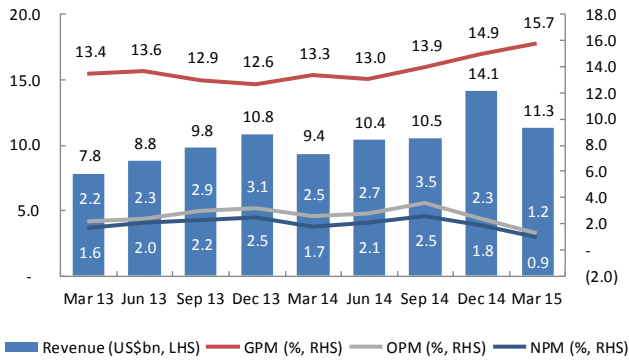
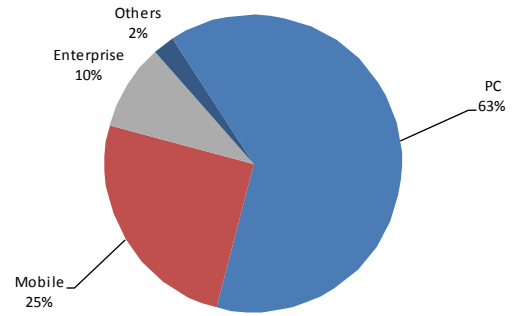


Figure 3: Lenovo - Sales mix by division (Jan-Mar 2015)



Sources: Company data, GF Securities (HK)

Rating definitions

Benchmark: Hong Kong Hang Seng Index

Time horizon: 12 months

Company ratings

Buy	Stock expected to outperform benchmark by more than 15%
Accumulate	Stock expected to outperform benchmark by more than 5% but not more than 15%
Hold	Expected stock relative performance ranges between -5% and 5%
Underperform	Stock expected to underperform benchmark by more than 5%

Sector ratings

Positive	Sector expected to outperform benchmark by more than 10%
Neutral	Expected sector relative performance ranges between -10% and 10%
Cautious	Sector expected to underperform benchmark by more than 10%

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