

Company Report

Lenovo Group (992 HK)

FY3Q18 below on mobile miss; Maintain NEUTRAL

■ FY3Q18 PTI below our estimate/ consensus by 18%/27% due to weaker mobile business and continued mobile/ datacentre losses

■ PC remains solid, datacentre is narrowing losses but no clear signs of turnaround for mobile segment given intense competition

■ Maintain NEUTRAL with new TP HK\$4.1, based on 11x FY19E P/E

3Q18 below on weaker mobile and margin miss

Lenovo reported 3Q18 revenue of US\$12.9bn (+10% QoQ, +6% YoY), mainly driven by solid PC/ datacenter (+8%/+17% YoY), while mobile segment remained weak with 5% YoY sales decline. Gross margin came in at 13.5%, below our estimates/ consensus of 13.8%/14.3%, and PTI of US\$150 was 18%/27% below our estimates/ consensus on continued loss in mobile and datacenter businesses. We fine-tuned FY18E-20E EPS to reflect better PC/ datacenter sales but slower-than-expected mobile/ datacentre turnaround under intensified competition.

PC momentum held up well but mobile turnaround still distant

Lenovo's PCSD segment recorded solid growth of 8% YoY/10% QoQ, driven by commercial refresh cycle and better product mix in consumer segment. PTI margin stayed largely flattish at 4.5% due to better ASP offsetting higher component costs. For datacenter (DCG), 3Q18 revenue grew 17% YoY/ 26% QoQ, driven by early success of restructuring to boost sales in hyperscale server, high-performance PC and software-defined server. PTI margin improved to -7% in 3Q, vs. 13%/15% in 2Q/ 1Q. For mobile (MBG), revenue declined 5% YoY in 3Q, due to lack of attractive products and emerging market weakness. PTI margin remained weak at -6%, vs -8%/-10% in 2Q/1Q. Looking ahead, we believe PC biz will remain solid with stable margins, while datacenter loss will narrow gradually with stronger product offerings and sales strategy. However, we remain cautious on profitability of mobile biz given lack of scale and intensified competition in both China/emerging markets.

Uncertainties in turnaround, maintain NEUTRAL

The stock is now trading at 11.9x FY19E P/E, and we maintain our Neutral rating with new TP of HK\$4.1 based on 11.0x FY19E P/E (4-yr historical mean). We recommend investors to stay on the sidelines until seeing more signs of mobile shipment recovery and profitability improvement. Downside risks include slower PC demand, higher mobile loss, and slower than expected enterprise growth.

Financials

US\$m (Mar-YE)	FY16	FY17	FY18E	FY19E	FY20E
Revenue	44,912	43,035	44,896	45,656	46,668
Growth (%)	-3.0%	-4.2%	4.3%	1.7%	2.2%
Net profit	-128	535	-122	523	585
Growth (%)	-115.5%	n.a.	n.a.	n.a.	12.0%
EPS (USD)	-0.012	0.049	-0.011	0.047	0.053
DPS (USD)	0.03	0.03	-0.00	0.02	0.02
P/E (x)	n.a.	11.6	n.a.	11.9	10.6
P/B (x)	2.1	2.0	2.0	1.8	1.7
ROE (%)	-4.2%	16.8%	-3.9%	15.3%	15.6%

Sources: Company data, CMS (HK) estimates

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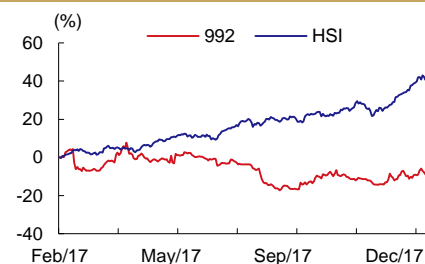
WHAT'S NEW

Estimates revised and TP lowered

NEUTRAL

Previous	NEUTRAL
Price	HK\$4.39
12-month Target Price (Potential downside)	HK\$4.1 (-7%)
Previous	HK\$4.2

Price Performance



Source: Bigdata

%	1m	6m	12m
992 HK	0.7	(6.6)	(12.1)
HSI	9.9	20.4	40.8

Sector: Hardware Technology

Hang Seng Index	32642
HSCEI	13562

Key Data

52-week range (HK\$)	4.1-5.4
Market cap (HK\$ mn)	121,352.0
Avg. daily volume ('000)	5870.35
BVPS (USD)	0.29

Shareholdings Structure

Legend Holdings Corp	31.48%
UNION STAR LTD.	8.16%
No. of shares outstanding (mn)	11,108.7
Free float	53.87%

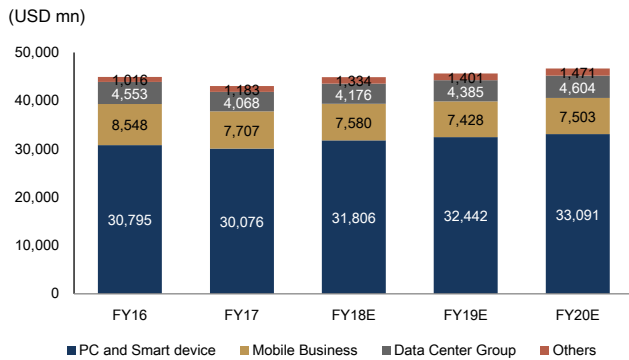
Sources: Bigdata, Bloomberg

Related Research

1. Lenovo Group(992 HK) – FY4Q17 miss on operating income; Maintain NEUTRAL(26/05/2017)
2. Lenovo Group (992 HK) - FY1Q18 operating loss continued, maintain NEUTRAL (22/08/2017)

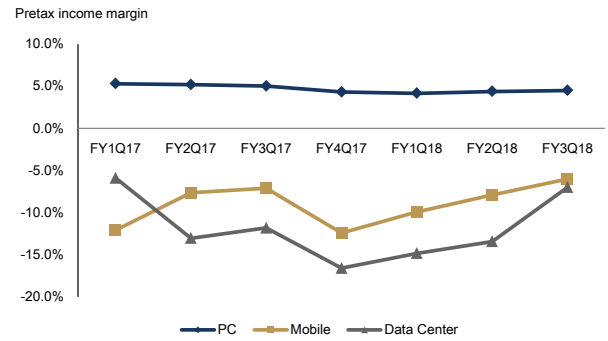
Focus charts

Figure 1: PC revenue to maintain solid growth while mobile slowdown to continue



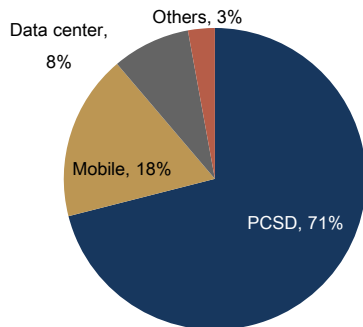
Sources: Company, CMS (HK)

Figure 2: Mobile/data center remains loss-making. PC PTI slightly improved despite rising component cost



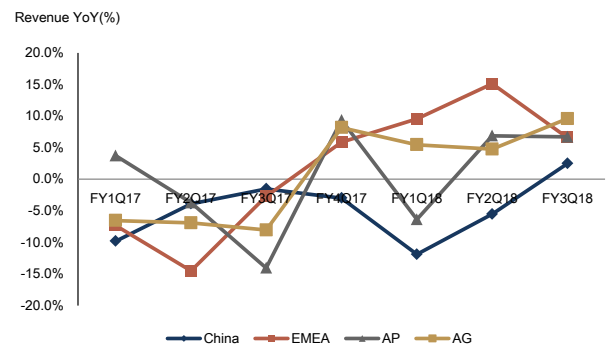
Sources: Company, CMS (HK)

Figure 3: FY18E revenue mix



Sources: Company, CMS (HK)

Figure 4: Revenue growth resumed across all regions in FY3Q18



Sources: Company, CMS (HK)

Figure 5: FY3Q18 Summary

US\$m (Mar-YE)	FY3Q17	FY2Q18	FY3Q18	YoY	QoQ	CMS (HK)		Consensus	
						FY3Q18	Diff (%)	FY3Q18	Diff (%)
Revenue	12,169	11,761	12,939	6%	10%	12,506	3%	12,243	6%
Gross profit	1,595	1,613	1,751	10%	9%	1,726	1%	1,748	0%
Operating income	138	88	204	48%	133%	224	-9%	271	-25%
Pre-tax income	101	35	150	48%	325%	183	-18%	207	-27%
Net profit	107	153	(275)	n.a.	n.a.	184	n.a.	170	n.a.
EPS(USD)	0.888	1.262	(2.621)	n.a.	n.a.	0.017	n.a.	0.025	n.a.
Gross margin (%)	13.1%	13.7%	13.5%			13.8%		14.3%	
Operating margin (%)	1.1%	0.7%	1.6%			1.8%		2.2%	
Pre-tax margin (%)	0.8%	0.3%	1.2%			1.5%		1.7%	
Net margin (%)	0.9%	1.3%	-2.1%			1.5%		1.4%	

Sources: Company, Bloomberg estimates, CMS (HK)

Earnings revisions

Figure 6: Revenue assumptions

US\$m (Mar-YE)	FY16	FY17	FY1Q18	FY2Q18	FY3Q18	FY4Q18E	FY18E	FY19E
PC	30,795	30,076	7,005	8,382	9,250	7,169	31,806	32,442
YoY growth	-8%	-2%	0%	7%	8%	7%	6%	2%
Mobile devices	8,548	7,707	1,746	2,077	2,076	1,682	7,580	7,428
YoY growth	-7%	-10%	2%	2%	-5%	-5%	-2%	-2%
Enterprise	4,553	4,068	971	976	1,225	1,005	4,176	4,385
YoY growth	73%	-11%	-11%	-10%	17%	18%	3%	5%
Others	1,016	1,183	290	327	388	329	1,334	1,401
YoY growth	-14%	16%	7%	9%	16%	20%	13%	5%
Total	44,912	43,035	10,012	11,761	12,939	10,184	44,896	45,656
YoY growth	-3%	-4%	0%	5%	6%	6%	4%	2%

Sources: Company, CMS (HK)

Figure 7: FY18-19E earnings revision

US\$m (Mar-YE)	New			Old			Diff (%)		
	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E
Revenue	44,896	45,656	46,668	43,259	44,269	45,393	4%	3%	3%
Gross profit	6,185	6,447	6,627	5,994	6,242	6,446	3%	3%	3%
Operating profit	378	741	841	553	756	820	-32%	-2%	3%
Net profit	-122	523	585	389	542	566	n.a.	-4%	3%
EPS (USD)	-0.011	0.047	0.053	0.036	0.050	0.052	n.a.	-4%	3%
Gross margin	13.8%	14.1%	14.2%	13.9%	14.1%	14.2%			
Operating margin	0.8%	1.6%	1.8%	1.3%	1.7%	1.8%			
Net Margin	-0.3%	1.1%	1.3%	0.9%	1.2%	1.2%			

Figure 8: CMS (HK) vs. Consensus

US\$m (Mar-YE)	CMS (HK)			Consensus			Diff (%)		
	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E
Revenue	44,896	45,656	46,668	44,504	46,109	47,309	1%	-1%	-1%
Gross profit	6,185	6,447	6,627	6,200	6,545	6,782	0%	-1%	-2%
Operating profit	378	741	841	416	739	883	-9%	0%	-5%
Net profit	(122)	523	585	442	634	715	n.a.	-18%	-18%
EPS (USD)	(0.011)	0.047	0.053	0.042	0.061	0.074	n.a.	-22%	-28%
Gross margin	13.8%	14.1%	14.2%	13.9%	14.2%	14.3%			
Operating margin	0.8%	1.6%	1.8%	0.9%	1.6%	1.9%			
Net Margin	-0.3%	1.1%	1.3%	1.0%	1.4%	1.5%			

Sources: Company, CMS (HK)

FY2Q18: PC/Mobile: Solid revenue growth, slightly improving margin; Data center loss narrowed

Figure 9: Revenue breakdown by segment

US\$m	FY3Q17	FY2Q18	FY3Q18	YoY	QoQ	Comments
PC and Smart Device (PCSD)	8,598	8,382	9,250	7.6%	10.4%	<ul style="list-style-type: none"> ASP rise offset continuous component cost hike Robust EMEA, AP and LA growth; Strong Brazil shipment (67% YoY growth); Momentum in China continued PTI margin at 4.5% up 0.1ppt QoQ
Mobile Business (MBG)	2,185	2,077	2,076	-5.0%	0.0%	<ul style="list-style-type: none"> Challenges came up in AP on competition Strong progress in LA, W. Europe, North America PTI margin improved by 1.9 ppt QoQ Component cost hike remained a concern and repositioning in w. Europe was slower than expected
Data Center (DCG)	1,050	976	1,225	16.7%	25.6%	<ul style="list-style-type: none"> Transformation on track: Revenue up 25.5% QoQ and PTII margin improved 6.4ppt QoQ Positive YoY growth in largest markets: NA and EMEA Continued strong performance in Hyperscale and Software Defined Infrastructure (SDI) segments China regained revenue growth with margin enhancement
Others	335	327	388	15.5%	18.6%	
Total	12,169	11,761	12,939	6.3%	10.0%	

Sources: Company, CMS (HK)

Figure 10: Revenue breakdown by region

US\$m	FY3Q17	FY2Q18	FY3Q18	YoY	QoQ	Comments
China	3,464	3,018	3,550	2.5%	17.6%	<ul style="list-style-type: none"> PC: Momentum continued due to innovative products and channel improvement Mobile: Faced fierce competition, brand repositioning on process Data center: Resumed rev growth and enhanced margin on better hyperscale, HPC&SDI biz
EMEA	3,359	3,151	3,580	6.6%	13.6%	<ul style="list-style-type: none"> PTI margin improved to 5.7%, vs 3.8% in FY2Q18 PC: Strong rev. hike backed by commercial demand Mobile: Robust West Europe performance on Moto Brand, weak East Europe/Middle east/Africa on brand transition Data center: Rev. improved YoY driven by HPC, SDI and Hyperscale segments
AP	1,702	2,028	1,816	6.7%	-10.4%	<ul style="list-style-type: none"> PTI margin slightly down to -0.3% from -0.1% in FY2Q18 PC: Revenue double-digit-growth YoY on continued share gain Mobile: Faced challenge on competition; Refined structure and channels to regain growth Data center: revenue rebounded - double-digit YoY growth PTI margin down to -3.3%, vs -0.6% in FY2Q18
AG	3,644	3,563	3,993	9.6%	12.1%	<ul style="list-style-type: none"> PC: Operational improvement on enhanced product mix Mobile: Strong LA with enhanced profitability; Continued effort in NA on models and carrier expansion Data center: revenue continued YoY growth backed by HPC, SDI and hyperscale PTI margin up to 0.7% from -1.6% FY2Q18
Total	12,169	11,761	12,939	6.3%	10.0%	

Sources: Company, CMS (HK)

Figure 11: Operating margin by segment/ region

%	FY3Q17	FY4Q17	FY1Q18	FY2Q18	FY3Q18
PC	5.0%	4.3%	4.2%	4.4%	4.5%
Mobile devices	-7.1%	-12.4%	-9.9%	-7.9%	-6.0%
Enterprise	-11.8%	-16.6%	-14.8%	-13.4%	-7.0%
Blended OPM	1.2%	-0.8%	-0.3%	0.6%	1.6%

Sources: Company, CMS (HK)

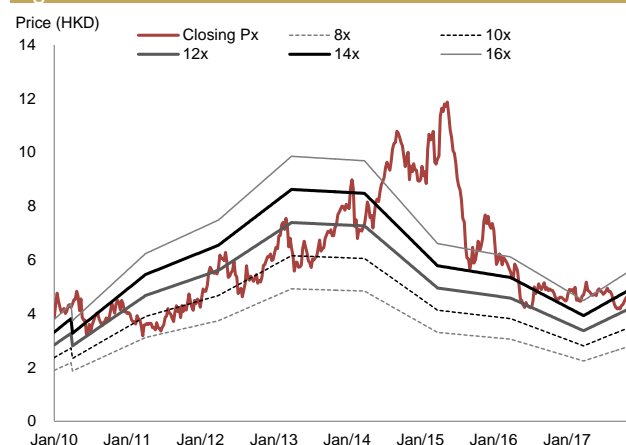
Valuation

Maintain NEUTRAL with new TP of HK\$4.1

We fine-tuned FY18E-20E EPS to reflect better PC/ datacenter sales but slower-than-expected mobile/ datacentre turnaround under intensified competition.

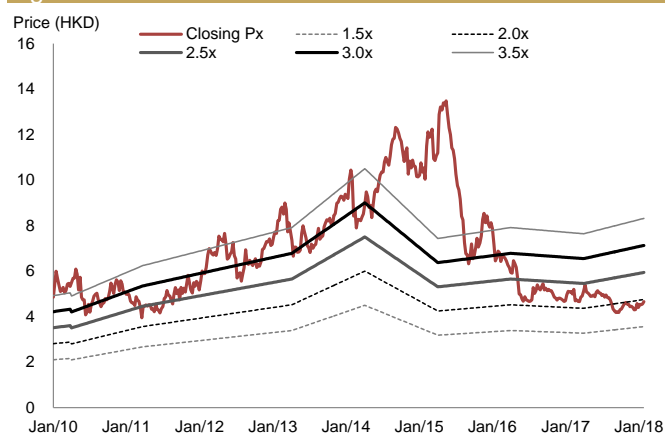
The stock is now trading at 11.9x FY19E P/E, and we maintain our Neutral rating with new TP of HK\$4.1 based on 11.0x FY19E P/E (4-yr historical mean). We recommend investors to stay on the sidelines until seeing more signs of mobile shipment recovery and profitability improvement. Downside risks include slower PC demand, higher mobile loss, and slower than expected enterprise growth.

Figure 12: Forward P/E band



Sources: Company, CMS (HK)

Figure 13: Forward P/B band



Sources: Company, CMS (HK)

Peers Comparison

Figure 14: Sector valuation comparison

Company	Ticker	Rating	Mkt Cap (USD mn)	Current Price (HKD)	Target Price (HKD)	Upside (%)	P/E (x)		P/B (x)		ROE (%)	
							FY17E	FY18E	FY17E	FY18E	FY17E	FY18E
Lenovo*	992 HK	NEUTRAL	6,607	4.30	4.1	-12%	n.a.	11.9	2.0	1.8	n.a.	15%
Sunny Optical	2382 HK	BUY	15,894	113.30	157	39%	35.0	22.9	13.6	9.2	39%	40%
Truly	732 HK	NEUTRAL	1,069	2.68	2.75	3%	10.7	8.7	0.9	0.8	13%	14%
AAC Tech	2018 HK	BUY	22,159	142.00	195	37%	25.5	18.1	7.6	5.7	30%	32%
Tongda	698 HK	BUY	1,439	1.86	2.6	40%	10.3	7.8	2.0	1.7	19%	22%
Q-Tech	1478 HK	NR	1,535	10.76	n.a.	n.a.	19.4	13.5	4.6	3.5	26%	30%
ZTE	763 HK	NR	18,462	27.60	n.a.	n.a.	20.0	18.0	2.6	2.4	14%	14%
BYD E	285 HK	NR	5,498	19.08	n.a.	n.a.	12.9	10.8	2.4	2.0	20%	20%
FIH	2038 HK	NR	2,380	2.29	n.a.	n.a.	n.a.	36.8	0.7	0.7	-5%	4%
Ju Teng	3336 HK	NR	329	2.24	n.a.	n.a.	8.6	6.3	0.4	0.4	4%	6%
Average							17.8	15.5	3.7	2.8	16%	20%

Sources: Bloomberg, CMS (HK) estimates, *Adj for calendar year

Financial Summary

Statement of financial position

US\$m (Mar-YE)	FY16	FY17	FY18E	FY19E	FY20E
Current assets	12,967	12,218	12,792	12,317	13,862
Cash & equivalents	1,927	1,198	1,112	1,130	1,525
Trading investments	27	27	27	27	27
Trade notes	131	125	131	133	136
Trade receivables	4,404	4,557	4,791	4,215	4,735
Other receivables	3,549	3,400	3,547	3,608	3,688
Inventories	2,637	2,624	2,891	2,910	3,453
Other current assets	0	0	0	0	0
Non-current assets	11,967	12,066	12,145	12,202	12,239
Investment property	0	0	0	0	0
PPE	1,391	1,491	1,569	1,627	1,664
Intangible assets	8,661	8,661	8,661	8,661	8,661
Other non-current assets	1,914	1,914	1,914	1,914	1,914
Total assets	24,933	24,284	24,936	24,519	26,101
Current liabilities	15,760	15,080	15,684	14,910	16,083
Bank loans	746	635	621	682	751
Trade payables	4,267	4,030	4,879	3,929	4,847
Prepaid accounts	0	0	0	0	0
Other liquid liabilities	10,748	10,415	10,184	10,299	10,485
Long term liabilities	6,147	6,025	6,146	6,195	6,261
Loans	2,505	2,505	2,505	2,505	2,505
Others	3,642	3,520	3,641	3,690	3,755
Total liabilities	21,907	21,106	21,830	21,105	22,344
Issued capital	2,690	2,690	2,690	2,690	2,690
Capital reserves	0	0	0	0	0
Reserves	310	467	394	707	1,058
NCI	239	232	234	227	220
Parents	3,000	3,157	3,084	3,397	3,748
Total equity and	24,933	24,282	24,934	24,517	26,099

Statement of cash flows

US\$m (Mar-YE)	FY16	FY17	FY18E	FY19E	FY20E
CF from OA	292	(18)	102	390	785
Net profit	(128)	535	(122)	523	585
D&A	902	151	171	192	213
Finance costs	237	232	232	231	235
Investment income	11	0	0	0	0
Changes of WC	(147)	(660)	68	(297)	14
Others	(549)	(202)	(511)	(242)	(279)
CF from IA	(854)	(222)	(222)	(224)	(224)
Capital expenditure	(203)	(250)	(250)	(250)	(250)
Other investments	(650)	28	28	26	26
CF from FA	(305)	(489)	35	(148)	(165)
Borrowings	(415)	(111)	(14)	61	69
Share capital	0	0	0	0	0
Changes of reserves	0	0	0	0	0
Dividends	(379)	(378)	49	(209)	(234)
Others	0	0	0	0	0
Net cash flow	(867)	(729)	(86)	18	396

Sources: Company, CMS (HK)

Statement of comprehensive income

US\$m (Mar-YE)	FY16	FY17	FY18E	FY19E	FY20E
Revenues	44,912	43,035	44,896	45,656	46,668
Cost of sales	(38,28)	(36,929)	(38,711)	(39,209)	(40,041)
Selling exp	(2,373)	(2,681)	(2,864)	(2,785)	(2,800)
Admin exp	(2,109)	(1,852)	(1,759)	(1,735)	(1,773)
Op expenses	(6,688)	(5,444)	(5,807)	(5,706)	(5,786)
Op profit	(62)	672	378	741	841
Financial costs	(237)	(232)	(232)	(231)	(235)
FV changes	0	0	0	0	0
Inv income	(11)	21	(4)	(4)	(4)
Non-op inc	0	0	0	0	0
Non-op exp	(715)	(715)	0	0	0
PBT	(277)	490	170	532	628
Taxes	132	41	(291)	(16)	(50)
PAT	(145)	530	(121)	516	578
NCI	(16)	(7)	2	(7)	(7)
Net Profit	(128)	535	(122)	523	585
EPS (USD)	(0.012)	0.049	(0.011)	0.047	0.053

Ratios

	FY16	FY17	FY18E	FY19E	FY20E
YoY growth rate					
Revenue	-3%	-4%	4%	2%	2%
Op profit	-106%	-1188%	-44%	96%	14%
Net profit	-115%	-518%	-123%	-528%	12%
Profitability					
Gross margin	14.7%	14.2%	13.8%	14.1%	14.2%
NP margin	-0.3%	1.2%	-0.3%	1.1%	1.3%
ROE	-4%	17%	-4%	15%	16%
ROIC	-3.7%	13.8%	-2.9%	11.8%	12.7%
Liquidity					
D/A	13.0%	12.9%	12.5%	13.0%	12.5%
ND/A	5.3%	8.0%	8.1%	8.4%	6.6%
Liquid ratio	0.8	0.8	0.8	0.8	0.9
Quick ratio	0.7	0.6	0.6	0.6	0.6
Operating					
Asset turnover	3.5	3.5	3.5	3.7	3.4
Inventory turnover	14.5	14.1	13.4	13.5	11.6
AR turnover	10.2	9.4	9.4	10.8	9.9
AP turnover	8.7	8.1	8.1	9.3	8.5
Per share (USD)					
EPS	(0.012)	0.049	(0.011)	0.047	0.053
CFPS	0.03	(0.00)	0.01	0.04	0.07
BPS	0.27	0.29	0.28	0.31	0.34
DPS	0.03	0.03	(0.00)	0.02	0.02
Valuation ratio					
PE	n.a.	11.6	n.a.	11.9	10.6
PB	2.1	2.0	2.0	1.8	1.7
EV/EBITDA	4.2	5.7	-6.0	6.1	5.5

Investment Ratings

Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
NEUTRAL	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

Analyst Disclosure

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