Last Closing: HK\$ 4.39

Upside: -11%

Target Price: HK\$ 3.90 Ψ

Technology Sector

Lenovo (992 HK)

Earnings recovery to remain muted

Financial Highlights

Y/E 31 Mar	2016	2017	2018E	2019E	2020E
Revenue (US\$ m)	44,912	43,035	45,246	48,095	50,184
YoY growth (%)	-3	-4	5	6	4
Net profit (US\$ m)	(128)	535	(184)	469	575
EPS (US\$)	(0.01)	0.05	(0.02)	0.04	0.05
Vs. Consensus (+/- %)	NA	NA	NA	-7	-8
EPS growth (%)	-79	21	NA	NA	49
P/E (x)	NA	11.6	NA	13.7	11.2
P/B (x)	2.1	2.6	4.3	3.4	3.3
Dividend yield (%)	6.1	6.1	0.0	4.5	5.2

Source: Company data, BOCOM Int'l estimates

3QFY18 pre-tax profit returned to growth and came largely in line with our estimates. With a healthier market and stable margins, the PC business was a bright spot. The Data Center Business Group (DCG) also posted YoY revenue growth for the first time in over a year. Mobile Business Group (MBG) was again a soft spot and we expect the path of recovery will remain challenging. For 4QFY18E, we expect a seasonal slowdown and steep loss in MBG to continue. The YoY PTI growth in 3QFY18 is a sign of stabilization, but we believe the overall recovery will remain slow. We maintain a cautious view on this name. Our new TP of HK\$3.9 (previously HK\$4.1) is based on 12x FY19E P/E. Maintain Sell.

- 3QFY18 largely in line operationally; healthier PC market and DCG growth are bright spots. Helped by growth in PC and narrowed losses in DCG, pre-tax profit returned to YoY growth for the first time in five quarters. PTI came in at US\$150m vs. our/Street estimates of US\$146m/US\$151m. PC revenue grew 8% YoY helped by a stable market and 9% ASP increase. PC PTI margin remained stable at 4.5% despite component price hike, while DCG PTI margin was better than our expectation. However, we believe the smartphone business came in softer than expected as shipments fell 20% QoQ despite peak seasonality.
- Smartphone competition remains intense; looking for sustained datacenter recovery. We expect the PC business to remain healthy with growth driven by (1) the Fujitsu acquisition to be closed by March (to add about 800k units of shipment per quarter), (2) growth in gaming and enterprise PC which should drive ASP, and (3) continued industry consolidation. Smartphone competition, especially in the Asia-Pacific and other developing markets, continued to intensify. We expect smartphone profitability to worsen again in the near term due to product down-cycle and slower seasonality. We expect losses in smartphone to continue for at least the next few quarters. For DCG, while we were encouraged by the healthy YoY revenue growth (first growth quarter since 1QFY17), we remain cautious and continue to watch for sustainable growth. For 4QFY18, we expect company revenue to decline 19% QoQ with pre-tax profit of US\$42m.
- Stay cautious on lack of further earnings recovery near-term. We believe the company's overall profitability is stabilizing, but further improvement in the near term may be limited due to challenges in smartphones and slower seasonality. Shares trade at 14x FY19E P/E, largely in line with its closest peers HP/Asus' 13x/13x CY18 P/E. We lower our FY18/19 PTI estimates by 30%/4% on weaker-than-expected margin outlook for smartphones. Our new TP of HK\$3.9 (previously HK\$4.1) is based on 12x FY19E P/E. Maintain Sell.



- 3QFY18 came largely in line operationally; healthier PC market and DCG growth are bright spots.
- Smartphone competition remains intense; looking for sustained datacenter recovery.
- Maintain cautious view on a lack of further earnings recovery near-term.

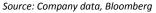
Stock data

52w high (HK\$)	5.40
52w low (HK\$)	4.10
Market cap (HK\$m)	52,744.94
Issued shares (m)	12,014.79
Avg daily vol (m)	54.38
1-mth change (%)	-0.45
YTD change (%)	-0.45
50d MA (HK\$)	4.47
200d MA (HK\$)	4.65
14d RSI	47.6

Source: Company data, Bloomberg

1 Year Performance chart





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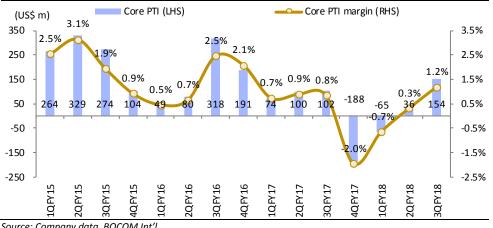


Figure 1: We lower our FY18/19 estimates on weaker-than-expected margin outlook for smartphones

(US\$ m)	FY18E			FY19E				
	Old	New	Change	Chg %	Old	New	Change	Chg %
Revenue	45,344	45,246	(98)	0	47,633	48,095	462	1
OP	440	382	(58)	-13	739	728	(11)	-1
PTI	226	158	(67)	-30	536	517	(19)	-4
NP	315	(184)	(499)	-159	486	469	(17)	-4
EPS (US cents)	2.9	(1.6)	(4.5)	-156	4.4	4.1	(0.3)	-7

Source: Company data, BOCOM Int'l estimates

Figure 2: Lenovo's historical core PTI and margin trends



Source: Company data, BOCOM Int'l

*The core PTI is calculated by the reported PTI plus one-time loss (mainly restructuring costs including severance costs and loss from disposal of assets) and minus one-time gain (mainly gain from disposal of PP&E).



Figure 3: Lenovo quarterly forecasts and key assumptions

Lenovo consolidated (992 HK)	Jun-16			Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Mar-16	Mar-17	Mar-18	Mar-19	Mar-19
US\$ m (FY end March)	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18E	1QFY19E	2QFY19E	3QFY19E	4QFY19E	FY16	FY17	FY18E	FY19E	FY20E
Revenue	10,056	11,231	12,169	9,579	10,012	11,761	12,939	10,534	11,063	12,214	13,391	11,427	44,912	43,035	45,246	48,095	50,184
Seq %	10	12	8	-21	5	17	10	-19	5	10	10	-15	-3	-4	5	6	42 000
COGS	8,522	9,624	10,573	8,211	8,648	10,148	11,188	9,111	9,502	10,520	11,532	9,813	38,288	36,929	39,095	41,367	43,209
% of sales Gross Profit	85	86 1.607	87 1 505	86 1 269	86 1 265	86 1 612	86	86 1 422	86	86 1.602	86 1 950	86 1.614	85 6.624	86 6 106	86 6 16 1	86 6,728	86 6,976
GPM%	1,535 <i>15.3</i>	1,607 <i>14.3</i>	1,595 <i>13.1</i>	1,368 <i>14.3</i>	1,365 <i>13.6</i>	1,613 <i>13.7</i>	1,751 <i>1</i> 3.5	1,423 <i>13.</i> 5	1,562 14.1	1,693 <i>13.9</i>	1,859 <i>13.</i> 9	1,614 <i>14.1</i>	0,024 14.7	6,106 <i>14.2</i>	6,151 <i>13.6</i>	0,720 14.0	13.9
OPEX	1,289	1,392	1,457	1,294	1,371	1,525	1,547	1,327	1,438	1,527	1,607	1,428	6,686	5,434	5,770	6,000	6,112
% of sales	1,209	1,392	1,437	1,234	1,371	1,525	1,547	1,327	1,430	1,527	1,007	1,420	0,000	3,434 13	13	0,000	12
Operating Profit	245	215	138	74	(6)	88	205	96	123	167	252	186	(62)	672	382	728	863
OM%	2.4	1.9	1.1	0.8	-0.1	0.7	1.6	0.9	1.1	1.4	1.9	1.6	-0.1	1.6	0.8	1.5	1.7
Pretax Profit	206	168	101	15	(69)	35	150	42	70	114	200	133	(277)	490	158	517	639
PTI%	2.0	1.5	0.8	0.2	-0.7	0.3	1.2	0.4	0.6	0.9	1.5	1.2	-0.6	1.1	0.3	1.1	1.3
Tax (benefit)	38	16	(6)	(89)	(15)	(118)	425	4	3	11	20	13	(132)	(41)	296	48	64
Net Profit	173	157	98	107	(72)	139	(289)	38	66	102	180	120	(128)	535	(184)	469	575
EPS (US\$ cents)	1.6	1.4	0.9	1.0	(0.7)	1.3	(2.5)	0.3	0.6	0.9	1.6	1.1	(1.1)	4.9	(1.6)	4.1	5.0
Revenue by division (US\$ m)																	
PCSD (PC/tablets)	6,992	7,804	8,598	6,682	7,005	8,382	9,250	7,580	7,784	8,677	9,423	8,146	30,796	30,076	32,217	34,030	34,888
MBG (Mobile)	1,706	2,045	2,185	1,772	1,746	2,077	2,076	1,599	1,806	1,969	2,264	1,811	8,548	7,708	7,498	7,851	8,483
DCG (Servers)	1,086	1,082	1,050	850	971	976	1,225	980	1,078	1,153	1,269	1,078	4,553	4,068	4,152	4,579	4,972
Others	272	300	336	275	290	326	388	376	395	414	435	392	1,015	1,183	1,379	1,636	1,842
Total	10,056	11,231	12,169	9,579	10,012	11,761	12,939	10,534	11,063	12,214	13,391	11,427	44,912	43,035	45,246	48,095	50,184
Revenue by division (% total)																	
PCSD (PC/tablets)	69.5	69.5	70.7	69.8	70.0	71.3	71.5	72.0	70.4	71.0	70.4	71.3	68.6	69.9	71.2	70.8	69.5
MBG (Mobile)	17.0	18.2	18.0	18.5	17.4	17.7	16.0	15.2	16.3	16.1	16.9	15.9	19.0	17.9	16.6	16.3	16.9
DCG (Servers)	10.8	9.6	8.6	8.9	9.7	8.3	9.5	9.3	9.7	9.4	9.5	9.4	10.1	9.5	9.2	9.5	9.9
Others	2.7	2.7	2.8	2.9	2.9	2.8	3.0	3.6	3.6	3.4	3.2	3.4	2.3	2.7	3.1	3.4	3.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
PTI by division (US\$)																	
PCSD (PC/tablets)	370	405	431	288	291	367	416	334	343	390	433	367	1,458	1,494	1,408	1,533	1,536
MBG (Mobile)	(206)	(156)	(155)	(220)	(173)	(164)	(124)	(160)	(126)	(128)	(102)	(109)	(662)	(737)	(621)	(465)	(408)
DCG (Servers)	(64)	(141)	(124)	(141)	(144)	(131)	(86)	(69)	(69)	(63)	(51)	(22)	(103)	(470)	(430)	(205)	(129)
Others	106	60	(51)	88	(43)	(37)	(56)	(63)	(77)	(85)	(80)	(103)	(970)	202	(199)	(346)	(361)
Total	206	168	101	15	(69)	35	150	42	70	114	200	133	(277)	489	158	517	639
PTI margin by division (%)																	
PCSD (PC/tablets)	5.3	5.2	5.0	4.3	4.2	4.4	4.5	4.4	4.4	4.5	4.6	4.5	4.7	5.0	4.4	4.5	4.4
MBG (Mobile)	-12.1	-7.7	-7.1	-12.4	-9.9	-7.9	-6.0	-10.0	-7.0	-6.5	-4.5	-6.0	-7.7	-9.6	-8.3	-5.9	-4.8
DCG (Servers)	-5.9	-13.1	-11.8	-16.6	-14.9	-13.4	-7.0	-7.0	-6.4	-5.5	-4.0	-2.0	-2.3	-11.6	-10.3	-4.5	-2.6
	Jun-15	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17		Jun-18	Sep-18	Dec-18	Mar-19	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20
Segment breakdown	1QFY17	ZQFY17	3QFY17	4QFY17		2QFY18	3QFY18	4QFY18E	1QFY19E	ZQFY19E	JUFY19E	4QFY19E	FY16	FY17	FY18E	FY19E	FY20E
PC Desitions																	
Desktops	4,909	5 121	5,499	1 100	1 150	5 116	5 652	1 166	1 511	1 016	5 350	1 555	20 645	10 6/1	10 222	10 2/1	10 2/2
Units ('000) Seg %	4,909	5,131 5	5,499 7	4,102 -25	4,153 <i>1</i>	5,116 23	5,653 10	4,466 -21	4,511 1	4,916 9	5,359 9	4,555 -15	20,645 -9	19,641 -5	19,388 -1	19,341 0	19,343 0
ASP (US\$)	548	о 575	7 581	-25 581	604	23 616	10 624	-27 631	637	9 637	9 630	-15 624	-9 568	-ə 571	- <i>1</i> 619	632	613
Notebooks	J40	515	501	501	004	010	024	001	007	037	000	024	500	571	019	052	013
Units ('000)	8,294	9,374	10,213	8,215	8,209	9,375	10,042	8,034	8,275	9,268	10,009	8,708	35,444	36,096	35,660	36,259	38,136
Seq %	0,294	9,314 13	10,213	-20		9,373 14	7 10,042	-20	3	9,200 12	10,009	-13	-5	2	-1	20,209	50,150
ASP (US\$)	489	517	528	523	548	559	570	564	564	570	575	581	501	515	560	573	575
Total PC	-03	017	020	020	0+0	000	010	004	004	010	0/0	001	001	010	000	010	010
Units ('000)	13,203	14,505	15,712	12,317	12,362	14,491	15,695	12,499	12,785	14,184	15,368	13,263	56,089	55,737	55,047	55,600	57,478
Q0Q %	9	10	8	-22		17	8	-20	2	11	8	-14	,000		,•	,000	
		-3	2	2		0	0	1	3	-2	-2	6	-6	-1	-1	1	3
YoY %	-2																
	-2 530	538	547	543	567	578	589	606	609	612	613	614	549	540	585	612	607
YOY % ASP (US\$) Seq %			547 2	543 -1	567 4	578 2	589 2	606 3	609 0	612 0	613 0	614 0	549 0	540 -2	585 8	612 5	
ASP (US\$)	530	538															
ASP (US\$) Seq %	530	538			4												607 -1 48.3

Source: Company data, BOCOM Int'l estimates

01 February 2018



Company background

Incorporated in Hong Kong in 1988 and listed on the main board of HKSE in 1994, Lenovo is a Fortune 500 company and a leading global solution provider in PC, smartphones and servers, serving both consumer and enterprise markets.

Lenovo (992 HK): Financial Statements

Profit & loss (US\$ m)					
Year ended 31 Mar	2016	2017	2018E	2019E	2020E
Revenue	44,912	43,035	45,246	48,095	50,184
COGS	(38,288)	(36,929)	(39,095)	(41,367)	(43,209)
Gross Profit	6,624	6,106	6,151	6,728	6,976
OPEX	(6,686)	(5,434)	(5,770)	(6,000)	(6,112)
OP	(62)	672	382	728	863
Net interest expense	(204)	(204)	(220)	(225)	(239)
Equity Method	(11)	21	(4)	14	14
Others	-	-	-	-	-
Non-OP income	(215)	(182)	(224)	(211)	(225)
Pre-tax income	(277)	490	158	517	639
Tax	(132)	(41)	296	48	64
Net income (before minority)	(145)	530	(138)	469	575
Minority interest	(16)	(5)	47	-	-
Net income	(128)	535	(184)	469	575
EPS (US\$ cents)	-1.2	4.9	-1.6	4.1	5.0

D.I					
Balance sheet (US\$		0047	00405	00405	00005
As of 31 Mar	2016	2017	2018E	2019E	2020E
Cash & cash equiv.	1,927	2,755	2,262	3,012	3,534
Marketable Securities	152	197	197	197	197
Account Receivables	4,404	4,468	4,698	4,994	5,211
Inventory	2,627	2,794	2,938	3,123	3,258
Others	3,857	4,655	4,655	4,655	4,655
Current Assets	12,967	14,868	14,749	15,980	16,855
Land/CIP	-	-	-	-	-
PP&E, net	1,392	1,649	1,576	1,385	1,097
Investment securities	140	256	269	286	298
Interest bearing asset	-	-	-	-	-
Intangible asset	8,661	8,349	8,349	8,349	8,349
Other fixed assets	1,774	2,063	2,063	2,063	2,063
Total Assets	24,933	27,186	27,007	28,063	28,662
Accounts payable	4,267	6,486	6,819	7,248	7,563
Short-term debt	746	70	70	70	70
Others	10,748	11,778	11,778	11,778	11,778
Current Liabilities	15,760	18,334	18,667	19,096	19,411
Long-term debt	2,505	2,967	2,967	2,967	2,967
Others	3,642	1,790	2,042	2,287	2,529
Total Liabilities	21,907	23,091	23,676	24,350	24,907
Common stock	2,690	2,690	2,690	2,690	2,690
Retained earnings	310	534	(278)	104	147
Shareholder equity	3,000	3,224	2,412	2,794	2,837
minority interest	26	872	918	918	918
Total capital	24,933	27,186	27,007	28,063	28,662

Cash flow (US\$ m)					
Year ended 31 Mar	2016	2017	2018E	2019E	2020E
Profit before tax	(277)	490	158	517	639
Depreciation/Amortization	741	742	560	703	825
Changes in work capital	(482)	1,618	(40)	(51)	(38)
Forex gain//loss	123	87	-	-	-
Others	187	(817)	(296)	(48)	(64)
Cash flow from operations	292	2,120	382	1,120	1,362
Capex	(203)	(464)	(487)	(511)	(537)
Sales of tangible assets	92	412	-	-	-
Investments	(64)	(45)	(13)	(17)	(12)
Others	(678)	(1,301)	-	-	-
Cash flow from investing	(854)	(1,398)	(500)	(528)	(549)
Dividends paid	(379)	(377)	(375)	158	(291)
New share issued	-	-	-	-	-
Debt issuance/(repayment)	226	655	-	-	-
Other	(151)	(133)	-	-	-
Cash flow from financing	(305)	145	(375)	158	(291)
Other	(62)	(40)	-	-	-
Net cash flow	(928)	828	(492)	750	522
Cash at beginning	2,855	1,927	2,755	2,262	3,012
Cash at end	1,927	2,755	2,262	3,012	3,534

Financial ratios					
Year ended 31 Mar	2016	2017	2018E	2019E	2020E
P/E (x)	(48.0)	11.6	NA	13.7	11.2
P/B (x)	2.1	2.6	4.3	3.4	3.3
P/S (x)	0.1	0.1	0.1	0.1	0.1
EV/EBITDA (x)	7.4	5.4	10.2	5.3	4.0
Dividend yield (%)	6.1	6.1	0.0	4.5	5.2
Net debt/equity (x)	0.4	0.0	0.2	(0.1)	(0.2)
ROE (%)	-3.6	20.1	-9.6	27.8	30.3
ROA (%)	-0.5	2.1	-0.7	1.7	2.0
ROIC (%)	3.3	4.2	-7.5	4.0	5.7

Source: Company data, BOCOM Int'l estimates

01 February 2018



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Rating System Analyst Stock Ratings

Analyst Stock Ratings:	Analyst Industry Views:
Buy: The stock's total return is expected to exceed that of the corresponding industry over the next 12 months.	Outperform: The analyst expects the industry coverage universe to be attractive relative to the relevant broad market benchmark over
Neutral: The stock's total return is expected to be in line with that of the corresponding industry over the next 12 months.	the next 12 months. Market perform: The analyst expects the industry coverage
Sell: The stock's total return is expected to be below that of the corresponding industry over the next 12 months.	universe to be in line with the relevant broad market benchmark over the next 12 months.
Not-Rated: The analyst does not have conviction regarding the outlook of the stock's total return relative to that of the corresponding industry over the next 12 months.	Underperform: The analyst expects the industry coverage universe to be unattractive relative to the relevant broad market benchmark over the next 12 months.
Trading Buy: The stock's absolute return is expected to be very attractive in the near term. This rating can be different from the rating with a view over the next 12 months.	Broad market benchmark for Hong Kong is the Hang Seng Composite Index, for China A-shares is the MSCI China A Index, for US-listed Chinese companies is S&P US Listed China 50 (USD) Index.
Trading Sell: The stock's absolute return is expected to be very unattractive in the near term. This rating can be different from the rating with a view over the next 12 months.	

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01 February 2018



Analyst Certification

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