

Last Closing: HK\$ 4.39

Upside: -11%

Target Price: HK\$ 3.90↓

Technology Sector

Lenovo (992 HK)

Earnings recovery to remain muted

UP

MP

OP

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**.



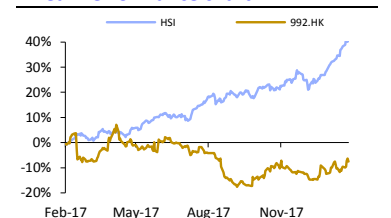
- 3QFY18 came largely in line operationally; healthier PC market and DCG growth are bright spots.
- Smartphone competition remains intense; looking for sustained datacenter recovery.
- Maintain cautious view on a lack of further earnings recovery near-term.

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



Source: Company data, Bloomberg

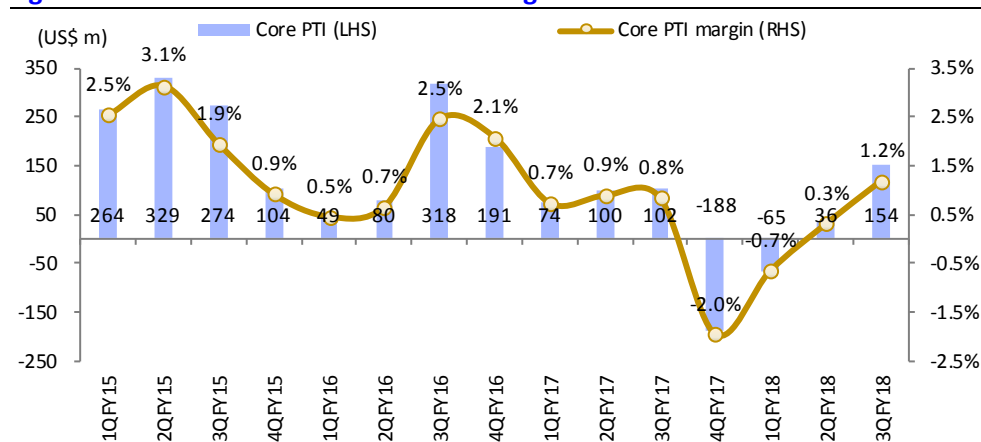
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Figure 1: We lower our FY18/19 estimates on weaker-than-expected margin outlook for smartphones

(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).

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

Balance sheet (US\$ m)					
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

Source: Company data, BOCOM Int'l estimates

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

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Analyst Stock Ratings:	Analyst Industry Views:
<p>Buy: The stock's total return is expected to exceed that of the corresponding industry over the next 12 months.</p> <p>Neutral: The stock's total return is expected to be in line with that of the corresponding industry over the next 12 months.</p> <p>Sell: The stock's total return is expected to be below that of the corresponding industry over the next 12 months.</p> <p>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.</p> <p>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.</p> <p>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.</p>	<p>Outperform: The analyst expects the industry coverage universe to be attractive relative to the relevant broad market benchmark over the next 12 months.</p> <p>Market perform: The analyst expects the industry coverage universe to be in line with the relevant broad market benchmark over the next 12 months.</p> <p>Underperform: The analyst expects the industry coverage universe to be unattractive relative to the relevant broad market benchmark over the next 12 months.</p> <p>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.</p>

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