

COMPANY NEWS

Lenovo Group Limited [992.HK; HK\$4.39; Not Rated] -

Q3 FY18 results presentation key takeaway. Transformation strategy pays off; no reason to ignore the counter.

Market Cap: US\$6,744m; Free Float: 57.4%; 3-months Average Daily Turnover: US\$29.3m

Analyst: Mark Po

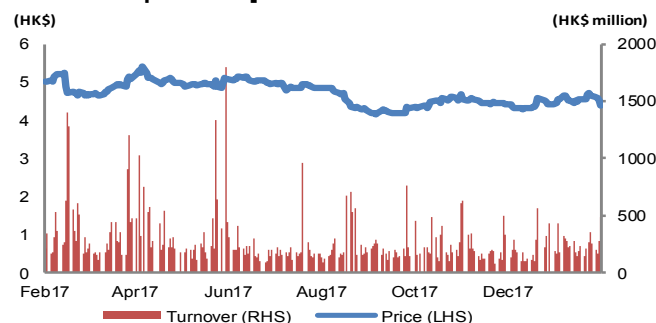
The Company. Lenovo Group Limited [992.HK], through its subsidiaries, manufactures and sells personal computers and handheld devices.

Core net profit meets market expectations. Lenovo reported its Q3 FY18 results yesterday. Its Q3 FY18 net loss was US\$289m vs. a net profit of US\$98m in Q3 FY17. The reported net loss in Q4 FY18 was mainly due to a US\$400m write-off of deferred income tax assets, following the Tax Cuts and Jobs Act enacted by the US Government. Lenovo reported profit before taxation of US\$150m in Q3 FY18, up from US\$101m in Q3 FY17. Excluding the impact of the write-off of deferred income tax assets, Lenovo's Q3 FY18 results are in line with market expectations. Lenovo's turnover was US\$12,939m in Q3 FY18, up 6% YoY, driven mainly by an 8% YoY increase in turnover for the PC & Smart Device Business Group and a 17% YoY increase in turnover for the Data Center Business Group. The Mobile Division reported a 5% YoY decline in turnover in Q3 FY18. We believe that Lenovo's Q3 FY18 results show that the Company's transformation has paid off, as all geographical segments, including China, Asia Pacific, EMEA and the Americas, reported positive YoY top-line growth, there was a 0.4% YoY improvement in gross margin, and the business divisions, including the PC & Smart Device Business Group and Data Center Business Group, reported progress in operating performance. The Company also controlled expenses well, as the expense-to-revenue ratio remained flat YoY at 12%, so the increase in turnover is reflected in the bottom line.

PCs held up well, servers showed progress but smartphones remained a drag. The PC & Smart Device Business Group reported a pre-tax profit margin of 4.5% in Q3 FY18, down from 5% in Q3 FY17 but up from 4.4% in Q2 FY18. The QoQ improvement in profit margin was due to better pricing and a more favorable product mix. In the results conference call, Lenovo management mentioned that the Company has a positive view on the outlook for the PC & Smart Devices Business Group in 2018, given the improvement in the performance of the China market and growing gaming product shipments. Given the stabilization of the PC market, Lenovo's PC & Smart Device Business Group should report a continuous improvement in operating performance, as management is focusing more on profitability than volume shipment growth. The stable performance of the PC division should provide support for Lenovo to turn around the server and smartphone businesses. The strong YoY top-line growth of the Data Center Business Group in Q3 FY18 was driven mainly by strong growth in the hyperscale and software defined network segments and improvement in the performance of the China market. The Data Center Business Group reported an operating loss of US\$56m in Q3 FY18, an improvement from the operating loss of US\$94m in Q3 FY17 and US\$100m in Q2 FY18. The smartphone (Mobile Business Group) is still a laggard, but Lenovo managed to report a YoY decline in operating loss to US\$92m in Q3 FY18 from US\$112m in Q3 FY17 and US\$132m in Q2 FY18. Component cost hikes remained a challenge for the Mobile Business Group in Q3 FY18, constraining an improvement in operating performance. In terms of geographical breakdown, China remained a core market, reporting turnover of US\$3,559m in Q3 2018, up 2.5% YoY. The China market reported segment profit of US\$204m, up from US\$180 in Q3 FY17. EMEA also reported good progress, recording a segment loss of US\$11m, down from US\$102m a year ago. Asia Pacific and Americas were not a drag on overall performance.

The Q3 FY18 results show that the impact of high component prices will

[Lenovo Group Limited]



| Key Financials (in US\$ m) | FY18 | FY17 | FY18E | FY19E |
|-------------------------------|-----------|----------|----------|----------|
| Revenue | 44,912.1 | 43,034.7 | 44,500.7 | 45,999.2 |
| Gross Profit | 6,623.9 | 6,105.5 | n.a. | n.a. |
| Gross Margin % | 14.7 | 14.2 | 13.9 | 14.2 |
| Net Profit | (128.1) | 537.0 | 412.1 | 645.0 |
| Net Margin % | (0.3) | 1.2 | 0.9 | 1.4 |
| EPS (Basic) | (0.01) | 0.05 | 0.04 | 0.06 |
| ROE (%) | (3.6) | 17.2 | 8.7 | 13.4 |
| Dividend Yield (%) | 6.04 | 6.02 | 4.07 | 4.42 |
| PER (x) | (48.77) | 11.64 | 14.51 | 9.27 |
| PBR (x) | 2.09 | 1.95 | 1.62 | 1.51 |
| Capex (m) | (779.9) | (639.1) | (503.7) | (551.3) |
| Free cash flow (m) | (454.3) | 1,547.2 | (1.6) | 471.3 |
| Net cash/(net debt) (r) | (1,235.5) | (162.8) | (697.7) | (68.8) |

Source: Bloomberg, Company Data.

ease gradually, as the Company passes on the increased costs to customers. Regarding the mobile business, Lenovo has a clear strategy of continuing to strengthen its leading position and profitability in Latin America. The Company will continue to try to grab market share in mature markets, particularly in North America, where Lenovo reported an 85% YoY increase in shipments.

Our view. We believe that the market may take the view that there is no major catalyst to re-rate Lenovo and stay on the sidelines. But the Company's Q3 FY18 results show that its transformation strategy is paying off, so we take this as a starting point for rebuilding confidence in the Company. We suggest investors take a more constructive view of Lenovo, especially since its turnover resumed growth in Q3 FY18. There was a massive de-rating, and its share price underperformed in the China TMT hardware segment, and we believe negatives such as the weak performance of the Mobile Group Business have been priced in. The news flow may boost sentiment on the Company and trigger share price movement. Recent industry news flow suggests that PC and server market performance is resilient. The market treats Lenovo as a proxy for the PC and server market. If Lenovo is removed from Hang Seng Index in the upcoming review, we think it would be a very good time to revisit.

Risks: Longer-than-expected turnaround of the mobile business group and weaker PC shipments.

Figure 1: Peer Comparison.

| Ticker | Company | Price Lcy | Market Cap US\$m | PE | | | EV/EBITDA | | | PIB | | ROE | | ROA | | Div yield | | Share Price Performance | | | |
|-----------|------------------------------|--------------|---------------------|------------|------------|------------|------------|------------|------------|-----------|------------|-----------|------------|-----------|------------|-----------|------------|-------------------------|------------|---------|---------|
| | | | | 2017F x | 2018F x | 2019F x | 2017F x | 2018F x | 2019F x | 2016 x | 2017F x | 2016 % | 2017F % | 2016 % | 2017F % | 2016 % | 2017F % | 2016 % | 2017F % | 1M % | 3M % |
| 992 HK | Lenovo Group Ltd | 4.39 | 6744.2 | 14.4 | 9.2 | 7.5 | 7.7 | 5.9 | 5.5 | 2.0 | 1.6 | 23.4 | 8.7 | -0.3 | 1.3 | n.a. | 4.1 | -0.5 | -4.1 | -9.1 | -12.9 |
| 3396 HK | Legend Holdings Corp-H | 28.50 | 8586.4 | 10.4 | 9.3 | 7.8 | 10.9 | 8.4 | 7.8 | 1.0 | 0.8 | 11.5 | 7.4 | 1.6 | 1.6 | 1.1 | 1.3 | -20.6 | 33.8 | 38.7 | 60.3 |
| HPQ US | Hp Inc | 23.32 | 38366.7 | 12.9 | 12.3 | 11.6 | 8.7 | 8.3 | 7.9 | n.a. | n.a. | 16.7 | -111.8 | 8.2 | 8.9 | 3.4 | 2.4 | 11.0 | 8.6 | 21.8 | 55.6 |
| IBM US | Intl Business Machines Corp | 163.70 | 151552.0 | 11.8 | 11.5 | 11.0 | 9.5 | 9.4 | 9.8 | 8.8 | 7.1 | 101.0 | 62.6 | 4.7 | 9.1 | 3.6 | 3.8 | 6.7 | 6.3 | 12.7 | -6.1 |
| AAPL US | Apple Inc | 167.43 | 851725.8 | 14.3 | 13.3 | 12.5 | 8.2 | 8.0 | 7.7 | 6.4 | 5.5 | 46.2 | 38.5 | 13.9 | 14.5 | 1.4 | 1.6 | -1.1 | 0.3 | 11.6 | 30.0 |
| 005930 KS | Samsung Electronics Co Ltd | 2491000.00 | 300195.4 | 7.0 | 6.9 | 6.9 | 2.9 | 2.9 | 2.8 | 1.5 | 1.3 | 9.7 | 20.1 | 13.4 | 15.0 | n.a. | 2.8 | -2.2 | -12.9 | 2.5 | 27.4 |
| 2353 TT | Acer Inc | 27.35 | 2880.3 | 33.1 | 25.1 | 25.1 | 13.2 | 10.9 | 10.3 | 1.5 | 1.4 | 1.0 | 3.9 | -2.6 | 1.8 | n.a. | 1.2 | 13.3 | 74.8 | 82.9 | 96.1 |
| 2357 TT | Asustek Computer Inc | 283.00 | 7195.0 | 14.2 | 12.8 | 12.1 | 10.3 | 8.8 | 8.4 | 1.2 | 1.2 | 10.3 | 8.1 | 4.8 | 4.2 | n.a. | 5.1 | 1.3 | 8.8 | 0.0 | 3.7 |
| 000977 CH | Inspur Electronic Informat-A | 16.02 | 3280.8 | 44.7 | 31.8 | 22.5 | 30.3 | 23.5 | 18.4 | 2.9 | 3.4 | 17.4 | 7.8 | 1.6 | 3.0 | n.a. | 0.2 | -19.4 | -11.1 | -3.2 | -11.5 |
| 600601 CH | Founder Technology Group -A | 2.94 | 1025.0 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | 1.7 | n.a. | 3.1 | n.a. | -0.2 | n.a. | n.a. | n.a. | -19.2 | -22.0 | -23.8 | -35.0 |
| 603019 CH | Dawning Information Indust-A | 37.81 | 3862.0 | 84.6 | 60.8 | 43.3 | 64.7 | 50.7 | 40.8 | 8.3 | 7.7 | 14.0 | 9.2 | 3.1 | 4.5 | n.a. | 0.3 | -6.0 | -11.1 | 51.1 | 51.6 |
| POSI3 BZ | Positivo Informatica Sa | 3.70 | 101.9 | 24.7 | 8.6 | 5.3 | 4.6 | 4.4 | n.a. | 0.6 | n.a. | -12.9 | 2.2 | 0.0 | n.a. | n.a. | n.a. | 19.0 | 15.3 | -4.1 | 6.0 |
| Average | | | | 24.7 | 14.7 | 13.0 | 11.3 | 9.6 | 8.7 | 3.2 | 2.8 | 26.4 | 5.0 | 5.0 | 6.6 | 2.4 | 2.5 | -1.5 | 7.2 | 15.1 | 22.1 |
| 2382 TT | Quanta Computer Inc | 64.00 | 8461.7 | 15.3 | 12.3 | 11.0 | 10.0 | 8.5 | 7.7 | 1.9 | 1.8 | 13.4 | 12.1 | 2.5 | 2.7 | n.a. | 5.4 | 3.4 | -9.6 | -12.2 | 0.6 |
| 2324 TT | Compal Electronics | 21.45 | 3245.4 | 13.9 | 9.7 | 9.0 | 6.5 | 5.6 | 5.4 | 0.9 | 0.9 | 8.5 | 6.4 | 1.8 | 2.1 | n.a. | 5.0 | 0.7 | -2.9 | 6.2 | 15.0 |
| 3231 TT | Wistron Corp | 24.20 | 2276.9 | 15.8 | 10.2 | 9.1 | 6.7 | 5.3 | 4.9 | 1.0 | 1.0 | 1.9 | 5.9 | 1.2 | 1.4 | n.a. | 4.6 | 1.0 | -3.0 | -17.9 | -6.5 |
| 4938 TT | Pegatron Corp | 77.00 | 6889.8 | 11.8 | 9.6 | 8.7 | 5.2 | 4.2 | 3.9 | 1.4 | 1.3 | 16.8 | 11.0 | 3.2 | 3.8 | n.a. | 5.8 | 6.9 | -1.5 | -18.7 | 2.5 |
| 2356 TT | Inventec Corp | 23.65 | 2904.1 | 12.0 | 10.6 | 9.7 | 8.2 | 7.4 | 7.1 | 1.6 | 1.5 | 9.8 | 12.0 | 3.4 | 3.6 | n.a. | 7.1 | -0.4 | 1.1 | -1.0 | 0.6 |
| 2352 TT | Qisda Corp | 21.25 | 1430.6 | 7.9 | 10.6 | n.a. | 12.4 | 9.9 | n.a. | 1.4 | 1.3 | 8.1 | 17.3 | 5.6 | 6.4 | n.a. | 7.7 | 0.5 | -4.1 | -12.2 | 30.0 |
| 2317 TT | Hon Hai Precision Industry | 93.50 | 55459.1 | 12.7 | 9.7 | 9.4 | 7.5 | 6.1 | 5.8 | 1.5 | 1.4 | 15.2 | 11.4 | 5.3 | 4.8 | n.a. | 4.4 | -1.8 | -16.5 | -19.7 | 11.7 |
| 2038 HK | Fih Mobile Ltd | 2.32 | 2400.9 | n.a. | 37.1 | 22.8 | 3.1 | 1.3 | 1.0 | 0.7 | 0.7 | 6.0 | -5.5 | -1.3 | -2.2 | 1.8 | 2.0 | -2.5 | -6.5 | -11.5 | -5.0 |
| 285 HK | Byd Electronic Intl Co Ltd | 18.40 | 5301.1 | 12.5 | 10.5 | 9.2 | 6.6 | 5.8 | 5.2 | 2.6 | 2.3 | 9.0 | 19.8 | 9.1 | 10.6 | 4.4 | 1.1 | 8.1 | -12.2 | -3.0 | 197.3 |
| Average | | | | 12.7 | 13.4 | 11.1 | 7.3 | 6.0 | 5.1 | 1.4 | 1.4 | 9.8 | 10.0 | 3.4 | 3.7 | 3.1 | 4.8 | 1.8 | -6.1 | -10.0 | 27.4 |
| 2369 HK | Coolpad Group Ltd | 0.72 | 463.4 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | 0.6 | n.a. | 43.5 | -22.3 | -18.6 | -11.6 | 0.0 | n.a. | 0.0 | 0.0 | 0.0 | -12.2 |
| 763 HK | Zte Corp-H | 26.55 | 17846.3 | 19.3 | 17.3 | 14.8 | 15.9 | 14.4 | 13.0 | 3.1 | 2.5 | 11.8 | 14.5 | -0.9 | 3.6 | 0.0 | 1.3 | -9.5 | -0.2 | 35.2 | 120.5 |
| 2498 TT | Htc Corp | 70.50 | 1980.7 | n.a. | 4.4 | n.a. | n.a. | n.a. | n.a. | 1.3 | 1.3 | -21.4 | -18.8 | -10.5 | -10.3 | n.a. | 0.0 | -3.6 | 2.0 | -1.5 | -11.1 |
| 2000 HK | Sim Technology Group Ltd | 0.40 | 130.9 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | 0.5 | n.a. | 3.4 | n.a. | 2.4 | n.a. | 2.5 | n.a. | -1.2 | -7.0 | -1.2 | 27.0 |
| Average | | | | 19.3 | 10.8 | 14.8 | 15.9 | 14.4 | 13.0 | 1.4 | 1.9 | 9.3 | -8.9 | -6.9 | -6.1 | 0.8 | 0.7 | -3.6 | -1.3 | 8.1 | 31.1 |
| 732 HK | Truly International Holdings | 2.65 | 1057.3 | 31.5 | 9.0 | 6.3 | 7.0 | 5.0 | 4.2 | 1.1 | 1.1 | 11.9 | 2.9 | -0.2 | 1.0 | 1.9 | 1.5 | -21.6 | -14.5 | 1.5 | -17.2 |
| 2382 HK | Sunny Optical Tech | 108.00 | 15148.8 | 35.3 | 24.5 | 18.6 | 27.4 | 19.1 | 14.7 | 16.7 | 13.5 | 21.5 | 42.7 | 18.8 | 20.1 | 0.7 | 0.7 | 8.1 | -9.5 | 18.4 | 143.2 |
| 2018 HK | Aac Technologies Holdings In | 131.50 | 20546.9 | 24.0 | 17.8 | 14.6 | 17.7 | 13.4 | 11.1 | 8.7 | 7.3 | 30.4 | 32.5 | 22.7 | 20.4 | 1.3 | 1.6 | -5.7 | -9.0 | 25.0 | 68.8 |
| 3336 HK | Ju Teng International Hldgs | 2.23 | 327.2 | 8.5 | 6.3 | 5.3 | 4.9 | 3.8 | 3.4 | 0.4 | 0.4 | 13.4 | 4.1 | 2.5 | 0.8 | 4.5 | 3.3 | -12.5 | -18.6 | -28.1 | -10.8 |
| 698 HK | Tongda Group Holdings Ltd | 1.84 | 1423.8 | 10.5 | 8.0 | 6.7 | 8.1 | 6.4 | 5.4 | 2.2 | 2.0 | 18.7 | 20.4 | 8.8 | 9.9 | 2.6 | 2.9 | -8.0 | -16.0 | -16.7 | -14.4 |
| 1415 HK | Cowell E Holdings Inc | 2.34 | 248.8 | 5.6 | 4.5 | 4.2 | 2.4 | 2.1 | 2.0 | 0.8 | 0.7 | 25.4 | 14.2 | 8.7 | 8.2 | 4.2 | 4.7 | -11.4 | -37.8 | -25.7 | -3.7 |
| Average | | | | 19.3 | 11.7 | 9.3 | 11.2 | 8.3 | 6.8 | 5.0 | 4.2 | 20.2 | 19.5 | 10.2 | 10.1 | 2.5 | 2.4 | -8.5 | -17.6 | -4.3 | 27.7 |
| 861 HK | Digital China Holdings Ltd | 4.52 | 969.4 | n.a. | 22.3 | 15.4 | 45.1 | 16.0 | 14.6 | 0.8 | 0.8 | 7.6 | -2.2 | -2.1 | -0.7 | 0.0 | 0.0 | -14.9 | -5.6 | -8.8 | -31.1 |
| 856 HK | Vst Holdings Ltd | 4.18 | 780.3 | 9.7 | 7.2 | 5.1 | 9.6 | 7.0 | 5.7 | 1.5 | 1.4 | 11.6 | 15.4 | 3.4 | n.a. | 3.0 | 3.1 | -13.3 | 9.4 | 100.0 | 52.0 |
| Average | | | | 9.7 | 14.7 | 10.3 | 27.3 | 11.5 | 10.2 | 1.1 | 1.1 | 9.6 | 6.6 | 0.7 | -0.7 | 1.5 | 1.6 | -14.1 | 1.9 | 45.6 | 10.5 |

Sources: Bloomberg, CGIS Research

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