

Technology	Last Close	Target Price	Upside	12 April 2018
	HK\$4.09	HK\$3.70↓	-10%	

Lenovo (992 HK)

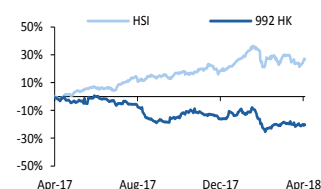
PC market stable; earnings likely to remain depressed

- ⊕ **PC market remained stable in 1Q18:** Global PC shipments were flat YoY in 1Q18 at 60.3m units, per IDC data. Shipments in the US returned to growth while China was a soft spot. HP was again the #1 maker, with Dell the fastest-growing among major peers, while Lenovo's growth was in line with market. Lenovo saw some recovery in the US market as its channel inventory is now healthier after correction in the prior quarters. Market consolidation continued with top three makers accounting for 59.9% of shipments (vs. 58.1% in 1Q17).
- ⊕ **4QFY18 earnings to remain depressed.** Lenovo's 4QFY18 PC shipments came in 2% lower than our estimate. We attribute the slower growth (vs HP/Dell) partly to geographical mix. We believe the company has renegotiated prices with some commercial PC customers which should help offset high component cost. As such, we expect PC PTI margin to remain stable at 4.4% in 4QFY18. We expect continued weakness from the smartphone business on intense competition (in Asia markets) and seasonal slowdown (70% of shipment from the Americas). We expect 4QFY18 pre-tax profit to be largely flat YoY at US\$20m (annual earnings due out in May).
- ⊕ **Maintain Sell:** We expect the PC market to remain stable, with rising ASP (due to higher commercial customer mix and gaming PC) as the key driver. We expect smartphone loss to remain a drag, and wait for more signs of DCG (server business) turnaround. Given the challenging smartphone market, we believe the company may further shift its focus towards profitability. Shares trade at 13x FY19E P/E, largely in line with closest peers HP/Asus at 11x/12x. We lower FY18E net profit from -US\$184m to -US\$204m and FY19E net profit by 5% on softer revenue and margin outlook. Our new TP of HK\$3.70 (previously HK\$3.90) is based on 12x FY19E P/E.

Stock Rating

SELL

1-year stock performance



Source: Bloomberg

Stock data

52w high (HK\$)	5.21
52w low (HK\$)	3.76
Market cap (HK\$ m)	48,900.20
Avg daily vol (m)	32.19
YTD change (%)	-7.71
200d MA (HK\$)	4.44

Source: Bloomberg

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Financial highlights

Y/E 31 Mar	2016	2017	2018E	2019E	2020E
Revenue (US\$ m)	44,912	43,035	45,129	47,578	49,664
YoY growth (%)	-3	-4	5	5	4
Net profit (US\$ m)	(128)	535	(204)	446	558
EPS (US\$)	(0.01)	0.05	(0.02)	0.04	0.05
YoY growth (%)	-79	21	-269	-144	57
Previous EPS (US\$)			(0.02)	0.04	0.05
Change (%)			NA	-5	-3
P/E (x)	NA	10.8	NA	13.4	10.7
BVPS (US\$)	0.27	0.21	0.13	0.13	0.14
P/B (x)	1.9	2.4	4.0	4.0	3.7
Dividend yield (%)	6.5	6.5	2.9	3.4	4.2

Source: Company data, BOCOM Int'l estimates

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Lenovo (992 HK)



Figure 1: Lenovo quarterly forecasts and key assumptions

Lenovo consolidated (992 HK)	Jun-16	Sep-16	Dec-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	10,418	10,944	12,082	13,248	11,305	44,912	43,035	45,129	47,578	49,664
Seq %	10	12	8	-21	5	17	10	-19	5	10	10	-15	-3	-4	5	5	4
COGS	8,522	9,624	10,573	8,211	8,648	10,148	11,188	9,031	9,415	10,401	11,412	9,710	38,288	36,929	39,015	40,939	42,771
% of sales	85	86	87	86	86	86	86	87	86	86	86	86	85	86	86	86	86
Gross Profit	1,535	1,607	1,595	1,368	1,365	1,613	1,751	1,386	1,529	1,680	1,836	1,595	6,624	6,106	6,115	6,640	6,893
GPM%	15.3	14.3	13.1	14.3	13.6	13.7	13.5	13.3	14.0	13.9	13.9	14.1	14.7	14.2	13.5	14.0	13.9
OPEX	1,289	1,392	1,457	1,294	1,371	1,525	1,547	1,313	1,423	1,510	1,590	1,413	6,686	5,434	5,755	5,936	6,049
% of sales	13	12	12	14	14	13	12	13	13	13	12	13	15	13	13	12	12
Operating Profit	245	215	138	74	(6)	88	205	74	106	170	246	182	(62)	672	360	704	844
OM%	2.4	1.9	1.1	0.8	-0.1	0.7	1.6	0.7	1.0	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	20	52	117	195	129	(277)	490	136	493	620
PTI%	2.0	1.5	0.8	0.2	-0.7	0.3	1.2	0.2	0.5	1.0	1.5	1.1	-0.6	1.1	0.3	1.0	1.2
Tax (benefit)	38	16	(6)	(89)	(15)	(118)	425	2	3	12	19	13	(132)	(41)	294	47	62
Net Profit	173	157	98	107	(72)	139	(289)	18	50	105	175	116	(128)	535	(204)	446	558
EPS (US\$ cents)	1.6	1.4	0.9	1.0	(0.7)	1.3	(2.5)	0.2	0.4	0.9	1.5	1.0	(1.1)	4.9	(1.8)	3.9	4.9
Revenue by division (US\$ m)																	
PCSD (PC/tablets)	6,992	7,804	8,598	6,682	7,005	8,382	9,250	7,463	7,665	8,545	9,280	8,023	30,796	30,076	32,100	33,513	34,368
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	10,418	10,944	12,082	13,248	11,305	44,912	43,035	45,129	47,578	49,664
PTI by division (US\$)																	
PCSD (PC/tablets)	370	405	431	288	291	367	416	328	345	393	427	361	1,458	1,494	1,402	1,526	1,513
MBG (Mobile)	(206)	(156)	(155)	(220)	(173)	(164)	(124)	(168)	(143)	(128)	(102)	(109)	(662)	(737)	(629)	(481)	(408)
DCG (Servers)	(64)	(141)	(124)	(141)	(144)	(131)	(86)	(78)	(73)	(63)	(51)	(22)	(103)	(470)	(439)	(209)	(129)
Others	106	60	(51)	88	(43)	(37)	(56)	(63)	(77)	(85)	(79)	(102)	(970)	202	(198)	(342)	(357)
Total	206	168	101	15	(69)	35	150	20	52	117	195	129	(277)	489	136	493	620
PTI margin by division (%)																	
PCSD (PC/tablets)	5.3	5.2	5.0	4.3	4.2	4.4	4.5	4.4	4.5	4.6	4.6	4.5	4.7	5.0	4.4	4.6	4.4
MBG (Mobile)	-12.1	-7.7	-7.1	-12.4	-9.9	-7.9	-6.0	-10.5	-7.9	-6.5	-4.5	-6.0	-7.7	-9.6	-8.4	-6.1	-4.8
DCG (Servers)	-5.9	-13.1	-11.8	-16.6	-14.9	-13.4	-7.0	-8.0	-6.8	-5.5	-4.0	-2.0	-2.3	-11.6	-10.6	-4.6	-2.6
Shipments																	
Total PC																	
Units ('000)	13,203	14,505	15,712	12,317	12,362	14,491	15,695	12,306	12,588	13,967	15,132	13,061	56,089	55,737	54,854	54,748	56,607
QoQ %	9	10	8	-22	0	17	8	-22	2	11	8	-14	-6	-1	-2	0	3
YoY %	-2	-3	2	2	-6	0	0	0	2	-4	-4	6	-6	-1	-2	0	3
Smartphone shipment (m units)	11.2	13.9	15.0	11.5	11.2	15.3	12.3	9.8	10.2	11.0	12.6	10.7	66.0	51.7	48.6	44.5	48.3
Seq %	3	24	8	-23	-3	37	-20	-20	4	8	14	-15	-13	-22	-6	-9	9

Source: Company data, BOCOM Int'l estimates

Financial Statements

Income statement (US\$ m)

Y/E 31 Mar	2016	2017	2018E	2019E	2020E
Revenue	44,912	43,035	45,129	47,578	49,664
COGS	(38,288)	(36,929)	(39,015)	(40,939)	(42,771)
Gross Profit	6,624	6,106	6,115	6,640	6,893
OPEX	(6,686)	(5,434)	(5,755)	(5,936)	(6,049)
OP	(62)	672	360	704	844
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	136	493	620
Tax	(132)	(41)	294	47	62
Net income (before minority)	(145)	530	(158)	446	558
Minority interest	(16)	(5)	47	-	-
Net income	(128)	535	(204)	446	558
EPS (US\$ cents)	-1.2	4.9	-1.8	3.9	4.9

Balance sheet (US\$ m)

As of 31 Mar	2016	2017	2018E	2019E	2020E
Cash & cash equiv.	1,927	2,755	2,245	2,650	3,244
Marketable Securities	152	197	197	197	197
Account Receivables	4,404	4,468	4,686	4,940	5,157
Inventory	2,627	2,794	2,930	3,089	3,224
Others	3,857	4,655	4,655	4,655	4,655
Current Assets	12,967	14,868	14,712	15,530	16,477
Land/CIP	-	-	-	-	-
PP&E, net	1,392	1,649	1,576	1,385	1,097
Investment securities	140	256	268	283	295
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	26,969	27,610	28,281
Accounts payable	4,267	6,486	6,801	7,170	7,485
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	18,649	19,019	19,333
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	23,658	24,273	24,829
Common stock	2,690	2,690	2,690	2,690	2,690
Retained earnings	310	534	(298)	(271)	(156)
Shareholder equity	3,000	3,224	2,392	2,419	2,534
minority interest	26	872	918	918	918
Total capital	24,933	27,186	26,969	27,610	28,281

Source: Company data, BOCOM Int'l estimates

Cash flow statement (US\$ m)

Y/E 31 Mar	2016	2017	2018E	2019E	2020E
Profit before tax	(277)	490	136	493	620
Depreciation/Amortization	741	742	560	703	825
Changes in work capital	(482)	1,618	(38)	(44)	(38)
Forex gain/loss	123	87	-	-	-
Others	187	(817)	(294)	(47)	(62)
Cash flow from operations	292	2,120	364	1,105	1,345
Capex	(203)	(464)	(487)	(511)	(537)
Sales of tangible assets	92	412	-	-	-
Investments	(64)	(45)	(12)	(15)	(12)
Others	(678)	(1,301)	-	-	-
Cash flow from investing	(854)	(1,398)	(499)	(526)	(549)
Dividends paid	(379)	(377)	(375)	(175)	(201)
New share issued	-	-	-	-	-
Debt issuance/(repayment)	226	655	-	-	-
Other	(151)	(133)	-	-	-
Cash flow from financing	(305)	145	(375)	(175)	(201)
Other	(62)	(40)	-	-	-
Net cash flow	(928)	828	(509)	404	595
Cash at beginning	2,855	1,927	2,755	2,245	2,650
Cash at end	1,927	2,755	2,245	2,650	3,245

Financial ratios

Y/E 31 Mar	2016	2017	2018E	2019E	2020E
P/E (x)	NA	10.8	NA	13.4	10.7
P/B (x)	1.9	2.4	4.0	4.0	3.7
P/S (x)	0.1	0.1	0.1	0.1	0.1
EV/EBITDA (x)	7.0	5.0	9.9	5.3	3.9
Dividend yield (%)	6.5	6.5	2.9	3.4	4.2
Net debt/equity (x)	0.4	0.0	0.2	0.1	(0.2)
ROE (%)	-3.6	20.1	-10.7	30.0	35.8
ROA (%)	-0.5	2.1	-0.8	1.6	2.0
ROIC (%)	3.3	4.2	-7.8	3.7	5.7

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Buy: The stock's total return is expected to **exceed** that of the corresponding industry over the next 12 months.

Neutral: The stock's total return is expected to be **in line with** that of the corresponding industry over the next 12 months.

Sell: The stock's total return is expected to be **below** that of the corresponding industry 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.

Analyst Industry Views:

Outperform: The analyst expects the industry coverage universe to be **attractive** relative to the relevant broad market benchmark over the next 12 months.

Market perform: The analyst expects the industry coverage universe to be **in line with** the relevant broad market benchmark 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.

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**.

12 April 2018

Lenovo (992 HK)



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