

Technology	Last Close HK\$3.91	Target Price HK\$4.10↑	Upside +5%	25 May 2018
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Lenovo Group (992 HK)

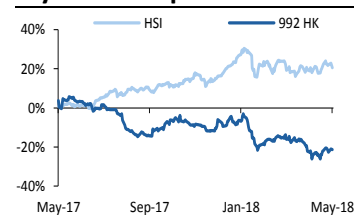
Earnings stabilizing; upgrade to Neutral

- ⊕ **4QFY18 earnings slightly ahead of expectations:** Solid PCSD (PC) margins and strong revenue growth for data center business (DCG) were the bright spots in 4QFY18, offsetting the continued weakness in its mobile segment. Quarterly revenue grew 11% YoY to US\$10.6bn (vs. Street estimate of US\$9.8bn). Pre-tax profit remained depressed at US\$37m but continued to show YoY growth. While improving product mix and rising ASP were the main reasons for the strong PTI margin of PCSD, we believe USD weakness (especially against RMB in 1Q18, calendar year) also contributed to the margin strength.
- ⊕ **Data center showing sustained growth; smartphone business still soft.** 4QFY18 DCG revenue grew 44% YoY, helped by the strength from North American and EMEA, with hyper-scale, HPC and software showing solid growth. For mobile business, Lenovo intends to reduce the complexity of the business (e.g. by cutting models) and possibly exit some unprofitable emerging markets, in order to improve profitability. We continue to believe that scale is highly important to smartphone profitability, especially at the mid- to low end, and thus remain cautious on the outlook of Lenovo's smartphone business.
- ⊕ **Earnings stabilizing; upgrade to Neutral on limited further downside:** We believe Lenovo's earnings outlook is stabilizing, helped by the improving prospect of DCG, but we expect smartphone business to remain a drag. Its shares have underperformed the market YTD (down 11% vs. HSI up 3%), and now trade at 12.8x FY19E P/E, largely in line with its closest peers HPQ/Asus of 11x/13x forward P/E. We fine-tune our FY19/20E net profit estimates by 2%/4%. Our new TP of HK\$4.10 is based on 13x FY19E P/E (previously HK\$3.70 on 12x FY19E P/E). Upgrade from Sell to **Neutral**.

Stock Rating

NEUTRAL ↑

1-year stock performance



Source: Bloomberg

Stock data

52w high (HK\$)	5.21
52w low (HK\$)	3.53
Market cap (HK\$ m)	46,977.84
Avg daily vol (m)	44.20
YTD change (%)	-11.34
200d MA (HK\$)	4.29

Source: Bloomberg

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Financial highlights

Y/E 31 Mar	2016	2017	2018	2019E	2020E
Revenue (US\$ m)	44,912	43,035	45,350	48,751	50,910
YoY growth (%)	-3	-4	5	7	4
Net profit (US\$ m)	(128)	535	(189)	456	582
EPS (US\$)	(0.01)	0.05	(0.02)	0.04	0.05
YoY growth (%)	-79	21	-266	-149	49
Previous EPS (US\$)				0.04	0.05
Change (%)				0	2
P/E (x)	NA	10.3	NA	12.8	10.1
BVPS (US\$)	0.27	0.21	0.22	0.20	0.19
P/B (x)	1.9	2.3	2.3	2.5	2.6
Dividend yield (%)	6.8	6.9	6.8	7.0	7.5

Source: Company data, BOCOM Int'l estimates

25 May 2018

Lenovo (992 HK)



Figure 1: Lenovo quarterly forecasts and key assumptions

US\$ m (FY end March)	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
	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19E	2QFY19E	3QFY19E	4QFY19E	FY16	FY17	FY18	FY19E	FY20E
Revenue	10,056	11,231	12,169	9,579	10,012	11,761	12,939	10,638	11,351	12,316	13,466	11,618	44,912	43,035	45,350	48,751	50,910
Seq %	10	12	8	-21	5	17	10	-18	7	9	9	-14	-3	-4	5	7	4
COGS	8,522	9,624	10,573	8,211	8,648	10,148	11,188	9,094	9,730	10,599	11,610	9,946	38,288	36,929	39,078	41,885	43,669
% of sales	85	86	87	86	86	86	86	85	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	1,544	1,621	1,717	1,856	1,672	6,624	6,106	6,272	6,867	7,241
GPM%	15.3	14.3	13.1	14.3	13.6	13.7	13.5	14.5	14.3	13.9	13.8	14.4	14.7	14.2	13.8	14.1	14.2
OPEX	1,289	1,392	1,457	1,294	1,371	1,525	1,547	1,443	1,476	1,540	1,616	1,452	6,686	5,444	5,885	6,083	6,317
% of sales	13	12	12	14	14	13	12	14	13	13	12	13	15	13	13	12	12
Operating profit	245	215	138	74	(6)	88	205	101	145	178	240	220	(62)	672	387	783	923
OM%	2.4	1.9	1.1	0.8	-0.1	0.7	1.6	1.0	1.3	1.4	1.8	1.9	-0.1	1.6	0.9	1.6	1.8
Pretax profit	206	168	101	15	(69)	35	150	37	80	113	177	155	(277)	490	153	525	647
PTI%	2.0	1.5	0.8	0.2	-0.7	0.3	1.2	0.3	0.7	0.9	1.3	1.3	-0.6	1.1	0.3	1.1	1.3
Tax (benefit)	38	16	(6)	(89)	(15)	(118)	425	(12)	24	11	18	16	(132)	(41)	280	68	65
Net profit	173	157	98	107	(72)	139	(289)	33	56	101	159	140	(128)	535	(189)	456	582
EPS (US cents)	1.6	1.4	0.9	1.0	(0.7)	1.3	(2.5)	0.3	0.5	0.9	1.4	1.2	(1.1)	4.9	(1.7)	3.9	5.0
Revenue by division (US\$ m)																	
PCSD (PC/tablets)	6,992	7,804	8,598	6,682	7,005	8,382	9,250	7,741	8,310	9,062	9,841	8,509	30,796	30,076	32,379	35,723	36,441
MBG (mobile)	1,706	2,045	2,185	1,772	1,746	2,077	2,076	1,342	1,530	1,668	1,934	1,393	8,548	7,708	7,241	6,525	6,523
DCG (servers)	1,086	1,082	1,050	850	971	976	1,225	1,223	1,162	1,220	1,305	1,371	4,553	4,068	4,394	5,058	6,318
Others	272	300	336	275	290	326	388	332	349	366	385	346	1,015	1,183	1,336	1,446	1,628
Total	10,056	11,231	12,169	9,579	10,012	11,761	12,939	10,638	11,351	12,316	13,466	11,618	44,912	43,035	45,350	48,751	50,910
PTI by division (US\$)																	
PCSD (PC/tablets)	370	405	431	288	291	367	416	384	382	408	443	383	1,458	1,494	1,458	1,616	1,632
MBG (mobile)	(206)	(156)	(155)	(220)	(173)	(164)	(124)	(142)	(142)	(142)	(130)	(97)	(662)	(737)	(603)	(511)	(414)
DCG (servers)	(64)	(141)	(124)	(141)	(144)	(131)	(86)	(64)	(58)	(55)	(29)	(37)	(103)	(470)	(425)	(179)	(164)
Others	106	60	(51)	88	(43)	(37)	(56)	(141)	(102)	(99)	(108)	(93)	(970)	202	(277)	(401)	(407)
Total	206	168	101	15	(69)	35	150	37	80	113	177	155	(277)	489	153	525	647
PTI margin by division (%)																	
PCSD (PC/tablets)	5.3	5.2	5.0	4.3	4.2	4.4	4.5	5.0	4.6	4.5	4.5	4.5	4.7	5.0	4.5	4.5	4.5
MBG (mobile)	-12.1	-7.7	-7.1	-12.4	-9.9	-7.9	-6.0	-10.6	-9.3	-8.5	-6.7	-7.0	-7.7	-9.6	-8.3	-7.8	-6.3
DCG (servers)	-5.9	-13.1	-11.8	-16.6	-14.9	-13.4	-7.0	-5.2	-5.0	-4.5	-2.2	-2.7	-2.3	-11.6	-9.7	-3.5	-2.6
Shipments																	
Total PC																	
Units ('000)	13,203	14,505	15,712	12,317	12,362	14,491	15,695	12,418	12,832	13,902	15,062	13,000	56,089	55,737	54,966	54,796	56,350
QoQ %	9	10	8	-22	0	17	8	-21	3	8	8	-14	-6	-1	-1	0	3
YoY %	-2	-3	2	2	-6	0	0	1	4	-4	-4	5	-6	-1	-1	0	3
Smartphone shipment (m units)	11.2	13.9	15.0	11.5	11.2	15.3	12.3	9.8	9.1	9.8	11.1	9.4	66.0	51.7	48.6	39.4	42.7
Seq %	3	24	8	-23	-3	37	-20	-20	-8	7	14	-15	-13	-22	-6	-19	8

Source: Company data, BOCOM Int'l estimates

Financial Statements

Income statement (US\$ m)					
Y/E 31 Mar	2016	2017	2018	2019E	2020E
Revenue	44,912	43,035	45,350	48,751	50,910
COGS	(38,288)	(36,929)	(39,078)	(41,885)	(43,669)
Gross Profit	6,624	6,106	6,272	6,867	7,241
OPEX	(6,686)	(5,444)	(5,885)	(6,083)	(6,317)
OP	(62)	672	387	783	923
Net interest expense	(204)	(204)	(231)	(273)	(290)
Equity Method	(11)	21	(3)	14	14
Others	-	-	-	-	-
Non-OP income	(215)	(182)	(234)	(259)	(276)
Pre-tax income	(277)	490	153	525	647
Tax	(132)	(41)	280	68	65
Net income (before minority)	(145)	530	(127)	456	582
Minority interest	(16)	(5)	63	-	-
Net income	(128)	535	(189)	456	582
EPS (US\$ cents)	-1.2	4.9	-1.7	3.9	5.0

Balance sheet (US\$ m)					
As of 31 Mar	2016	2017	2018	2019E	2020E
Cash & cash equiv.	1,927	2,755	1,848	2,022	2,392
Marketable Securities	152	197	84	84	84
Account Receivables	4,404	4,468	4,973	5,346	5,582
Inventory	2,627	2,794	3,792	4,076	4,257
Others	3,857	4,655	4,967	4,967	4,967
Current Assets	12,967	14,868	15,663	16,495	17,282
Land/CIP	-	-	-	-	-
PP&E, net	1,392	1,649	1,305	1,049	762
Investment securities	140	256	373	401	419
Interest bearing asset	-	-	-	-	-
Intangible asset	8,661	8,349	8,515	8,515	8,515
Other fixed assets	1,774	2,063	2,639	2,639	2,639
Total Assets	24,933	27,186	28,494	29,098	29,616
Accounts payable	4,267	6,486	7,252	7,796	8,141
Short-term debt	746	70	1,167	1,167	1,167
Others	10,748	11,778	11,041	11,041	11,041
Current Liabilities	15,760	18,334	19,460	20,004	20,349
Long-term debt	2,505	2,967	2,649	2,649	2,649
Others	3,642	1,790	1,840	2,068	2,310
Total Liabilities	21,907	23,091	23,948	24,720	25,307
Common stock	2,690	2,690	3,186	3,186	3,186
Retained earnings	310	534	333	165	95
Shareholder equity	3,000	3,224	3,519	3,351	3,281
minority interest	26	872	1,027	1,027	1,027
Total liabilities and equity	24,933	27,186	28,494	29,098	29,616

Source: Company data, BOCOM Int'l estimates

Cash flow statement (US\$ m)					
Y/E 31 Mar	2016	2017	2018	2019E	2020E
Profit before tax	(277)	490	153	525	647
Depreciation/Amortization	741	742	739	784	842
Changes in work capital	(482)	1,618	(1,090)	(113)	(72)
Forex gain/loss	123	87	(258)	-	-
Others	187	(817)	(300)	(68)	(65)
Cash flow from operations	292	2,120	(756)	1,127	1,352
Capex	(203)	(464)	(503)	(528)	(555)
Sales of tangible assets	92	412	41	-	-
Investments	(64)	(45)	58	(28)	(18)
Others	(678)	(1,301)	(709)	-	-
Cash flow from investing	(854)	(1,398)	(1,114)	(556)	(573)
Dividends paid	(379)	(377)	(381)	(396)	(411)
New share issued	-	-	496	-	-
Debt issuance/(repayment)	226	655	877	-	-
Other	(151)	(133)	(118)	-	-
Cash flow from financing	(305)	145	874	(396)	(411)
Other	(62)	(40)	89	-	-
Net cash flow	(928)	828	(907)	174	369
Cash at beginning	2,855	1,927	2,755	1,848	2,022
Cash at end	1,927	2,755	1,848	2,022	2,392

Financial ratios					
Y/E 31 Mar	2016	2017	2018	2019E	2020E
P/E (x)	NA	10.3	NA	12.8	10.1
P/B (x)	1.9	2.3	2.3	2.5	2.6
P/S (x)	0.1	0.1	0.1	0.1	0.1
EV/EBITDA (x)	6.7	4.8	8.7	5.8	4.8
Dividend yield (%)	6.8	6.9	6.8	7.0	7.5
Net debt/equity (x)	0.4	0.0	0.5	0.5	0.4
ROE (%)	-3.6	20.1	-7.8	19.0	25.4
ROA (%)	-0.5	2.1	-0.7	1.6	2.0
ROIC (%)	3.3	4.2	-6.6	3.1	4.8

25 May 2018

Lenovo (992 HK)



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Rating System

Analyst Stock Ratings:

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**.

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