



Company Report

Lenovo (992 HK) – Buy
Computer Hardware Industry
 Maintain 12-month target price at HK\$7.92

Key data

Share price (HK\$)	6.58
Target price (HK\$)	7.92
Upside potential (%)	20.4
52Wk H/L(HK\$)	5.04 / 7.66
Issued shares (mn)	10,335.6
Market cap (HK\$m)	67,921
30-day avg vol (HK\$m)	379.35
Major shareholders (%):	
Legend Holdings Ltd	33.6
Yuanqing Yang-CEO	9.3

Source: Company, Bloomberg, ABCI Securities

Revenue composition in FY3/12 (%)

China	41.9
North America	15.4
Europe-Middle East-Africa	21.3
Asia Pacific/Latin America	21.4

Source: Company

Share performance (%)

	Absolute	Relative*
1-mth	6.3%	0.2%
3-mth	10.3%	1.1%
6-mth	(2.9%)	(10.6%)

Source: Bloomberg

*Relative to Hang Seng Index

1 year price performance



Source: Bloomberg

Analyst

Report date: 09 Oct, 2012

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Previous report

Date: 11 July, 2012

Rating: Buy

We've attended the tele-conference of Lenovo on 08 Nov2012. Lenovo outperformed global PC market by gain market share in all geographic districts. The fast ramp-up of its smartphone business will bring a new engine for its profit.

Margin improve in 2Q FY3/13: Its sales and net profit grew by 11.4% YoY and 12.6% YoY to US\$8,672mn and US\$162mn(or FD EPS US\$1.55cents) in 2QFY3/13, in line with our forecast. Its operating profit margin increased by 0.3pptYoY and 0.1pptQoQ to 2.4% in 2Q FY3/13 due to tight control of operating cost.

Gaining market shares in a tough PC market: Owing to proper consumer PC marketing strategy in developing markets, its global PC shipment grew by 10.8% YoY in 2Q FY3/13 while global PC shipment dropped 8.6% YoY for the same period. Its global market share reached 15.6% in 2Q FY3/13, further narrowed the gap with HP (market share of 15.8%). We expect it will surpass HP to become the No.1 in 3Q FY3/13.

MIDH business grew rapidly due to fast ramp-up of smartphone sales: Its MIDH business increased by 150% YoY and accounted for 8.3% of total sales(vs 3.6% in 1QFY3/13) in 2QFY3/13 due to strong smartphone sales in China. Lenovo was ranked No.2 with 14.2% market share in China's smartphone market. The group will launch its smartphone in other emerging markets like Indonesia to achieve business scale. We expect the smartphone business to become profitable in next couple quarters.

3Q FY3/13 outlook: Although the overall PC market is weak, the management still confident in sequential PC shipment and sales growth. The launch of Window 8 in Oct will boost PC sales in next two quarters. We expect its 3Q and 4Q PC shipment to grow by 14.6% YoY and 13.0% YoY. We expect its operating margin to further improve to 2.5% in 3Q (vs 2.4% in 2Q).

Valuation: We maintain our "Buy" rating and set 12mth target price at HK\$7.92, representing 16xPER for FY3/13.

Risk: Lower-than-expected PC shipment growth; Rapid ASP decline; Substitution effect of tablets

Forecast and valuation

FY ended Mar 31	FY11	FY12	FY13E	FY14E	FY15E
Revenue(US\$m)	21,594	29,574	34,072	38,283	43,792
Chg (% YoY)	30.0	37.0	15.2	12.4	14.4
Net Income(US\$m)	273	473	569	655	742
Chg (% YoY)	111.2	74.0	20.3	14.6	13.2
Diluted EPS(HK\$)	0.212	0.355	0.432	0.495	0.560
Chg (% YoY)	105.3	67.4	21.7	14.6	13.2
P/E	-	18.5	15.2	13.3	11.8
BVPS(US cents)	18.33	23.65	27.39	32.27	37.79
P/B	-	3.6	3.1	2.6	2.2
DPS(UScents)	0.687	1.774	1.391	1.593	1.803
Dividend yield(%)	-	1.8	2.1	2.5	2.9

^ Source: Company data, Bloomberg, ABCI Securities estimates; @HK\$7.75/US\$



Exhibit 1:2Q FY results

(US\$ mn)	Actual	ABC I est.	Difference	qoq (%)	yoy (%)
Revenues	8,673	8,631	0.5%	8.3%	11.4%
Gross profit	1,050	1,053	-0.3%	9.5%	10.8%
Operating profit	206	207	-0.7%	13.1%	23.8%
Pretax profit	204	208	-2.0%	10.0%	23.6%
Net profit	163	162	0.5%	12.8%	12.6%
Gross profit margin	12.1%	12.2%			
Operating profit margin	2.4%	2.4%			
Net profit margin	1.9%	1.9%			

Source: ABCI Securities



Lenovo: Financial Summary
Consolidated Income Statement

Yr to Mar31 (US\$ mn)	FY11	FY12	FY13E	FY14E	FY15E
Sales	21,594.37	29,574.44	34,071.79	38,282.65	43,791.68
Cost of sales	(19,230.42)	(26,128.22)	(30,009.56)	(33,889.06)	(38,765.82)
Gross profit	2,363.95	3,446.22	4,062.22	4,393.59	5,025.87
Other income	0.42	1.20	(0.32)	0.00	0.00
Selling and distribution expense	(1,038.46)	(1,690.78)	(1,911.89)	(2,073.98)	(2,383.79)
Admin expense	(719.71)	(730.29)	(904.75)	(950.48)	(1,084.44)
R&D expense	(303.41)	(453.33)	(509.82)	(538.15)	(615.95)
Other operating(expense)/income	79.43	11.07	(1.72)	0.00	0.00
EBITDA	558.36	438.50	494.13	582.01	0.00
Depreciation & amortization	176.14	(145.58)	(239.59)	(248.97)	0.00
EBIT	382.22	584.08	733.72	830.98	941.69
Interest income	24.93	42.69	38.43	35.73	35.73
Interest cost	(49.18)	(43.48)	(32.71)	(32.78)	(32.78)
Share of (losses)/profits of associates	(0.23)	(0.85)	(0.08)	0.00	0.00
PBT	357.75	582.44	739.35	833.92	944.63
Taxation	(84.52)	(107.03)	(167.45)	(178.77)	(203.04)
Net Income	273.24	475.42	571.90	655.15	741.59
Net profit attributable to equity holders	273.23	472.99	568.83	655.15	741.59
Diluted EPS (US cents)	2.730	4.570	5.562	6.372	7.213
Diluted EPS (HK\$)	0.212	0.355	0.432	0.495	0.560
Dividend	68.73	183.21	142.98	163.79	185.40
DPS(US cents)	0.687	1.774	1.391	1.593	1.803
Dividend payout ratio(%)	25%	39%	25%	25%	25%

Source: Company data, ABCI Securities estimates



Consolidated Balance sheet

As of Mar31 (US\$ mn)	FY11	FY12	FY13E	FY14E	FY15E
Non-current assets:	2,769.48	4,040.35	4,084.13	4,149.85	4,236.12
Property, plant and equip	209.42	392.47	399.64	428.75	478.29
Prepaid lease payments	9.68	13.55	13.42	13.28	13.15
Construction-in-progress	32.09	103.99	114.38	125.82	138.41
Intangible assets	2,134.45	3,091.21	3,117.56	3,142.85	3,167.14
Other non-current assets	383.83	439.13	439.13	439.13	439.13
Current assets:	7,936.46	11,820.40	10,943.82	15,245.29	15,415.93
Inventories	803.70	1,218.49	1,509.65	1,571.18	1,799.76
Trade receivables	1,368.92	2,354.91	2,041.45	2,866.58	2,747.74
Notes receivables	391.65	639.33	545.77	788.81	737.83
Derivative financial assets	13.30	62.88	62.88	62.88	62.88
Deposits, prepayments and other receivables	2,305.33	3,303.05	3,156.05	4,101.32	4,200.42
Income tax recoverable	56.91	70.41	70.41	70.41	70.41
Bank deposit	42.16	413.67	413.67	413.67	413.67
Cash and cash equivalents	2,954.50	3,757.65	3,143.93	5,370.44	5,383.22
Total asset	10,705.94	15,860.75	15,027.96	19,395.14	19,652.05
Current liabilities:	8,032.65	11,809.68	10,605.90	14,470.50	14,159.98
Trade payables	2,179.84	4,050.27	3,010.80	4,870.38	4,250.99
Notes payable	98.96	127.32	132.58	160.91	174.81
Provisions, accruals and other payables	5,096.65	7,074.20	6,904.63	8,881.31	9,176.28
Bank borrowings	71.56	62.95	62.95	62.95	62.95
Other current liabilities	585.64	494.94	494.94	494.94	494.94
Non-current liabilities:	838.39	1,603.10	1,603.10	1,603.10	1,603.10
Total liabilities	8,871.04	13,412.78	12,209.00	16,073.60	15,763.08
Total equity	1,834.90	2,447.97	2,815.80	3,318.39	3,885.82

Source: Company data, ABCI Securities estimates



Cash flow statement

Yr to Mar31 (US\$ mn)	FY11	FY12	FY13E	FY14E	FY15E
Profit before taxation	357.75	582.44	739.35	833.92	944.63
D&A add-back	217.52	241.82	236.61	239.73	249.11
Change in working capital	597.97	1,388.79	(940.91)	1,789.63	(468.37)
Cash flow from operations	965.25	1,939.96	(170.74)	2,648.78	486.60
Cash flow from investing	65.52	(837.07)	(241.97)	(269.71)	(299.65)
Cash flow from financing	(372.51)	(315.52)	(201.00)	(152.57)	(174.16)
Net change in cash	658.26	787.36	(613.72)	2,226.50	12.78
Beginning cash	2,238.20	2,954.50	3,757.65	3,143.93	5,370.44
Ending cash	2,954.50	3,757.65	3,143.93	5,370.44	5,383.22

Growth&Margin

Sales growth	30.05%	36.95%	15.21%	12.36%	14.39%
EBIT growth	74.78%	52.81%	25.62%	13.26%	13.32%
Net income growth	111.21%	73.11%	20.26%	15.18%	13.19%
EPS growth	105.26%	67.40%	21.71%	14.56%	13.19%
Gross profit margin	10.95%	11.65%	11.92%	11.48%	11.48%
EBIT margin	1.77%	1.97%	2.15%	2.17%	2.15%
Net profit margin	1.27%	1.60%	1.67%	1.71%	1.69%

Ratios

ROAE	15.88%	22.09%	21.61%	21.36%	20.59%
ROAA	2.78%	3.56%	3.68%	3.81%	3.80%
Inventory days	16	14	17	17	16
Trade & notes receivables days	27	29	30	30	30
Trade & notes payable days	52	45	45	44	45
Net cash/equity	1.59	1.68	1.24	1.72	1.48
Book value per share(US cents)	18.33	23.65	27.39	32.27	37.79

Source:Company data,ABCI Securities estimates



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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return $- 6\% \leq$ Stock return $<$ Market return rate
Sell	Stock return $<$ Market return $- 6\%$

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate from 2007-2011 (~15%)

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 1.5
Low	180 day volatility/180 day benchmark index volatility $<$ 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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