



# Company Report

## Lenovo (992 HK) – Buy

Computer Hardware Industry

Raise 12-month target price to HK\$7.92 (previous HK\$6.65)

### Key data

Share price (HK\$)	6.94
Target price (HK\$)	7.92
Upside potential (%)	14.1
52Wk H/L(HK\$)	4.37 / 7.71
Issued shares (mn)	10,335.6
Market cap (HK\$mn)	71,356
30-day avg vol (HK\$mn)	335.91
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	12.4	9.6
3-mth	1.1	(4.0)
6-mth	(3.9)	2.4

Source: Bloomberg

\*Relative to Hang Seng Index

### 1 year price performance



Source: Bloomberg

### Analyst

Report date: 17 Aug, 2012

Judy Hu

Tel: (852) 2147 8310

Email: [judyhu@abci.com.hk](mailto:judyhu@abci.com.hk)

Previous report

Date: 5 June, 2012

Rating: Hold

### Key takeaways from the tele-conference with Lenovo

We had a post-result tele-conference with Lenovo's management on 17 July 2012. We upgrade it from "Hold" to "Buy" as we are confident with its revenue and net profit growth in coming two quarters. The continue share gain in four major markets will bring operating scale benefit to the group, which will further improve its operating margin. We expect that its smartphone business will turn to profit in the China market in 4Q FY3/2013.

**Stronger-than-expected sales growth in 1Q FY3/13:** Its sales and net profit grew by 35.3% YoY and 32.8%YoY to US\$8,010mn and US\$141mn in 1QFY3/13. Its net profit was 16%/6% higher than our forecast/consensus. Its operating profit margin increased by 0.5pptYoY and 0.92pptQoQ to 2.3% in 1Q FY3/13, better than our forecast /consensus of 1.90% / 2.04%.

**2Q and 3Q FY3/13 outlook:** Although the overall PC market is weak, the management still confident in sequential PC shipment and sales growth. Management guided its PC shipment growth will be 10%-15% higher than the overall market. As 2Q and 3Q are the traditional peak season for Lenovo, we expect its 2Q and 3Q PC shipment to grow by 10%QoQ and 6% QoQ. The launch of Windows 8 product in 2Q and 3Q will be a catalyst of its PC shipment growth. We expect its operating margin to further improve to 2.4% and 2.5% in 2Q and 3Q (vs 2.27% in 1Q).

### Valuation:

We revise up our net profit forecast to US\$569mn for FY3/13 from US\$558mn. We upgrade the counter from "Hold" to "Buy" and raise 12mth target price to HK\$7.92(previous TP HK\$6.65), representing 16xPER for FY3/13.

**Risk: Lower-than-expected PC shipment growth; Rapid ASP decline; Substitution effect of tablets; Delay of launching Windows 8**

### Forecast and valuation

FY ended Mar 31	FY11	FY12	FY13E	FY14E	FY15E
Revenue(US\$mn)	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\$mn)	273	473	569	655	742
Chg (%YoY)	111.2	74.0	20.3	14.6	13.2
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
Chg (%YoY)	105.3	67.4	21.7	14.6	13.2
P/E	-	19.56	16.07	14.03	12.39
BVPS(US cents)	18.33	23.65	27.39	32.27	37.79
P/B	-	3.84	3.31	2.81	2.40
DPS(US cents)	0.687	1.774	1.391	1.593	1.803
Dividend yield(%)	-	1.98	1.56	1.78	2.02

^ Source: Company data, Bloomberg, ABCI Securities estimates;@HK\$7.765/US\$



Exhibit1:1QFY3/12 results

(US\$ mn)	Actual	ABCI est.	Difference	Consensus	Difference	qoq(%)	yoy(%)
Revenues	8,010	7,979	0.39%	8,124.00	-1.41%	6.85%	35.30%
Gross profit	958.883	910	5.42%	928.82	3.24%	19.01%	29.84%
Operating profit	181.824	152	19.94%	166.00	9.53%	79.20%	47.75%
Pretax profit	185.248	152	21.61%	169.10	9.55%	82.08%	50.01%
Net profit	141.367	122	16.00%	133.50	5.89%	113.74%	29.94%
Gross profit margin	11.97%	11.40%		11.43%			
Operating profit margin	2.27%	1.90%		2.04%			
Net profit margin	1.76%	1.53%		1.64%			

Source:ABCI Securities estimates,Bloomberg

(US\$ mn)	New forecast			Old forecast			Change%		
	FY13	FY14	FY15	FY13	FY14	FY15	FY13	FY14	FY15
Revenues	34,071.79	38,282.65	43,791.68	34,598.26	40,288.16	47,092.00	(1.5%)	(5.0%)	(7.0%)
Gross profit	4,062.22	4,393.59	5,025.87	3,970.82	4,623.88	5,404.83	2.3%	(5.0%)	(7.0%)
Operating profit	733.72	830.98	941.69	715.29	824.5	977.83	2.6%	0.8%	(3.7%)
Pretax profit	739.35	833.92	944.63	718.23	827.44	980.78	2.9%	0.8%	(3.7%)
Net profit	571.90	655.15	741.59	558.48	643.55	763.2	2.4%	1.8%	(2.8%)
Diluted EPS(US cents)	5.56	6.37	7.21	5.36	6.17	7.32	3.8%	3.3%	(1.5%)
Gross profit margin	11.92%	11.48%	11.48%	11.48%	11.48%	11.48%	3.9%	(0.0%)	(0.0%)
Operating profit margin	2.15%	2.17%	2.15%	2.07%	2.05%	2.08%	4.2%	6.1%	3.6%
Net profit margin	1.68%	1.71%	1.69%	1.61%	1.60%	1.62%	4.0%	7.1%	4.5%

Source:ABCI Securities estimates

**Gaining market shares in a tough PC market:** Its global PC shipment grew by 14.97%YoY in 1Q FY3/13 while global PC shipment dropped 1.6% YoY for the same period. PC shipment grew by 41.2%YoY and 15.7%YoY in Europe-Middle East-Africa(EMEA) and Asia Pacific/Latin America(APLA) markets. Its global market share reach 15.0% in 1Q FY3/13, further narrowed the gap with HP (market share of 15.7%).

**Smartphone business may turn to profit in 4Q FY3/13:**

Lenovo's smartphone shipment reached 4.9mn in 1Q FY3/12 vs 2.4mn units in 4Q FY3/12 and 3mn in 3Q FY3/12. We expect the smartphone business to become profitable in 4Q given operating scale and increasing sales to open market channel. Sale in open market will have high gross profit margin compared with sales in telecom channels.(Currently around 70% of its smartphones are sold in telecom channels).



Lenovo Quarterly Earnings Model

Yr to Mar31 (US\$ mn)	FY2012/2013				FY2013/2014				FY2014/2015			
	1Q	2Q	3Q	Q4	1Q	2Q	3Q	Q4	1Q	2Q	3Q	Q4
Sales	8,009.70	8,631.19	9,155.86	8,275.03	8,914.58	9,779.97	10,458.68	9,129.42	10,176.35	11,280.57	12,047.19	10,287.58
Gross profit	958.88	1,053.01	1,098.70	951.63	1,016.26	1,124.70	1,202.75	1,049.88	1,160.10	1,297.27	1,385.43	1,183.07
Operating profit	181.82	207.15	228.90	115.85	178.29	254.28	261.47	136.94	213.70	270.73	313.23	144.03
PBT	185.25	207.88	229.63	116.59	179.03	255.02	262.20	137.68	214.44	271.47	313.96	144.76
Net profit	141.37	162.15	183.71	81.61	143.22	198.91	209.76	103.26	171.55	211.75	251.17	107.12
<b>Ratio(%)</b>												
Gross profit margin	11.97%	12.20%	12.00%	11.50%	11.40%	11.50%	11.50%	11.50%	11.40%	11.50%	11.50%	11.50%
Operating profit margin	2.27%	2.40%	2.50%	1.40%	2.00%	2.60%	2.50%	1.50%	2.10%	2.40%	2.60%	1.40%
Net profit margin	1.76%	1.88%	2.01%	0.99%	1.61%	2.03%	2.01%	1.13%	1.69%	1.88%	2.08%	1.04%
E/R Ratio*	9.70%	9.80%	9.50%	10.10%	9.40%	8.90%	9.00%	10.00%	9.30%	9.10%	8.90%	10.10%
<b>QoQ Growth(%)</b>												
Revenue	6.85%	7.76%	6.08%	-9.62%	7.73%	9.71%	6.94%	-12.71%	11.47%	10.85%	6.80%	-14.61%
Gross profit	19.01%	9.82%	4.34%	-13.39%	6.79%	10.67%	6.94%	-12.71%	10.50%	11.82%	6.80%	-14.61%
Operating profit	79.20%	13.93%	10.50%	-49.39%	53.90%	42.62%	2.83%	-47.63%	56.05%	26.69%	15.70%	-54.02%
Net profit	111.57%	14.70%	13.29%	-55.58%	75.49%	38.88%	5.46%	-50.77%	66.14%	23.43%	18.62%	-57.35%
<b>YoY Growth(%)</b>												
Revenue	35.30%	10.85%	9.36%	10.39%	11.30%	13.31%	14.23%	10.32%	14.15%	15.34%	15.19%	12.69%
Gross profit	29.84%	11.10%	15.15%	18.11%	5.98%	6.81%	9.47%	10.32%	14.15%	15.34%	15.19%	12.69%
Operating profit	47.75%	24.72%	18.31%	14.18%	-1.94%	22.75%	14.23%	18.21%	19.86%	6.47%	19.80%	5.17%
Net profit	29.94%	12.67%	19.71%	22.14%	1.31%	22.67%	14.18%	26.53%	19.78%	6.45%	19.74%	3.74%

Source: Company data, ABCI Securities estimates

\* E/R Ratio (Operating expense to revenue ratio)



Lenovo:Financial Summary

Consolidated Income Statement

Yr to Mar31 (US\$ mn)	FY11	FY12	FY13E	FY14E	FY15E
<b>Sales</b>	<b>21,594.37</b>	<b>29,574.44</b>	<b>34,071.79</b>	<b>38,282.65</b>	<b>43,791.68</b>
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
<b>EBITDA</b>	<b>558.36</b>	<b>438.50</b>	<b>494.13</b>	<b>582.01</b>	<b>0.00</b>
Depreciation & amortization	176.14	(145.58)	(239.59)	(248.97)	0.00
<b>EBIT</b>	<b>382.22</b>	<b>584.08</b>	<b>733.72</b>	<b>830.98</b>	<b>941.69</b>
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
<b>PBT</b>	<b>357.75</b>	<b>582.44</b>	<b>739.35</b>	<b>833.92</b>	<b>944.63</b>
Taxation	(84.52)	(107.03)	(167.45)	(178.77)	(203.04)
<b>Net Income</b>	<b>273.24</b>	<b>475.42</b>	<b>571.90</b>	<b>655.15</b>	<b>741.59</b>
<b>Net profit attributable to equity holders</b>	<b>273.23</b>	<b>472.99</b>	<b>568.83</b>	<b>655.15</b>	<b>741.59</b>
<b>Diluted EPS(US cents)</b>	<b>2.730</b>	<b>4.570</b>	<b>5.562</b>	<b>6.372</b>	<b>7.213</b>
<b>Diluted EPS(HKS)</b>	<b>0.212</b>	<b>0.355</b>	<b>0.432</b>	<b>0.495</b>	<b>0.560</b>
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**

<b>As of Mar31 (US\$ mn)</b>	<b>FY11</b>	<b>FY12</b>	<b>FY13E</b>	<b>FY14E</b>	<b>FY15E</b>
<b>Non-current assets:</b>	<b>2,769.48</b>	<b>4,040.35</b>	<b>4,084.13</b>	<b>4,149.85</b>	<b>4,236.12</b>
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
<b>Current assets:</b>	<b>7,936.46</b>	<b>11,820.40</b>	<b>10,943.82</b>	<b>15,245.29</b>	<b>15,415.93</b>
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
<b>Total asset</b>	<b>10,705.94</b>	<b>15,860.75</b>	<b>15,027.96</b>	<b>19,395.14</b>	<b>19,652.05</b>
<b>Current liabilities:</b>	<b>8,032.65</b>	<b>11,809.68</b>	<b>10,605.90</b>	<b>14,470.50</b>	<b>14,159.98</b>
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
<b>Non-current liabilities:</b>	<b>838.39</b>	<b>1,603.10</b>	<b>1,603.10</b>	<b>1,603.10</b>	<b>1,603.10</b>
<b>Total liabilities</b>	<b>8,871.04</b>	<b>13,412.78</b>	<b>12,209.00</b>	<b>16,073.60</b>	<b>15,763.08</b>
<b>Total equity</b>	<b>1,834.90</b>	<b>2,447.97</b>	<b>2,815.80</b>	<b>3,318.39</b>	<b>3,885.82</b>

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



農銀國際

ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

Lenovo Group Limited

---

### Disclosures

I, Hu Zhaoling, Judy, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

ABCI Securities Company Limited and/or its member companies (“ABCI”) may pursue financial interests to the companies mentioned in the report.”

### Disclaimer

This report is for our clients only and is for distribution only under such circumstances as may be permitted by applicable law. It has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either expresses or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein. This report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are subject to change without notice and may differ or be contrary to opinions expressed by other business areas as a result of using different assumptions and criteria. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. ABCI Securities Company Limited is under no obligation to update or keep current the information contained herein. ABCI Securities Company Limited relies on information barriers to control the flow of information contained in one or more areas within ABCI Securities Company Limited, into other areas, units, groups or affiliates of ABCI Securities Company Limited. The compensation of the analyst who prepared this report is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking revenues, however, compensation may relate to the revenues of ABCI Securities Company Limited as a whole, of which investment banking, sales and trading are a part. The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. The price and value of the investments referred to in this research and the income from them may fluctuate. Past performance is not necessarily indicative of future results. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related instrument mentioned in this report. For investment advice, trade execution or other enquiries, clients should contact their local sales representative. Neither ABCI Securities Company Limited nor any of its affiliates, directors, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report. Additional information will be made available upon request.

---

Copyright 2012 ABCI Securities Company Limited

No part of this material may be (i) copied, photocopied or duplicated in any form by any means or (ii) redistributed without the prior written consent of ABCI Securities Company Limited.

**Office address: ABCI Securities Company Limited, 13/F Fairmont House,  
8 Cotton Tree Drive, Central, Hong Kong.**

**Tel: (852) 2868 2183**