

# China / Hong Kong Company Update

# Lenovo Group

Bloomberg: 992 HK EQUITY | Reuters: 0992.HK

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DBS Group Research . Equity

27 May 2022

## BUY

Last Traded Price (26 May 2022): HK\$7.27 (HSI : 20,116)  
Price Target 12-mth: HK\$13.00 (79% upside) (Prev HK\$11.30)

### Analyst

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### What's New

- Net profit increased 58% y-o-y to US\$ 412m, ahead of the expectations by 16% due to a stronger operating margin
- Strong cost control and product premiumization offset the impact of slower revenue growth from supply chain challenges
- Raised FY3/23 and FY3/24 earnings by 16% and 4% to reflect services business' operating margin improvement
- Maintain BUY with a higher TP of HK\$13.0 on stronger earnings growth; maintain BUY.

## Strong service growth boosting profit margin

### Investment Thesis

Tech hardware giant transforming into a service-led company by leveraging the world's largest active PC user base (218m) and its strong reputation in hardware products, channeling growth into the services and solutions business.

New SSG business's operating profit is projected to grow at a CAGR of 32% in FY22-25F, on a strong industry trend and low attached rate, boosting the company's operating margin to 6.0% in FY3/25 from 4.3% in FY3/22, as SSG's operating margin is 22% (vs. 4% of the group).

FY3/23 and FY3/24 net profit 18%/42% higher than the market, due to a stronger boost from investment in the "Eastern Data, Western Computing" initiative and higher contributions from the services and solutions business.

### Price Relative



### Forecasts and Valuation

FY Mar (US\$m)	2021A	2022F	2023F	2024F
Turnover	60,742	71,618	74,884	79,495
EBITDA	3,219	4,338	4,697	5,616
Pre-tax Profit	1,774	2,768	3,235	4,146
Net Profit	1,211	2,030	2,288	2,932
Net Pft (Pre Ex) (core profit)	1,211	2,030	2,288	2,932
Net Profit Gth (Pre-ex) (%)	68.4	67.6	12.7	28.2
EPS (US\$)	0.10	0.16	0.17	0.22
EPS (HK\$)	0.80	1.22	1.37	1.76
EPS Gth (%)	68.6	52.6	12.7	28.2
Diluted EPS (HK\$)	0.72	1.24	1.37	1.76
DPS (HK\$)	0.28	0.31	0.45	0.58
BV Per Share (HK\$)	2.32	3.25	4.12	5.28
PE (X)	9.1	6.0	5.3	4.1
CorePE (X)	9.1	6.0	5.3	4.1
P/Cash Flow (X)	3.0	2.9	3.1	2.4
P/Free CF (X)	4.0	4.2	4.6	3.4
EV/EBITDA (X)	3.7	2.7	2.3	1.6
Net Div Yield (%)	3.9	4.3	6.2	7.9
P/Book Value (X)	3.1	2.2	1.8	1.4
Net Debt/Equity (X)	0.2	CASH	CASH	CASH
ROAE (%)	35.8	47.5	40.4	40.6
Earnings Rev (%)		13	16	5
Consensus EPS (US\$)		0.16	0.167	0.14
Other Broker Recs:		B:18	S:2	H:7

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

### Valuation:

We set our TP at HK\$13.0, based on an 8.5x FY23 PE, in line with the historical average. The re-rating is supported by a stronger growth profile over the next two to three years.

### Where we differ:

FY23/24 net profits are 18%/42% higher than the market due to stronger operating margin of SSG and IDG.

### Key Risks to Our View:

Rigorous competition in PCs, smartphones, and servers. Longer-than-expected chip shortage and supply chain woes.

### At A Glance

Issued Capital (m shrs)	12,042
Mkt Cap (HKm/US\$m)	87,545 / 11,153
Major Shareholders (%)	
Legend Holdings Corporation	29.9
Union Star Ltd	6.0
Sureinvest Holdings Ltd.	5.2
Free Float (%)	58.9
3m Avg. Daily Val. (US\$m)	52.80
GICS Industry: Information Technology / Technology Hardware & Equipment	



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## Lenovo Group

### WHAT'S NEW

#### Net profit beating the market, margin expansion expected to continue

##### 4QFY3/22 result highlight

4Q revenue increased 6.8% y-o-y to US\$16.7 bn, behind expectations by 5.6% due to smart devices' sluggish shipment growth caused by supply chain and logistics challenges during China's lockdown.

Segment-wise, Intelligent Devices Group (IDG) and solutions and services group (SSG) increased 7.8% and 28.3% y-o-y to US\$14.7bn and US\$1.4bn respectively. Server business (ISG) revenue declined 12.1% y-o-y to US\$1.4bn due to supply chain constraints.

Operating margin increased to 3.5%, up 0.4ppt y-o-y, due to tightened cost control and increasing contribution from high margin service segment. IDG and SSG's operating increased 0.4/1.1 ppts y-o-y to 7.7% and 22.5% respectively. These are driven by the ASP hike in PC premiumisation and ramping up scale in service business.

Net profit accordingly increased by 58.4% y-o-y to US\$ 412m, ahead of the market consensus by 16.1%.

##### Our View

Despite the sluggish shipment growth of PC expectation in FY3/23, we expect the investment in the "Eastern Data, Western Computing" initiative and penetration of service business in its user base to continue to boost Lenovo's growth in the coming three years.

We revised up the operating margin forecast for SSG by 0.8/ 0.8ppt to 24.0% and 25.0%, and the overall operating margin by 0.6/0.7ppt to 4.7% and 5.6% in FY3/23 and FY3/24. These are driven by an improving margin in both IDG and SSG under the smooth progress in smart device premiumisation and ramping up of scale in service business.

We accordingly increase FY3/23 and FY3/24 earnings forecast by 15.9% and 4.4% and revised up our TP to HK\$ 13.0. Lenovo is currently trading at 4.7x FY3/23 PE, well below its five-year average. We maintain our BUY rating on the stock.

##### Company Background

Founded in 1984 and listed in 1994, Lenovo is the largest global PC vendor, with a 24% global market share in 2021. Lenovo expanded into the server business through the acquisition of IBM's x86 server business and the smartphone business through the acquisition of Motorola Mobility in 2014. (1) Intelligent Devices Group (IDG), (2) Infrastructure Solutions Group (ISG), and (3) Solutions and services group (SSG) accounted for 89.6%, 10.4%, and 8.0% of FY3/20 gross revenue, respectively. Yang Yuanqing, the Chief Executive Officer (CEO) and Chairman of Lenovo, holds a c.9.3% stake in the company.

### Historical PE and PB band

Forward PE band (x)



PB band (x)



Source: Thomson Reuters, DBS HK

## Lenovo Group

### Key Assumptions

FY Mar	2020A	2021A	2022F	2023F	2024F
ISG Revenue ('000 USD)	5,500.2	6,331.1	7,140.1	7,971.0	13,420.3
Operating Margin (%)	(4.1)	(2.1)	0.1	0.5	4.2
SSG Revenue ('000 USD)	N/A	N/A	5,441.5	6,612.5	8,571.8
Operating Margin (%)	N/A	N/A	22.0	24.0	25.0

Source: Company, DBS HK

### Segmental Breakdown (US\$ m)

FY Mar	2020A	2021A	2022F	2023F	2024F
<b>Revenues (US\$ m)</b>					
IDG	45,216	54,411	62,310	64,000	61,431
ISG	5,500	6,331	7,140	7,971	13,420
SSG	0	0	5,442	6,613	8,572
Intersegment cancellation	0	0	(3,274)	(3,700)	(3,928)
<b>Total</b>	<b>50,716</b>	<b>60,742</b>	<b>71,618</b>	<b>74,884</b>	<b>79,495</b>

Source: Company, DBS HK

## Lenovo Group

### Income Statement (US\$ m)

FY Mar	2020A	2021A	2022F	2023F	2024F
Revenue	50,716	60,742	71,618	74,884	79,495
Cost of Goods Sold	(42,359)	(50,974)	(59,569)	(61,953)	(65,099)
<b>Gross Profit</b>	<b>8,357</b>	<b>9,768</b>	<b>12,049</b>	<b>12,931</b>	<b>14,397</b>
Other Opg (Exp)/Inc	(6,919)	(7,587)	(8,968)	(9,377)	(9,955)
<b>Operating Profit</b>	<b>1,439</b>	<b>2,180</b>	<b>3,081</b>	<b>3,553</b>	<b>4,442</b>
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	(15)	(32)	(7)	(46)	(54)
Net Interest (Exp)/Inc	(406)	(374)	(306)	(273)	(242)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
<b>Pre-tax Profit</b>	<b>1,018</b>	<b>1,774</b>	<b>2,768</b>	<b>3,235</b>	<b>4,146</b>
Tax	(213)	(461)	(622)	(750)	(961)
Minority Interest	(86)	(102)	(116)	(197)	(253)
Preference Dividend	0	0	0	0	0
<b>Net Profit</b>	<b>719</b>	<b>1,211</b>	<b>2,030</b>	<b>2,288</b>	<b>2,932</b>
Net Profit before Except.	719	1,211	2,030	2,288	2,932
EBITDA	2,403	3,219	4,338	4,697	5,616
<b>Growth</b>					
Revenue Gth (%)	(0.6)	19.8	17.9	4.6	6.2
EBITDA Gth (%)	21.6	33.9	34.8	8.3	19.6
Opg Profit Gth (%)	22.1	51.6	41.3	15.3	25.0
Net Profit Gth (%)	10.6	68.4	67.6	12.7	28.2
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	16.5	16.1	16.8	17.3	18.1
Opg Profit Margin (%)	2.8	3.6	4.3	4.7	5.6
Net Profit Margin (%)	1.4	2.0	2.8	3.1	3.7
ROAE (%)	21.8	35.8	47.5	40.4	40.6
ROA (%)	2.3	3.5	4.9	5.0	6.0
ROCE (%)	9.6	13.7	20.0	20.3	22.1
Div Payout Ratio (%)	60.0	35.9	23.6	30.2	30.2
Net Interest Cover (x)	3.5	5.8	10.1	13.0	18.3

Source: Company, DBS HK

## Lenovo Group

### Balance Sheet (US\$ m)

FY Mar	2020A	2021A	2022F	2023F	2024F
Net Fixed Assets	2,515	2,675	2,986	3,079	3,237
Invt in Associates & JVs	60	65	340	400	491
Other LT Assets	10,820	11,915	12,188	12,724	13,300
Cash & ST Invt	3,756	3,246	4,137	5,474	7,499
Inventory	4,947	6,381	8,301	8,679	8,782
Debtors	9,834	13,454	16,304	16,651	17,671
Other Current Assets	196	254	256	255	255
<b>Total Assets</b>	<b>32,128</b>	<b>37,991</b>	<b>44,510</b>	<b>47,263</b>	<b>51,237</b>
ST Debt	3,295	698	788	788	788
Creditors	18,813	25,332	30,370	31,103	32,590
Other Current Liab	1,150	1,342	1,601	1,814	2,048
LT Debt	1,565	3,300	2,633	2,633	2,633
Other LT Liabilities	3,246	3,709	3,724	3,923	4,061
Shareholder's Equity	3,198	3,559	4,991	6,322	8,105
Minority Interests	862	51	404	680	1,011
<b>Total Cap. &amp; Liab.</b>	<b>32,128</b>	<b>37,991</b>	<b>44,510</b>	<b>47,263</b>	<b>51,237</b>
Non-Cash Wkg. Capital	(4,986)	(6,584)	(7,111)	(7,332)	(7,929)
Net Cash/(Debt)	(1,103)	(752)	715	2,053	4,078
Debtors Turn (avg days)	73.0	70.0	75.8	80.3	78.8
Creditors Turn (avg days)	159.8	161.4	174.4	184.6	182.0
Inventory Turn (avg days)	37.0	41.4	46.0	51.0	49.9
Asset Turnover (x)	1.6	1.7	1.7	1.6	1.6
Current Ratio (x)	0.8	0.9	0.9	0.9	1.0
Quick Ratio (x)	0.6	0.6	0.6	0.7	0.7
Net Debt/Equity (X)	0.3	0.2	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	0.3	0.2	CASH	CASH	CASH
Capex to Debt (%)	19.3	21.8	36.2	38.3	42.6
Z-Score (X)	0.0	0.0	0.0	0.0	NA

Source: Company, DBS HK

### Cash Flow Statement (US\$ m)

FY Mar	2020A	2021A	2022F	2023F	2024F
Pre-Tax Profit	1,018	1,774	2,768	3,235	4,146
Dep. & Amort.	970	1,060	1,264	1,189	1,228
Tax Paid	(392)	(624)	(622)	(750)	(961)
Assoc. & JV Inc/(loss)	11	1	7	46	54
(Pft)/ Loss on disposal of FAs	(76)	(285)	0	0	0
Chg in Wkg.Cap.	276	1,661	526	221	597
Other Operating CF	403	65	200	29	(11)
<b>Net Operating CF</b>	<b>2,210</b>	<b>3,653</b>	<b>4,144</b>	<b>3,970</b>	<b>5,053</b>
Capital Exp.(net)	(938)	(872)	(1,237)	(1,312)	(1,458)
Other Invt.(net)	67	(58)	(308)	(15)	0
Invt in Assoc. & JV	(92)	(48)	(281)	(106)	(144)
Div from Assoc & JV	6	2	0	0	0
Other Investing CF	0	0	(149)	0	0
<b>Net Investing CF</b>	<b>(957)</b>	<b>(976)</b>	<b>(1,975)</b>	<b>(1,433)</b>	<b>(1,602)</b>
Div Paid	(431)	(434)	(479)	(691)	(886)
Chg in Gross Debt	334	(1,076)	(577)	0	0
Capital Issues	0	18	0	0	0
Other Financing CF	(141)	(1,736)	(466)	(394)	(489)
<b>Net Financing CF</b>	<b>(238)</b>	<b>(3,228)</b>	<b>(1,522)</b>	<b>(1,085)</b>	<b>(1,375)</b>
Currency Adjustments	(126)	69	215	(128)	(51)
Chg in Cash	888	(483)	862	1,323	2,025
Opg CFPS (US\$)	0.16	0.17	0.28	0.29	0.34
Free CFPS (US\$)	0.11	0.23	0.22	0.20	0.27

Source: Company, DBS HK

**Lenovo Group**

**Target Price & Ratings History**



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	19-Nov-21	HK\$7.98	HK\$12.50	Buy
2:	28-Feb-22	HK\$8.75	HK\$11.80	Buy
3:	16-May-22	HK\$7.99	HK\$11.30	Buy

Source: DBS HK

Analyst: Jim Au

Tsz Wang Tam

## Lenovo Group

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**STRONG BUY** (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

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**FULLY VALUED** (negative total return, i.e., > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

\*Share price appreciation + dividends

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