

China / Hong Kong Company Update

Lenovo Group

Bloomberg: 992 HK EQUITY | Reuters: 0992.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

23 Feb 2024

HOLD

Last Traded Price (22 Feb 2024): HK\$8.84 (HSI : 16,743)
Price Target 12-mth: HK\$8.40 (5% downside) (Prev HK\$9.00)

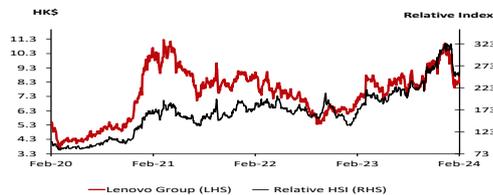
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What's New

- 3QFY3/24 revenue increased slightly by 3.0% y-o-y, due to a slow recovery in the PC end-market demand
- Net profit fell 23% y-o-y due to continuous operational loss in the server business
- Cut earnings forecast for FY3/24F and FY3/25F by 18%/23% in anticipation of a slower-than-expected PC shipment growth
- Maintain HOLD; lower TP of HK\$8.4 based on a 10.5x FY3/25F PE

Price Relative



Forecasts and Valuation

FY Mar (US\$m)	2023A	2024F	2025F	2026F
Turnover	61,947	56,033	60,117	64,505
EBITDA	4,005	3,215	3,623	4,085
Pre-tax Profit	2,136	1,260	1,636	2,121
Net Profit	1,608	936	1,215	1,575
Net Pft (Pre Ex) (core profit)	1,608	936	1,215	1,575
Net Profit Gth (Pre-ex) (%)	(20.8)	(41.8)	29.8	29.6
EPS (US\$)	0.12	0.07	0.09	0.12
EPS (HK\$)	0.97	0.56	0.73	0.95
Core EPS (US\$)	0.12	0.07	0.09	0.12
Core EPS (HK\$)	0.97	0.56	0.73	0.95
EPS Gth (%)	(20.1)	(41.8)	29.8	29.6
Core EPS Gth (%)	(20.1)	(41.8)	29.8	29.6
Diluted EPS (HK\$)	0.99	0.56	0.73	0.95
DPS (HK\$)	0.37	0.22	0.28	0.00
BV Per Share (HK\$)	3.61	3.74	3.99	4.41
PE (X)	9.1	15.7	12.1	9.3
CorePE (X)	9.1	15.7	12.1	9.3
P/Cash Flow (X)	5.2	7.6	7.9	4.8
P/Free CF (X)	11.6	16.7	15.8	7.2
EV/EBITDA (X)	3.7	4.7	4.3	3.7
Net Div Yield (%)	4.2	2.5	3.2	0.0
P/Book Value (X)	2.4	2.4	2.2	2.0
Net Debt/Equity (X)	CASH	CASH	0.0	CASH
ROAE(%)	30.4	16.5	20.3	24.2
Earnings Rev (%):		(14)	(18)	(23)
Consensus EPS (US\$)		0.08	0.12	0.15
Other Broker Recs:		B:27	S:1	H:4

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

More time to resume growth

Investment Thesis

New Solutions and Services Group (SSG) operating profit projected to grow 12%/17% in FY3/24F and FY3/25F on the back of a strong industry trend. There is ample room for rate improvement, boosting the company's operating margin to 4.4% in FY3/26 (from 3.4% in FY3/24F), as SSG's operating margin is 21% (vs. 4% for the group). Lenovo is transforming into a service-led company. It has the world's largest active PC userbase and can leverage its strong reputation in hardware products, channelling growth into its services and business.

Weak PC and server end-market may take more time for recovery.

We expect PC shipment growth to remain sluggish until end-2024 due to slower recovery in both consumer sentiment and IT spending due to macroeconomic uncertainty. Lacklustre profit margin in the hardware business is expected to remain until shipment growth resumes.

We expect earnings growth of 29.8% and 29.6% in FY3/25F and FY3/26F on the hardware business recovery after a 41.8% decline in FY3/24F. We also expect the commercial PC replacement cycle to start from early 2025 for the migration of the operating system from Windows 10 (official technical support ends in 2025) to Windows 11.

Maintain HOLD with a lower TP of HK\$8.4 (prev. TP: HK\$9.0) following our earnings cut, pegged to its historical average PE of 10.5x on FY3/25F earnings. Unless PC shipment can resume solid momentum, re-rating catalyst is missing. The rising AI PC penetration is something that should be watched out for, though in our view this could be more a mid-term catalyst than an immediate one.

Key Risks

Rigorous competition in PCs, smartphones, and servers, as well as prolonged weak consumer sentiment for consumer electronics.

At A Glance

Issued Capital (m shrs)	12,128
Mkt Cap (HKm/US\$m)	107,212 / 13,706
Major Shareholders (%)	
Legend Holdings Corporation	31.4
Free Float (%)	68.6
3m Avg. Daily Val. (US\$m)	73.46
GICS Industry: Information Technology / Technology Hardware & Equipment	

Lenovo Group**WHAT'S NEW****3QFY3/24 declined 23% y-o-y; expect hardware growth to be sluggish in 2024****3QFY3/24 result highlights**

Revenue increased slightly by 3.0% y-o-y to US\$15.7bn in 3QFY3/24 due to a slow recovery in the PC end-market demand. Segment-wise, the IDG (Intelligent Device Group) revenue increased 6.7% y-o-y to US\$12.4bn, driven by a mild consumer electronics end-market recovery. The ISG (Infrastructure Solutions Group) revenue decreased 13.4% y-o-y to US\$2.5bn due to enterprise customers' cautious views on IT capital expenditures during an uncertain economic climate. SSG (Solutions and Services Group) revenue increased by 10.0% y-o-y to US\$2.0bn, continuously driven by a higher service-attached rate of its hardware user base, especially in support service.

Operating profit declined by 18.3% y-o-y to US\$613m, with operating margin decreased 1.0ppts y-o-y to 3.9% due to a continuous loss in the server business. Net profit, accordingly, decreased by 22.9% y-o-y to US\$337m, ahead of market expectations by c.7%, driven by faster-than-expected hardware margin recovery.

Our View

3QFY3/24 results aligned with our cautious review of the PC and server business recovery. Furthermore, contribution from AI PC's and AI servers will still be insignificant to the group in FY3/24 and FY3/25. We anticipated sluggish growth in Lenovo's PC shipments in 2024. Meanwhile we expected the server shipments to take a few more quarters to resume growth due to macroeconomic uncertainty.

We cut our earnings forecast for FY3/24F and FY3/25F by 17.8% and 22.6%, respectively, to account for the slower growth in the PC and server business.

We maintain HOLD with a reduced TP of HK\$8.4 (prev. TP: HK\$9.0) based on a higher multiple of 10.5x FY3/25F (vs. the prev. 9x), pegged to its historical valuation average. We have increased the valuation multiple in response to improved market sentiment towards the AI-theme business.

In the mid-term, we expect revenue to grow by only 7.3% for both FY3/25F and FY3/26F, with earnings increasing by 29.8% and 29.6% respectively. Earning recovery is mostly enhanced by lower finance costs and is well expected by the market. The company is currently trading at 10.3x FY3/25F PE and has priced in the recovery vs. historical average of 10x.

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.

Lenovo Group

Quarterly Income Statement (US\$m)

FY MAR	3QFY3/23	2QFY3/24	3QFY3/24	% chg yoy	% chg qoq
Revenue	15,267	14,410	15,721	3.0%	9.1%
Cost of Goods Sold	(12,655)	(11,888)	(13,120)	3.7%	10.4%
Gross Profit	2,612	2,522	2,601	-0.4%	3.1%
Other Oper. (Exp)/Inc	(1,930)	(2,008)	(2,008)	4.0%	0.0%
Operating Profit	682	514	594	-12.9%	15.5%
Other Non Opg (Exp)/Inc	68	-	19	-72.0%	nm
Associates & JV Inc	(2)	(8)	(2)	23.4%	-70.4%
Net Interest (Exp)/Inc	(143)	(148)	(139)	-2.5%	-5.8%
Exceptional Gain/(Loss)	-	-	-	nm	nm
Pre-tax Profit	605	358	471	-22.1%	31.7%
Tax	(123)	(69)	(94)	-23.4%	37.4%
Minority Interest	(45)	(40)	(40)	-11.6%	0.0%
Net Profit	437	249	337	-22.9%	35.2%
Net profit bef Except.	437	249	337	-22.9%	35.2%

Margins (%)

Gross Margins	17.1	17.5	16.5
Opg Profit Margins	4.5	3.6	3.8
Net Profit Margins	2.9	1.7	2.1

Source: Company, DBS HK

Depreciation	199	213	187
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Source: xxxxx

Historical PE and PB band



Source: Thomson Reuters, DBS HK

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Key Assumptions

FY Mar	2022A	2023A	2024F	2025F	2026F
ISG Revenue ('000 USD)	7,140.1	9,755.6	8,588.8	9,420.0	10,071.5
Operating Margin (%)	0.1	1.0	(2.6)	(1.0)	1.0
SSG Revenue ('000 USD)	5,441.5	6,663.4	7,433.8	8,278.1	9,686.5
Operating Margin (%)	22.0	20.9	20.5	20.5	20.5

Source: Company, DBS HK

Segmental Breakdown (US\$ m)

FY Mar	2022A	2023A	2024F	2025F	2026F
Revenues (US\$ m)					
IDG	62,310	49,371	44,117	46,808	49,457
ISG	7,140	9,756	8,589	9,420	10,071
SSG	5,442	6,663	7,434	8,278	9,687
Intersegment cancellation	(3,274)	(3,844)	(4,107)	(4,389)	(4,710)
Total	71,618	61,947	56,033	60,117	64,505
Gross Profit (US\$ m)					
IDG	4,738	3,598	3,131	3,323	3,610
ISG	7	98	(224)	(94)	101
SSG	1,195	1,392	1,513	1,697	1,986
Intersegment cancellation	(1,001)	(1,208)	(1,268)	(1,478)	(1,709)
Total	4,938	3,880	3,152	3,448	3,988
Gross Profit Margins (%)					
IDG	7.6	7.3	7.1	7.1	7.3
ISG	0.1	1.0	(2.6)	(1.0)	1.0
SSG	22.0	20.9	20.4	20.5	20.5
Intersegment cancellation	30.6	31.4	30.9	33.7	36.3
Total	6.9	6.3	5.6	5.7	6.2

Source: Company, DBS HK

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Income Statement (US\$ m)

FY Mar	2022A	2023A	2024F	2025F	2026F
Revenue	71,618	61,947	56,033	60,117	64,505
Cost of Goods Sold	(59,569)	(51,446)	(46,641)	(49,694)	(52,994)
Gross Profit	12,049	10,501	9,392	10,423	11,510
Other Opg (Exp)/Inc	(8,968)	(7,832)	(7,508)	(8,103)	(8,695)
Operating Profit	3,081	2,669	1,883	2,319	2,816
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	(7)	(17)	(22)	(22)	(20)
Net Interest (Exp)/Inc	(306)	(516)	(601)	(662)	(676)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	2,768	2,136	1,260	1,636	2,121
Tax	(622)	(455)	(265)	(344)	(445)
Minority Interest	(116)	(73)	(60)	(78)	(101)
Preference Dividend	0	0	0	0	0
Net Profit	2,030	1,608	936	1,215	1,575
Net Profit before Except.	2,030	1,608	936	1,215	1,575
EBITDA	4,338	4,005	3,215	3,623	4,085
Growth					
Revenue Gth (%)	17.9	(13.5)	(9.5)	7.3	7.3
EBITDA Gth (%)	34.8	(7.7)	(19.7)	12.7	12.7
Opg Profit Gth (%)	41.3	(13.4)	(29.4)	23.2	21.4
Net Profit Gth (%)	67.6	(20.8)	(41.8)	29.8	29.6
Margins & Ratio					
Gross Margins (%)	16.8	17.0	16.8	17.3	17.8
Opg Profit Margin (%)	4.3	4.3	3.4	3.9	4.4
Net Profit Margin (%)	2.8	2.6	1.7	2.0	2.4
ROAE (%)	47.5	30.4	16.5	20.3	24.2
ROA (%)	4.9	3.9	2.4	3.0	3.7
ROCE (%)	20.0	16.4	10.7	12.1	14.1
Div Payout Ratio (%)	23.6	36.0	36.0	36.0	36.0
Net Interest Cover (x)	10.1	5.2	3.1	3.5	4.2

Source: Company, DBS HK

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Balance Sheet (US\$ m)

FY Mar	2022A	2023A	2024F	2025F	2026F
Net Fixed Assets	2,986	3,304	2,904	2,780	2,754
Invt in Associates & JVs	340	438	560	723	849
Other LT Assets	12,188	12,237	12,831	13,055	13,306
Cash & ST Invt	4,137	4,359	5,154	4,862	5,595
Inventory	8,301	6,372	5,603	6,641	7,126
Debtors	16,304	11,886	11,999	12,868	13,800
Other Current Assets	256	325	255	255	255
Total Assets	44,510	38,920	39,307	41,185	43,684
ST Debt	788	272	340	340	340
Creditors	30,370	24,288	23,219	24,395	25,912
Other Current Liab	1,601	1,534	1,306	1,406	1,521
LT Debt	2,633	3,683	4,614	4,614	4,614
Other LT Liabilities	3,724	3,097	3,450	3,501	3,538
Shareholder's Equity	4,991	5,588	5,780	6,175	6,826
Minority Interests	404	459	597	753	932
Total Cap. & Liab.	44,510	38,920	39,307	41,185	43,684
Non-Cash Wkg. Capital	(7,111)	(7,240)	(6,667)	(6,036)	(6,252)
Net Cash/(Debt)	715	404	199	(92)	640
Debtors Turn (avg days)	75.8	83.0	77.8	75.5	75.5
Creditors Turn (avg days)	174.4	199.1	191.4	179.7	177.6
Inventory Turn (avg days)	46.0	53.5	48.3	46.2	48.6
Asset Turnover (x)	1.7	1.5	1.4	1.5	1.5
Current Ratio (x)	0.9	0.9	0.9	0.9	1.0
Quick Ratio (x)	0.6	0.6	0.7	0.7	0.7
Net Debt/Equity (X)	CASH	CASH	CASH	0.0	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	0.0	CASH
Capex to Debt (%)	36.9	39.0	21.0	18.6	20.3
Z-Score (X)	0.0	0.0	NA	NA	NA

Source: Company, DBS HK

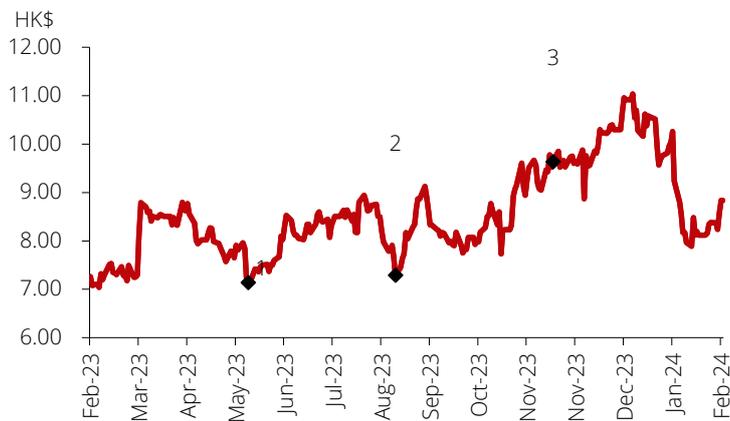
Cash Flow Statement (US\$ m)

FY Mar	2022A	2023A	2024F	2025F	2026F
Pre-Tax Profit	2,768	2,136	1,260	1,636	2,121
Dep. & Amort.	1,264	1,353	1,353	1,326	1,288
Tax Paid	(729)	(528)	(265)	(344)	(445)
Assoc. & JV Inc/(loss)	7	13	22	22	20
(Pft)/ Loss on disposal of FAs	(31)	(238)	0	0	0
Chg in Wkg.Cap.	365	(228)	(573)	(630)	216
Other Operating CF	434	293	121	(160)	(153)
Net Operating CF	4,077	2,801	1,919	1,849	3,046
Capital Exp.(net)	(1,263)	(1,543)	(1,042)	(920)	(1,007)
Other Invt.(net)	(118)	143	(91)	0	0
Invt in Assoc. & JV	(122)	(518)	(144)	(185)	(145)
Div from Assoc & JV	4	3	0	0	0
Other Investing CF	0	0	0	0	0
Net Investing CF	(1,498)	(1,915)	(1,277)	(1,105)	(1,152)
Div Paid	(479)	(579)	(337)	(437)	(567)
Chg in Gross Debt	(747)	385	1,000	0	0
Capital Issues	0	0	0	0	0
Other Financing CF	(531)	(220)	(435)	(503)	(436)
Net Financing CF	(1,757)	(414)	228	(940)	(1,003)
Currency Adjustments	41	(153)	(166)	(95)	(159)
Chg in Cash	862	320	704	(292)	732
Opg CFPS (US\$)	0.28	0.23	0.19	0.19	0.22
Free CFPS (US\$)	0.22	0.10	0.07	0.07	0.16

Source: Company, DBS HK

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Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	12-mth Target Price	Rating
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1:	25-May-23	HK\$7.24	HK\$8.10	Buy
2:	18-Aug-23	HK\$7.67	HK\$7.40	Hold
3:	17-Nov-23	HK\$9.52	HK\$9.00	Hold

Source: DBS HK

Analyst: Jim Au

Tsz Wang Tam

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DBS Group Research recommendations are based on an Absolute Total Return* Rating system, defined as follows:

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)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

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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Sources for all charts and tables are DBS HK unless otherwise specified.

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