

COMPANY RESULTS

Lenovo Group (992 HK)

3QFY24: Solid Results; Recovery In FY25 Could Be Slower Than Expected

Lenovo's 3QFY24 results are solid, with a slight beat across all segments on both revenue and profitability. Growth in FY25 may turn out to be moderate as enterprise clients are delaying purchases in 1H while awaiting more meaningful AI PC launches. Nevertheless, the AI PC-driven replacement cycle should kick in by 2H24, and the rate of penetration of AI PC in 2025-26 may surprise on the upside which can potentially bolster earnings growth during the period. Maintain BUY and cut target price to HK\$10.50.

3QFY24 RESULTS

Year to 31 Mar	3Q23	2Q24	3Q24	yoy (%)	qoq (%)	9M23	9M24	yoy(%)
Revenue (US\$m)	15,267	14,410	15,721	3.0	9.1	74,847	43,031	(42.5)
Intelligent Devices Group (IDG)	11,586	11,515	12,362	6.7	7.4	59,632	34,137	(42.8)
Infrastructure Solutions Group (ISG)	2,855	2,002	2,473	(13.4)	23.6	11,669	6,389	(45.3)
Solutions and Services Group (SSG)	1,836	1,918	2,021	10.0	5.3	8,377	5,652	(32.5)
Gross profit	2,612	2,522	2,601	(0.4)	3.2	12,753	7,375	(42.2)
Net profit	437	249	337	(22.9)	35.2	1,784	763	(57.2)
Operating margin (OPM) (%)	4.9	3.6	3.9	(1.0)	0.3	4.8	3.5	(1.3)
Intelligent Devices Group (IDG)	7.3	7.4	7.4	0.1	0.0	7.4	7.1	(0.4)
Infrastructure Solutions Group (ISG)	1.5	(2.7)	(1.5)	(3.0)	1.1	1.2	(2.4)	(3.6)
Solutions and Services Group (SSG)	20.2	20.0	20.4	0.2	0.4	21.3	20.5	(0.8)

Source: Lenovo Group, UOB Kay Hian

RESULTS

• **3QFY24 revenue a slight beat; solid operating margins across all segments.** Revenue across all three segments – Intelligent Device Group (IDG) (+6.7% yoy and +7.4% qoq to US\$12.4b), Infrastructure Device Group (ISG) (-13.4% yoy and +23.6% qoq to US\$2.5b) and Solutions and Service Group (SSG) (+10.0% yoy and +5.3% qoq to US\$2.0b) – came in slightly above our estimates. Operating margin came in at 3.9% (-1.0ppt yoy and +0.3ppt qoq). Operating margins for both ISG (-3.0ppt yoy and +1.1ppt qoq to -1.5%) and SSG (+0.2ppt yoy and +0.4ppt qoq to 20.4%) exceeded expectations while operating margin for IDG (+0.1ppt yoy and flat qoq to 7.4%) is in line with our estimates. Net profit was US\$337m, representing a robust 35.2% sequential recovery, which is above our/consensus' estimates of US\$310m/305m respectively.

KEY FINANCIALS

Year to 31 Mar (US\$m)	2022	2023	2024F	2025F	2026F
Net turnover	71,618	61,947	56,196	61,295	68,986
EBITDA	4,357	4,027	3,306	4,043	4,867
Operating profit	3,081	2,669	1,895	2,544	3,242
Net profit (rep./act.)	2,037	1,608	946	1,453	2,182
Net profit (adj.)	2,037	1,608	946	1,453	2,182
EPS (cent)	17.5	13.5	7.9	12.2	18.3
PE (x)	6.5	8.4	14.3	9.3	6.2
P/B (x)	2.6	2.4	2.3	2.0	1.6
EV/EBITDA (x)	3.1	3.3	4.1	3.3	2.8
Dividend yield (%)	4.4	4.4	4.4	4.4	4.4
Net margin (%)	2.8	2.6	1.7	2.4	3.2
Net debt/(cash) to equity (%)	(12.1)	(6.6)	(2.5)	(6.0)	(13.4)
Interest cover (x)	10.1	5.2	3.3	4.7	14.1
ROE (%)	47.6	30.4	16.4	22.8	28.7
Consensus net profit	-	-	997	1,526	1,874
UOBKH/Consensus (x)	-	-	0.95	0.95	1.16

Source: Lenovo Group, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	HK\$8.84
Target Price	HK\$10.50
Upside	+18.8%
(Previous TP)	HK\$12.10

COMPANY DESCRIPTION

Lenovo Group develops, manufactures and distributes intelligent devices. The company provides laptops, desktops, table PCs, accessories, and data centre equipment such as servers and storage devices, as well as infrastructure solutions and software services. Lenovo Group serves customers worldwide

STOCK DATA

GICS sector	Computer Hardware & Storage
Bloomberg ticker:	992 HK
Shares issued (m):	12,391
Market cap (HK\$m):	109,536
Market cap (US\$m):	16,108
3-mth avg daily t'over (US\$m):	72.6

Price Performance (%)

52-week high/low HK\$11.1/HK\$6.9

1mth	3mth	6mth	1yr	YTD
(10.0)	(7.9)	15.7	28.5	(19.0)

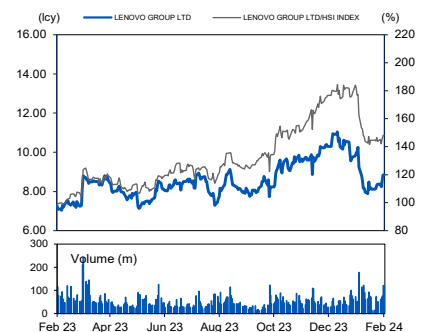
Major Shareholders

Legend Holdings Corp	29.73
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FY24 NAV/Share (RMB) (1.26)

FY24 Net Cash/Share (RMB) 0.10

PRICE CHART



Source: Bloomberg

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STOCK IMPACT

- **IDG entering a low season in March quarter; recovery cycle intact this year but could be backloaded by year-end.** While the PC demand upcycle driven by the windows update and GenAI remains solid, management stated that some of their enterprise clients are now delaying purchases as they are monitoring the development of AI PC and waiting for product launches with more significant upgrades. As such, IDG business' growth will be backloaded to 2H24, while shipments in the March and June quarter could be worse than our previous expectations. This may also negatively impact the business' margins during the two quarters due to a lower operating scale.
- That said, the super cycle driven by AI PCs remains unchanged going forward. Management guided that AI PCs are margin accretive to the business and have an ASP that is mid-high single digit higher than its traditional PCs. Management guided that the penetration rate of AI PC can surge from mid-single digit in 2024 to 50-60% of new PC sales by 2026, implying a growth of >10x in two years' time. We are also expecting to see more news about edge AI during the Mobile World Congress next week, while new product launches in the June quarter should provide a better representation of AI PC's capabilities.
- **ISG business to see more contribution from AI servers; GP servers to remain a drag.** Lenovo had started to deliver L40S servers to Microsoft in the December quarter, and we understand that Lenovo will be one of the key OEM/ODM partners of AMD's MI300x server from June onwards. It will also be more involved in the NVIDIA supply chain with better allocation to the H200/GB200 servers, which should help bolster its AI infrastructure business (~US\$1b to be delivered in FY25) going forward. That said, its GP server business may remain a drag through the March-June quarter as clients' procurement may remain slow, dragging overall profitability during the period.

EARNINGS REVISION/RISKS

- **We now expect the PC market to grow at a slower rate due to the delay in purchases.** Due to the enterprise client's delayed purchases, we believe some of the demand will be pushed forward to 2025. As such, we are trimming our 2024 global PC shipment growth forecast from +7.6% yoy to +4.0% yoy.
- **We also trim our ISG revenue by 3.4-3.7% for FY24-26,** due to a slower-than-expected recovery in its GP server business. The lower operating will also impact its profitability, and as such, we cut our operating margin assumptions to -2.6%/-1.1% in FY24-25 (-0.5ppt/-1.6ppt respectively). Our FY26 operating margin assumption remains unchanged.
- **Factoring in a slower IDG/ISG recovery, we cut our FY24-26 earnings estimates by 13.6%/22.1%/10.1% respectively to US\$946m/US\$1,453m/US\$2,182m.** Our FY24-26 revenue is trimmed by 1.8%/3.7%/1.7% respectively to US\$56b/US\$61b/US\$69b, and our gross margins assumptions are trimmed by 0.5ppt/0.5ppt/0.4ppt to 17.0%/17.2%/17.4% respectively to factor in a lower operating scale. Our FY24 estimate now implies a March quarter revenue of US\$13b and net profit of US\$183m.

VALUATION/RECOMMENDATION

- **Maintain BUY but cut target price to HK\$10.50,** based on a lower earnings estimate, and a target PE multiple of 11.0x FY25F PE, still on a par with peers' average. Lenovo's share price could be under selling pressure in the near term given the weaker outlook in 1H24. However, we believe any share price correction will provide an enhanced buying opportunity, as we expect the market to be focusing on the massive opportunities from Gen AI as more edge AI applications and new AI PCs are launched in the next few months.

SHARE PRICE CATALYSTS

- Launch of more AI PC products and key order wins in AI servers.

PROFIT & LOSS

Year to 31 Mar (US\$m)	2023	2024F	2025F	2026F
Net turnover	61,947	56,196	61,295	68,986
EBITDA	4,027	3,306	4,043	4,867
Deprec. & amort.	(1,359)	(1,411)	(1,499)	(1,625)
EBIT	2,669	1,895	2,544	3,242
Associate contributions	-	(0)	-	-
Net interest income/(expense)	(17)	(15)	-	-
Pre-tax profit	(516)	(574)	(539)	(230)
Tax	2,136	1,305	2,005	3,012
Minorities	(455)	(255)	(391)	(587)
Net profit	(73)	(105)	(161)	(242)
Net profit (adj.)	1,608	946	1,453	2,182

CASH FLOW

Year to 31 Mar (US\$m)	2023	2024F	2025F	2026F
Operating	3,407	2,495	2,954	3,096
Pre-tax profit	2,136	1,305	2,005	3,012
Tax	(528)	(255)	(391)	(587)
Depreciation/amortization	1,359	1,411	1,499	1,625
Associates	17	15	-	-
Working capital changes	1,914	(556)	(698)	(1,184)
Non-cash items	(1,491)	574	539	230
Other operating cashflows	-	-	-	-
Investing	(1,915)	(1,427)	(1,457)	(1,434)
Capex (growth)	(428)	(420)	(420)	(420)
Investments	(507)	-	-	-
Proceeds from sale of assets	265	-	-	-
Others	(1,245)	(1,007)	(1,037)	(1,014)
Financing	(1,019)	(1,283)	(1,240)	(944)
Dividend payments	(579)	(588)	(588)	(588)
Issue of shares	-	-	-	-
Proceeds from borrowings	10,980	10,646	10,813	10,730
Loan repayment	(10,980)	(10,646)	(10,813)	(10,730)
Others/interest paid	(441)	(695)	(652)	(356)
Net cash inflow (outflow)	473	(216)	257	718
Beginning cash & cash equivalent	3,930	4,250	4,034	4,291
Changes due to forex impact	(153)	-	-	-
Ending cash & cash equivalent	4,250	4,034	4,291	5,010

BALANCE SHEET

Year to 31 Mar (US\$m)	2023	2024F	2025F	2026F
Fixed assets	2,006	2,401	2,771	3,598
Other LT assets	13,973	13,716	13,417	12,524
Cash/ST investment	4,250	4,034	4,291	5,010
Other current assets	18,691	18,564	21,604	22,966
Total assets	38,920	38,715	42,084	44,098
ST debt	272	272	272	272
Other current liabilities	25,822	25,139	27,481	27,659
LT debt	3,683	3,683	3,683	3,683
Other LT liabilities	3,097	3,097	3,097	3,097
Shareholders' equity	3,559	4,991	5,588	5,945
Minority interest	459	564	726	968
Total liabilities & equity	38,920	38,700	42,068	44,083

KEY METRICS

Year to 31 Mar (%)	2023	2024F	2025F	2026F
Profitability				
EBITDA margin	17.0	17.0	17.2	17.4
Pre-tax margin	3.4	2.3	3.3	4.4
Net margin	2.6	1.7	2.4	3.2
ROA	3.9	2.4	3.6	5.1
ROE	30.4	16.4	22.8	28.7
Growth				
Turnover	(13.5)	(9.3)	9.1	12.5
EBITDA	(12.8)	(9.0)	10.4	13.9
Pre-tax profit	(23.0)	(38.9)	53.6	50.2
Net profit	(21.1)	(41.2)	53.6	50.2
Net profit (adj.)	(21.1)	(41.2)	53.6	50.2
EPS	(22.9)	(41.2)	53.6	50.2
Leverage				
Debt to total capital	10.2	10.2	9.4	9.0
Debt to equity	70.8	66.5	58.1	47.1
Net debt/(cash) to equity	(6.6)	(2.5)	(6.0)	(13.4)
Interest cover (x)	5.2	3.3	4.7	14.1

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