

COMPANY UPDATE

Lenovo Group (992 HK)

Lenovo Partners Up With Alat To Expand Business Opportunities in MEA

Lenovo announced a strategic partnership with Alat, which involves a CB issuance of US\$2b, and the establishment of a regional supply chain in Saudi Arabia for the MEA market by Lenovo. The deal is very positive for Lenovo's mid-long-term growth as it helps Lenovo strengthens its position in a fast-growing market, although the sizable dilution (around 19%) from this round of fund raising may impact investor sentiment in the near term. Maintain BUY and target price of HK\$13.50.

WHAT'S NEW

- **Lenovo to introduce Alat as a strategic investor through the issuance of a zero-coupon Convertible Bond (CB)**, an investment vehicle under Saudi Arabia's Public Investment Fund (PIF). Lenovo and Alat formed a strategic collaboration framework through the deal, and the terms state that Lenovo will expand its business in the Middle East and Africa (MEA), by setting up a regional headquarters in Saudi Arabia, along with a new manufacturing facility (and likely supply chain as well) locally which will initially focus on the production of PCs and servers for the MEA region.
- **The details of the CB are as follow:**
 - a) The CB has a conversion price of HK\$10.42, and a size of 1,499,328,214 shares. The exercise price is equivalent to an 11.8% discount to its last closing price of HK\$11.82, and the CB issued amounts to 12.1% of existing share, and 10.8% of total enlarged shares once fully converted.
 - b) The CB's reaches maturity three years from the issue date. The conversion period is at the very end of the three-year period - from the 30th calendar day prior to the maturity date to two business days prior. If there are any outstanding CBs not yet converted, Lenovo will redeem the unconverted CB at 100% of the principal amount.
- **The proceeds will be utilised in the following manner:** a) to repay the high-interest debts to optimise Lenovo's finance structure; b) around US\$300m will be spent on building the manufacturing hub in Saudi Arabia; and c) there are some potential inorganic growth deals (M&A) that Lenovo is looking at.

KEY FINANCIALS

Year to 31 Mar (US\$m)	2023	2024	2025F	2026F	2027F
Net turnover	61,947	56,864	62,779	69,993	78,330
EBITDA	4,027	3,419	3,824	4,557	5,169
Operating profit	2,669	2,006	2,323	2,940	3,447
Net profit (rep./act.)	1,608	1,011	1,289	1,953	2,335
Net profit (adj.)	1,608	1,011	1,289	1,953	2,335
EPS (cent)	13.5	8.4	10.8	16.4	19.6
PE (x)	10.8	17.3	13.4	8.8	7.4
P/B (x)	3.1	3.1	2.8	2.3	1.8
EV/EBITDA (x)	4.3	5.1	4.5	3.8	3.3
Dividend yield (%)	3.4	3.4	3.4	3.4	3.4
Net margin (%)	2.6	1.8	2.1	2.8	3.0
Net debt/(cash) to equity (%)	(6.6)	(0.1)	21.5	(5.6)	(2.7)
Interest cover (x)	5.2	3.3	4.3	12.0	15.4
ROE (%)	30.4	18.1	21.7	28.0	27.4
Consensus net profit	-	-	1,302	1,756	1,954
UOBKH/Consensus (x)	-	-	0.99	1.11	1.20

Source: Lenovo Group, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	HK\$11.62
Target Price	HK\$13.50
Upside	+16.2%

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):	140,266
Market cap (US\$m):	20,627
3-mth avg daily t'over (US\$m):	71.3

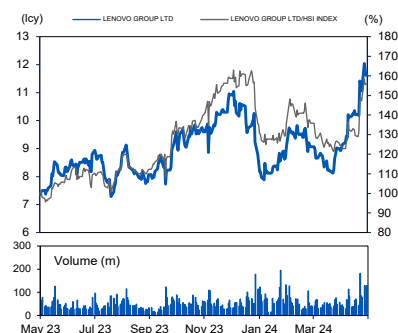
Price Performance (%)

52-week high/low	HK\$12.3/HK\$7.1			
1mth	3mth	6mth	1yr	YTD
29.1	34.1	21.0	56.6	6.4

Major Shareholders

Legend Holdings Corp	29.73
FY24 NAV/Share (Rmb)	(1.84)
FY24 Net Cash/Share (Rmb)	0.00

PRICE CHART



Source: Bloomberg

ANALYST(S)

Johnny Yum
 +852 2236 6706
 johnny.yum@uobkayhian.com.hk

- **Lenovo also announced a proposal to issue warrants.**

- Lenovo is looking to issue 1,150,000,000 three-year warrants at an issue price of HK\$1.43.
- This amount of warrants is equivalent to 9.3% of existing shares, and 8.5% of enlarged shares upon the full exercise of the warrants.
- The initial exercise price is HK\$12.31.
- Lenovo's parent co, Legend Holdings, owns the First offer rights to the warrants. That means that in the case of any holders intending to sell or exercise the subscription rights, Legend Holdings will always have the first opportunity to buy these warrants, and the first right to exercise the conversion.

STOCK IMPACT

- **Business potential from MEA is huge.** According to Lenovo, revenue from the MEA market registered an 11% yoy growth last year (vs the company's revenue growth of -9.7% yoy amid an industry downcycle), and contributed to US\$1.3b-1.4b, or about 2% of total revenue. Management now expects the region's growth to accelerate to high-double digit yoy going forward, driven by a combination of the region's faster demand growth for consumer electronic products, and assistance from Alcatel in the penetration of large enterprises in the region. We also believe that acquiring major AI server orders from MEA could be a major catalyst for Lenovo as it can potentially help the company catching up with its more established server OEM peers, such as Dell.
- **Exploration of a new major region can also help hedge against US-China tension.** Given that US remained the largest revenue contributor at 34% of total revenue in FY24 for Lenovo, there had been looming concerns of geopolitical risks given the tension between US and China. The exploration of a new business region will help hedge against some of the geopolitical risks going forward.
- **The zero-coupon CB can help lower interest cost by US\$100m in 2024,** according to management. As of end-FY24, the company had ~US\$5.6b outstanding in interest bearing loans. Under our preliminary assumptions, every US\$1b reduction in debt will result in Lenovo's FY24 earnings increasing by ~4.1% (or ~US\$53m). Lenovo also stated that given Alcatel's ample capital, it can continue to assist in Lenovo's financing needs going forward, especially when it comes to the development in MEA region, which implies that there are more room to optimise its debt structure further down the road.
- **Initial reception seems mixed due to dilution. The CB and Warrants will not pose an immediate dilution,** as the respective conversion period and exercisable timing of the CB and Warrant is nearly three years from now. However, the market's view on this round of fund raising is relatively mixed, especially for the minority shareholders, as the potential dilution for the two deals is still very sizable at a total of 19.3%. As such, although the deal is very positive for the company's longer-term growth, we believe it is likely that we may receive some negative reactions initially in the near term.

EARNINGS REVISION/RISKS

- **None for now.** We will be adjusting its share price after assessing the growth potential of the MEA market. Also note that most of the dilution arrives in FY28, as such it should not impact our estimates much in FY25-27.

VALUATION/RECOMMENDATION

- **Maintain BUY and target price of HK\$13.50.** We believe the dilution risk will pose limited impact to our FY25 earnings-based target price, as we expect limited warranty exercise during the period. Our positive view on Lenovo's positioning in the AI PC-driven replacement cycle from end-24 onwards is further enhanced after the deal, as we believe Alcatel will be able to provide meaningful contribution to its business expansion to a fast-growing MEA market. Our current target price is based on 16.0x FY25F PE, which is based on peers' average PE.

PROFIT & LOSS

Year to 31 Mar (US\$m)	2024	2025F	2026F	2027F
Net turnover	56,864	62,779	69,993	78,330
EBITDA	3,419	3,824	4,557	5,169
Deprec. & amort.	(1,413)	(1,501)	(1,617)	(1,723)
EBIT	2,006	2,323	2,940	3,447
Associate contributions	(26)	-	-	-
Net interest income/(expense)	(615)	(544)	(244)	(223)
Pre-tax profit	1,365	1,779	2,696	3,223
Tax	(263)	(347)	(526)	(629)
Minorities	(92)	(143)	(217)	(259)
Net profit	1,011	1,289	1,953	2,335
Net profit (adj.)	1,011	1,289	1,953	2,335

CASH FLOW

Year to 31 Mar (US\$m)	2024	2025F	2026F	2027F
Operating	2,755	1,510	4,205	2,305
Pre-tax profit	1,365	1,779	2,696	3,223
Tax	(614)	(347)	(526)	(629)
Depreciation/amortization	1,413	1,501	1,617	1,723
Associates	26	-	-	-
Working capital changes	157	(1,967)	174	(2,236)
Non-cash items	408	544	244	223
Other operating cashflows	-	-	-	1
Investing	(1,283)	(1,660)	(1,512)	(1,562)
Capex (growth)	(275)	(420)	(420)	(420)
Investments	(147)	-	-	-
Proceeds from sale of assets	153	-	-	-
Others	(1,014)	(1,240)	(1,092)	(1,142)
Financing	(2,080)	(1,208)	(914)	(914)
Dividend payments	(583)	(588)	(588)	(588)
Issue of shares	-	-	-	-
Proceeds from borrowings	11,793	11,387	11,590	11,488
Loan repayment	(11,799)	(11,387)	(11,590)	(11,488)
Others/interest paid	(1,491)	(620)	(326)	(326)
Net cash inflow (outflow)	(609)	(1,358)	1,779	(171)
Beginning cash & cash equivalent	4,250	3,560	2,202	3,981
Changes due to forex impact	(82)	-	-	-
Ending cash & cash equivalent	3,560	2,202	3,981	3,810

BALANCE SHEET

Year to 31 Mar (US\$m)	2024	2025F	2026F	2027F
Fixed assets	2,010	2,419	2,536	2,588
Other LT assets	14,054	13,879	13,739	13,629
Cash/ST investment	3,560	2,202	3,981	3,810
Other current assets	19,127	22,536	23,470	27,576
Total assets	38,751	41,037	43,727	47,604
ST debt	50	50	50	50
Other current liabilities	26,009	27,451	28,559	30,429
LT debt	3,569	3,569	3,569	3,569
Other LT liabilities	3,097	3,041	3,041	3,041
Shareholders' equity	4,991	5,588	5,583	6,283
Minority interest	499	642	859	1,118
Total liabilities & equity	38,751	41,037	43,727	47,604

KEY METRICS

Year to 31 Mar (%)	2024	2025F	2026F	2027F
Profitability				
EBITDA margin	17.2	17.0	17.1	17.1
Pre-tax margin	2.4	2.8	3.9	4.1
Net margin	1.8	2.1	2.8	3.0
ROA	2.6	3.2	4.6	5.1
ROE	18.1	21.7	28.0	27.4
Growth				
Turnover	(8.2)	10.4	11.5	11.9
EBITDA	(6.6)	8.9	12.1	11.9
Pre-tax profit	(36.1)	30.3	51.5	19.6
Net profit	(37.1)	27.5	51.5	19.6
Net profit (adj.)	(37.1)	27.5	51.5	19.6
EPS	(37.7)	28.8	51.5	19.6
Leverage				
Debt to total capital	9.3	8.8	8.3	7.6
Debt to equity	64.8	57.6	47.3	38.5
Net debt/(cash) to equity	(0.1)	21.5	(5.6)	(2.7)
Interest cover (x)	3.3	4.3	12.0	15.4

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