

JPM-pp1

Asia Pacific Equity Research

20 March 2015

China Resources Enterprise (291 HK)

Underweight

Price: HK\$15.06

19 Mar 2015

Price Target: HK\$15.50

PT End Date: 31 Dec 2015

HK\$1.36bn loss in 4Q14 alone; slightly higher than expected but not a huge surprise given profit warning earlier

CRE announced HK\$794mn recurring net loss for FY14, which suggests HK\$1.36bn recurring net loss in 4Q14 alone with HK \$1bn loss at retail and HK\$280mn loss at the beer division. 4Q14 loss figure is worse than our estimate of HK\$1.23bn as the beer segment loss and headquarter expenses were higher than expected, while retail loss came in line. Given that the company had announced a profit warning earlier, we do not expect these figures to surprise the market.

For FY15, we expect CRE to report a HK\$ HK\$170mn recurring net loss. We expect HK\$1bn net loss from retail operations in FY15 compared to FY14 retail loss estimate of HK\$1.3bn. CRE will consolidate 12 months of Tesco losses in FY15 but at the same time we have started to build in some savings from: i) integration with Tesco; and ii) closure of some loss making stores. If these do not materialize, we will have downside risk to FY15 earnings estimates. With savings, we expect overall retail loss to narrow down in FY15; and for the beer segment we are looking for 9% sales and 17% earnings growth as we expect the market to go back to MSD volume growth. We rate CRE as UW as we see no catalysts in the future.

Table 1: CRE 2H14 results vs JPM estimates

HKD mn	2H13	2H14A	% chg y/y	2H14E	Actual/Est
Revenue	74,556	85,358	14.5%	87,420	-2.4%
Gross profit	19,338	21,063	8.9%	22,717	-7.3%
Operating profit	2,355	-807	-134.3%	-847	4.7%
PBT	2,568	-656	-125.5%	-895	26.7%
Net profit	890	-1,090	-222.5%	-1,268	14.0%
Recurring net profit	637	-1,462	-329.5%	-1,327	-10.2%
Margins					
Gross margin	25.9%	24.7%		26.0%	
Operating margin	3.2%	-0.9%		-1.0%	
Tax rate	-34.7%	na		na	
Net margin	1.2%	-1.3%		-1.5%	
Recurring net margin	0.9%	-1.7%		-1.5%	

Source: J.P. Morgan estimates, Company data.

Table 2: CRE FY14 results vs JPM estimates

HKD mn	FY13	FY14A	% chg y/y	FY14E	Actual/Est
Revenue	146,413	168,864	15.3%	170,926	-1.2%
Gross profit	37,373	42,445	13.6%	44,099	-3.8%
Operating profit	4,789	1,717	-64.1%	1,677	2.4%
PBT	5,046	1,841	-63.5%	1,602	14.9%
Net profit	1,908	-161	-108.4%	-339	52.5%
Recurring net profit	1,642	-794	-148.4%	-659	-20.5%
Margins					
Gross margin	25.5%	25.1%		25.8%	
Operating margin	3.3%	1.0%		1.0%	
Tax rate	-37.5%	-84.2%		-103.0%	
Net margin	1.3%	-0.1%		-0.2%	
Recurring net margin	1.1%	-0.5%		-0.4%	

Source: J.P. Morgan estimates, Company data.

Table 3: CRE 4Q14 revenue and net income breakdown

HK\$m	4Q13	4Q14A	% chg y/y	4Q14E	Actual/Est
Turnover breakdown					
Retail and property	23,347	27,329	17.1%	27,452	-0.4%
Beer	5,584	5,096	-8.7%	5,267	-3.2%
Beverage	1,436	1,672	16.4%	1,752	-4.6%
Food processing and distribution	3,894	4,117	5.7%	5,252	-21.6%
Intersegment	-288	-407	41.3%	165	NA

Total	33,973	37,807	11.3%	39,889	-5.2%
Recurring net income					
Retail and property	35	-1,066	-3145.7%	-1,033	-3.2%
Beer	-164	-281	71.3%	-189	-49.0%
Beverage	-23	86	-473.9%	-8	NA
Food processing and distribution	-48	-43	-10.4%	-28	-54.9%
Unallocated corporate expenses	-74	-57	-23.0%	30	NA
Total	-274	-1,361	396.7%	-1,227	-10.9%
Recurring net margins					
Retail and property	0.1%	-3.9%		-3.1%	
Beer	-2.9%	-5.5%		2.7%	
Beverage	-1.6%	5.1%		1.6%	
Food processing and distribution	-1.2%	-1.0%		-0.5%	
Total	-0.8%	-3.6%		-1.5%	

Source: J.P. Morgan estimates.

Table 4: CRE 2H14 revenue and net income breakdown

HK\$m	2H13	2H14A	% chg y/y	2H14E	Actual/Est
Turnover breakdown					
Retail and property	47,267	56,911	20.4%	57,484	-1.0%
Beer	16,916	16,007	-5.4%	16,178	-1.1%
Beverage	3,930	4,834	23.0%	4,914	-1.6%
Food processing and distribution	7,065	8,451	19.6%	9,586	-11.8%
Intersegment	-622	-845	35.9%	-742	-13.9%
Total	74,556	85,358	14.5%	87,420	-2.4%
Recurring net income					
Retail and property	110	-1,798	-1734.5%	-1,765	-1.9%
Beer	585	344	-41.2%	436	-21.2%
Beverage	67	171	155.2%	77	121.5%
Food processing and distribution	-18	-62	244.4%	-47	-32.6%
Unallocated corporate expenses	-107	-117	9.3%	-29	-306.8%
Total	637	-1,462	-329.5%	-1,327	-10.2%
Recurring net margins					
Retail and property	0.2%	-3.2%		-3.1%	
Beer	3.5%	2.1%		2.7%	
Beverage	1.7%	3.5%		1.6%	
Food processing and distribution	-0.3%	-0.7%		-0.5%	
Total	0.9%	-1.7%		-1.5%	

Source: J.P. Morgan estimates, Company data.

Table 5: CRE FY14 revenue and net income breakdown

HK\$m	FY13	FY14A	% chg y/y	FY14E	Actual/Est
Turnover breakdown					
Retail and property	95,174	109,500	15.1%	110,073	-0.5%
Beer	32,994	34,482	4.5%	34,653	-0.5%
Beverage	7,305	9,891	35.4%	9,971	-0.8%
Food processing and distribution	12,069	16,486	36.6%	17,621	-6.4%
Intersegment	-1,129	-1,495	32.4%	-1,392	-7.4%
Total	146,413	168,864	15.3%	170,926	-1.2%
Recurring net income					
Retail and property	734	-1,359	-285.1%	-1,326	-2.5%
Beer	943	761	-19.3%	853	-10.8%
Beverage	106	237	123.6%	143	65.5%
Food processing and distribution	53	-134	-352.8%	-119	-12.8%
Unallocated corporate expenses	-194	-299	54.1%	-212	-41.2%
Total	1,642	-794	-148.4%	-660	-20.3%
Recurring net margins					
Retail and property	0.8%	-1.2%		-1.2%	
Beer	2.9%	2.2%		2.5%	
Beverage	1.5%	2.4%		1.4%	
Food processing and distribution	0.4%	-0.8%		-0.7%	
Total	1.1%	-0.5%		-0.4%	

Source: J.P. Morgan estimates, Company data.

Investment Thesis

We believe CRE's weak earnings momentum in 3Q14 is likely to continue in 4Q14 as the food retail segment remains lacklustre and beer numbers are weaker than expected. For FY14, we now expect the company to report HK\$660mn recurring net loss which implies a HK \$1.2bn recurring net loss as of 4Q14, notably above the 3Q14 net loss figure of HK\$101mn as 4Q is a low season for beer (loss making)

and retail losses continue to impact overall earnings. We have increased our earnings estimates for FY15 for retail as we are now building some savings on the back of bigger integration with Tesco and we have further assumed that CRE will be looking to close down some its loss-making stores. If these do not materialize we will have downside risk to FY15 earnings estimates. As such as we are expecting HK \$170mn recurring net loss for FY15, out of this HK\$1bn is from retail operations (which will consolidate 12 months of Tesco losses). We continue to rate CRE as UW as we see no catalysts in the future.

Valuation

Our Dec-15 PT is HK\$15.50, based on our sum-of-the-parts valuation, in which we assign: 1) 6x EV/ EBITDA to FY16E Retail discounted to FY15; 2) 22x P/E for Beer, 3) 15x P/E for beverages; 4) 10x P/E for food and 5) 10x P/E for property.

CRE: SOTP Valuation

2015E	Recurring earnings (EBITDA for retail)	Valuation Method	Valuation (HK \$m)	% of Total Valuation
Retail*		6x EV/ EBITDA for FY16E discounted to		
	1,820	FY15E	9,666	26%
Beer	1,052	22x P/E	23,139	62%
Beverage	186	15x P/E	2,791	7%
Food processing and distribution	2	10x P/E	19	0%
Property	400	10x P/E	4,000	11%
Net corporate interest & expenses	-212	discounted at 10%	-2,118	-6%
Total (HK\$m)			37,497	100%
Price Target per share (HK\$)			15.5	

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Risks to Rating and Price Target

Key upside risks to our rating and price target include: 1) a faster-than-expected turnaround in NE China retail; 2) a faster-than-expected turnaround in the Tesco JV; 3) better-than-expected margin improvements from product mix in beer; and 4) sizeable M&A.

Key downside risks include: 1) further deterioration in retail margins from extended losses; 2) worsening competition in beverage; and 3) worsening competition in retail.

Consumer

AC

Ebru Sener Kurumlu

(852) 2800-8521

ebru.sener@jpmorgan.com

Bloomberg JPMA KURUMLU <GO>

Shen Li, CFA

(852) 2800 8523

shen.w.li@jpmorgan.com

George Hsu

(852) 2800-8559

george.hsu@jpmorgan.com

Dylan Chu

(852) 2800-8537

dylan.chu@jpmorgan.com

J.P. Morgan Securities (Asia Pacific) Limited

www.jpmorganmarkets.com

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
30-Apr-07	OW	26.90	32.80
18-Jul-07	N	32.40	32.80
27-Aug-07	OW	30.50	35.00
31-Mar-08	OW	25.00	30.00
21-Jul-08	OW	20.50	24.80
04-Sep-08	OW	19.80	25.00
20-Nov-08	OW	12.60	18.00
06-Mar-09	OW	10.68	13.80
01-Apr-09	OW	12.00	13.50
22-May-09	UW	16.26	16.00
03-Aug-09	N	19.38	22.30
03-Sep-09	OW	18.60	21.40
30-Oct-09	OW	24.35	27.00
11-Nov-09	N	26.50	27.00
26-Mar-10	N	28.90	29.00
27-Aug-10	N	31.55	32.00
18-Nov-10	N	32.95	34.00
06-Apr-11	N	32.60	28.00
12-Oct-11	N	28.65	26.00
14-Jan-12	N	27.90	24.50
22-Mar-12	N	29.75	25.00
16-May-12	N	27.95	24.50
17-Aug-12	N	24.25	23.00
21-Nov-12	N	26.25	22.50
05-Feb-13	NR	27.20	--
19-Feb-14	N	23.30	21.00
17-Apr-14	N	22.85	22.00
26-May-14	N	23.90	20.00
24-Sep-14	N	19.52	18.40
16-Nov-14	UW	17.18	15.00
25-Feb-15	UW	16.42	15.50

<http://gps-app.amer.jpmchase.net:6080/server/console/chart/?shareClassId=502044&shareClassServerId=4&chartDesignation=1&actionType=C>

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