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HONG KONG RESEARCH
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CHINA RESOURCES ENTERPRISE, LIMITED (華潤創業)

Sector	:	Conglomerates
HKSE Code	:	00291
Market Price	:	HK$14.98 (23/03/2015)
HSI	:	24,494.51 (23/03/2015)
Shares Issued	:	2,421.37 million
Market Cap.	:	HK$36,272 million
52-week Hi / Lo	:	HK$24.55 / HK$14.04

Chairman	:	Mr. Chen Lang
Chief Executive Officer	:	Mr. Hong Jie

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2014

Final Results Highlights

	2014 HK$ million	2013 HK$ million	*y-o-y Change*
• Turnover	168,864	146,413	*15.3%*
• EBITDA	6,500	8,705	*(25.3%)*
• Profit before tax	1,841	5,046	*(63.5%)*
• **Revaluation gain on investment properties**	**486**	**280**	***73.6%***
• Share of profits of associates	(64)	27	*(337.0%)*
• **Profit attributable to shareholders**	**(161)**	**1,908**	***(108.4%)***
• EPS – Basic (HK$)	(0.07)	0.79	*(108.9%)*
• Final dividend per share (HK$)	0.16	0.14	*14.3%*
• Total dividend per share (HK$)	0.27	0.27	*Unchanged*

- China Resources Enterprise ("CRE" or the "Group") turned from an attributable profit of HK$1,908 million in 2013 into an attributable loss of HK$161 million for the year ended 31st December 2014. Excluding the after-tax effect of asset revaluation and disposal gain of non-core investments, underlying loss was HK$794 million (vs. underlying profit of HK$1,642 million in 2013), in-line with market expectations as the Group previously issued profit warnings.

- Revenue posted a solid growth of 15.3% from a year earlier, driven by higher revenue in retail, food and beverage divisions which surged by 15.1%, 36.6% and 35.4% year-on-year, respectively.

- The Group recorded loss per share of HK$0.07 per share in 2014, against earnings per share of HK$0.79 per share in 2013. Nevertheless, CRE increased its final dividend by 14.3% year-on-year to HK$0.16 per share. Together with its interim dividend of HK$0.11 per share (1H13: HK$0.13 per share), its full-year dividend stayed flat as last year at HK$0.27 per share.

- Its net gearing ratio substantially increased from 2.0% at the end of 2013 to 11.6% at the end of 2014, as a result of a surge in short-term borrowings (+168.8% year-on-year to HK$9.03 billion) and a decrease in cash balance (-4.1% year-on-year to HK$20.65 billion).

- **Turnover breakdown**:

HK$ million	2014	%	2013	%	*y-o-y Change*
Retail	109,500	64.3%	95,174	64.5%	*15.1%*
Beer	34,482	20.2%	32,994	22.4%	*4.5%*
Food	16,486	9.7%	12,069	8.2%	*36.6%*
Beverage	9,891	5.8%	7,305	5.0%	*35.4%*
Total	170,359	100.0%	147,542	100.0%	*15.5%*
Less: inter-segment transactions	(1,495)		(1,129)		
Turnover	**168,864**		**146,413**		*15.3%*

- **Underlying profit breakdown**:

HK$ million	2014	%	2013	%	*y-o-y Change*
Retail	(1,359)	274.5%	734	40.0%	*(285.1%)*
Beer	761	-153.7%	943	51.4%	*(19.3%)*
Food	(134)	27.1%	53	2.9%	*(352.8%)*
Beverage	237	-47.9%	106	5.8%	*123.6%*
Total	(495)	100.0%	1,836	100.0%	*(127.0%)*
Less: net corporate interest and expenses	(299)		(194)		
Underlying profit	(794)		1,642		*(148.4%)*

Retail division

- Turnover from the retail division rose 15.1% year-on-year to HK$109,500 million. Yet, the division recorded an underlying loss of HK$1,359 million in 2014, down 285.1% year-on-year, as a provision of HK$800 million was made in 4Q14 for the closure of less efficient stores and stores with poor prospect. Further, negatively affected by government austerity campaign as well as intense competition from the rapid growth of the e-commerce business which diverted sales from physical stores, the same-store-sales-growth (SSSG) declined 2.6% year-on-year, against 4.7% growth in the previous year.
- Underlying EBITDA margin squeezed by 2 percentage points year-on-year from 3.6% in 2013 to 0.6% in 2014.

Beer division

- Beer sales volume grew marginally by 1% year-on-year to 11,842,000 kilolitres in 2014 (2013: +10% year-on-year), of which "Snow" beer accounted for more than 90% of the Group's total sales volume of beer. The slower volume growth was primarily due to the cooler-than-usual summer in the middle and lower reaches of the Yangtze River in 3Q14, where the hot summer in the same period in 2013 drove up sales. Market shares of "Snow" beer slightly improved from 23% in 2013 to 24% in 2014.
- Underlying profit of the beer division dropped 19.3% year-on-year, as a result of rising labour costs as well as an increase in investment for its promotions and marketing activities in the face of intense market competition.
- EBITDA margin contracted by 80 basis points from a year ago to 12.6% in 2014, whereas the net margin declined from 5.6% in 2013 to 4.3% in 2014.

Food division

- Turnover posted solid growth of 36.6% year-on-year to HK$16,486 million in 2014. Yet, the food division recorded an underlying loss of HK$134 million (2013: underlying profit of HK$53 million), mainly due to the high initial investment and marketing expenses incurred from the expansion of its rice business.

- Its meat operation in China performed well, with i) expansion of its first-tier meat wholesale business and carved meat business and ii) an increase in the number of specialized meat retail stores. However, its livestock raising business in Hong Kong remained sluggish on high costs of raw materials and low selling prices of live pigs.
- Underlying EBITDA margin declined from 3.4% in 2013 to merely 1.6% in 2014.

Beverage division

- Turnover of the segment surged by 35.4% year-on-year, driven by an increase in total sales volume. The total sales volume of the beverage division increased by 33% year-on-year to approximately 6,556,000 kilolitres, driven by the marked growth in the sale volume of "C-estbon" purified water. Underlying profit jumped 123.6% year-on-year to HK$237 million in 2014.
- EBITDA margin improved from 4.4% in 2013 to 6.8% in 2014, whereas net margin expanded by 1.6 percentage points year-on-year to 4.0% in 2014.

Outlook & Prospect

- ***Retail division.*** In respect of the integration with Tesco, loss from Tesco was HK$300 million to HK$350 million in 4Q14, way smaller than a loss of HK$600 million to HK$650 million in June to September 2014. The better performance was mainly attributable to the cost savings from combining the functions of the two headquarters. In particular, CRE will close 38 non-performing stores (5% of these non-performing stores were already closed in 2014 and the remaining will be closed this year), in which 36 and 2 are CRE stores and Tesco stores respectively, which may bring a total cost savings of RMB200 million to RMB300 million for CRE. Further, Management anticipated an upside on the gross margin, with the focus of launching private labels of Tesco.

  Nevertheless, the outlook for the retail market in China remains challenging, amid slowing economic growth, low inflation and anti-extravagance issues. The SSSG of its retail stores dropped 2.6% year-on-year in 2M15. The Group also scaled back its net opening of new stores this year from previously 300 stores to 150-200 stores, a majority of which will be convenience stores instead of hypermarkets. Besides, the Group will launch its e-commerce platform in June to July 2015, which will start in Shenzhen and Guangzhou leveraging on its existing logistics.
- ***Beer division.*** Volume growth of its beer products grew 3% to 4% year-on-year in 2M15, above Management's target of 1% yearly increase for 2015. In addition, Management expected an improvement in the profit margin of its beer division through product mix upgrades by launching more premium products. Hence, the average selling price of its beers increased by 3% to 4% year-on-year in 2M15. Lower packaging and barley costs will likely pass on to an increase in selling and distribution expenses this year, so as to further expand its market share.
- ***Food division.*** The results of its food division may continue to be dragged by its rice business which is still at the initial investment stage for national expansion. Management targeted to turn around the rice business in 2-3 years from 2014.
- ***Beverage division.*** Management expected the net margin of the division to sustain in 2015, thanks to economies of scale as well as lower PET (polyethylene terephthalate, packaging materials for the production of beverage containers and bottles) costs. The lower packaging costs will be partially reinvested in selling and distribution expenses.
- **Valuation**. The valuation of CRE shares is not attractive, trading at 31.2x 2015E P/E, against the sector average of 33.7x, given that turnaround of its retail business will be unlikely in the near term and loss of its rice distribution business may linger. Key downside risks include higher-than-expected loss from Tesco, rising market competition and higher input costs.

Recommendation: Underperform

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