

China Resources Enterprise, Ltd.

Revised offer

On 18 June 2015, CRE announced that its parent, China Resources Holdings (CRH), had marginally revised up its offer to buy CRE's non-beer businesses to HK\$30bn from HK\$28bn. This amounts to an increase of about HK\$0.80/share, raising the earlier offer of HK\$11.50/share to HK\$12.30/share. In addition, CRH also proposed to increase its stake in the BeerCo (which is what CRE will become post the spin-off of its non-beer assets) by increasing its partial offer to acquire an additional 10% stake earlier to 20% now. Therefore, shareholders will be able to sell to the parent about 40% of their shares outstanding of the BeerCo at HK\$12.75/share (unchanged from the previous offer). Combined, this rounds up to a total value of HK\$25/share for the existing entity (BeerCo and non-Beer), which is close to where CRE's stock is now trading. CRH is also offering a loan of up to HK\$10bn to the BeerCo for three years. We raise our 12-month price target for CRE by 4% to HK\$24 to reflect the increase in the proposed special dividend as part of the revised offer.

Concerns over the loan facility: CRE only disclosed that the loan facility would be used for the development of its beer business, thus, raising the possibility of a potential large acquisition. However, depending on the details, we believe this would augur well for long-term growth for BeerCo. Also, we note that the beer division's performance surprised to the upside for 1Q15, and it looks likely to deliver double-digit earnings growth for FY15. We are incrementally more bullish although we note that holding onto the stock at HK\$25 implies being comfortable owning the beer business at 34x forward earnings, which is where CRE is now trading.

Considerable potential upside to beer margins: We see substantial potential upside to margins for BeerCo, but it is sobering to note that even if revenue were to grow at a high single-digit rate and margins were to double in five years, we estimate that the total return would be only about 11-12% if the P/E multiple were to contract to the low 20s by then from the current low- to mid-30s.

Valuation and key risks: Our new price target values the remaining beer business on a generous forward P/E of 30x and assumes that the offer goes through, providing a blended fair value for the business of HK\$24/share. This valuation is contingent on the offer being accepted by minority shareholders and approved by regulators and, thus, is subject to downside risk if the offer were rejected.

0291.HK: Financial and Valuation Metrics EPS HKD

FY Dec	2013	2014	2015	2016	2017
EPS	0.68A	-0.33A	0.35E	0.57E	0.77E
Previous EPS	0.68A	-0.33A	0.35E	0.57E	0.77E
P/E	37.8	N/A	73.1	45.3	33.3

Source: Barclays Research.

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PLEASE SEE ANALYST CERTIFICATION(S) AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 5.

Stock Rating	EQUAL WEIGHT Unchanged
Industry View	NEUTRAL Unchanged
Price Target	HKD 24.00 raised 4% from HKD 23.10

Price (18-Jun-2015)	HKD 25.80
Potential Upside/Downside	-7%
Tickers	291 HK / 0291.HK

Market Cap (USD mn)	8059
Shares Outstanding (mn)	2421.37
Free Float (%)	48.14
52 Wk Avg Daily Volume (mn)	5.1
52 Wk Avg Daily Value (USD mn)	13.29
Dividend Yield (%)	1.1
Return on Equity TTM (%)	-0.35
Current BVPS (HKD)	20.14

Source: Thomson Reuters

Price Performance	Exchange-HKG
52 Week range	HKD 26.15-14.04



[Link to Barclays Live for interactive charting](#)

Asia ex-Japan Staples

Vineet Sharma, CFA

+852 2903 4609

v.sharma@barclays.com

Barclays Bank, Hong Kong

Ally Wang

+852 2903 4261

ally.wang@barclays.com

Barclays Bank, Hong Kong

China Resources Enterprise, Ltd. (0291.HK)

Stock Rating: EQUAL WEIGHT

Income statement (HKDmn)	2014A	2015E	2016E	2017E	CAGR
Revenue	168,864	193,513	215,670	238,440	12.2%
EBITDA	7,278	7,995	9,212	10,382	12.6%
EBIT	2,431	2,848	3,765	4,635	24.0%
Pre-tax income	1,841	2,109	3,021	3,885	28.3%
Net income	-794	850	1,374	1,866	N/A
EPS (reported) (HKD)	-0.33	0.35	0.57	0.77	N/A
Diluted shares (mn)	2,410	2,410	2,410	2,410	0.0%
DPS (HKD)	0.27	0.14	0.23	0.31	4.6%

Price (18-Jun-2015) HKD 25.80
Price Target HKD 24.00

Why Equal Weight? We have an EW rating on the stock as the shares are trading close to our PT of HK\$24.0, derived by applying 30x forward P/E to the company's beer business.

Upside case HKD 28.80

Key upside risks include faster-than-expected transaction completion, as well as better-than-expected growth in beer with its acquisition of Kingway and JV partnership with Kirin. This case assumes earnings are 20% above our current forecasts.

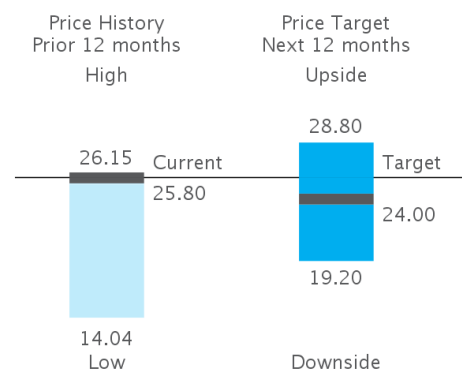
Downside case HKD 19.20

Key downside risks include delay in transaction completion and a worsening competitive landscape for beer, commodity cost and wage inflation. Our downside case assumes earnings being 20% below current projections.

Margin and return data	Average				
EBITDA margin (%)	4.3	4.1	4.3	4.4	4.3
EBIT margin (%)	1.4	1.5	1.7	1.9	1.7
Pre-tax margin (%)	1.1	1.1	1.4	1.6	1.3
Net margin (%)	-0.5	0.4	0.6	0.8	0.3
ROIC (%)	1.4	5.4	6.2	6.8	4.9
ROA (%)	0.7	2.8	3.2	3.4	2.5
ROE (%)	-1.3	1.2	2.0	2.6	1.1

Balance sheet and cash flow (HKDmn)	CAGR				
Tangible fixed assets	56,302	47,487	48,040	48,293	-5.0%
Intangible fixed assets	23,364	23,364	23,364	23,364	0.0%
Cash and equivalents	20,647	23,221	27,208	29,607	12.8%
Total assets	181,364	186,595	197,484	206,691	4.5%
Short and long-term debt	28,897	28,897	28,897	28,897	0.0%
Net debt/(funds)	8,250	5,676	1,689	-710	N/A
Other long-term liabilities	3,270	3,270	3,270	3,270	0.0%
Total liabilities	111,741	116,369	125,665	135,345	6.6%
Shareholders' equity	69,623	70,226	71,819	71,346	0.8%
Change in working capital	4,147	-7,126	2,615	2,737	-12.9%
Cash flow from operations	9,263	-347	10,327	11,358	7.0%
Capital expenditure	-6,000	-6,000	-6,000	-6,000	N/A
Free cash flow	3,263	-6,347	4,327	5,358	18.0%

Upside/Downside scenarios



Valuation and leverage metrics	Average				
P/E (reported) (x)	N/A	73.1	45.3	33.3	50.6
EV/EBITDA (x)	9.7	8.5	7.0	6.0	7.8
Equity FCF yield (%)	5.2	-10.2	7.0	8.6	2.7
EV/sales (x)	0.4	0.4	0.3	0.3	0.3
P/BV (x)	1.3	1.3	1.2	1.3	1.3
Dividend yield (%)	1.0	0.5	0.9	1.2	0.9
Total debt/capital (%)	29.3	29.2	28.7	28.8	29.0
Net debt/EBITDA (x)	1.1	0.7	0.2	-0.1	0.5

Selected operating metrics				
Retail revenue growth (%)	15.1	15.0	10.6	9.2
Beer revenue growth (%)	4.5	11.2	11.2	11.2
Water revenue growth (%)	35.4	22.4	17.3	17.3
Food revenue growth (%)	36.6	13.0	13.0	13.0
Effective tax rate (%)	84.2	36.0	36.0	36.0
Capex/sales (%)	3.6	3.1	2.8	2.5
Number of hypermarkets	678.0	691.0	761.0	821.0

Source: Company data, Barclays Research
Note: FY End Dec

Revised proposal on CRE's non-beer assets disposal

On 15 June 2015, CRE received a revised binding proposal from its parent company, CRH, regarding the disposal of CRE's non-beer assets. The revised proposal is a follow-up on CRH's original proposal announced on 21 April 2015.

First, the total consideration of CRE's non-beer (including Retail, Beverage and Food) assets will increase from HK\$28bn to HK\$30bn with reference to CRH's updated view of the value of these businesses. This amount will be payable in cash at HK\$14.6bn, and the balance will be by way of a promissory note. As a result, the special dividend to shareholders will rise from HK\$11.50 per share to HK\$12.30 per share.

Second, for a period of three years from the date of the transaction's completion for the purposes of CRE's beer business development, including both organic and inorganic growth opportunities, CRH will provide a shareholder loan for a maximum amount of HK\$10bn for a duration of no more than three years. CRE would borrow the money at an interest rate at which CRH is able to borrow in Hong Kong dollars in an amount equal to the relevant loan from a bank or a financial institution for that relevant period.

Third, the maximum number of shares under the pre-conditional partial offer to increase CRH's stake in CRE (BeerCo) is to increase from 242mn shares (10% of CRE's issued share capital) to 484mn shares (20% of CRE's issued share capital). The aggregate cash payable under this revised partial offer will amount to HK\$6.15bn. Upon completion of the revised partial offer (and assuming full acceptance of public shareholders), CRH's shareholding in CRE would increase to 71.87% from 51.87% now. CRH said the revised offer reinforces its commitment to CRE.

FIGURE 1

CRE – Cash proceeds for a share tendered into and accepted in the revised partial offer

HK\$ per share	Revised offer	Original offer
Revised special dividend	12.3	11.5
Offer price	12.7	12.7
Revised special dividend + offer price	25.0	24.2

Source: Company circular.

More colour on 1Q15 results

CRE released its results for 1Q15 results on Wednesday, 17 June 2015 (please click [here](#) for our published note). At its conference call on Thursday, 18 June, management provided more detail on the 1Q15 results with a focus on the Retail and Beer businesses.

On the *Retail* business, management noted the following:

- **Turnaround timing:** Management mentioned that its previous guidance of a 3-5 year turnaround is still on-track but that a faster-than-expected turnaround is highly unlikely given severe macro headwinds and ongoing threat from e-commerce.
- **1Q15 SSSG decline:** The company recorded a decline in same-store sale growth (SSSG) for 1Q15 of 3.3%, which primarily referred to the Vanguard stores' performances while no Tesco stores have been included since they are considered as "new stores" as they have only been consolidated from last year. Although it provided no figures, management guided that the Tesco stores' performances also declined in line with Vanguard and the industry. Management said the overall retail environment remains weak; SSSG post the decline for 1Q15 deteriorating further.

On the *Beer* business, management noted the following:

- **Kingway integration:** Management maintained its guidance of a 3-5 year time horizon for the Kingway integration. Of note, Kingway fares particularly well in Southern China, and some of its factories have started to produce “Snow” beer as well.
- **Revenue growth outlook:** Management guided for 5-10% y/y revenue growth for full-year 2015 and quoted a third-party market data provider that forecasts a high single-digit to low-teen market size growth rate for the medium term.
- **ASP uplift trend:** Management commented that the average selling price (ASP) uplift trend started a few years back as consumers have gradually traded up as high-end products have become better received. In 1Q15, sales volume of mid-end and high-end products increased by c30% y/y and the overall ASP rose by 5.6% y/y.
- **Opex/sales ratio:** Management confirmed that the Beer division’s opex/sales ratio was at c.30%. With the upcoming splitting of the beer and non-beer businesses, the ratio should remain similar as corporate expenses are insignificant, according to management.
- **Utilization rate:** No quantitative information was given regarding CRE’s utilization rate, but management mentioned that the first quarter is usually a seasonally slack quarter and that in a good year the utilization rate is more than 70%. Per guidance, on a 5-year time horizon, the company’s average utilization rate will see an upward trend.
- **Beer division management change should be minimal:** According to CRE’s current management team, there is no plan for changes to the Beer division’s management.

A circular containing further financial details is to be despatched on or before 9 July 2015.

Valuation and key risks

We increase our 12-month price target by 4% to HK\$24. Our price target is first based on our target forward P/E of 30x applied on our earnings estimate of HK\$0.40/share for CRE’s beer business for 2015 given the proposed sell-off of the non-beer business to its parent, China Resources Holdings. To this, we also factor in the proposed special dividend of HK\$12.30 per share as per the revised offer. Our target P/E of 30x remains unchanged and is derived from 20% premium to the average of China staples universe, which we think is justified given the potential unlocking value from a more simplified structure, allowing CRE to focus on beer with no exposure to earnings volatility of the non-beer business.

The key risks to our price target, in our view, include the following: To the upside, faster-than-expected transaction completion as well as better-than-expected growth in the beer division along with its integration of the acquisition of Kingway and joint venture with Kirin. To the downside, any delay in the transaction’s completion, worsening competitive landscape in beer and higher commodity costs or greater wage inflation.

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Primary Stocks (Ticker, Date, Price)

China Resources Enterprise, Ltd. (0291.HK, 18-Jun-2015, HKD 25.80), Equal Weight/Neutral, J/K/M

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Ginko International (8406.TWO)	ITC Ltd. (ITC.NS)	KT&G (033780.KS)
Marico Ltd. (MRCO.NS)	Merida Industry (9914.TW)	Nestle India Ltd. (NEST.NS)
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China Resources Enterprise, Ltd. (291 HK / 0291.HK)

Stock Rating

Industry View

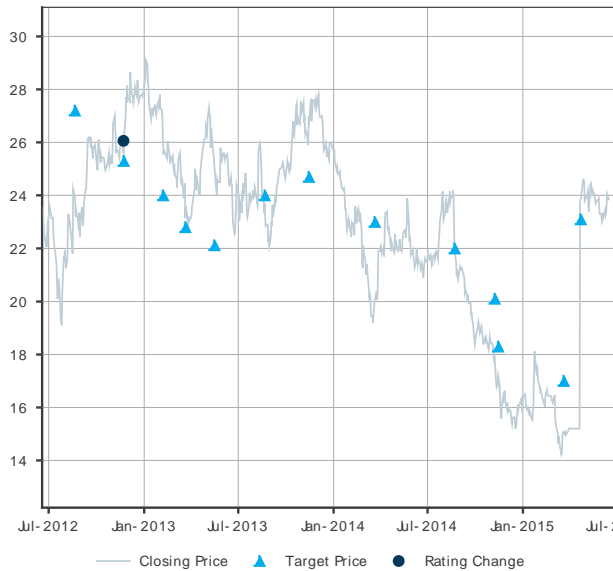
HKD 25.80 (18-Jun-2015)

EQUAL WEIGHT

NEUTRAL

Rating and Price Target Chart - HKD (as of 18-Jun-2015)

Currency=HKD



Date	Closing Price	Rating	Adjusted Price Target
22-Apr-2015	23.85		23.10
20-Mar-2015	15.08		17.00
14-Nov-2014	17.18		18.30
07-Nov-2014	17.90		20.10
22-Aug-2014	21.95		22.00
21-Mar-2014	20.00		23.00
14-Nov-2013	27.00		24.70
21-Aug-2013	23.70		24.00
16-May-2013	25.15		22.12
21-Mar-2013	23.15		22.80
06-Feb-2013	26.10		24.00
22-Nov-2012	25.60	Equal Weight	25.30
20-Aug-2012	23.95		27.20

Source: Thomson Reuters, Barclays Research

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Risks which May Impede the Achievement of the Barclays Research Price Target: The key risks to our price target, in our view, include the following: To the upside, faster-than-expected transaction completion as well as better-than-expected growth in the beer division along with its integration of the acquisition of Kingway and joint venture with Kirin. To the downside, any delay in the transaction's completion, worsening competitive landscape in beer and higher commodity costs or greater wage inflation.

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