



China Resources Enterprise, Limited

Retailing Strategies and Execution Plan

July, 2002

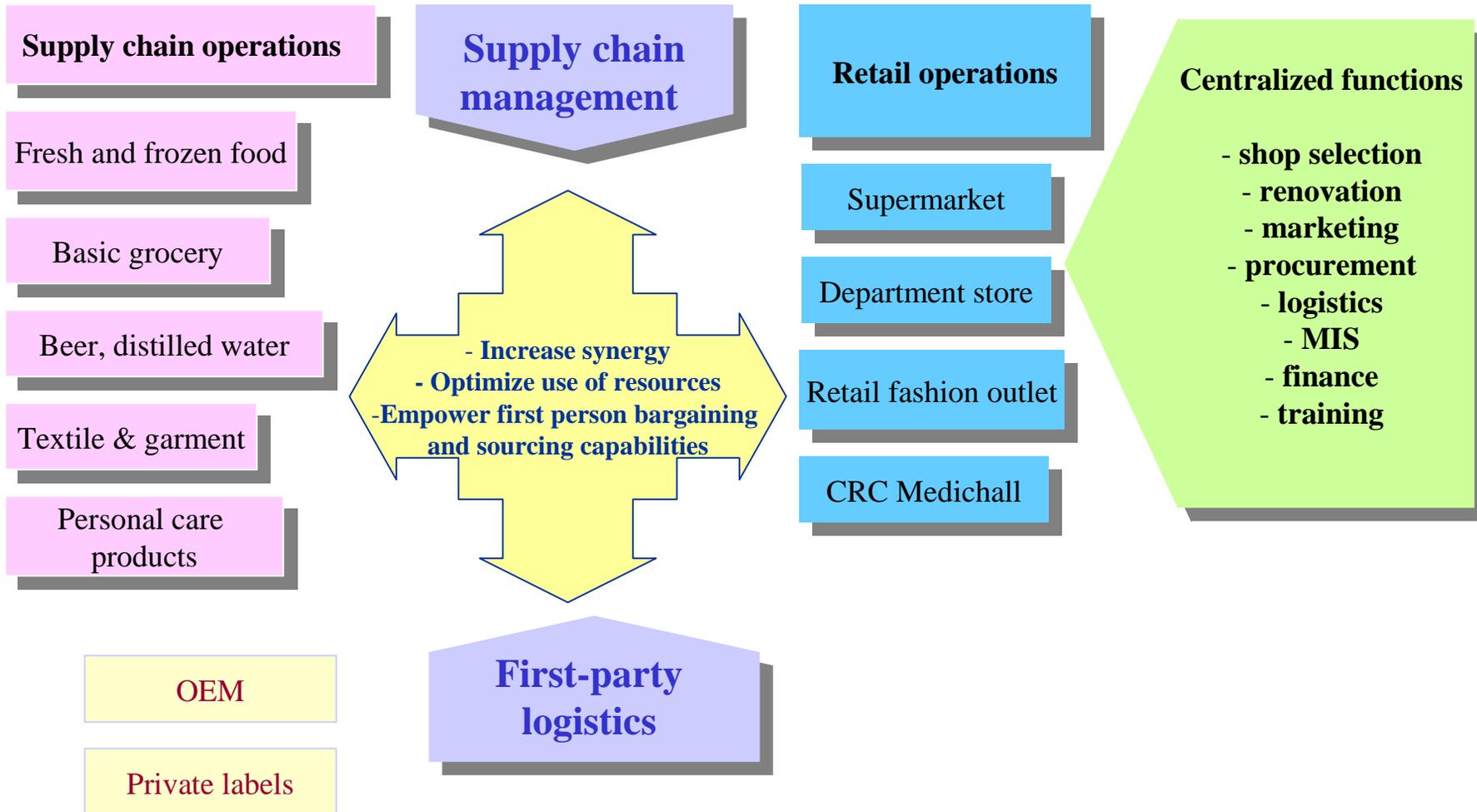


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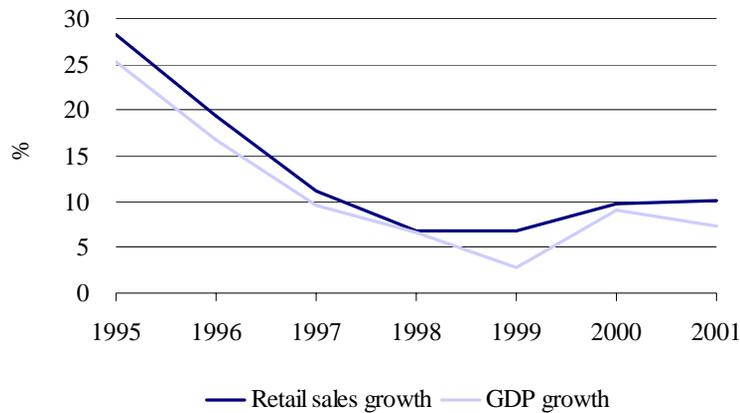
Retail-led Distribution Model



Retail-led Distribution Model

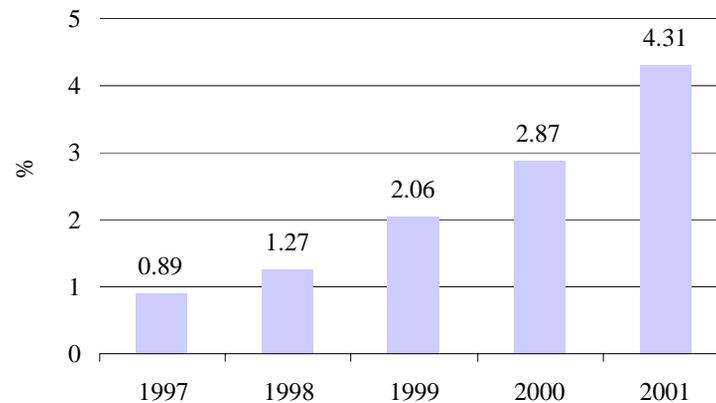
- Retail sales growth has been faster than GDP growth in China
- Nominal retail sales grew 10.1% in 2001 compared with GDP's 7.5%
- Chain-store format sales growth was about 50% in 2001

Nominal retail sales growth vs GDP growth



Source: National Bureau of Statistics

Top 100 chain store sales as a proportion of nominal retail sales



Source: China Chain Stores Association



Retail-led Distribution Model

- **Fragmented supermarket industry provides a platform for consolidation, like brewery**
- **Combined with Vanguard, our supermarket operation ranked #10 in 2001 from #13 in six months**
- **Stores are primarily self-operated and managed rather than franchised**

Profile of leading chain stores in China 2001

Rank	Retailer	Turnover (RMBm)	Y-o-y change (%)	Ranking in H1 2001	Est market share (%) *
1	Shanghai Lianhua	14,063	+26	1	4.26
2	Shanghai Hualian	8,504	+52	3	2.58
3	Beijing Hualian	8,000	+60	5	2.42
4	Shanghai Nong Gong Sang	7,475	+38	2	2.27
5	San Lian (electrical goods)	7,026	+32	4	2.13
6	Beijing Guo Mei (electrical goods)	6,150	+120	9	1.86
7	Jiangsu Su Guo Supermarket	5,282	+31	6	1.60
8	Bai Sen (fast food)	5,205	+24	7	1.58
9	Shanghai Jinjiang Metro	4,949	+32	8	1.50
10	China Resources Vanguard	4,648	+35	13	1.41

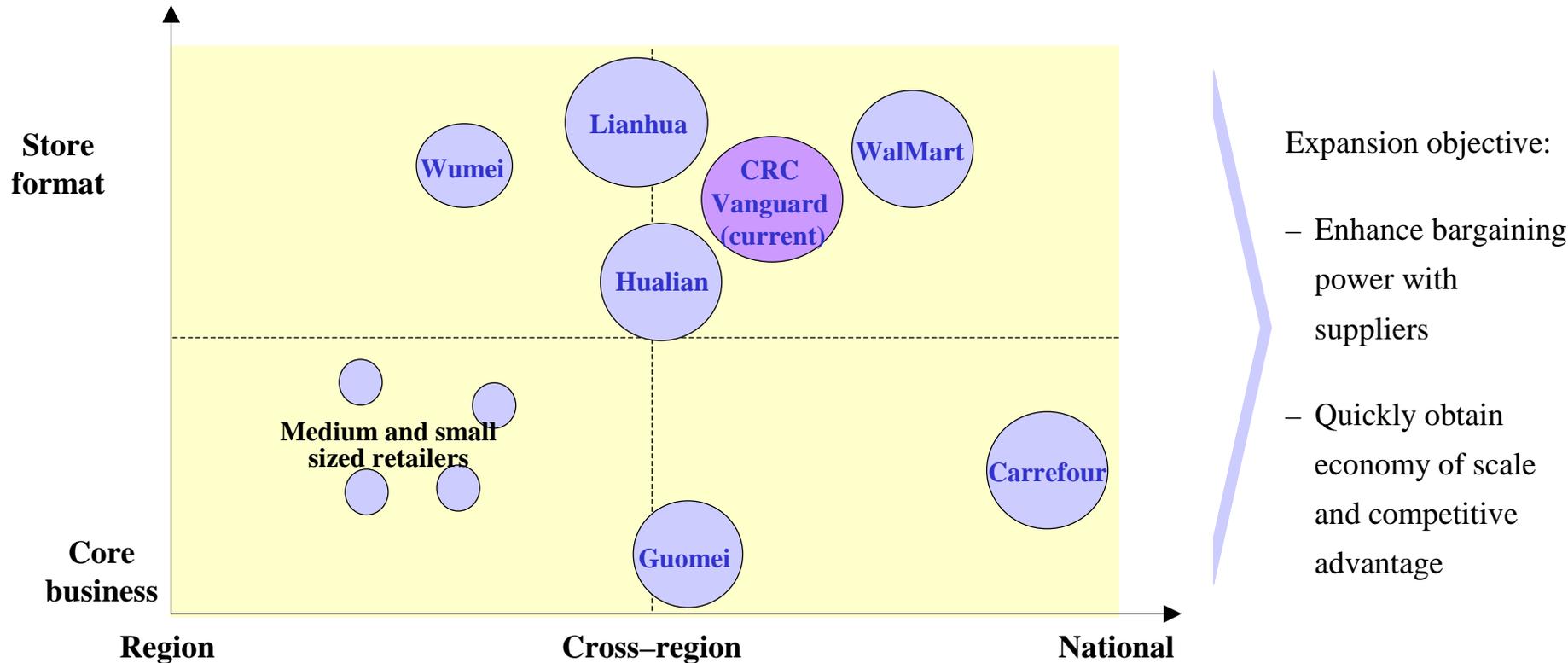
* Based on estimated chain-store format sales in FY2001 of RMB330bn

Source: State Economic and Trade Commission

Strategies

- Retailers achieve economy of scale through a “cross–region and multi-store format” expansion strategy

Expansion path for Chinese retailers



Source: Roland Berger



Strategies

SWOT analysis

Strengths

- Local management with extensive experience in China's retail business
- Sound local knowledge and good relationship with provincial governments
- Unique business model combining retailing and manufacturing operations
- An existing national network with localised supply chain and a good supplier relationship
- Strong balance sheet and cashflow

Weaknesses

- Management resources facing growth challenge
- Different logistic and supply chain structures among different businesses
- Various store formats require synergies between them

Threats

- Current deflationary economic environment
- Foreign competition and foreign ownership limit will be lifted in 3 years
- Different shopping behavior and preference in different provinces

Opportunities

- Chain store format sales growing at 50% pa in a highly fragmented market
- Most retailers have poor supplier relationship
- Rapid expansion before the liberalisation of the market

Strategies

Supermarket format in China

	Vanguard-type hypermarket	Superstore	Discount store	Traditional supermarket
Size	15,000-20,000 sm	4,000-6,000 sm	1,000 sm	500 sm
Assortment	60,000 SKU	7,000-11,000 SKU	1,000 SKU (incl 35% under private labels)	2,000 SKU
Product mix	Half supermarket and half department store	Food, toiletry and groceries account for ~85%, durables and fashion ~15%	Food account for ~75%	Food account for ~65%
Store opening	Focus on Shenzhen, Guangdong, Beijing, Shanghai	Enter Jiangsu and Zhejiang first, open stores in Pearl River Delta in 2004, probably in Tianjin	Open stores in 2004, initially in Guangzhou and Shenzhen and expand gradually into other cities of the Pearl River Delta	More or less halted
Penetration	Penetrate major residential and commercial districts	Penetrate major residential and commercial districts	Penetrate all residential districts	Penetrate all residential districts
Investment cost per store	RMB50m	RMB11m	RMB2m	RMB0.5m
No of store by 2006	50	190	180	400
Sales per store by 2006	RMB300m	RMB100m	RMB15m	RMB6m
Sales per sm	RMB20,000	RMB20,000	RMB15,000	RMB12,000
Sales per receipt	RMB80	RMB35	RMB25	RMB16
No of receipts per day	10,000	8,000	1,500	1,000
No of staff per store	400	130	12	12
Strategies	One-stop shopping, rich merchandising	Attractive pricing, product differentiation, rapid expansion	Daily basket with high turnover, pricing 15% cheaper than supermarket	Convenience
Inventory day	50	30	21	30



Strategies

Product Distribution

	Vanguard-type hypermarket *	Superstore	Discount store
	%	%	%
Dry and frozen food	27	51	68
Fresh food	11	12	8
Toiletry & beauty	15	11	15
General merchandise	15	10	10
Durables	20	5	
Fashion	12	11	
	100	100	100

*FY2001 breakdown



Execution Plan

- Our target of achieving retailing turnover of RMB50bn in five years will be achieved mainly through organic growth
- Approximately, RMB5bn will be invested to generate earnings of about RMB500m

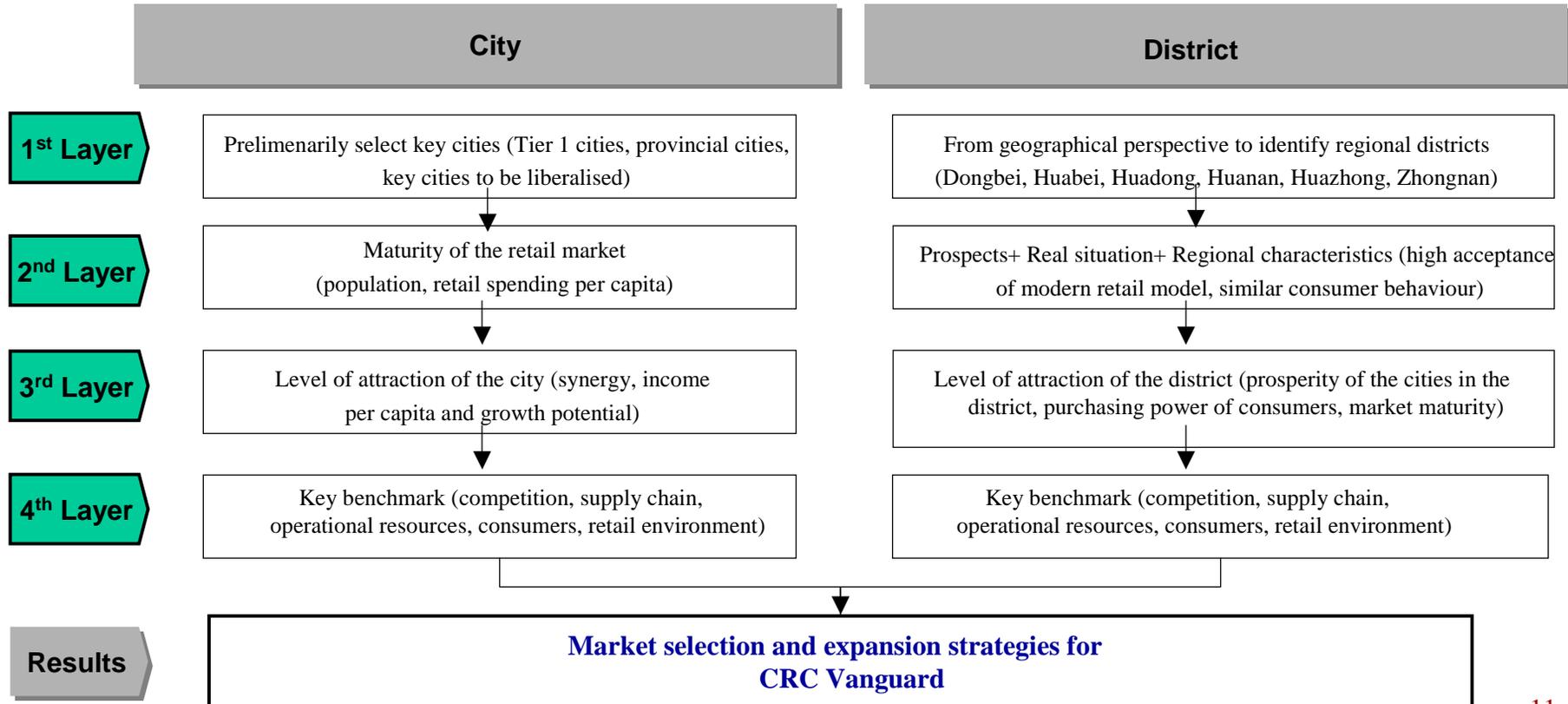
Number of mainland supermarket over the next five years – base case

	FY2002	FY2003	FY2004	FY2005	FY2006
Vanguard-type hypermarket	17	23	31	39	50
Superstore	2	29	67	120	190
Discount store	0	0	20	80	180
Traditional supermarkets and others *	380	385	390	395	400
Total	399	437	508	634	820
% change		+10	+16	+25	+29

*Excluding acquisitions

Execution Plan

- Geographical focus determined by a point system, dividing the cities/districts into A, B, C types according to: market potential, competition, maturity of supply chain as well as city retailing policy
- A nationwide city/district screening process





Execution Plan

- **Acquisition as a platform to enter a market or increase market share based on the following two criteria:**

Strategic store format fit

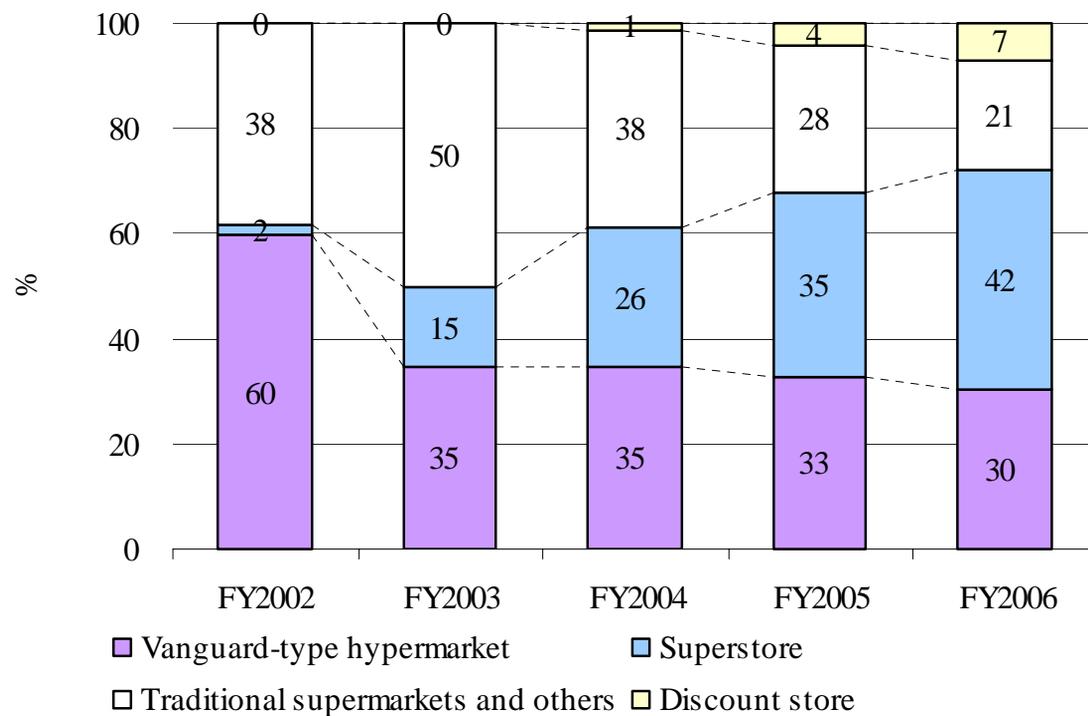
- **similar main business**
- **average store size comparable to our format**
- **location in target provinces**
- **high average sales per store**
- **concentrated store locations**

Supply chain integration

- **leading market share in a target province**
- **food and grocery items fall into our supply chain**

Execution Plan

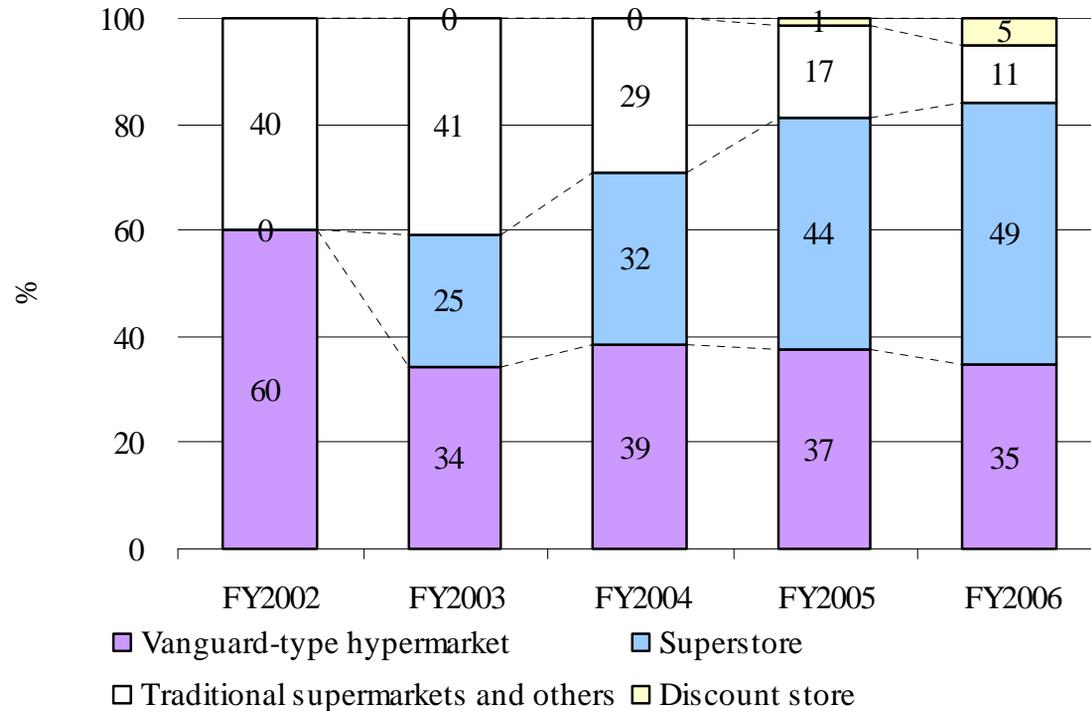
Estimated turnover contribution from different types of retail formats



Note: The above estimates are based on the assumption that turnover reaches RMB50bn in 2006

Execution Plan

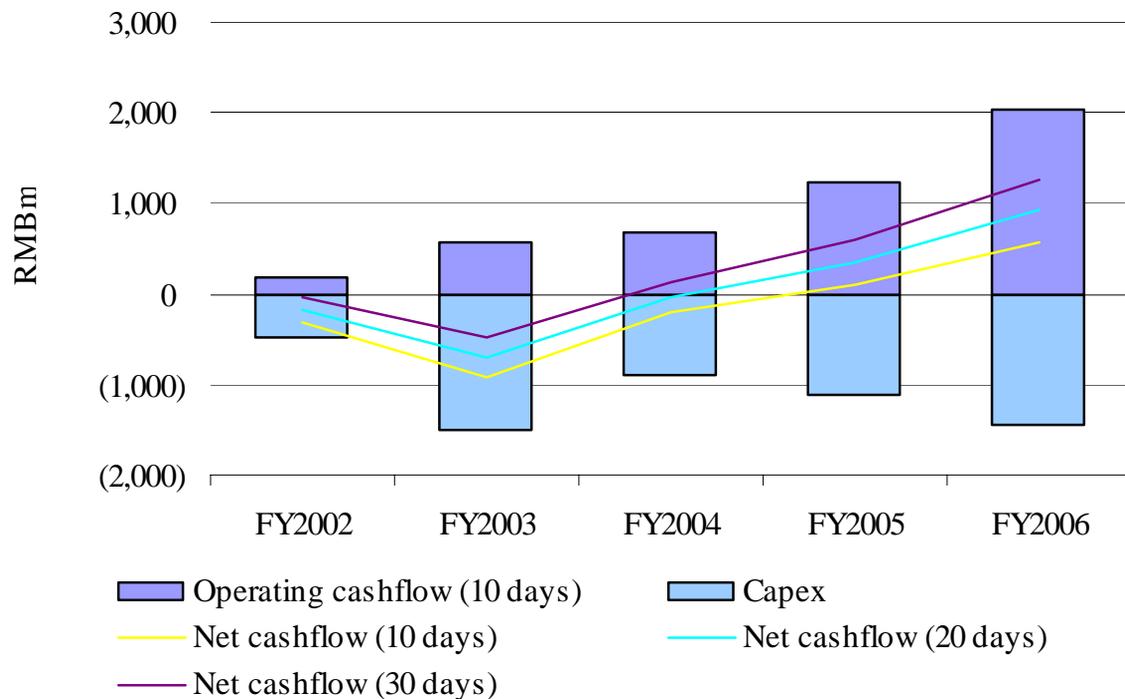
Estimated operating profit contribution from different types of retail formats



Note: The above estimates are based on the assumption that turnover reaches RMB50bn in 2006

Execution Plan

Estimated cashflow over the next five years



Note: The above estimates are based on the assumption that turnover reaches RMB50bn in 2006. Three scenarios, using different gaps between creditor days and inventory days of 10 days, 20 days and 30 days, have also been prepared.

Vanguard – Existing Stores



Cuizhu Store, Shenzhen
(opened Nov-96, 9,509 sm)



Caitian Store, Shenzhen
(opened Dec-98, 10,518 sm)



Baoan Store, Shenzhen
(opened Jan-00, 19,068 sm)

Vanguard – Existing Stores



**Cufeng Store, Shenzhen
(opened Nov-00, 14,463 sm)**



**Zhuhai Store, Guangdong
(opened Sep-01, 23,701 sm)**



**Zhongshan Store, Guangdong
(opened Sep-01, 19,620 sm)**



Vanguard – Existing Stores



Wuyang Store, Guangzhou
(opened Dec-01, 8,349 sm)



Liwan Store, Guangzhou
(opened Jan-02, 19,444 sm)



Longgang Store, Shenzhen
(opened May-02, 21,071 sm)

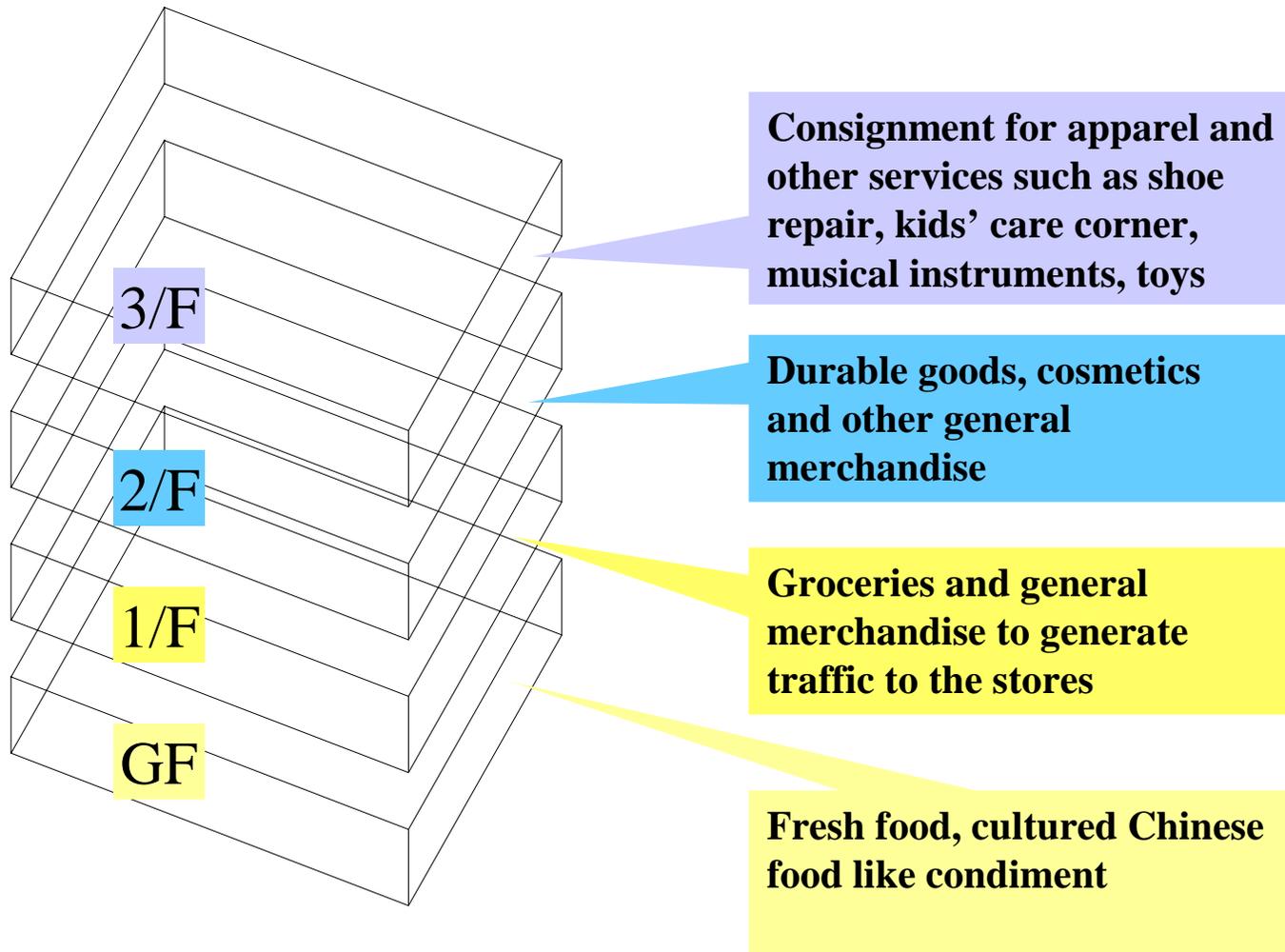
About 8 more stores will be opened by 2002, all signed:

Shenzhen:	Huaqiang	Xili	Shajin	Futian
Guangzhou:	Dongyin (Haizhu)	New World (Tianhe)	Fengxing (Tianhe)	
Guangdong:	Huizhou			



Vanguard – Store Format

- Typical “four-storey format” to capture different segments of consumers



Vanguard – Wide Choice for Customers



Fresh food is available with emphasis on hygiene



Cultured Chinese food like condiment are popular items

Vanguard – Wide Choice for Customers



Grocery and general merchandise

Vanguard – Wide Choice for Customers



Consignment corners for fashion, leather goods and cosmetics in cosy atmosphere

Vanguard – Wide Choice for Customers



**Other household goods to
broaden customer base**



Supply Chain and Logistics Management

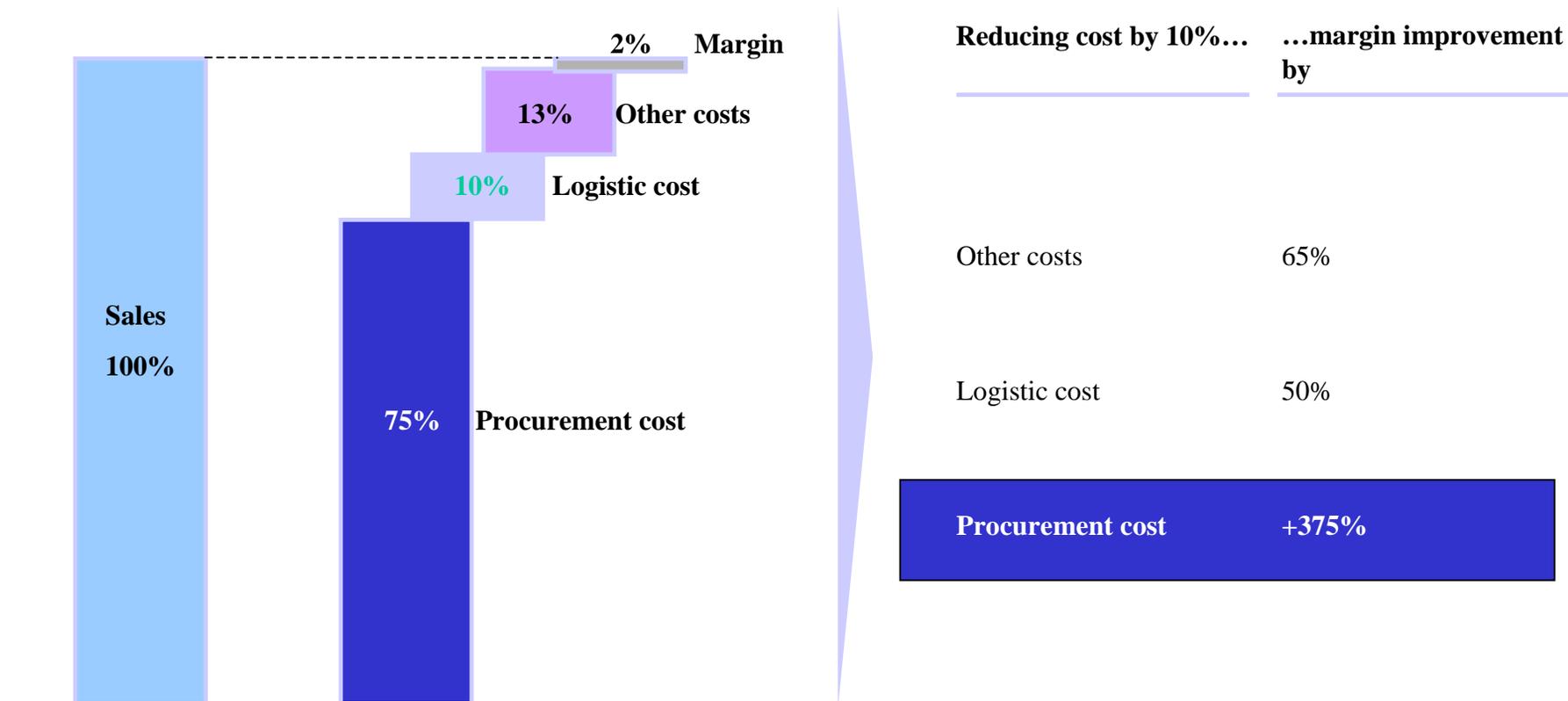


- **Two logistic centers are under construction in Shenzhen and Suzhou with a total GFA of around 80,000 sm. The one in Shenzhen (as shown) has a GFA of 65,000 sm in two phases. It has full capacity to service 40 Vanguard department stores and 400 superstores/discount stores**
- **A zero inventory concept**

Supply Chain and Logistics Management

- Reducing procurement cost is the most effective way in improving margin

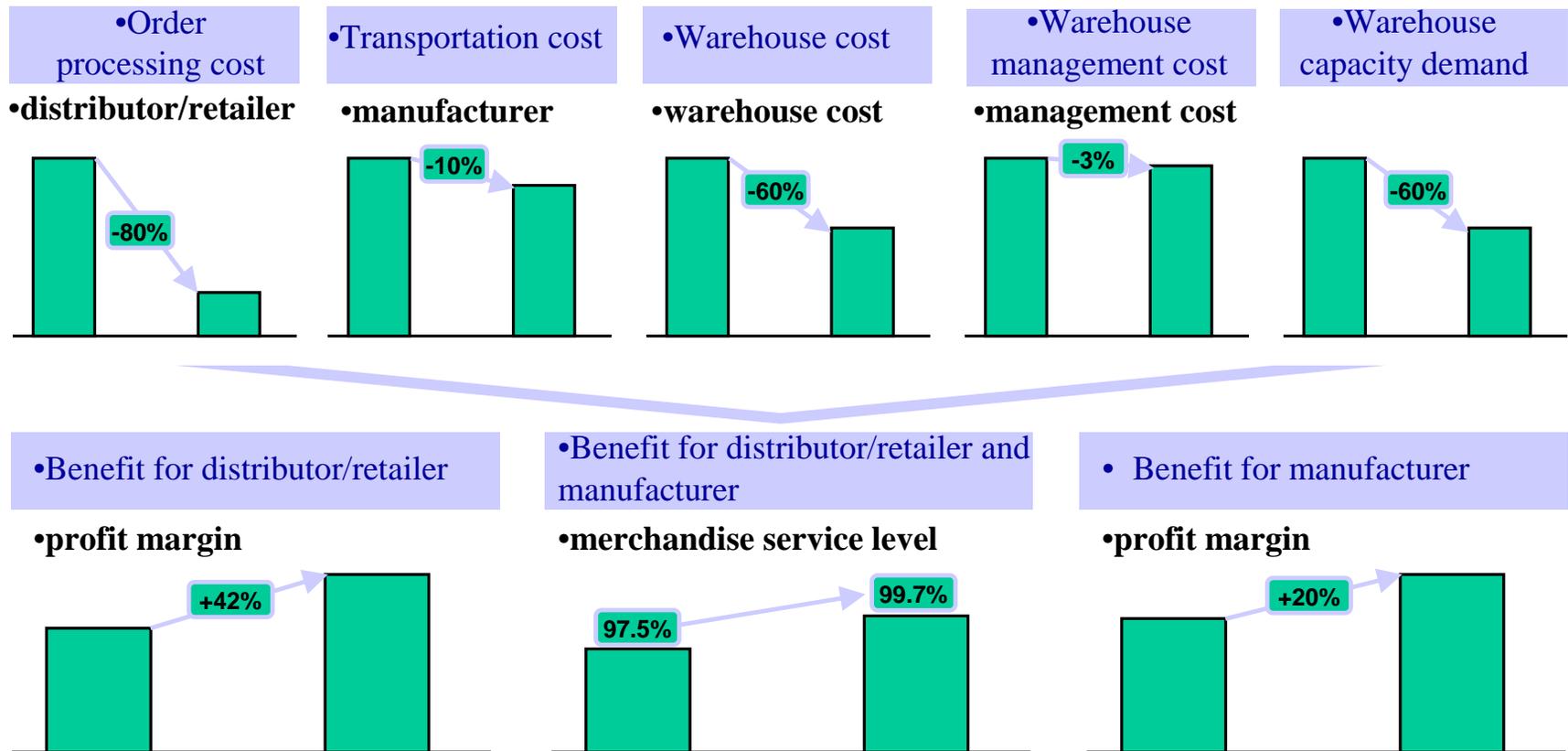
How change in cost of sales affect margin level



Supply Chain and Logistics Management

▪ “Win-win” results from restructuring and collaboration of supply chain - manufacturer, distributor and retailer are all winners

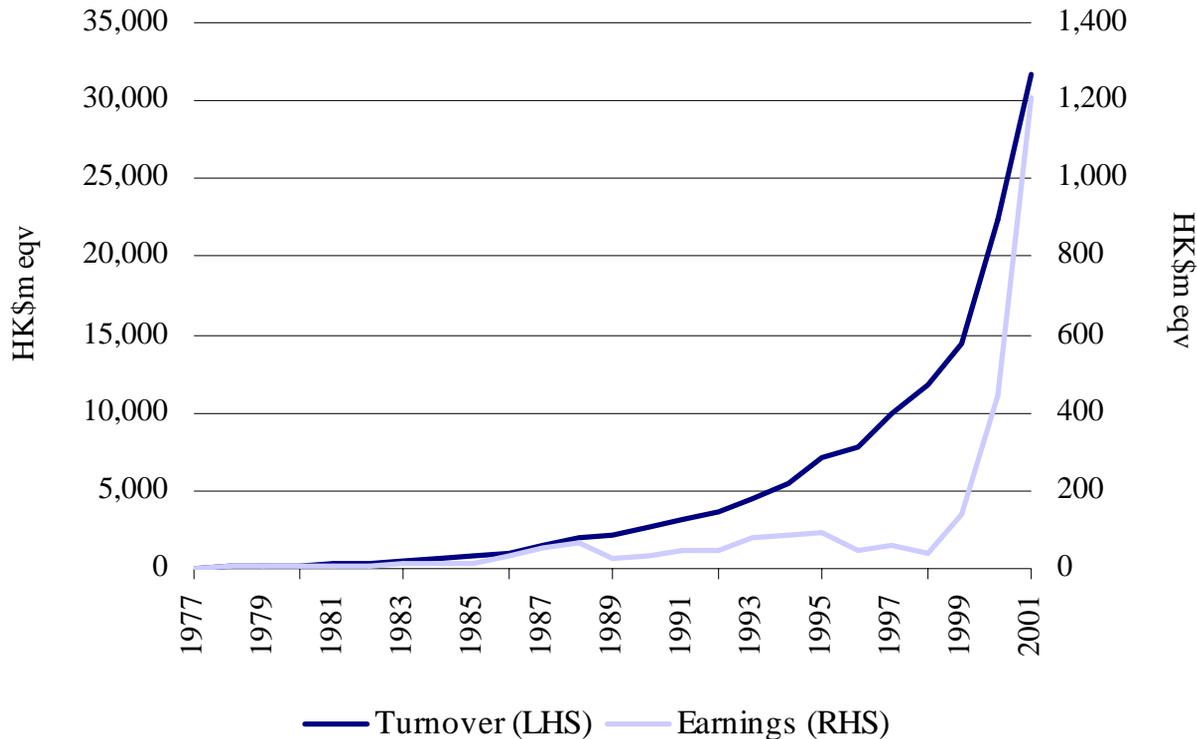
Result of ECR Europe



Supply Chain and Logistics Management

- Critical mass is crucial, as reflected by Shinsegae
- Investors should focus on turnover, cashflow, earnings and ROE sequentially

Case study - Shinsegae in Korea



Appendix

Peer comparison

	Vanguard	Walmart	Carrefour	Hua Lian *	Shanghai Friendship **
Price (US\$)	na	56.40	€54.75	RMB12.72	1.03
Valuation:					
PER (x)	12.4***	37.9	32.2	39.1	56.9
EV/EBITDA (x)	5.3***	18.7	12.2	16.9	9.0
EV/sales (x)	0.3***	1.3	0.8	0.7	0.5
Profitability:					
Gross profit margin (%)	20.6	21.2	22.5	14.1	13.3
Operating margin (%)	3.3	5.5	4.1	2.5	2.1
Net profit margin (%)	2.9	3.1	1.8	1.5	0.6
ROE (%)	13.9****	19.0	15.5	20.5	6.3
ROCE (%)	13.9****	11.5	4.3	7.5	1.7
Balance sheet:					
Creditor days	61	26	68	31	83
Inventory days	36	48	40	40	37
Quick ratio (x)	0.54	0.21	0.48	0.39	0.42

Note: The above comparison is based on the historical year performance

* A-share price

** B-share price

*** Based on the acquisition price of HK\$372m for a 65% stake

**** About 18% using weighted average equity during the year

Source: Annual reports of respective companies

Appendix

Turnover breakdown

Year end 31 Dec	H1 2001 HK\$m	H2 2001 HK\$m	FY2001 HK\$m	H1 2000 HK\$m	H2 2000 HK\$m	FY2000 HK\$m	Full year % change
Property development	498	501	999	483	2,342	2,825	-65
Rental properties (incl godown)	229	251	480	181	241	422	+14
Beverage	1,131	1,282	2,413	865	934	1,799	+34
Food processing and distribution	2,854	2,896	5,750	2,689	2,869	5,558	+3
Petroleum and chemicals	5,150	4,740	9,889	0	1,851	1,851	+434
Building materials	337	330	667	418	437	854	-22
Retail (incl supermarkets)	1,894	2,132	4,026	1,655	1,773	3,428	+17
Investment & others	43	64	108	90	109	198	-46
	12,136	12,195	24,331	6,380	10,556	16,936	+44
Less: inter-co transactions	(76)	(58)	(135)	(59)	(67)	(125)	+7
Turnover	12,059	12,137	24,196	6,321	10,489	16,810	+44

Appendix

Earnings breakdown

Year end 31 Dec	H1 2001 HK\$m	H2 2001 HK\$m	FY2001 HK\$m	H1 2000 HK\$m	H2 2000 HK\$m	FY2000 HK\$m	Full year % change
Property development	102	106	208	112	361	473	-56
Rental properties (incl godown)	147	158	305	110	144	253	+20
Beverage	48	13	61	44	45	89	-32
Food processing and distribution	221	176	397	195	116	311	+28
Petroleum and chemicals	91	137	228	0	26	26	+789
Building materials	72	70	142	98	107	205	-31
Retail (incl supermarkets)	(6)	37	31	26	7	34	-8
Investment & others	225	(197)	28	241	147	388	-93
	899	499	1,399	825	954	1,779	-21
Net corporate interest & expenses	(111)	(82)	(194)	(60)	(62)	(122)	+58
Earnings	788	417	1,205	765	891	1,657	-27



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