2017 年 11 月 15 日

投资决策

买入

贵州茅台 (600519.SS)

潜在回报： 30%

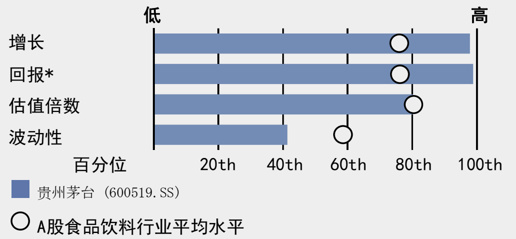
证券研究报告

新零售模式：借助云商平台重获控制权；强力买入（摘要）

建议理由

很难想像一家企业要将近半盈利交予经销商，但贵州茅台就是这样。许多与我们交流的投资者都认为其分销渠道拿走了过多的利润。茅台现在正在解决这一问题，方法就是通过“新零售”模式来将一大部分销售转移至云商平台。我们认为这应该会在中长期内给公司带来实实在在的益处，包括改善定价能力，平滑盈利增速，因为在这种模式下供需更加匹配，并能带来新的收入机会。鉴于此，我们将目标估值倍数上调至 25 倍 2021 年预期市盈率，并重申我们对于公司持续调整业务模式以及再创价值的乐观看法。

投资摘要



* 回报 - 资本回报率

投资摘要指标的全面描述请参见本报告的信息披露部分。

推动因素

茅台已经成功地将茅台酒的消费主体从政府部门转至个人领域，但时至今日其分销体系几乎未有任何变革，这影响了公司的定价能力、稳定价格以及有效调整供应的能力，使之难以真正了解最终消费者并阻碍了公司进军新市场。

不过，现在公司的新零售模式强制性要求分销商将手中 30%配额放上茅台云商平台，这将加强茅台对于经销商的控制权，使公司能更规律地持续上调出厂价、挤出经销商的过高盈利并显著提升自身盈利水平。在我们的两个持续提价情景下（每年上调 10%/15%），估值将提升约每股 211/311 元。

新零售模式还能更好地匹配供需、提高透明度，帮助公司了解最终是谁、在哪里购买了茅台酒。这有助于遏制因为区域错配而造成的存货堆积和供应短缺。

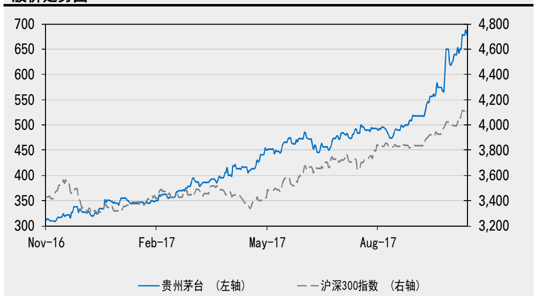
主要数据	当前
股价 (Rmb)	678.75
12个月目标价格 (Rmb)	881.00
市值 (Rmb mn / US$ mn)	852,644.3 / 128,342.6
外资持股比例 (%)	--

	12/16	12/17E	12/18E	12/19E
每股盈利 (Rmb)	13.31	19.40	25.59	35.08
每股盈利增长 (%)	7.8	45.7	31.9	37.1
每股摊薄盈利 (Rmb)	13.31	19.40	25.59	35.08
每股基本盈利 (Rmb)	13.31	19.40	25.59	35.08
市盈率 (X)	20.7	35.0	26.5	19.3
市净率 (X)	4.7	10.0	8.4	6.9
EV/EBITDA (X)	11.2	21.7	16.2	11.5
股息收益率 (%)	2.5	1.4	1.9	2.6
净资产回报率 (%)	24.4	30.8	34.5	39.3
CROCI (%)	24.3	30.7	33.7	37.7

估值

我们维持盈利预测不变。由于我们将估值切换到 18 年并将目标倍数从 23 倍上调至 25 倍，我们将 12 个月目标价格上调了 18%至人民币 881 元，对应 34 倍的 2018 年预期市盈率。**强力买入。**

股价走势图



主要风险

宏观经济增速放缓抑制白酒销售，对政府部门白酒消费的政令监管。

**全文翻译随后提供*

股价表现 (%)	3个月	6个月	12个月
绝对	35.8	64.2	118.3
相对于沪深300指数	22.4	35.6	82.6

资料来源：公司数据、高盛研究预测、FactSet（股价为11/14/2017收盘价）

所属投资名单

亚太买入名单

亚太强力买入名单

行业评级： 中性

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贵州茅台： 财务数据概要

损益表(Rmb mn)	12/16	12/17E	12/18E	12/19E
主营业务收入	**40,155.1**	**55,861.5**	**71,439.8**	**95,535.1**
主营业务成本	(3,533.1)	(5,290.8)	(6,662.8)	(8,007.4)
销售、一般及管理费用	(12,377.2)	(15,624.1)	(18,695.3)	(24,427.6)
研发费用	(11.5)	(11.2)	(14.3)	(19.1)
其它营业收入/（支出）	(12.3)	10.0	0.0	0.0
EBITDA	**25,166.6**	**35,981.3**	**47,172.3**	**64,289.0**
折旧和摊销	(934.2)	(1,024.6)	(1,090.6)	(1,188.9)
EBIT	**24,232.4**	**34,956.7**	**46,081.7**	**63,100.1**
利息收入	71.5	66.9	75.9	94.5
财务费用	(38.3)	0.0	0.0	0.0
联营公司	0.0	0.0	0.0	0.0
其它	(307.7)	(185.0)	(190.0)	(190.0)
税前利润	**23,957.9**	**34,838.6**	**45,967.6**	**63,004.7**
所得税	(6,027.2)	(8,709.6)	(11,491.9)	(15,751.2)
少数股东损益	(1,212.3)	(1,762.8)	(2,326.0)	(3,188.1)
优先股股息前净利润	**16,718.4**	**24,366.1**	**32,149.7**	**44,065.4**
优先股息	0.0	0.0	0.0	0.0
非经常性项目前净利润	**16,718.4**	**24,366.1**	**32,149.7**	**44,065.4**
税后非经常性损益	0.0	0.0	0.0	0.0
净利润	**16,718.4**	**24,366.1**	**32,149.7**	**44,065.4**
每股基本盈利（非经常性项目前）(Rmb)	13.31	19.40	25.59	35.08
每股基本盈利（非经常性项目后）(Rmb)	13.31	19.40	25.59	35.08
每股摊薄盈利（非经常性项目后）(Rmb)	13.31	19.40	25.59	35.08
每股股息(Rmb)	6.79	9.70	12.80	17.54
股息支付率(%)	51.0	50.0	50.0	50.0
自由现金流收益率(%)	10.4	2.1	3.6	5.1

资产负债表(Rmb mn)	12/16	12/17E	12/18E	12/19E
现金及等价物	66,855.0	75,875.9	94,545.5	122,353.7
应收账款	2,471.9	6,121.8	7,829.0	10,469.6
存货	20,622.3	30,156.4	37,064.2	43,446.7
其它流动资产	231.5	266.2	306.1	352.0
流动资产	**90,180.5**	**112,420.3**	**139,744.9**	**176,622.1**
固定资产净额	17,200.8	17,944.2	19,096.2	20,879.8
无形资产净额	3,531.7	3,739.6	3,940.3	4,133.8
长期投资	29.0	89.0	149.0	209.0
其它长期资产	1,992.5	1,992.5	1,992.5	1,992.5
资产合计	**112,934.5**	**136,185.5**	**164,922.7**	**203,837.1**
应付账款	26,241.6	31,889.5	38,334.0	46,069.7
短期贷款	0.0	0.0	0.0	0.0
其它流动负债	10,778.8	14,436.0	18,327.9	24,285.7
流动负债	**37,020.4**	**46,325.5**	**56,661.9**	**70,355.5**
长期贷款	0.0	0.0	0.0	0.0
其它长期负债	15.6	15.6	15.6	15.6
长期负债	15.6	15.6	15.6	15.6
负债合计	**37,036.0**	**46,341.1**	**56,677.5**	**70,371.0**
优先股	**0.0**	**0.0**	**0.0**	**0.0**
普通股权益	**72,894.1**	**85,077.2**	**101,152.0**	**123,184.7**
少数股东权益	3,004.4	4,767.3	7,093.2	10,281.3
负债及股东权益合计	**112,934.5**	**136,185.5**	**164,922.7**	**203,837.1**
每股净资产(Rmb)	**58.03**	**67.73**	**80.52**	**98.06**

增长率和利润率(%)	12/16	12/17E	12/18E	12/19E
主营业务收入增长率	20.1	39.1	27.9	33.7
EBITDA增长率	9.7	43.0	31.1	36.3
EBIT增长率	9.7	44.3	31.8	36.9
净利润增长率	7.8	45.7	31.9	37.1
每股盈利增长	7.8	45.7	31.9	37.1
毛利率	91.2	90.5	90.7	91.6
EBITDA利润率	62.7	64.4	66.0	67.3
EBIT利润率	60.3	62.6	64.5	66.0

比率	12/16	12/17E	12/18E	12/19E
CROCI(%)	24.3	30.7	33.7	37.7
净资产回报率(%)	24.4	30.8	34.5	39.3
总资产回报率(%)	16.8	19.6	21.4	23.9
平均运用资本回报率(%)	93.1	226.7	248.8	380.3
存货周转天数	1,995.7	1,751.6	1,841.2	1,835.0
应收账款周转天数	57.5	28.1	35.6	35.0
应付账款周转天数	2,083.0	2,005.2	1,923.5	1,923.7
净负债/股东权益(%)	(88.1)	(84.5)	(87.3)	(91.7)
EBIT利息保障倍数(X)	NM	NM	NM	NM

现金流量表(Rmb mn)	12/16	12/17E	12/18E	12/19E
优先股股息前净利润	16,718.4	24,366.1	32,149.7	44,065.4
折旧及摊销	934.2	1,024.6	1,090.6	1,188.9
少数股东权益	1,212.3	1,762.8	2,326.0	3,188.1
运营资本增减	19,162.4	(7,536.2)	(2,170.5)	(1,287.4)
其它	(576.0)	(34.7)	(39.9)	(45.9)
经营活动产生的现金流	**37,451.2**	**19,582.6**	**33,355.9**	**47,109.0**
资本开支	(1,019.2)	(1,975.8)	(2,443.2)	(3,166.1)
收购	0.0	0.0	0.0	0.0
剥离	0.1	0.0	0.0	0.0
其它	(83.4)	(60.0)	(60.0)	(60.0)
投资活动产生的现金流	**(1,102.5)**	**(2,035.8)**	**(2,503.2)**	**(3,226.1)**
支付股息的现金（普通股和优先股）	(7,752.0)	(8,525.8)	(12,183.0)	(16,074.9)
借款增减	0.0	0.0	0.0	0.0
普通股发行（回购）	16.0	0.0	0.0	0.0
其它	1,441.4	0.0	0.0	0.0
筹资活动产生的现金流	**(6,294.6)**	**(8,525.8)**	**(12,183.0)**	**(16,074.9)**
总现金流	**30,054.1**	**9,020.9**	**18,669.7**	**27,808.1**

估值	12/16	12/17E	12/18E	12/19E
基本市盈率(X)	20.7	35.0	26.5	19.3
市净率(X)	4.7	10.0	8.4	6.9
EV/EBITDA(X)	11.2	21.7	16.2	11.5
企业价值/总投资现金(X)	3.5	8.2	6.6	5.2
股息收益率(%)	2.5	1.4	1.9	2.6

注：最后一个实际年度数据可能包括已公布和预测数据。

资料来源：公司数据、高盛研究预测

对此报告有贡献的人员

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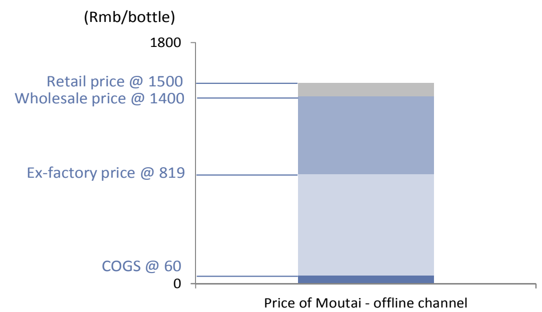
Contents

Moutai's distribution conundrum

Having successfully navigated the transition from chiefly government-driven consumption to private consumption, Kweichow Moutai's earnings are in many ways still captive to its distribution channels. 90% of its product is sold by third parties via franchise distributors and franchise stores and only 10% is sold directly by the company. This dependence on third party distributors has three key challenges. First, the **retail price of Moutai is volatile**, with distributors acting not only as intermediaries but as speculators, hoarding bottles of the spirit as prices rise and then offloading them as prices start to fall– accentuating price movements in each direction. Second, Moutai finds it **tough to raise its ex-factory prices** (i.e., those charged to distributors) in a consistent fashion because of volatile end-prices. Third, it has **limited information about the end consumers** of its product, hamstringing tailored promotion and brand building efforts. In recent times, with rising retail prices for the premium beverage, this dynamic has led to an **outsized proportion of the margins available accruing to distributors**. Of a Rmb1500 bottle of Moutai bought in the high street, Kweichow Moutai takes gross profit of c. Rmb760, Distributors Rmb580, and Retailers Rmb100. This profit accruing to Distributors seems disproportionately large, and their gross margin (currently at 45%) is certainly way above the historical average of 23%.

Exhibit 1: Who gets what from a bottle of Moutai
Moutai's price/bottle in offline channel – breakdown



Source: Company data

Summary: Leveraging E-Commerce to boost and smooth earnings

Kweichow Moutai announced in August 2017 that distributors and specialty stores should sell at least 30% of their remaining annual quotas via the Moutai Cloud E-com Platform at a price of Rmb1,299/bottle. The strategy worked well to alleviate short term rising pressure on Moutai's retail price. Also in mid-November, management indicated this policy will continue in 2018 and might be optimized, according to industry news agency Jiuyejia (Nov. 9).

More importantly, however, we think the new model will bring long-term positives in addressing its distributor conundrum — including better pricing power, more stable retail prices, more price hikes to tap a larger profit pool and more revenue opportunities by harvesting data on consumer demand. That said, since there is limited visibility on exactly what the effects of the strategy will be on earning, we do not yet revise our earnings.

However, we do give Moutai credit for the improvements in pricing power and earnings visibility set out below – **raising our target multiple to 25x** from 23x. We also roll forward by discounting 2021E P/E back to 2018E (previously discount back to 2017). Our 12-month target price rises 18% to Rmb881. To frame the opportunity if Moutai can fully leverage its strategy, we also set out **two bull case scenarios** for sustainable price hikes over the next four years. The first assumes a 10% annual price hike – offering a further Rmb211 to valuation and the second a 15% annual price hike – offering Rmb311 on top of our base case valuation. **Blue Sky:** We also provide a case study of Hermes, as a manufacturer of scarce luxury goods with strong pricing power– which has traded at an average 33x forward PE over the past 10 years and has seen consistent earnings growth.

Key benefits of the new retail model

Better price control

Under Moutai's new 30% quota for products to be sold online, price is determined by Moutai (Rmb1,299 now). This stabilizes retail prices and assists demand. It also provides better data on customer orders, allowing better matching of supply with demand and providing less room for stock piling, and smoothing price volatility. Moreover, the company will know the exact geographic locations of consumers, so that it can adjust its sales quotas in different regions more efficiently. It can better adjust order execution, shipment and even product packaging timing based on online data.

Price hikes

We think with greater pricing power the company can be able to hike ex-factory price more regularly in future, thereby boosting earnings.

Expanding the revenue pool

With better demand-supply matching more untapped demand can be fulfilled and there should be fewer shortages due to regional misallocation. Fake 'Moutai' sold by third party imitators can also be replaced with the real thing as products sold online via its Cloud platform are supplied by distributors certified by the Moutai Company — giving consumers greater trust in these products and boosting demand.

Access to big data on consumers

The move online should boost the number of individual customers as fewer bottles can be ordered online than taken via the traditional offline distributor channel. The company expects online customers to reach 3mn, from the current 250k. This will allow Moutai to get a better picture of its customers and allow it to tailor its product and marketing, based on consumers' preferences. This will be particular so among the younger demographic (25-35 yrs old) who make up 50% of sales on Moutai Clould E-com. Understanding these customers could allow the company to increase its penetration among the younger population and tap into a rising consumer group.

Investment case in a nutshell – Reiterate Buy (CL)

We reiterate our Buy (Conviction list) on Kweichow Moutai on several key drivers: (1) sustainable high end spirit demand growth, driven by rising numbers of people in the affluent and upper middle income population cohorts in China; (2) tight supply/demand balance in the next three years due to limited base spirit available, which drives upside to ASP; and (3) higher earnings visibility and pricing power thanks to the “new retail” model.

Key catalysts to watch in the next few quarters include: the annual distributor meeting on 18th December, where management might shed more light on plans for 2018. We also think 2017 operating results are also key to watch (2016 operating result were out Dec 23, 2016).

Dissecting Moutai’s sales channels and profit pool

Distribution dominated by franchisees

Kweichow Moutai’s current sales channel consists of a distribution layer and a retail layer, where the former gets product directly from the company itself while consumers are supplied by the distribution channel. There are four main distribution channels. The biggest two, accounting for c. 90% of Moutai’s revenue in 1H17, are:

(1) Franchise distributors, who are the main distribution channel;

(2) Franchise stores. Some franchise stores are owned and supplied by franchise distributors; others are supplied by the company. Currently the company has 2800+ distributors, including 1600+ franchise stores.

The remaining 10% comes from:

(3) E-com channels conducted through Moutai E-com Company (in which Moutai owns a 25% stake), which includes a B2C model (operated and supplied by Moutai company). In 2016 about 1% of revenue was from the B2C model.

(4) Self-owned stores, these are stores owned and supplied by the company. Given there are only 30+ self-owned stores, we estimate that revenue contribution from this channel is only 1% of total revenue.

(5) Offline direct sales, including customized products through Moutai Customization Company, and sales with permission notes written by management and sold directly at the distillery. These combined together contributes about 8% of Moutai’s total revenue.

Exhibit 1: Moutai’s distribution channels

Franchise distributors and franchise stores	E-commerce (B2C)		Self-owned stores	Offline direct sales
Moutai has 2,800+ distributors (incl. franchise stores) as of 1H17.	eMaotai and Weishang, self-owned E-com platform	Moutai flagship stores in Alibaba, JD.com, etc	Stores owned and operated by Moutai Company	Including Moutai Customization Company, and sales with permission notes written by mgmt.

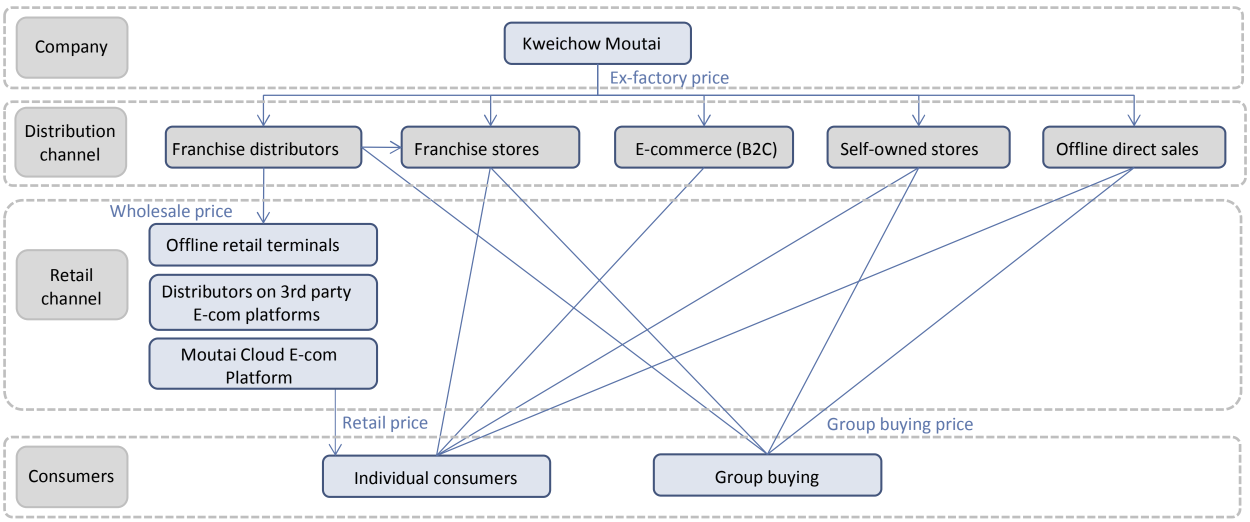
Source: Company data

Below the distribution channel layer are **offline retail terminals** (supermarkets and stores, tobacco and alcohol shops and restaurants, etc.), and online retail platforms (B2C) conducted by distributors, or O2O operated via the Moutai Cloud E-com platform). Product in these channels is supplied by distributors and sold to consumers.

Who buys Moutai?

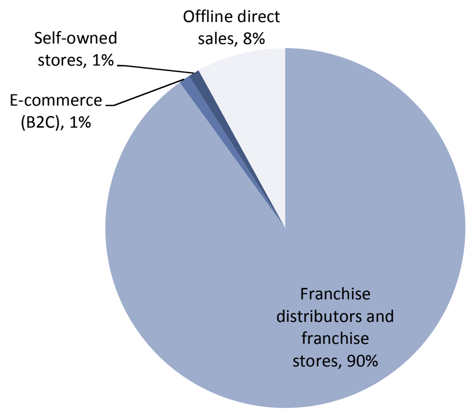
Apart from individual consumers, the other main major type of consumer is group buying, referring to corporate customers who tend to buy in larger volume. Group buying customers tend to purchase directly from distributors or franchise stores, at group sale prices, which are at a discount to the retail price. According to our channel checks, group buying accounts for 60-70% of Moutai's sales, mostly corporates.

Exhibit 2: Moutai's current sales channel structure



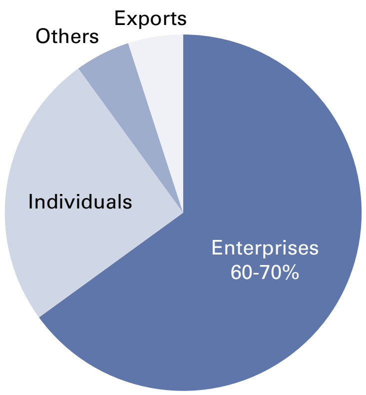
Source: Company data

Exhibit 3: Franchise distributors and stores account for c. 90% of Moutai's sales
Moutai sales breakdown by distribution channel, 2016



Source: Company data

Exhibit 4: 60-70% of purchasers are enterprises
Moutai sales breakdown by customer, 2016



Source: Company data, Gao Hua Securities Research

Distributors taking an outsized chunk of the profit margin

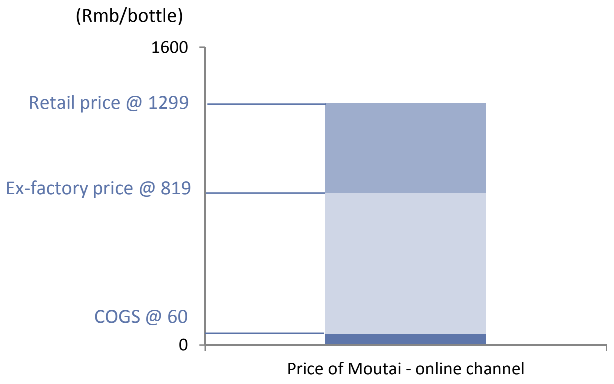
With wholesale and retail prices of Feitian Moutai has risen significantly in the past year, but the ex-factory price unchanged, distributors of Moutai are earning huge margins.

In the **online channel**, mainly Moutai Cloud, distributor sell Feitian Moutai at the company guided retail price of Rmb1,299, which is Rmb480 above the ex-factory price.

In the **offline channel**, distributors sell Feitian Moutai at the wholesale price, which is about Rmb1,400 currently, Rmb580 above ex-factory price. We estimate the distribution system earns a total gross profit of Rmb28.7bn, or about 63% of Moutai spirit gross profit. We estimate that distributors earn total net profit of Rmb20.5 bn, or about 92% of Moutai spirit net profit in 2017.

Exhibit 5: Moutai's retail price is Rmb489 above ex-factory price in the online channel

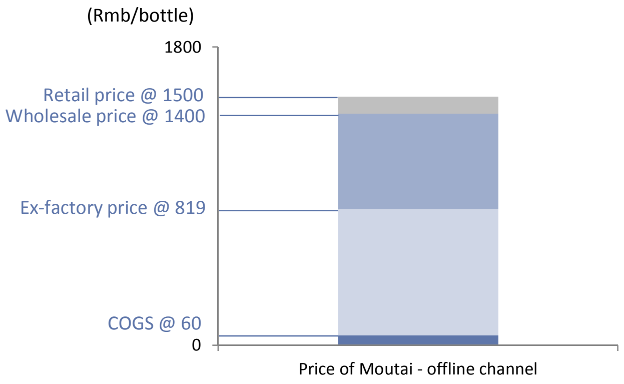
Feitian Moutai's price/bottle in the online Cloud platform



Source: Company data

Exhibit 6: Moutai's wholesale price is Rmb581 above ex-factory price in the offline channel

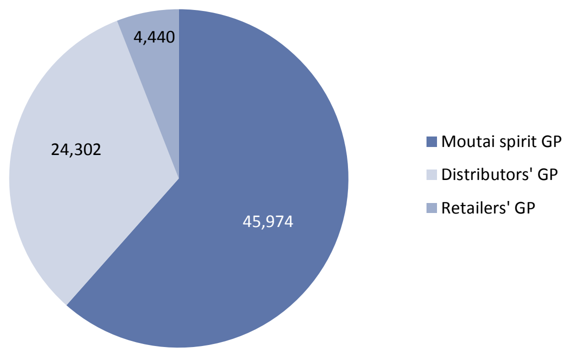
Feitian Moutai's price/bottle in offline channels



Source: Company data

Exhibit 7: Moutai distributors' gross profit is about 63% that of Moutai spirit

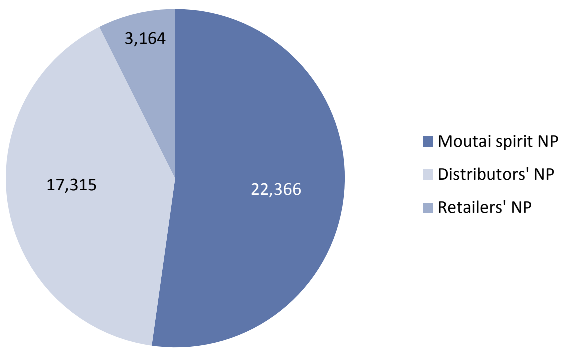
Moutai spirit's gross profit distribution (2017E)



Source: Gao Hua Securities Research

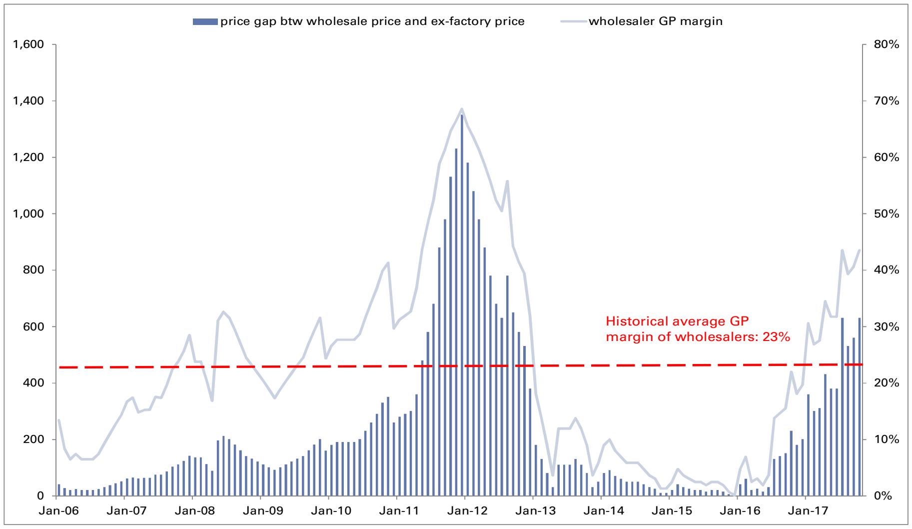
Exhibit 8: And their net profit is about 92% of the company

Moutai spirit's net profit distribution (2017E)



Source: Gao Hua Securities Research

Exhibit 9: Current wholesaler GP margin is way above the historic average
Moutai's historic wholesaler GP margin



Source: Company data

Moutai strikes back

We think it is unreasonable that distributors are earning almost as much net profit as the company does. Historically, the average distributor GP margin was 23%, whereas it is now 45%. We expect the company to take back some channel profits by hiking the ex-factory price of Feitian Moutai in September 2018.

However, more importantly, the key to its **ability to raise its ex-factory price consistently** will be its move into the cloud — which distributors may find hard to resist. We explain this in detail in the next section.

Difficult for competitors to replicate the model

We think Moutai will be able to successfully build out its new retail model as already more than 2800 distributors and specialty stores (ie, the vast majority) have joined the Moutai Cloud Platform, and we expect more will in future – including new distributors. This huge number of distributors and specialty stores constitutes a comprehensive, deeply penetrated and connected sales network.

Competitors would find it nigh-on impossible to replicate Moutai's distribution network in our view, because of Moutai's outsized bargaining power vs distributors due to its strong brand image, limited supply of the drink, and the wide slice of the margin accruing to distributors at present.

New retail model set to change the balance of power

We think its "New Retail Model" will over time allow Moutai to wrestle back control over pricing – paving the way for sustainable capability to increase ex-factory prices and smooth earnings.

Moutai successfully navigated the transition to building a customer base driven by private consumption, rather than one driven by government consumption. However, its sales channel has not been updated – until now.

Distribution channels in need of refreshment

The current distribution model has three main disadvantages:

(1) Moutai still relies heavily on distributors, meaning it has limited visibility on the inventory in the distribution network, and can exert only limited control over wholesale and retail prices

(2) Big customers and speculators tend to stockpile inventory when the price is rising, which can make it difficult for general consumers to get hold of a bottle. Moreover when the price starts to fall, speculators offload their stock —accentuating price volatility on both the way up and the way down. (Exhibit 11)

(3) Moutai has little information of who bought Moutai and on consumer characteristics – meaning it finds it difficult to tailor its marketing and promotion efforts.

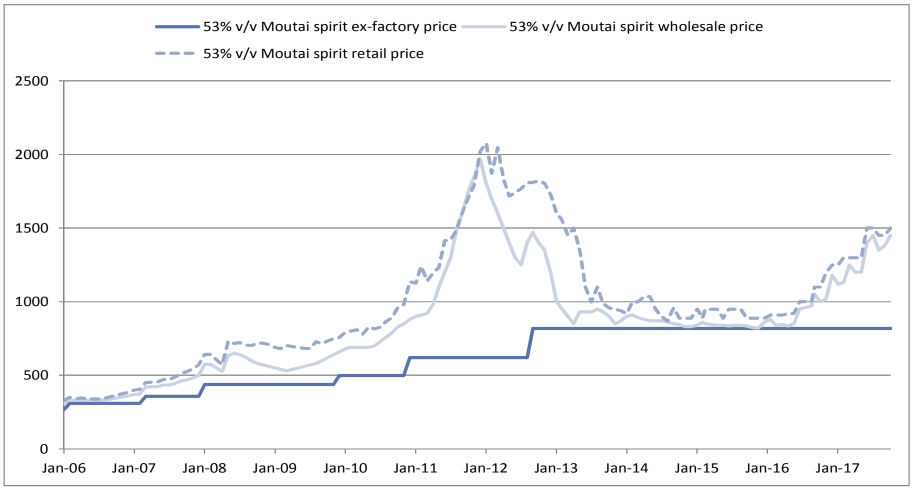
E-Commerce provides the tonic

We believe its new retail model, spearheaded by the Moutai Cloud E-com Platform, can address these disadvantages, and set the groundwork for the company to raise its ex-factory prices – claiming back a larger share of the profit pool from distributors.

That said, we think it is too early to build in any direct effect on earnings yet – but we do give Moutai credit for the improvements in pricing power and earnings visibility– raising our target multiple to 25x from 23x.

In the following pages we first explain Moutai's new strategy and then set out the potential benefits flowing to the company

Exhibit 10: Traditional distribution channels have exacerbated price volatility
Feitian Moutai's ex-factory, wholesale and retail prices



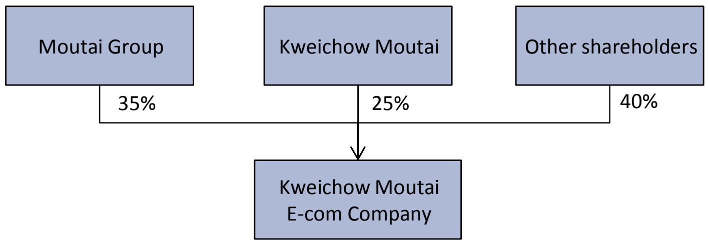
Source: Company data

Explaining Moutai’s E-com platform

The Structure of Moutai’s E-commerce channels

All of Moutai’s E-com businesses, including eMaotai, flagship stores and Moutai Cloud E-com platform, are operated by Kweichow Moutai Group E-commerce Company, which is 35% owned by Moutai Group (parent of list-co) and 25% owned by the list-co.

Exhibit 11: Ownership structure of Kweichow Moutai E-commerce Company



Source: Company data

Moutai’s E-com businesses include a B2C model and an O2O model and it's important to note the different between the two.

- **B2C E-com business** was established as early as 2010, including self-owned E-com platforms eMaotai.com, Weishang (eMaotai on Wechat), as well as various Moutai flagship stores on 3rd party E-com platforms like Alibaba and JD.com. So far, however, in terms of revenue contribution, B2C only accounts for 1%. Of more importance in our view, these B2C platforms are information release centers and brand builders, aimed at promoting Moutai and acquiring more potential consumers, according to management.
- **O2O business** (Moutai Cloud E-com Platform), was established in recent years as a product information platform and additional distribution channel. Consumers place their orders online but the orders will be filled by a distributor nearby, which is assigned automatically by the Cloud E-com platform based on location.

Exhibit 12: Comparison of Moutai’s B2C and O2O E-commerce models

	B2C model	O2O model
Operating entity	eMaotai.com + Moutai flagship stores on various 3rd party E-com platforms	Moutai Cloud E-com Platform
Positioning	Product information release, brand building and acquiring potential consumers	Product information release, product distribution, data collection and analysis
Product supply	From Moutai company	From distributors
Total transaction value in 2016	Rmb480mn	Rmb2.3bn

Source: Company data, Gao Hua Securities Research

Moutai Cloud: the cornerstone of Moutai's new retail strategy

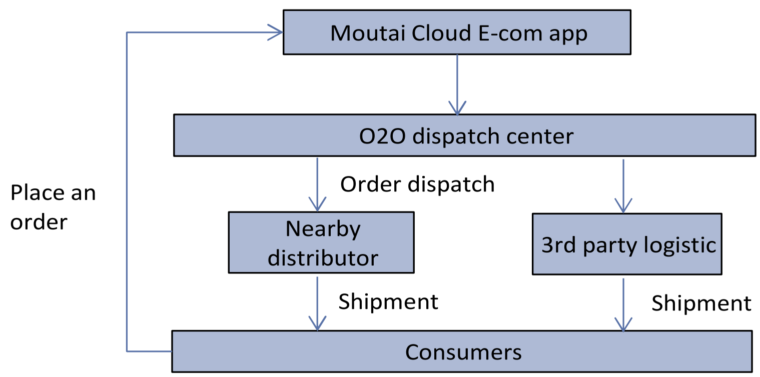
Moutai announced in Aug 2017 that distributors and specialty stores should sell at least 30% of their remaining quotas for 2017 through Moutai Cloud at a price of Rmb1,299/bottle. The strategy worked well to alleviate short term rising pressure on Moutai's retail price, but has much deeper and long term implications on Moutai's channel strategy, in our view.

Moutai Cloud E-com Platform leveraged the resources of 2,000+ distributors and 1,500+ specialty stores to enable faster and more efficient fulfillment of online orders. At the same time, distributors registered on the platform are endorsed by Moutai Company and therefore may appear more trustworthy to consumers. Consumers can order online and get the product as soon as possible; they can get the product in the mail or pick it up at nearby distributor stores.

We think Moutai Cloud E-com Platform is the cornerstone of Moutai's new retail strategy, because through this platform Moutai is able to move a significant portion (30%+) of its sales online (vs only 2-3% online penetration rate of alcohol in China).

Key benefits include obtaining more consumer preference data for analysis, making channel pricing and inventory more transparent, stabilizing pricing system and increasing the company's pricing power. We elaborate on the benefits in the next section.

Exhibit 13: Order process flow of Moutai's E-commerce business



Source: Gao Hua Securities Research

Soaring transaction values on E-Comm platforms

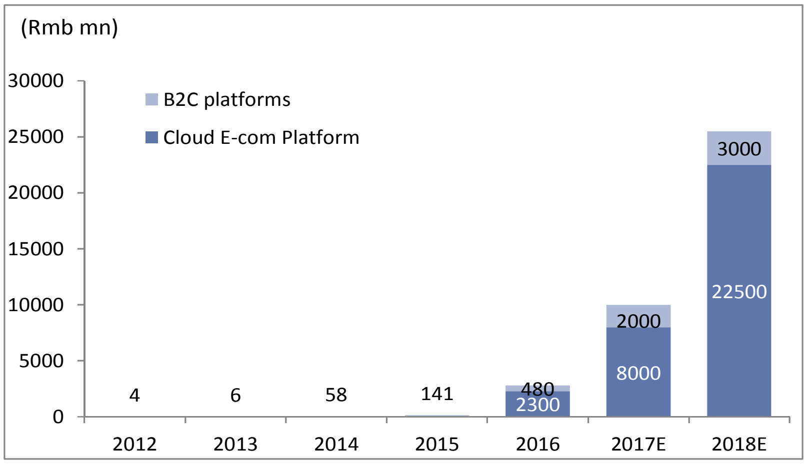
According to management, total sales on **B2C platforms** were c. Rmb480mn in 2016, made up from 64k orders. Total visitors to eMaotai.com were 8mn, with 12mn clicks. Total membership is 740k. Revenue in 1Q17 was Rmb390mn, up 875% yoy.

Total transaction value on the **Moutai Cloud E-com Platform** was Rmb2.3bn in 2016, made up from 30k+ orders. There were 732 offline stores and 150k members as end of 2016.

According to industry media TJKX, total transaction value of Moutai Cloud E-com Platform reached Rmb1.12 bn in 1Q17, already nearly half of 2016 transaction value. Management expects total transaction value in 2017 to reach Rmb8bn, up 250%+ yoy.

We estimate that the total transaction value of Moutai's E-com platforms will reach Rmb10bn in 2017. If the current policy of 30% distributor quota going online remains unchanged, we believe this might rise to Rmb25.5bn for 2018. If we factor in other online sales conducted by distributors on various e-com platforms, we think Moutai's online sales penetration rate would be 35%+, ranking it the highest in the industry.

Exhibit 14: Total transaction value of Moutai's E-com platforms to reach Rmb10bn in 2017
Transaction value of Moutai's E-com platforms



Source: Company data, Gao Hua Securities Research

How moving online will benefit Moutai

(1) Increase control over, and stabilize, channel prices

As discussed above, Moutai's wholesale and retail prices have been volatile — chiefly because it has exerted little control over distributors' inventory levels. When the retail price of Moutai is trending up, distributors tend to stockpile inventory in expectation of price appreciation. When the retail price declines, distributors tend to dump their inventory and precipitate the price decrease.

We think Moutai's new retail model will fundamentally change this situation. For the 30% quota sold online, the price is determined by Moutai (Rmb1,299 now). Moreover, as the company now has data on customer orders, future distributor quotas can be allocated based on actual demand – rather than that reported by distributors (who have an incentive to over-order), — allowing supply to be better matched to demand, and allowing much less room for stockpiling.

The effects are immediate. When Moutai announced on Aug 14, 2017 that distributors should sell at least 30% of their remaining quota in 2017 via its E-com platform, the retail price of Moutai fell from Rmb1,500+ to Rmb1,300-1400 in less than a month, reflecting the effectiveness of the New Retail model in stabilizing retail price. Should the company increase the quota online to 50%, the control on retail price would be even stronger.

A note on Supply. Adding new supply takes time as Moutai takes at least five years to reach maturity. Current supply is limited by the supply laid down at the beginning of the crackdown on graft that started about five years ago. Recent moves by the company to boost output will come to fruition only in three to four years' time.

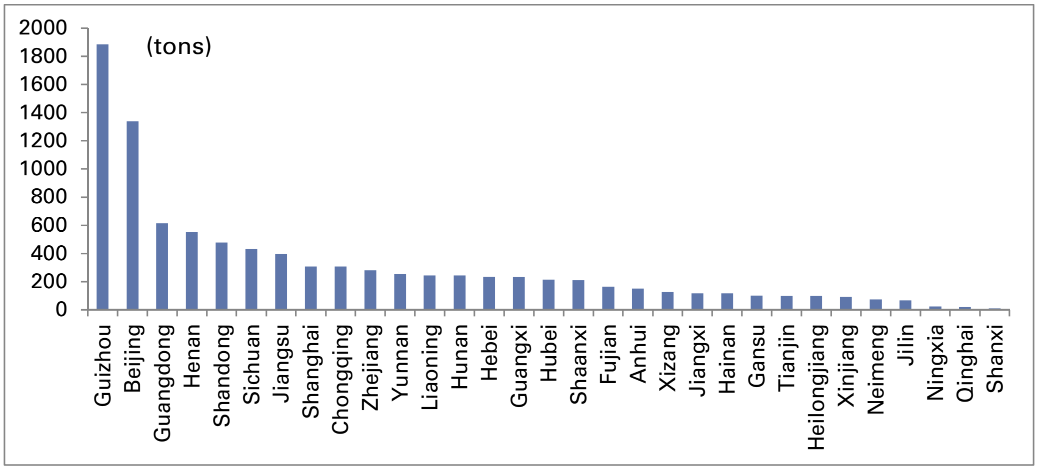
(2) More flexible production and distribution schedule

Currently Moutai's sales model is based on a planned mechanism, through which the company allocate each distributor's annual quota ex-ante. Distributors place orders monthly while the company controls the pace shipments according distributor orders.

We think this model tends to mismatch supply and demand. For example, if we look at the annual quota allocation plan in a certain year (we use 2012 as an example), Guizhou and Beijing were the top two regions, accounting for 15%/10% of total sales volume. Given that Guizhou's GDP is only 1.5% of China's total GDP (albeit the home of Moutai), we think that there might be some mismatch there. While the company has been actively adjusting the quota allocation since then, we believe this has been relatively slowly compared with the fast transition of the consumption base.

We think the new retail model can help the company: (1) more easily acquire the exact geographic locations of consumers, so that it could adjust its sales quotas in different regions more efficiently, and (2) better adjust the timing of order execution, shipments and even product packaging based on online data.

Exhibit 15: Moutai's quota allocation by province, 2012



Source: Company data

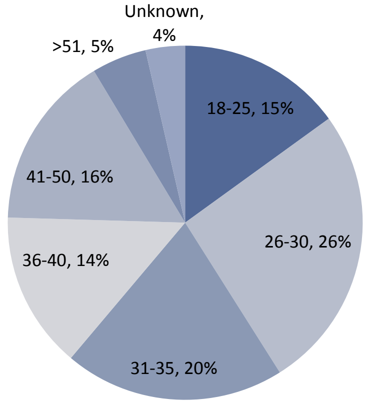
(3) Access to big data– building a nuanced picture of customers

We think Moutai's new retail model will give Moutai access to big data on their consumers, allowing them to build a better picture of consumer profiles and better target their marketing and promotion:

- By requiring distributors to allocate at least 30% of their quota on the Moutai Cloud E-com Platform, the number of individual consumers is likely to increase - as online sales are usually limited to 2 or 5 bottles per order, rather than bulk orders direct from distributors. The company expects the number of Moutai Cloud members to reach 3mn, from the current 250k.
- With online orders, the company can access basic information such as order size and product type. Accumulation of this data will enable the company to better adjust product and marketing, like targeted promotions and newsfeeds to the Moutai Cloud E-com app, based on individual consumer's preferences.

From data released by Tmall.com, young consumers (<35 yrs old) account for more than 50% of Moutai's E-com platform. These young consumers will be the majority of Moutai's total consumers in future, so it is very useful to understand their preferences now.

Exhibit 16: Younger consumers embrace Moutai Cloud E-com Platform
Consumer breakdown on Moutai' E-com Platform on "singles day", 2017



Source: Tmall.com

(4) Improve channel efficiency

The Moutai Cloud E-com Platform can also help the company better manage its distributors and improve channel efficiency. After joining the cloud platform, distributors and specialty stores have access to real time data on payment, shipment and distribution.

Distributors also have free access to ERP/CRM system, so that they can save cost related to information system. Furthermore, distributors on the platform also have access to consumer data and can therefore make more targeted sales promotions. Also, for distributors and specialty stores, being listed on the cloud platform is effectively an endorsement that can boost credibility among consumers.

(5) Expand the revenue pool for Moutai

We think Moutai's new retail model might also expand the revenue pool of Moutai. Not only can untapped demand be fulfilled with better matching with supply, but we also think shortages will be less of a problem due to ironing out regional misallocation.

Another happy by-product might also be replacement of sales of 'fake Moutai' (of which there is a great deal, in our view) with the real thing. Because products sold on the cloud platform are supplied by distributors who are certified by the Moutai Company, consumers should place greater trust in these products - boosting demand.

In addition, by gaining more data on young consumers and understanding more about them, the company might further increase the penetration of Moutai among the younger demographic and tap into a rising consumer group.

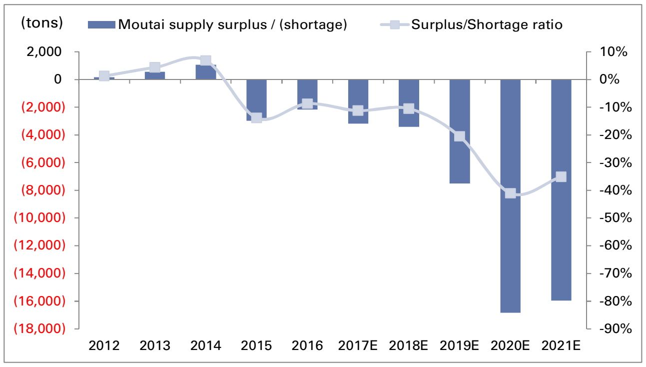
What the new retail model doesn't change

While the new retail model might have relieved some pressure on rising price for the beverage in the short term, it does not fundamentally change the situation of supply shortage over the next 2-3 years — which is determined by strong demand and Moutai's production capacity limit 5 years ago (which will mature for consumption over the next couple of years).

The new retail model does not change the customer composition of Moutai — that is, enterprise customers make up the majority of Moutai's purchasers by volume, meaning business entertainment demand will be the chief driver of demand for moutai.

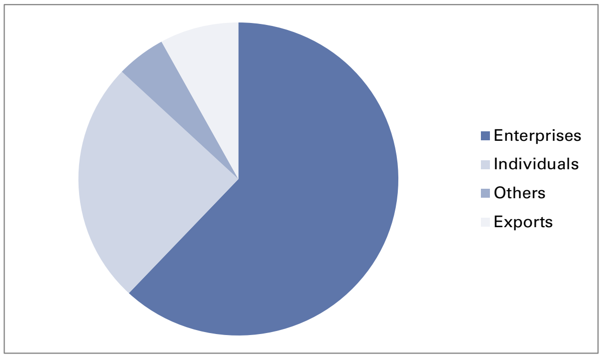
In the long term, we think moutai's retail price should go up in line with the rising disposable income of urban employees, consistent with mgmt's strategy of trying to make Moutai affordable for common citizens (who may only buy one bottle a year for the lunar new year). We expect the affordability of the drink (urban employee monthly disposable income / Moutai retail price) to remain above the historic average (3.3x) in the next few years, meaning the retail price will increase largely in line with citizens' rising income.

Exhibit 17: We expect Moutai will be in severe supply shortage in 2019-21E
Moutai supply surplus / shortage analysis



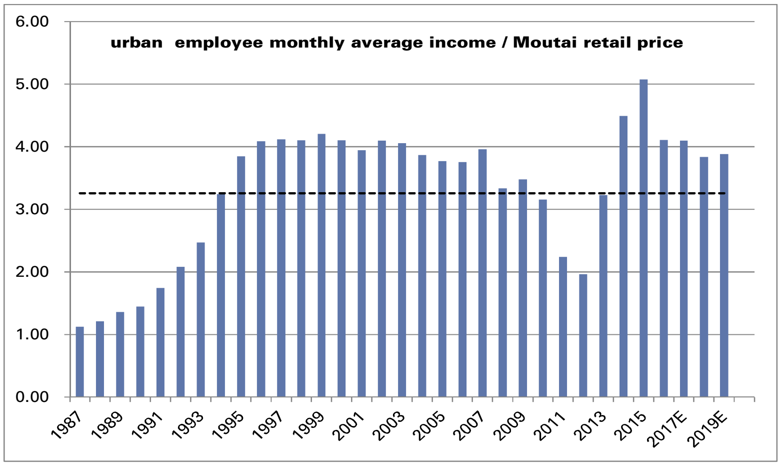
Source: Company data, Gao Hua Securities Research

Exhibit 18: Majority of Moutai's customers are enterprises
Moutai's revenue split by purchaser, as of 2016



Source: Company data, Gao Hua Securities Research

Exhibit 19: We expect Moutai's affordability level to remain above the historic average
Urban employee monthly average income / Moutai retail price



Source: Company data; note: we assume Rmb1300 / 1500 / 1600 retail price in 2017-19E.

Issues that still need to be resolved

Consumer E-commerce experience needs to improve

The mobile app of Moutai Cloud E-com Platform is a low frequency app selling a limited range of products. It is not necessarily logical for consumers to keep such an app on their phone when he/she can buy the same product on Taobao or JD.com for the same price. Moreover, given limited investment in the app relative to sites such as Taobao or JD.com, the user experience on the Moutai Cloud E-com app is underwhelming, in our view: response time is slow and it is not easy to find out where to buy Moutai. In addition, consumers cannot buy in large volumes on the app: orders on the cloud platform are initially limited to 5 bottles (sometimes even only 2 bottles), so most group buying customers would still need to go offline.

To improve consumer experience, Moutai is working with Alibaba's cloud team to roll out a 2.0 version of the Moutai Cloud E-com app, which should be easier to use and focus more on value-add services — such as information on promotional releases and professional consulting services (ie, which drinks to select for entertaining clients).

Control over distributors is more difficult when prices are falling

Moutai's control over distributors is more effective when the price is in an upcycle. As demand is strong and supply is controlled by Moutai, the company can force distributors to sell online. However, when prices are in a down cycle, it will be more difficult for the company to control distributors, who can sell offline more cheaply. In such a situation, the company would have to adjust online price in line with offline price.

Online-offline arbitrage

We learned through our channel checks that some distributors place orders on Moutai Cloud E-com Platform but then filled that order themselves in order to meet the obligation to make 30% of sales online quickly, and even arbitrage on the price gap between online and offline. The consequence is that retail consumers still cannot get hold of the products. The company will need to improve its consumer identity certification process to cope with this problem.

Balancing interests of distributors

A key consideration is not to alienate or over-penalize distributors. As orders on the cloud platform are dispatched automatically according to distance, some distributors worry that they may lose important clients. In response to this concern, the company has come up with an order code mechanism, whereby a client can place an order on the cloud platform with a code supplied by his distributor: the order is then directed to that distributor. In this way distributors can maintain relationships with key clients that they might have had for many years. As distributors are still the main sales channel for Moutai, it's important to balance their interests. However, this mechanism might also make it difficult for retail consumer to buy online as much of the online sales are taken by large customers.

Longer term options for building on E-Commerce

Expand product categories

As discussed earlier, it makes little sense for consumers to use the Moutai app if only a limited number of products can be bought on it. At the moment, the company offers other products on the cloud platform, like Guizhou Tea, liqueurs, etc. In the future more product types could be added, creating more revenue source from existing consumer traffic and improving the consumer experience. Other products currently are few and made up only less than 5% of total sales in 2016, according to our estimate.

Increase the quota allocated to the cloud platform

Currently the company requires distributors sell 30% of their quota via the cloud platform. It's possible that this ratio could be increased in the future. By that time Moutai Cloud E-com Platform should be more influential as discussed above and Moutai's control over retail price could become even stronger.

Increase the ratio of direct sales on the cloud platform

While the company plans to maintain the current quota to distributors, it has not ruled out employing direct sales for incremental quotas in the future. It might be possible that a certain portion of orders on the cloud platform will be filled by Moutai itself, bypassing the distributor channel. With direct sales the company would enjoy higher gross margin as there is no distributor cut, although it would incur distribution costs or need to build its own storage and distribution system. As such, we think it would only be a rather long term prospect for a direct sales model to become mainstream, and might undermine relations with existing distributors who it relies on to get its products to market.

Increase its stake in Moutai E-com Company

Currently Moutai owns only 25% of Moutai E-com Company, which is the platform owner and operator of Moutai's B2C and Cloud E-com Platform. The parent owns 35%. When the transaction value of E-com becomes significant enough, it is possible the Moutai lisco will take a larger share of the platform in order to consolidate it into its financials. If this were the case, it may offer upside potential to the listco's earnings.

Potential impact on earning and valuations

More stable earnings growth

We think Moutai's new retail model has long-term positive implication for earnings growth momentum and valuations. Under the new retail model, the company has better control over channel inventory, and supply can be better matched to demand growth. This will make the retail price less volatile and we think the company should have room to hike ex-factory and retail prices steadily per year — basically with supply based on actual demand, we believe there is less risk of stockpiling, meaning lower risk of eventual oversupply to the market, smoothing out the peaks and trough and allowing more stable prices and earnings growth.

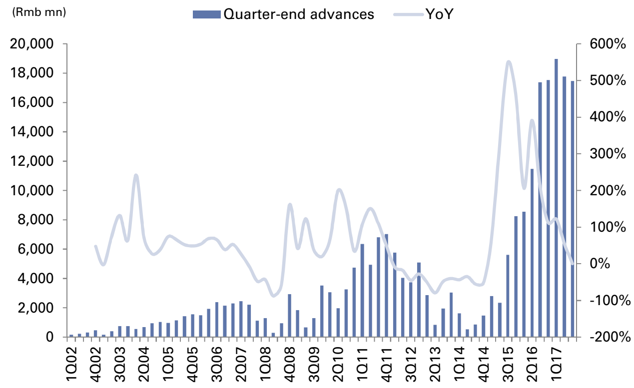
That said, given the limited visibility on the effect of the new retail model on earning in the forecast period, we do not yet revise our earnings estimates. However, we do provide scenarios that factor in annual ex-factory price hikes of 10% and 15% (see below).

More stable balance sheet and cash flow

According to the company's policy, distributors have to pay advances in order to receive products. In the upcycle, distributors tend to make a lot in advances with the balance piling up as inventory was unsold. In the down cycle, advances from distributors tend to decrease as product is offloaded. Therefore the balance of advances has also been very volatile.

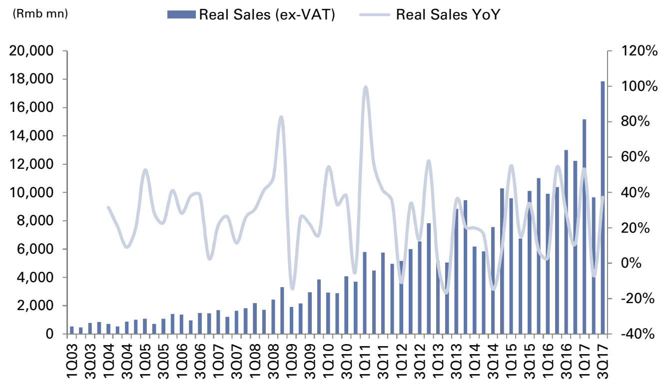
We think in the new in the retail model the company can better control the pace of distributor advances as quota execution and product shipment will be based on end-demand rather than distributors' own requests.

Exhibit 20: Moutai's distributor advances is also very volatile
Quarter end advances from distributors



Source: Company data

Exhibit 21: Distributor orders increase more steadily
Real cash sales (ex-VAT)



Source: Company data

Scenario analysis of price hikes

With Moutai's new retail model lending the company stronger pricing power — via better control of the flow of product to distributors and of the wholesale and retail price of the spirit — we think the company should be able to hike its ex-factory price more regularly in the future, particularly in light of the fat margins enjoyed by distributors at present.

In our base scenario, we assume an ex-factory price hike to Rmb999 (from Rmb819 at present) in Sept 2018 and no more price hikes thereafter. We show two bull cases in which we assume a 10% price hike each year from September 2019 and a 15% hike. As there is finite supply of Moutai due to production capacity limits five years ago, we assume no fall in volumes sold as the price rises. So, earnings are driven solely by price in our scenarios.

Exhibit 2: Our most bullish price hike case still leaves distributors with 17% gross margin in 2021
Description of scenarios

Scenarios	Scenario description	Distributor gross margin in 2021	Current gross margin	Historic average gross margin
Base case	Ex-factory price hike to Rmb999 in Sep 2018 and no more price hikes there after	45%	44%	23%
Bull case 1	Ex-factory price hike to Rmb999 in Sep 2018 and 10% price hike p.a. from 2019	27%	44%	23%
Bull case 2	Ex-factory price hike to Rmb999 in Sep 2018 and 15% price hike p.a. from 2019	17%	44%	23%

Source: Gao Hua Securities Research

Base case (zero price hike after September 2018)

- The ex-factory price of Feitian Moutai remains Rmb999 at year-end 2021
- Net income Rmb56.9bn in 2021.
- Valuation: 25x 2021 EPS discounted back to 2018 at 8.7% COE: **Rmb881**

Bull case 1 (10% annual hike from September 2019)

- The ex-factory price of Feitian Moutai rises to Rmb1,330 at year-end 2021

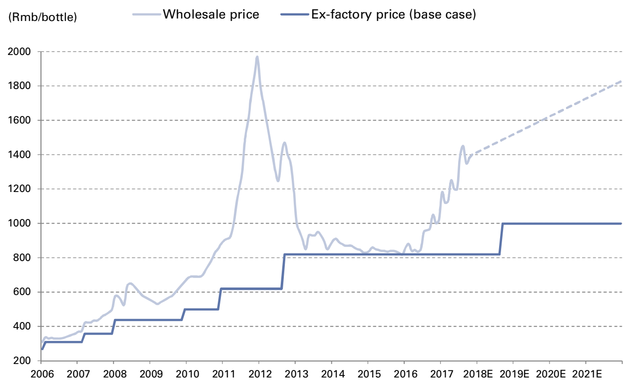
- Net income Rmb70.5bn in 2021 (i.e., 24% above base case)
- Valuation: 25x 2021 EPS discounted back to 2018: **Rmb1,092**

Bull case 2 (15% annual hike from September 2019)

- The ex-factory price of Feitian Moutai rises to Rmb1,519 at year-end 2021
- Net income Rmb76.9bn in 2021 (i.e., 35% above base case)
- Valuation: 25x 2021 EPS discounted back to 2018: **Rmb1,192**

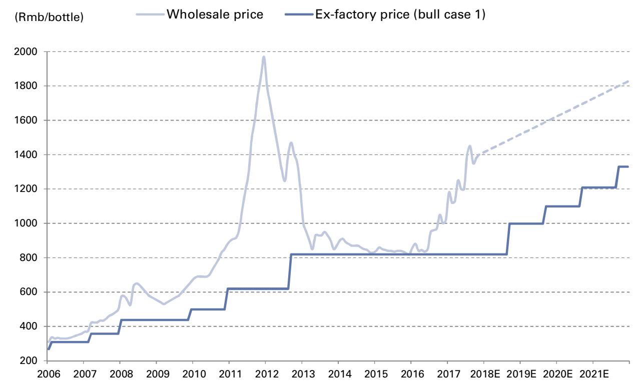
Moutai can take margin from distributors and still leave them plenty

Exhibit 3: Base case: no price hike after 2018
Moutai's wholesale and ex-factory prices in base case



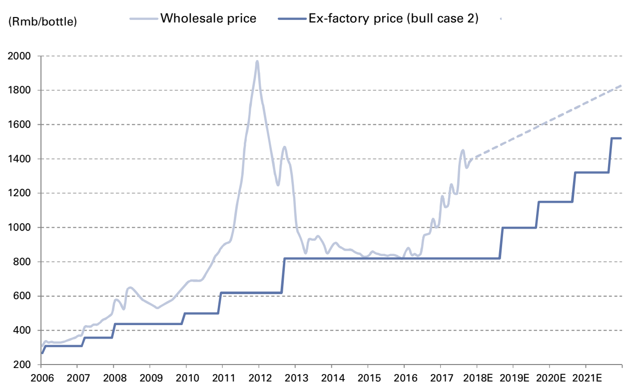
Source: Company data, Gao Hua Securities Research

Exhibit 4: Bull case 1: 10% price hike p.a. from 2019
Moutai's wholesale and ex-factory prices in bull case 1



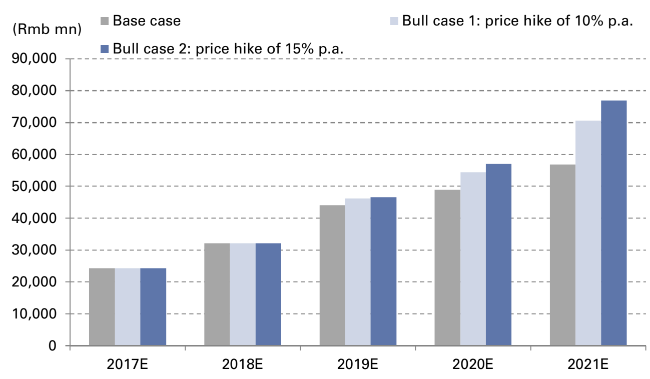
Source: Company data, Gao Hua Securities Research

Exhibit 5: Bull case 2: 15% price hike p.a. from 2019
Moutai's wholesale and ex-factory prices in bull case 2



Source: Company data, Gao Hua Securities Research

Exhibit 6: Bull case 2 will have 2021E net income 35% higher than base case
Net income comparison in different scenarios



Source: Gao Hua Securities Research

Exhibit 7: Our new TP implies 23.7X 2019PE using EPS under bull case 2
Current price and new TP implied PE in different scenarios

Current price: Rmb678	2018E	2019E	2020E
Current PE under base case EPS	26.5	19.3	17.4
Current PE under bull case 1 EPS	26.5	18.4	15.7
Current PE under bull case 2 EPS	26.5	18.3	14.9

New TP: Rmb881	2018E	2019E	2020E
TP implied PE under base case EPS	34.4	25.1	22.6
TP implied PE under bull case 1 EPS	34.4	24.0	20.3
TP implied PE under bull case 2 EPS	34.4	23.7	19.4

Source: Gao Hua Securities Research

Raising our valuation multiple to reflect Moutai's greater bargaining power

We value the stock on long term PE discount back to 2018E (previously to 2017E), and raise our 2021 exit multiple from 23x to 25x (c. 10% premium to industry average target exit multiple) based on: (1) Stronger pricing power based on the new retail model, and potential for a bigger profit pool from more regular price hikes. (2) Higher earnings visibility with less volatility around wholesale and retail prices. (3) Higher returns (ROE/CROCI) than peers due to stronger pricing power. (4) Further transition to private consumption and (younger) millennials consumers - leading to more sustainable growth in the long term.

We therefore raise our 12-month target price 18% to **Rmb881**, as we roll over our target price time frame and boost the exit multiple. Our revised target price implies 34x 2018 PE and 25x 2019 PE. **Maintain Buy (Conviction list).** There are no changes to our estimates, which imply 24% EPS CAGR over 2017-21E. Our 2018/19 EPS estimates are 2%/13% above Wind consensus, which we believe is due to our more bullish outlook for ASPs and margins.

Exhibit 8: Moutai has higher margin and return than domestic and global peers
Margin and return comparison

2017E	Gross margin	Net margin	ROE	CROCI
Domestic companies				
Kweichow Moutai	91%	44%	29%	31%
Wuliangye Yibin	72%	31%	19%	18%
Jiangsu Yanghe	63%	34%	25%	24%
Luzhou Laojiao	71%	25%	20%	19%
Anhui Gujing Distillery Co.	76%	15%	17%	20%
Shanxi Xinghuacun Fen Wine	71%	18%	23%	23%
Qinghai Huzhu Barley Wine Co.	66%	12%	6%	7%
Domestic average	**73%**	**25%**	**20%**	**20%**
Global companies				
Pernod Ricard	62%	16%	10%	8%
Remy Cointreau	67%	12%	11%	10%
Diageo	61%	23%	24%	12%
Davide Campari	57%	13%	12%	11%
Global average	**64%**	**17%**	**14%**	**11%**

Source: Gao Hua Securities Research, Goldman Sachs Global Investment Research

A note on our target multiple premium

In the last 10 years, Moutai has traded at an average 7% PE premium to Wuliangye and Luzhou Laojiao, supported by higher growth (27% 2006-16 EPS CAGR vs. 19% on average for Wuliangye and Luzhou Laojiao) and higher ROE (34% 10-year average ROE vs. 27%); in 2017-21E, we continue to forecast Moutai to lead peers in earnings growth (24% vs. 22%) and ROE (35% vs. 25%) with higher pricing power and potential for price hikes. With this in mind, we set our premium at 10%

Key risks

Slower-than expected high-end spirit growth: Macro economic slowdown could result in lower business entertainment demand and slower income growth among consumers, which would pose a downside risk to our investment case.

Tougher regulation on alcohol consumption: If the government were to impose tougher and more widespread policies on alcohol use by government officials or even by SOE employees (on official business), there could be a dampening effect on high end alcohol demand.

Potential pitfalls of the new retail model: as mentioned above, there are still some problems with Moutai's new retail model, such as poor consumer experience of the app and ongoing speculation by distributors. If these problems are not solved, the benefits of the new retail model would be impaired.

Exhibit 9: Income statement of Moutai
Rmb mn/Rmb

	2014	2015	2016	2017E	2018E	2019E	2020E	2021E
Total revenue	**32,217**	**33,447**	**40,155**	**55,862**	**71,440**	**95,535**	**104,976**	**121,437**
Moutai	30,637	31,546	36,714	49,008	62,578	84,614	92,229	106,554
Sales Volume (tons)	**17,957**	**19,776**	**22,918**	**28,860**	**34,121**	**39,073**	**39,073**	**46,538**
YoY	14%	10%	16%	26%	18%	15%	0%	19%
ASP(Rmb/bottle)	**853**	**798**	**801**	**849**	**917**	**1,083**	**1,180**	**1,145**
YoY	-8%	-7%	0%	6%	7%	13%	9%	-3%
Series products	935	1,108	2,127	4,253	5,742	7,177	8,254	9,492
Sales Volume (tons)	**6,211**	**7,742**	**14,027**	**28,053**	**37,872**	**47,340**	**54,441**	**62,607**
YoY	-34%	25%	81%	100%	35%	25%	15%	15%
ASP(Rmb/bottle)	**75**	**72**	**76**	**76**	**76**	**76**	**76**	**76**
YoY	-25%	-5%	6%	0%	0%	0%	0%	0%
YoY - total revenue	*4%*	*4%*	*20.1%*	*39.1%*	*28%*	*34%*	*10%*	*16%*
Moutai	*5%*	*3%*	*16%*	*33%*	*28%*	*35%*	*9%*	*16%*
series products	*-50%*	*18%*	*92%*	*100%*	*35%*	*25%*	*15%*	*15%*
Total COGS	**2,338**	**2,538**	**3,410**	**5,120**	**6,444**	**7,715**	**8,300**	**9,770**
Gross profit	**29879**	**30909**	**36745**	**50742**	**64996**	**87820**	**96676**	**111667**
Moutai	28699	29534	34329	45974	58955	80444	88039	101537
series products	535	586	1,139	2,258	3,021	3,742	4,264	4,858
YoY - gross profit	*3%*	*3%*	*19%*	*38%*	*28%*	*35%*	*10%*	*16%*
Gross margin	*92.7%*	*92.4%*	*91.5%*	*90.8%*	*91%*	*92%*	*92%*	*92%*
Moutai	*94%*	*94%*	*93.5%*	*93.8%*	*94.2%*	*95.1%*	*95.5%*	*95.3%*
series products	*57%*	*53%*	*54%*	*53%*	*53%*	*52%*	*52%*	*51%*
Sales tax and add-on	2,789	3,449	6,509	8,100	9,644	12,897	14,172	16,394
as % of revenue	*8.7%*	*10.3%*	*16.2%*	*14.5%*	*13.5%*	*13.5%*	*13.5%*	*13.5%*
Sales expense	1,675	1,485	1,681	3,031	3,519	4,419	4,646	5,131
as % of revenue	*5.2%*	*4.4%*	*4.2%*	*5.4%*	*4.9%*	*4.6%*	*4.4%*	*4.2%*
Administrative expense	3,378	3,813	4,187	4,493	5,532	7,112	7,552	8,432
as % of revenue	*10.5%*	*11.4%*	*10.4%*	*8.0%*	*7.7%*	*7.4%*	*7.2%*	*6.9%*
Net financial expenses	-123	-67	-33	-67	-76	-95	-122	-151
Pre-tax profit (income before tax)	21,882	22,002	23,958	34,839	45,968	63,005	69,917	81,298
Income taxes	5,613	5,547	6,027	8,710	11,492	15,751	17,479	20,324
Net income	16,269	16,455	17,931	26,129	34,476	47,253	52,438	60,973
Minority interests	920	952	1,212	1,763	2,326	3,188	3,538	4,114
Net income attributable to parent shareholders	**15,350**	**15,503**	**16,718**	**24,366**	**32,150**	**44,065**	**48,900**	**56,860**
YoY	*1%*	*1%*	*7.8%*	*45.7%*	*32%*	*37%*	*11%*	*16%*
EPS	**14.08**	**12.34**	**13.31**	**19.40**	**25.59**	**35.08**	**38.93**	**45.26**

Source: Company data, Gao Hua Securities Research

Case Study: Hermes International – Blue sky dreaming

Should Moutai be able to successfully establish the “new retail” model and implement a full direct sales model, it would likely have even greater pricing power and be able to tap a much larger profit pool, by essentially cutting out the middle man entirely.

To get a sense of the potentials benefits, we look at Hermes International (NC), the high fashion luxury brand in France. Similar to Moutai, the supply of Hermes Birkin bags is limited, with prices ranging upward from about US$7,000 per bag — due to the limited supply of raw materials (animal skins) and the limited number of craftsmen able to create them.

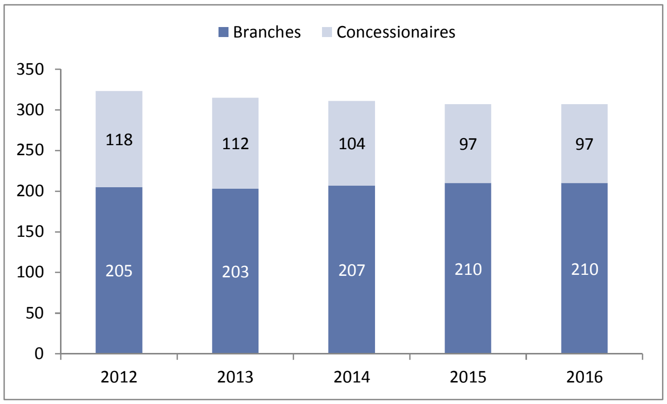
Different from Moutai’s distribution model, Hermes has a direct sales model. The company owns 307 retail stores worldwide – 210 self-owned stores and 97 concessionaires. The advantage of direct sales model is that the price is entirely controlled by the company. More importantly, the company knows the information of every customer and there is little chance for speculators to stockpile inventory.

Due to tight supply and strong control on pricing, the company has been able to expand steadily on the back of growing demand. Revenue growth at Hermes has been very stable (13% CAGR over the past 10 years). The company did not even suffer from any revenue decline during the financial crisis in 2008, reflecting its ability to smooth revenue growth. Earnings growth was also very stable (15% CAGR in 10 years).

We think very strong pricing power and steady earnings growth contribute to Hermes’ **premium valuation multiple**. Hermes is currently traded at 36X 12-month forward PE in the last 10 years, compared with 26X for Moutai.

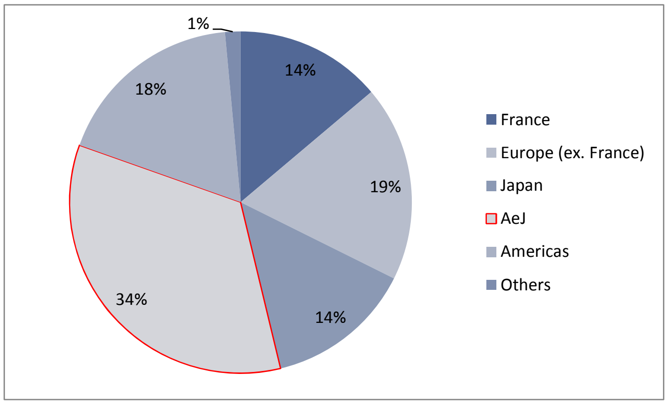
In terms of key financial metrics, Moutai has much higher gross margin and net margin, as production costs for spirits are small; but Hermes has higher asset turnover. The two companies have similar ROE.

Exhibit 10: Hermes has 307 retail stores as of 2016
Hermes number of retail stores



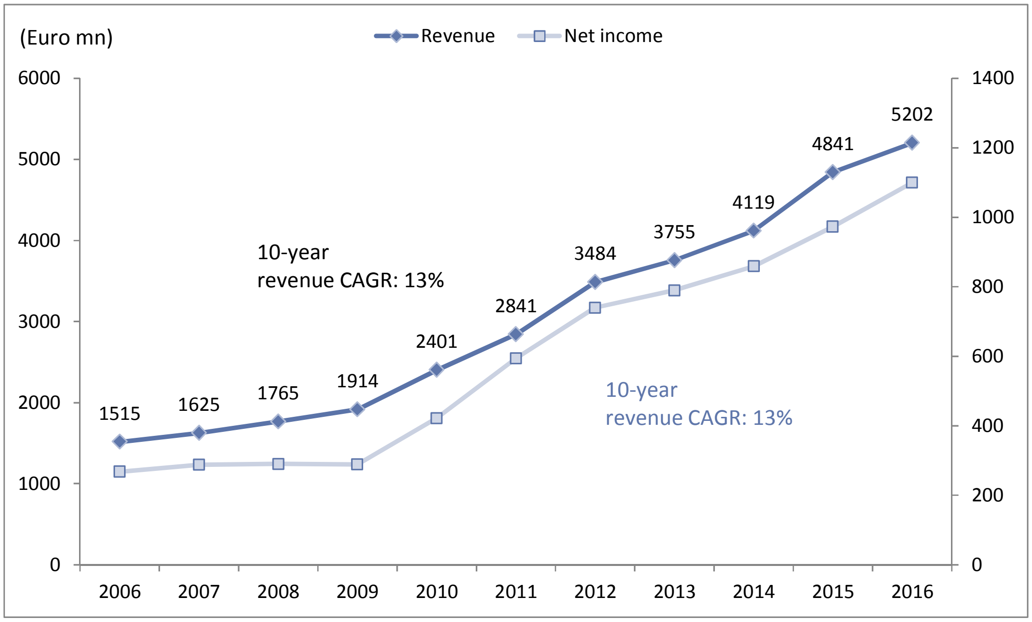
Source: Company data

Exhibit 11: AeJ accounts for 34% of 2016 Hermes revenue
Hermes revenue breakdown by region



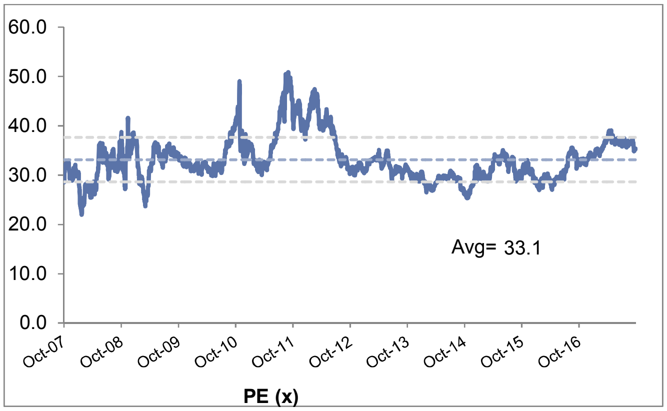
Source: Company data

Exhibit 12: Revenue and net income growth of Hermes has been very stable
Revenue and net income of Hermes



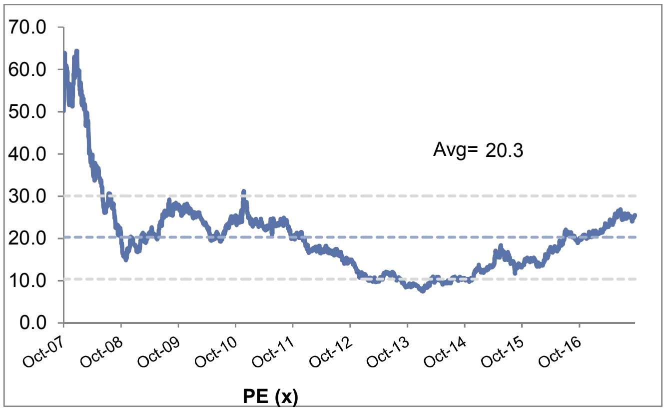
Source: Company data

Exhibit 13: Hermes average forward PE is 33X
NTM PE of Hermes International



Source: Bloomberg

Exhibit 14: …while Moutai's average PE is 20X
NTM PE of Kweichow Moutai



Source: Bloomberg

Exhibit 15: Moutai has similar ROE as Hermes, with higher margins and lower turnover
Comparison of key financial metrics

ROE	2010	2011	2012	2013	2014	2015	2016
Kweichow Moutai	31%	40%	45%	39%	32%	26%	24%
Hermes International	21%	27%	32%	31%	27%	27%	27%
Gross margin	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Kweichow Moutai	90%	90%	91%	92%	92%	91%	89%
Hermes International	66%	69%	68%	69%	67%	66%	68%
Net margin	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Kweichow Moutai	50%	55%	56%	54%	52%	52%	50%
Hermes International	18%	21%	21%	21%	21%	20%	21%
Asset turnover	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Kweichow Moutai	0.44	0.53	0.60	0.56	0.49	0.39	0.34
Hermes International	0.90	0.92	1.05	1.02	0.95	0.97	0.93

Source: Company data

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