



Rating
Buy

Asia
China

Consumer
Alcohol & Tobacco

Company
Kweichow Moutai

Reuters 600519.SS Bloomberg 600519 CG Exchange SHH Ticker 600519

Date
29 January 2018

Company Update

Price at 25 Jan 2018 (CNY)	768.88
Price target - 12mth (CNY)	790.00
52-week range (CNY)	788.21 - 343.71
Shanghai Composite	3,548

Increasing risk of over supply in 2018

Turning more prudent near-term

We think Moutai's channel restocking cycles could be peaking with expanding bubbles in its retail pricing recently. As retail prices are (currently at Rmb1700-1800) approaching the historic peak level (Rmb2000 in 2012), Moutai's investment demand and real consumption demand could be impacted in 2018, while supply looks set to increase. As a result, we think oversupply could pressure real retail prices. Though this won't impact Feitian Moutai's ex-factory sales, potential weakening in retail prices could pressure market sentiment.

2017: Channel restocking demand is main growth driver

There are two sources of demand for "Feitian Moutai" - real consumption demand and investment demand. During the retail price hike cycle, real consumption demand could decline due to price elasticity, and instead, investment demand, or channel/social restocking demand, would increase, driven by market's price hike expectation. In 2017, we estimate real consumption demand has declined 10% yoy to 24,000 tons, and channel/social stocking demand has absorbed 7,000 tons (compared to releasing 4,000 tons in 2016).

2018: Supply set to increase while demand might decline

As Feitian Moutai's current retail price is approaching its historic peak level, the expected ROI for channel stocking in 2018 is much lower than in 2017. This should lead to lower interest by investors and distributors to stock up on the liquor. Meanwhile, distributors normally have less incentive to stock up inventories after manufacturers raise ex-factory prices (Moutai announced a raise in price on Dec 2017). On the other hand, real consumption could also decline in 2018 due to the higher retail price. On the supply side, Moutai has announced it will raise supply by >7.6% to 28,000 tons. The increasing supply and declining demand might lead to a potential over supply situation in 2018.

Three potential impacts of over supply

If Moutai enters an over supply situation, the retail price might be under pressure in near-term. In a softer retail price scenario, the subsequent results could be: 1) distributors/investors further clean up inventories and enhance over supply; 2) weaker sales for super premium products; and 3) weaker demand for "ex-quota" Feitian volumes. These could pressure its share price in near-term. Besides this near-term risk, we still like the company for its strong branding and good positioning in consumers' trading up demand.

Valuation & Risks

Mark Yuan

Research Analyst
+852-2203 6181

Anne Ling

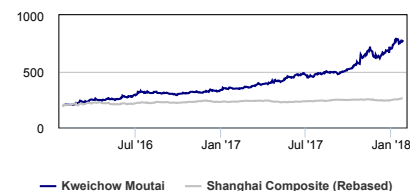
Research Analyst
+852-2203 6177

Key changes

TP	745.00 to 790.00	↑	6.0%
Sales (FYE)	48,551 to 49,967	↑	2.9%
Op prof margin (FYE)	71.8 to 72.5	↑	0.9%
Net profit (FYE)	25,350.4 to 26,281.9	↑	3.7%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	11.7	35.8	121.3
Shanghai Composite	8.2	4.4	12.7

Source: Deutsche Bank

Key indicators (FY1)

ROE (%)	32.1
Net debt/equity (%)	-87.6
Book value/share (CNY)	72.16
Price/book (x)	10.7
Net interest cover (x)	-
Operating profit margin (%)	72.5

Source: Deutsche Bank

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Channel restocking demand is main growth driver in 2017

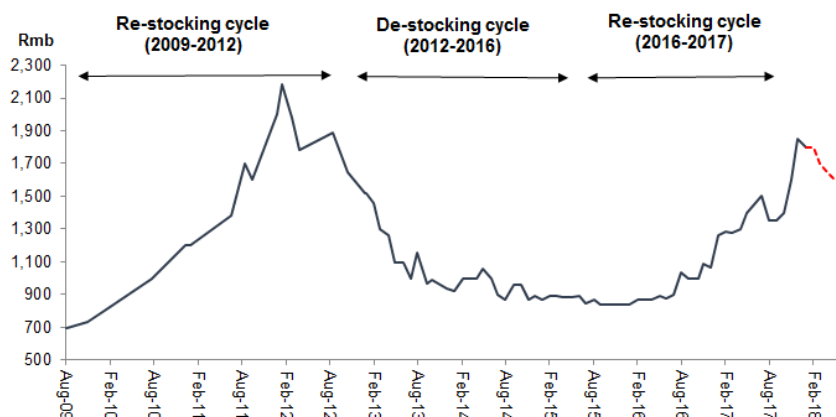
Moutai's demand includes real consumption demand and investment demand. Moutai's sales value grew by 50% and sales volume grew by 35% in 2017. We don't think such strong growth can be fully explained by consumers' trading up demand. Instead, a strong investment demand recovery would be the main driver in 2017. Specifically,

- **Investment demand:** From 2H16, market began to build up expectations that Moutai's retail price would continue to rally. With such an expectation, liquor investors began enter the market, including distributors, institutions (property developers and cola miners) and high net wealth individuals. Some consumers also purchased Moutai in advance to avoid future price hikes. **We estimate Moutai's channel has absorbed 7000 tons of ex-factory volume, representing 23% of Moutai's ex-factory volume in 2017.** (The channel released 4,000 tons of Moutai to the market in 2016.)
- **Real consumption demand:** "Feitian Moutai's average retail price rose by 50% in 2017 to Rmb1400. After the rally, the liquor became less affordable for private consumption. During our channel checks, some distributors also indicated that they were beginning to be concerned about whether the "corkage ratio" would decline after retail price hike. As Moutai's private consumption portion has increased since 2012, we think more consumption is becoming price sensitive. **We estimate Moutai's real consumption to decline 10% yoy to 24,000 tons in 2017 (Figure 2).**

The market in 2017 is similar as what the market experienced in Moutai's restocking cycle during 2011. In 2011, the retail price rose from Rmb1300 in year beginning to Rmb2000 in early 2012. The channel restocking became a key growth driver and resulted in undersupply in the retail market (Figure 1). (Refer to our report "[The restocking cycle](#)" published on June 22 2017 for more details.) After recent the restocking cycle in 2016-17, **we forecast Moutai's channel/social inventory to be 13,000 tons by the end of 2017, representing 6 months of its real consumption (Figure 3).**



Figure 1: Feitian Moutai's retail price history (Rmb/bottle)



Source: Deutsche Bank, wind, jianjiang.cn, baidu.com; retail price after Jan 2018 is Deutsche Bank forecast

Figure 2: Moutai's Demand Breakdown

in thousands tons	2012	2013	2014	2015	2016	2017E	2018E
Moutai's demand breakdown							
Real consumption demand	14	16	20	24	27	24	22
Investment demand	1	1	-1	-4	-4	7	4
Total demand	15	17	18	20	23	31	25
YoY changes							
Real consumption demand		18%	22%	20%	14%	-10%	-10%
Investment demand		-46%	na	na	na	na	-50%
Total demand		13%	10%	8%	16%	35%	-19%

Source: Deutsche Bank

Figure 3: Moutai's social inventory estimates

in thousands tons	2012	2013	2014	2015	2016	2017E	2018E
Beginning balance	13	14	15	14	10	6	13
Add: ex-factory sales	15	17	18	20	23	31	28
Less: real consumption demand	-14	-16	-20	-24	-27	-24	-22
Ending balance	14	15	14	10	6	13	20

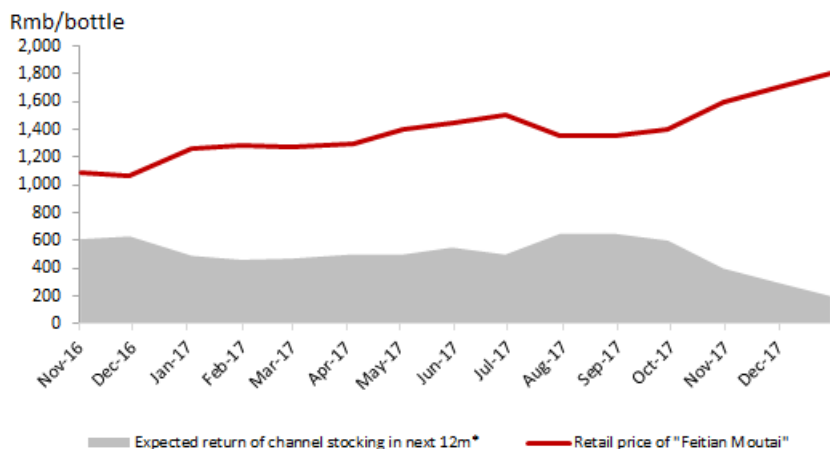
Source: Deutsche Bank

2018: could enter an over supply situation

If Moutai's retail price remains at current levels, both investment demand and consumption demand could begin to decline in 2018. In our base case, we estimate a typical Feitian liquor investor's 1 year expected return to decline from highest level at Rmb500 in Jan 2017 to Rmb200 in Jan 2018 and the ROI (expected return/spot market price) to decline from 40% in Jan 2017 to 10% in Jan 2018 (Figure 3), as cost to build up inventories are rising significantly in past 12 months. As a result, we forecast investment demand to decline 50% yoy to 3500 tons. Meanwhile, due to rising retail prices and price elasticity, we forecast real consumption demand to decline 10% yoy to 22,000 tons. **This implies that total demand would decline 20% yoy to 25,500 tons in 2018 (Figure 2).**



Figure 4: What's the expected return to store Moutai for 12 months?



Source: Deutsche Bank; the expected return = expected future retail price in 12 months less spot retail price

Moutai has announced an increase in supply by at least 7% to 28,000 tons in 2018. We believe this number is referred to "planned volume" before including "ex-quota" volume. To recap, Moutai's actual volume is 31,000 tons in 2017 including both planned volume and "out of quota" volume. **Yet even based on the "planned volume" at 28,000 tons, it will be still higher than total demand of 25,000 tons, result in an over supply situation.**

If Moutai enters an oversupply scenario in 2018, various potential events could pressure market sentiment, including ,

- **Channel de-stocking.** If the price hike expectation switches to price decline expectation, the channel restocking could switch into a destocking cycle. The incremental supply from channel could enhance the destocking cycle itself.
- **Weaker demand of super premium Moutai.** We forecast that super premium Moutai, or customized Moutai, contributed 10% sales growth in 2017. We expect the portion of investment demand is higher for super premium Moutai than for Feitian Moutai. Therefore, weaker investment demand could impact super premium Moutai harder.
- **"ex-quota" Feitian volumes might decline.** Within over supply situation, Moutai might reduce its "out of quota" Feitian to support retail price.



Figure 5: Moutai retail price channel check

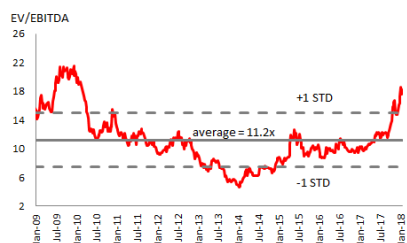
City	District	Retail price (RMB/bottle)	Remark
Shanghai	Huangpu District	1499	Moutai specialty store, each customer is limited to 2 bottles, the store only has 1 -2 cases per day for selling
Shanghai	Changning District	1499	Moutai specialty store, each customer is limited to 2 bottles and need to purchase on moutai app, the store only has 1 -2 cases per day for selling
Shanghai	Zhabei District	1499	Moutai specialty store, each customer is limited to 2 bottles, the store only has 1 -2 cases per day for selling
Shanghai	Hongkou District	1798	Retail store, no purchase limitation
Shanghai	Zhabei District	1950	Retail store, no purchase limitation, have discounts if buy a case
Shanghai	Pudong New Area	1800	Retail store, no purchase limitation, RMB1780/bottle if buy a case
Beijing	Tongzhou District	1600	Retail store, no purchase limitation, buy a case could get RMB100 off per case
Beijing	Chaoyang District	1980	Retail store, no purchase limitation, buy a case could get RMB100 off per bottle
Beijing	Fangshan District	1800	Retail store, no purchase limitation, have discounts if buy a case
Shenzhen	Baoan District	1730	Retail store, no purchase limitation, no discounts if buy a case
Shenzhen	Longgang District	1680	Retail store, no purchase limitation, little discounts if buy a case
Shenzhen	Futian District	1750	Retail store, no purchase limitation, buy a case could get RMB30 off per bottle

Source: Deutsche Bank channel checks.

We still like Moutai for its long-term solid growth

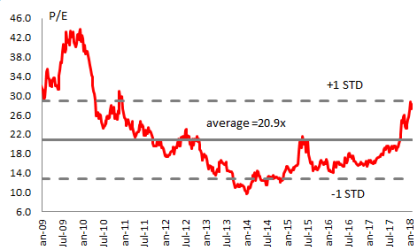
In the long term, we still expect Moutai to generate solid growth with its strong branding and increasing channel operating capability. We are maintaining a Buy on the stock. Our revised target price at Rmb790 is based on DCF methodology, factoring in 9.5% WACC (3.9% RFR, 5.6% ERP, 1.0 beta, debt-free structure) and a 2% terminal growth rate. Downside risk: earlier-than-expected channel de-stocking.

Figure 6: Moutai 1-year forward EV/ EBITDA



Source: Deutsche Bank, Bloomberg Finance LP

Figure 7: Moutai 1-year forward P/E



Source: Deutsche Bank, Bloomberg Finance LP



Figure 8: Peer comparison

Company	Ticker	Recom	Listing Curr	Price	Mkt Cap US\$m	PE (x)			PB (x)			EV/EBITDA			Div Yield (%)		
						Hist	FY1Y	FY2Y	Hist	FY1Y	FY2Y	Hist	FY1Y	FY2Y	Hist	FY1Y	FY2Y
Kweichow Moutai	600519.SS	Buy	CNY	777.22	154,511	20.7	36.8	28.2	5.8	10.7	8.7	12.1	23.6	17.6	2.5	1.4	1.9
Wuliangye Yibin	000858.SZ	Buy	CNY	86.84	52,168	17.4	35.4	26.5	2.8	6.2	5.4	9.2	22.9	16.4	2.9	1.4	1.9
Jiangsu Yanghe	002304.SZ	NR	CNY	131.94	31,466	18.2	29.4	24.3	4.1	6.7	5.8	12.0	21.2	17.8	1.6	1.7	2.1
Luzhou Laojiao	000568.SZ	NR	CNY	68.99	15,992	24.0	38.9	29.5	4.2	7.6	6.7	17.2	27.1	20.2	1.4	1.3	2.0
Shanxi Fen Wine	600809.SS	NR	CNY	NM	8,964	35.8	55.0	37.0	4.6	10.5	8.8	19.7	32.5	23.2	0.8	1.0	1.4
Anhui Gujing Distillery	000596.SZ	NR	CNY	73.69	5,224	27.6	34.1	27.0	4.1	5.8	4.9	17.8	19.2	15.9	0.8	0.9	1.1
Anhui Yingjia Distillery	603198.SS	NR	CNY	18.03	2,283	25.4	20.2	17.6	4.4	3.5	3.3	16.6	14.4	12.8	3.3	NM	NM
Sichuan Swellfun	600779.SS	NR	CNY	50.25	3,885	41.5	71.8	39.7	6.4	14.6	11.2	30.4	46.8	26.3	0.9	0.9	1.4
Tuopai Shede	600702.SS	NR	CNY	49.34	2,634	95.0	103.2	41.6	3.3	6.2	5.2	29.8	46.2	19.3	0.1	0.1	0.4
Guyuelongshan	600059.SS	NR	CNY	9.75	1,248	68.3	52.4	44.3	2.1	2.0	2.0	34.0	29.2	26.8	1.0	0.8	1.0
Jiugui Liquor	000799.SZ	NR	CNY	25.97	1,335	61.4	49.3	33.6	3.6	4.2	3.7	38.6	31.0	21.1	0.4	NM	NM
Xinjiang Yilite	600197.SS	NR	CNY	29.57	2,064	23.1	36.2	28.1	3.3	5.7	4.9	11.9	NM	NM	0.8	0.9	1.0
Average						38.2	46.9	31.5	4.0	7.0	5.9	20.8	28.5	19.8	1.4	1.0	1.4

Source: Deutsche Bank, Bloomberg Finance LP. Stock price is on 26 Jan 2018. We use DB estimates for those companies we cover and Bloomberg consensus for other companies.

The authors of this report wish to acknowledge the contribution made by Kerith Chen, an employee of Evalueserve, a third-party provider of offshore research support services to Deutsche Bank.



Model updated: 26 January 2018

Running the numbers

Asia

China

Alcohol & Tobacco

Kweichow Moutai

Reuters: 600519.SS Bloomberg: 600519 CG

Buy

Price (25 Jan 18) CNY 768.9

Target Price CNY 790.0

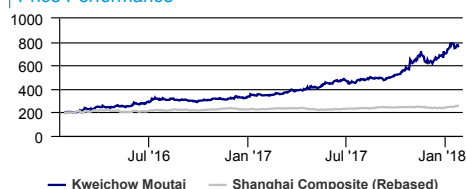
52 Week range CNY 343.71 - 788.21

Market cap (m) CNYm 965,867
USDm 152,423

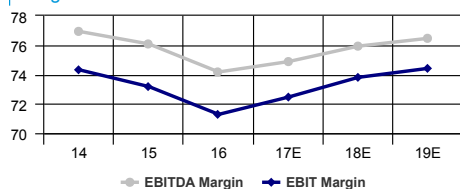
Company Profile

Kweichow Moutai is China's largest local spirit brand/producer by sales value.

Price Performance



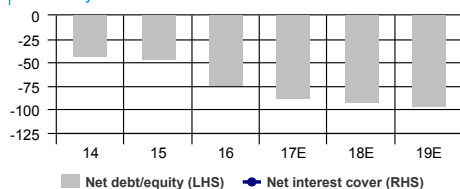
Margin Trends



Growth & Profitability



Solvency



Mark Yuan

+852 2203 6181

mark.yuan@db.com

Fiscal year end 31-Dec

Financial Summary

	2014	2015	2016	2017E	2018E	2019E
DB EPS (CNY)	12.22	12.34	13.31	20.92	27.28	32.20
Reported EPS (CNY)	12.22	12.34	13.31	20.92	27.28	32.20
DPS (CNY)	3.98	6.17	6.79	11.13	14.51	17.13
BVPS (CNY)	42.5	50.9	58.0	72.2	88.3	106.0
Weighted average shares (m)	1,256	1,256	1,256	1,256	1,256	1,256
Average market cap (CNYm)	169,335	256,416	346,172	965,867	965,867	965,867
Enterprise value (CNYm)	145,643	225,583	290,095	882,338	856,496	828,853

Valuation Metrics

P/E (DB) (x)	11.0	16.5	20.7	36.8	28.2	23.9
P/E (Reported) (x)	11.0	16.5	20.7	36.8	28.2	23.9
P/BV (x)	4.05	4.28	5.76	10.65	8.71	7.25
FCF Yield (%)	4.8	6.0	10.5	3.7	4.1	4.7
Dividend Yield (%)	2.9	3.0	2.5	1.4	1.9	2.2
EV/Sales (x)	5.1	7.7	9.0	17.7	13.4	11.2
EV/EBITDA (x)	6.6	10.2	12.1	23.6	17.6	14.6
EV/EBIT (x)	6.8	10.6	12.6	24.4	18.1	15.0

Income Statement (CNYm)

Sales revenue	28,785	29,210	32,353	49,967	64,124	74,230
Gross profit	26,446	26,672	28,943	44,761	57,919	67,205
EBITDA	22,146	22,223	23,997	37,414	48,689	56,759
Depreciation	753	848	934	1,207	1,363	1,519
Amortisation	0	0	0	0	0	0
EBIT	21,393	21,375	23,063	36,207	47,326	55,239
Net interest income/(expense)	707	780	1,203	1,819	1,915	2,510
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinary	0	0	0	0	0	0
Other pre-tax income/(expense)	-218	-153	-308	-243	-233	-226
Profit before tax	21,882	22,002	23,958	37,783	49,008	57,523
Income tax expense	5,613	5,547	6,027	9,824	12,546	14,496
Minorities	920	952	1,212	1,678	2,188	2,582
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	15,350	15,503	16,718	26,282	34,274	40,446
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	15,350	15,503	16,718	26,282	34,274	40,446

Cash Flow (CNYm)

Cash flow from operations	12,633	17,436	37,451	37,409	41,455	47,759
Net Capex	-4,431	-2,061	-1,019	-1,429	-1,633	-1,885
Free cash flow	8,201	15,375	36,432	35,980	39,822	45,874
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-5,122	-5,554	-8,351	-8,526	-13,980	-18,231
Net inc/(dec) in borrowings	1,246	1,948	4,811	11	11	11
Other investing/financing cash flows	105	65	6	-2	0	0
Net cash flow	4,430	11,834	32,899	27,464	25,853	27,654
Change in working capital	-4,480	471	19,162	7,621	3,630	3,213

Balance Sheet (CNYm)

Cash and other liquid assets	27,711	36,801	66,855	94,319	120,172	147,825
Tangible fixed assets	13,798	16,312	17,199	17,484	17,815	18,243
Goodwill/intangible assets	3,583	3,582	3,532	3,481	3,430	3,380
Associates/investments	64	29	29	29	29	29
Other assets	20,718	29,577	25,320	30,100	35,490	39,472
Total assets	65,873	86,301	112,935	145,412	176,936	208,949
Interest bearing debt	4,019	5,967	10,779	10,790	10,800	10,811
Other liabilities	6,543	14,100	26,257	39,290	48,321	55,527
Total liabilities	10,562	20,067	37,036	50,080	59,122	66,338
Shareholders' equity	53,430	63,926	72,894	90,650	110,945	133,159
Minorities	1,881	2,308	3,004	4,682	6,870	9,451
Total shareholders' equity	55,312	66,234	75,899	95,332	117,814	142,611
Net debt	-23,692	-30,833	-56,076	-83,529	-109,371	-137,014

Key Company Metrics

Sales growth (%)	2.3	1.5	10.8	54.4	28.3	15.8
DB EPS growth (%)	1.4	1.0	7.8	57.2	30.4	18.0
EBITDA Margin (%)	76.9	76.1	74.2	74.9	75.9	76.5
EBIT Margin (%)	74.3	73.2	71.3	72.5	73.8	74.4
Payout ratio (%)	32.5	50.0	51.0	53.2	53.2	53.2
ROE (%)	32.0	26.4	24.4	32.1	34.0	33.1
Capex/sales (%)	15.4	7.1	3.2	2.9	2.5	2.5
Capex/depreciation (x)	5.9	2.4	1.1	1.2	1.2	1.2
Net debt/equity (%)	-42.8	-46.6	-73.9	-87.6	-92.8	-96.1
Net interest cover (x)	nm	nm	nm	nm	nm	nm

Source: Company data, Deutsche Securities estimates



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Kweichow Moutai	600519.SS	777.33 (CNY) 26 Jan 2018	NA

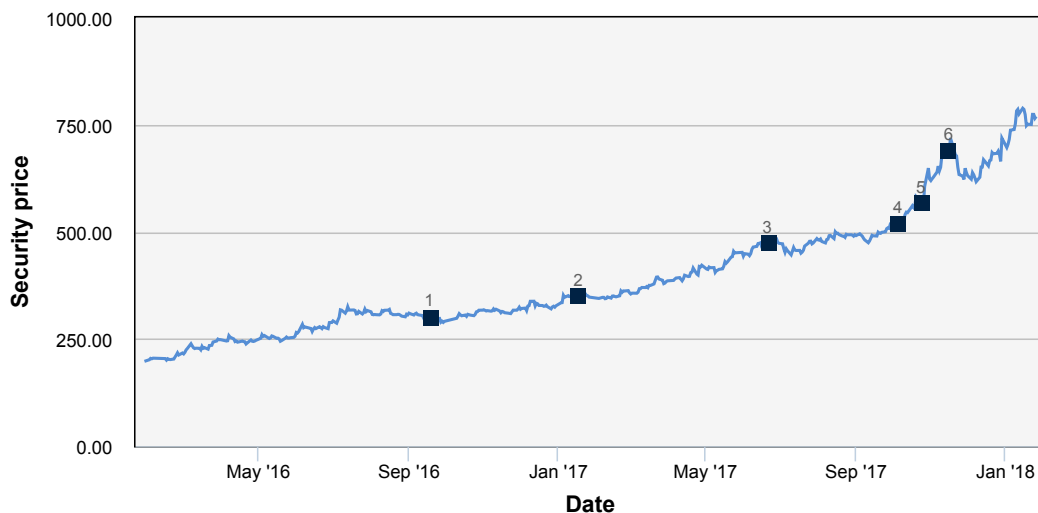
*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <http://gm.db.com/ger/disclosure/DisclosureDirectory.eqs>. Aside from within this report, important conflict disclosures can also be found at <https://gm.db.com/equities> under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

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The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Mark Yuan

Historical recommendations and target price. Kweichow Moutai (600519.SS)

(as of 01/26/2018)



Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

** Analyst is no longer at Deutsche Bank

1.	09/19/2016	Buy, Target Price Change CNY 385,00	Charlie Chen**	4.	10/06/2017	Buy, Target Price Change CNY 610,00	Mark Yuan
2.	01/18/2017	Buy, Target Price Change CNY 410,00	Charlie Chen**	5.	10/25/2017	Buy, Target Price Change CNY 650,00	Mark Yuan
3.	06/22/2017	Buy, Target Price Change CNY 550,00	Mark Yuan	6.	11/16/2017	Buy, Target Price Change CNY 745,00	Mark Yuan



Equity Rating Key

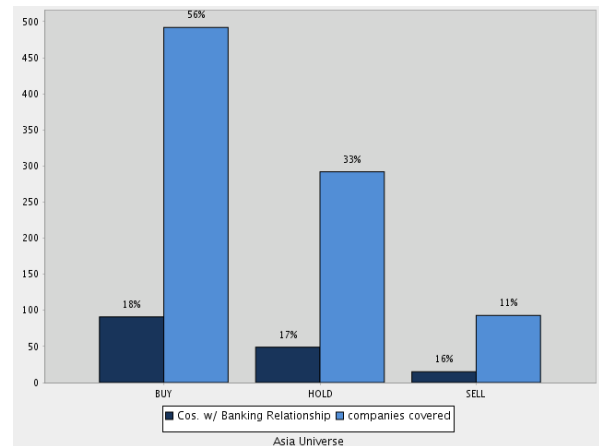
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Newly issued research recommendations and target prices supersede previously published research.

Equity rating dispersion and banking relationships





Additional Information

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David Folkerts-Landau

Group Chief Economist and Global Head of Research

Raj Hindocha
Global Chief Operating Officer
Research

Michael Spencer
Head of APAC Research
Global Head of Economics

Steve Pollard
Head of Americas Research
Global Head of Equity Research

Anthony Klarman
Global Head of
Debt Research

Paul Reynolds
Head of EMEA
Equity Research

Dave Clark
Head of APAC
Equity Research

Pam Finelli
Global Head of
Equity Derivatives Research

Andreas Neubauer
Head of Research - Germany

Spyros Mesomeris
Global Head of Quantitative
and QIS Research

International Production Locations

Deutsche Bank AG

Deutsche Bank Place
Level 16
Corner of Hunter & Phillip Streets
Sydney, NSW 2000
Australia
Tel: (61) 2 8258 1234

Deutsche Bank AG

Mainzer Landstrasse 11-17
60329 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG

Filiale Hongkong
International Commerce Centre,
1 Austin Road West, Kowloon,
Hong Kong
Tel: (852) 2203 8888

Deutsche Securities Inc.

2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6770

Deutsche Bank AG London

1 Great Winchester Street
London EC2N 2EQ
United Kingdom
Tel: (44) 20 7545 8000

Deutsche Bank Securities Inc.

60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250 2500
