



Rating  
**Buy**

Asia  
China

Consumer  
Food & Beverage

Company  
**Yanghe**

Reuters 002304.SZ    Bloomberg 002304 CH    Exchange SHZ    Ticker 002304

Date  
13 September 2018

Initiation of Coverage

Price at 12 Sep 2018 (CNY)	105.00
Price target - 12mth (CNY)	150.00
52-week range (CNY)	146.83 - 86.30
HANG SENG INDEX	26,345

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## Consolidator of premium liquor; initiating with Buy

### More resilient growth during macro slow down

Yanghe is the largest brand in premium liquor (Rmb300-600/bottle) in China. Near term, we expect its growth to be more resilient than other liquor brands, helped by its "value for money" nature, flat channels and rapid market response. Yanghe exhibited its resilience in the last downcycle in 2013-14. Long term, we expect it to consolidate the premium liquor sector through increased penetration and improved product mix. Risk/reward is attractive at 15x 2019E P/E with a 22% earnings CAGR over FY18-20E. Initiate Buy.

### Premium liquor sector: fast-growing sales and improving consolidation

The premium segment accounted for 9% of liquor volume and 20% of liquor sales in 2017. Premium liquor has good branding and reasonable pricing catered to the social and business demand. With middle-class consumers trading up, the premium segment is expected to have the highest growth among all categories in Baijiu, and estimated to have a 16% sales CAGR in 2018-20 by Euromonitor. Meanwhile, in view of consumers' increased brand awareness, we expect leading brands to gain market share in the segment.

### Yanghe: well positioned to scale up in the premium sector

Yanghe takes a 30% market share by volume in the premium segment and we expect it to continue to consolidate the segment. Compared to other premium peers, Yanghe has a wider distribution channel, better brand awareness and more diversified products. Management also has high incentives with a significant interest in the company. We expect Yanghe to gain market share through increased penetration and improved product mix in the long term.

### Initiating with Buy; Target price RMB150

Yanghe's shares have fallen 30% (MSCI China staples index: -23%) since June due to weak market sentiment, but we believe the story of market share gains in the premium segment is intact. The stock trades at 15x 2019E P/E with a 22% earnings CAGR in 2018-20E. We initiate on Yanghe with a Buy rating. Our target price of RMB150 is based on DCF (9.5% WACC and 2% terminal growth). Downside risk: macro slowdown, channel destocking of Moutai and food safety. (See pages 17 & 18).

### Price/price relative



Performance (%)	1m	3m	12m
Absolute	-9.8	-28.5	22.1
HANG SENG INDEX	-7.1	-15.3	-5.8

Source: Deutsche Bank

### Forecasts And Ratios

Year End Dec 31	2016A	2017A	2018E	2019E	2020E
Sales (CNYm)	16,873.5	18,766.1	21,300.4	25,870.9	30,603.2
EBITDA (CNYm)	7,896.5	8,832.3	11,403.3	14,046.9	16,885.8
Reported NPAT (CNYm)	5,827.2	6,627.2	8,476.6	10,502.5	12,674.5
Reported EPS FD(CNY)	3.87	4.40	5.62	6.97	8.41
DB EPS FD (CNY)	3.87	4.40	5.62	6.97	8.41
DB EPS growth (%)	8.6	13.7	27.9	23.9	20.7
PER (x)	16.6	20.2	18.7	15.1	12.5
EV/EBITDA (x)	12.0	15.0	13.3	10.4	8.2
DPS (net) (CNY)	2.10	2.55	3.09	3.83	4.63
Yield (net) (%)	3.3	2.9	2.9	3.7	4.4

Source: Deutsche Bank estimates, company data

<sup>1</sup> DB EPS is fully diluted and excludes non-recurring items

<sup>2</sup> Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

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Yanghe



Model updated: 13 September 2018

Running the numbers

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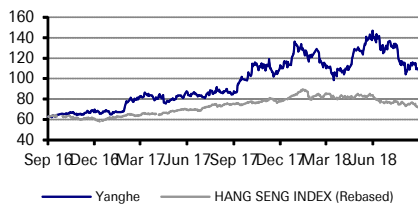
Buy

Price (12 Sep 18) CNY 105.00  
Target Price CNY 150.00  
52 Week range CNY 86.30 - 146.83  
Market Cap (m) CNYm 158,235 USDm 23,036

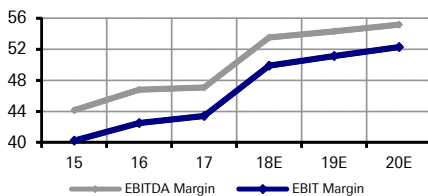
Company Profile

Yanghe Brewery is a national large-scale liquor production enterprise in China with two major liquor brands Yanghe and Shuanggou. Its major products are a series of mellow liquor including Dream Blue, Yanghe Blue Classic, Shuanggou Zhenbaofang, Yanghe Daqu and Shuanggou Daqu.

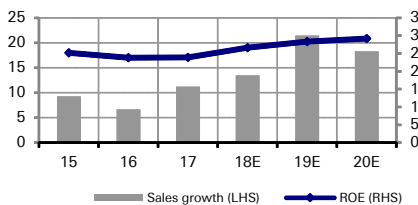
Price Performance



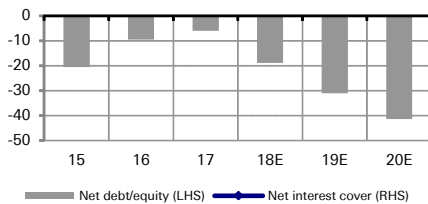
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

Financial Summary

	2015	2016	2017	2018E	2019E	2020E
DB EPS (CNY)	3.56	3.87	4.40	5.62	6.97	8.41
Reported EPS (CNY)	3.56	3.87	4.40	5.62	6.97	8.41
DPS (CNY)	1.80	2.10	2.55	3.09	3.83	4.63
BVPS (CNY)	15.2	17.3	19.6	22.7	26.5	31.1
Weighted average shares (m)	1,507	1,507	1,507	1,507	1,507	1,507
Average market cap (CNYm)	87,438	96,873	133,862	158,235	158,235	158,235
Enterprise value (CNYm)	82,730	94,416	132,111	151,816	145,846	138,837

Valuation Metrics

P/E (DB) (x)	16.3	16.6	20.2	18.7	15.1	12.5
P/E (Reported) (x)	16.3	16.6	20.2	18.7	15.1	12.5
P/BV (x)	4.21	3.91	5.77	4.63	3.96	3.37
FCF Yield (%)	5.9	7.1	4.9	5.6	6.7	8.1
Dividend Yield (%)	3.1	3.3	2.9	2.9	3.7	4.4
EV/Sales (x)	5.2	5.6	7.0	7.1	5.6	4.5
EV/EBITDA (x)	11.8	12.0	15.0	13.3	10.4	8.2
EV/EBIT (x)	13.0	13.2	16.2	14.3	11.0	8.7

Income Statement (CNYm)

Sales revenue	15,823	16,874	18,766	21,300	25,871	30,603
Gross profit	9,708	10,671	12,085	15,207	18,702	22,380
EBITDA	6,985	7,896	8,832	11,403	14,047	16,886
Depreciation	619	725	690	777	816	881
Amortisation	0	0	0	0	0	0
EBIT	6,366	7,171	8,142	10,626	13,231	16,005
Net interest income/(expense)	196	9	34	32	125	245
Associates/affiliates	0	-4	-1	0	0	0
Exceptionals/extraordinary	0	0	0	0	0	0
Other pre-tax income/(expense)	603	585	673	685	698	711
Profit before tax	7,165	7,761	8,848	11,343	14,054	16,960
Income tax expense	1,800	1,956	2,229	2,858	3,541	4,273
Minorities	0	-22	-8	8	11	13
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	5,365	5,827	6,627	8,477	10,502	12,675
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	5,365	5,827	6,627	8,477	10,502	12,675

Cash Flow (CNYm)

Cash flow from operations	5,836	7,405	6,883	9,752	11,776	13,924
Net Capex	-720	-480	-325	-848	-1,151	-1,147
Free cash flow	5,117	6,925	6,558	8,904	10,625	12,777
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-2,153	-2,714	-3,169	-3,843	-4,662	-5,776
Net inc/(dec) in borrowings	0	-84	0	0	0	0
Other investing/financing cash flows	-2,603	-6,379	-4,095	-393	7	8
Net cash flow	361	-2,251	-707	4,668	5,970	7,009
Change in working capital	409	1,352	236	480	437	346

Balance Sheet (CNYm)

Cash and other liquid assets	4,708	2,457	1,751	6,419	12,389	19,398
Tangible fixed assets	8,495	8,515	8,484	8,518	8,828	9,089
Goodwill/intangible assets	1,948	1,911	1,930	1,960	1,978	1,975
Associates/investments	1,205	1,479	3,462	3,862	3,862	3,862
Other assets	17,505	24,443	27,631	31,417	32,113	36,278
Total assets	33,860	38,804	43,258	52,176	59,170	70,602
Interest bearing debt	0	0	0	0	0	0
Other liabilities	10,919	12,767	13,763	18,039	19,182	23,703
Total liabilities	10,919	12,767	13,763	18,039	19,182	23,703
Shareholders' equity	22,937	26,053	29,515	34,149	39,989	46,887
Minorities	4	-16	-20	-12	-1	12
Total shareholders' equity	22,941	26,037	29,495	34,137	39,988	46,899
Net debt	-4,708	-2,456	-1,751	-6,419	-12,389	-19,398

Key Company Metrics

Sales growth (%)	9.3	6.6	11.2	13.5	21.5	18.3
DB EPS growth (%)	19.2	8.6	13.7	27.9	23.9	20.7
EBITDA Margin (%)	44.1	46.8	47.1	53.5	54.3	55.2
EBIT Margin (%)	40.2	42.5	43.4	49.9	51.1	52.3
Payout ratio (%)	50.6	54.3	58.0	55.0	55.0	55.0
ROE (%)	25.2	23.8	23.9	26.6	28.3	29.2
Capex/sales (%)	4.5	2.8	1.7	4.0	4.4	3.7
Capex/depreciation (x)	1.2	0.7	0.5	1.1	1.4	1.3
Net debt/equity (%)	-20.5	-9.4	-5.9	-18.8	-31.0	-41.4
Net interest cover (x)	nm	nm	nm	nm	nm	nm

Source: Company data, Deutsche Bank estimates

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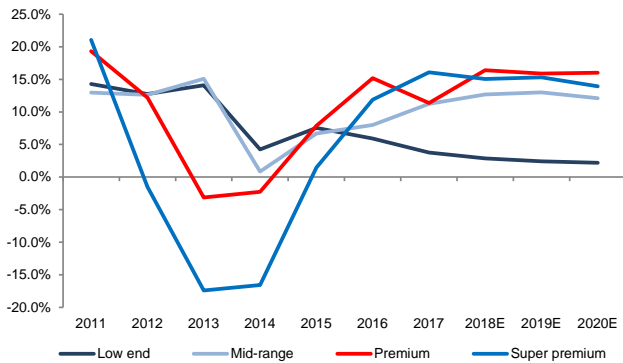
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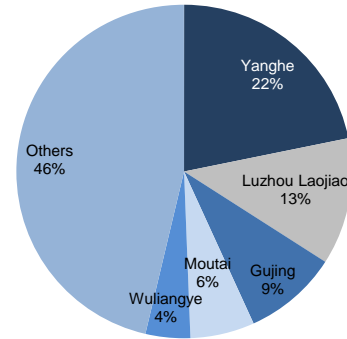
# Key investment thesis

Figure 1: Premium liquor to have the highest growth in Baijiu



Source: Deutsche Bank estimates, Euromonitor

Figure 2: Yanghe is the No.1 player in the premium segment by market share (2017 sales)



Source: Deutsche Bank, Euromonitor

Figure 3: Yanghe has strong sales force and distribution network

Company	Number of Salesperson	Number of Distributors
Moutai	684	3,083
Wuliangye	576	1,131
Luzhou Laojiao	588	4 major sales companies
<b>Yanghe</b>	<b>5,036</b>	<b>over 8000</b>
Fen Wine	1,058	1,268
Yingjia	828	1534
Kouzi	582	307
Kings' Luck	561	713
Swellfun	322	48

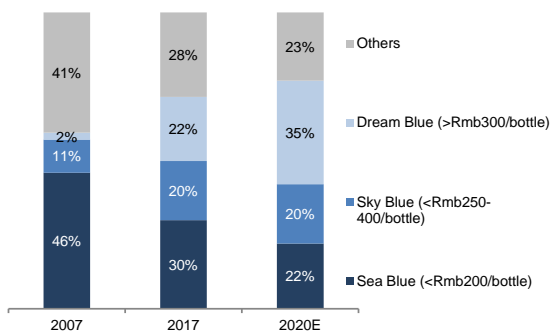
Source: Deutsche Bank, company annual reports; note: Luzhou Laojiao: Cooperate with major distributors to set up 4 sales companies with over 8000 salespersons

Figure 4: Yanghe has built a strong branding

Rank	Brands	Brand Value (USDm)
1	Moutai	11,548
2	Johnnie Walker	4,548
3	<b>Yanghe</b>	<b>4,281</b>
4	Jack Daniel's	3,055
5	Hennessy	2,711
6	Luzhou Laojiao	2,509
7	Bacardi Limited	2,185
8	Smirnoff	2,033

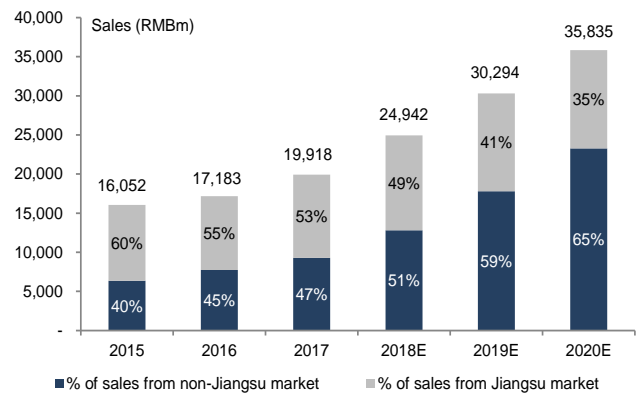
Source: Deutsche Bank, brandfinance.com

Figure 5: Mix upgrade to be key growth driver



Source: Deutsche Bank estimates, baidu.com, jianniang.com, tjcx.com

Figure 6: Regional expansion to be another growth driver



Source: Deutsche Bank estimates, company financial reports

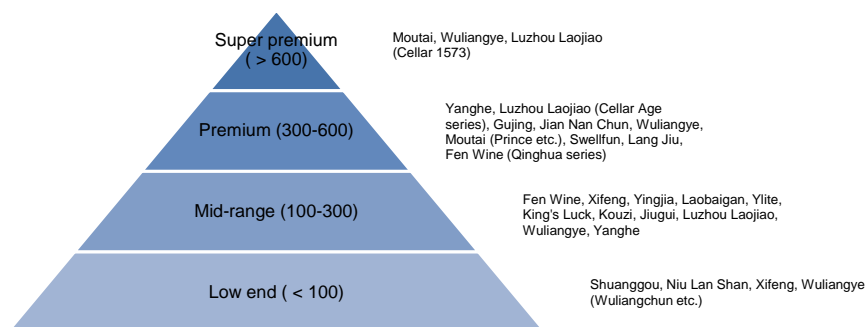


# Premium liquor: fast growing and improving consolidation

## Industry to witness a 16% CAGR in 2018-20E

Liquor brands are normally categorized into four categories based on retail prices: low end, mid-range, premium, super premium, with per bottle/500ml price at <RMB100, RMB100-300, RMB300-600, and >RMB600 respectively (Figure 7). According to Euromonitor, **the market size of the premium segment will register a 16% sales CAGR in the next three years, the highest among all categories (Figure 11).**

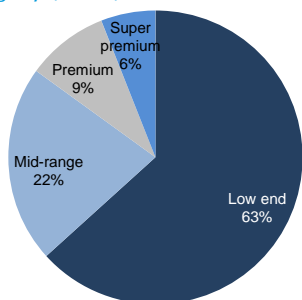
Figure 7: Major brands in each category



Source: Deutsche Bank, Euromonitor

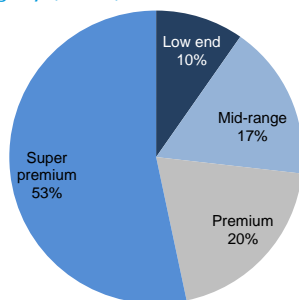
**Key driver of premium segment is growing income of middle-class consumers.** Consumers are trading up for better quality liquor and brands, especially during social events such as marriage celebrations and gatherings. Meanwhile, due to the expanding poverty-rich gap, the trade-up trend is more prevalent in the premium and super-premium segments than in the low-end segment. Lastly, the premium segment has good branding and reasonable prices – “Feitian Moutai” is priced at RMB1,800, which is still overly expensive even for high income individuals.

Figure 9: Liquor sales volume by category (2017)



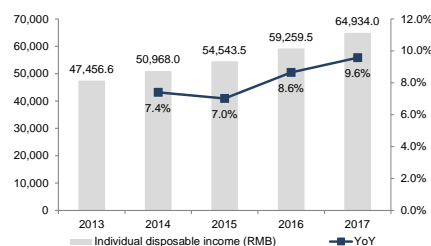
Source: Deutsche Bank, Euromonitor

Figure 10: Liquor sales value by category (2017)



Source: Deutsche Bank, Euromonitor

Figure 8: Individual disposable income of top 20% population in China



Source: Deutsche Bank, NBS

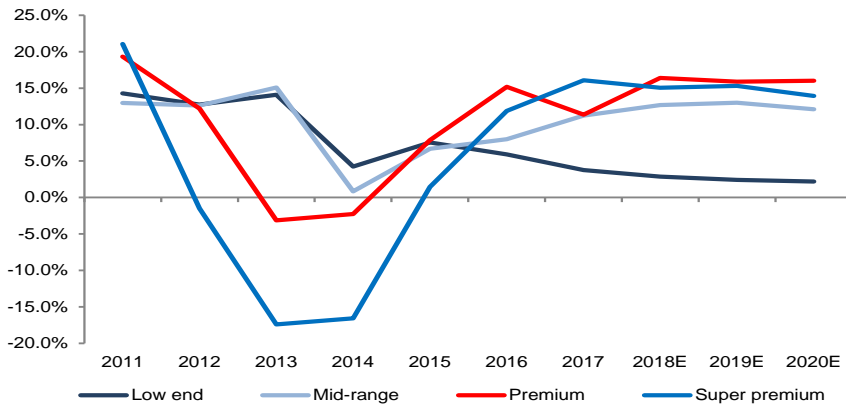
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Figure 11: China liquor sales growth by segment



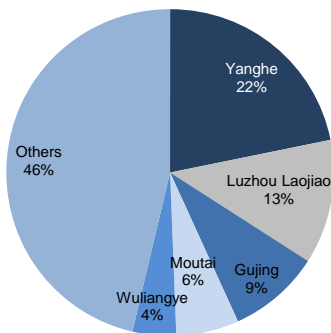
Source: Deutsche Bank, Euromonitor

### Industry consolidation to accelerate

While the super-premium segment is highly concentrated (dominated by Moutai, Wuliangye and Luzhou Laojiao), **the premium segment is still highly fragmented, with various local brands in each province.** Yanghe is the lead brand but with only a 30% volume share and a 22% value share in the premium segment. The top five brands occupied a value share of only 54% in 2017 (Figure 12).

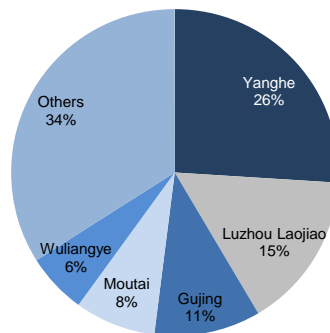
**We forecast consolidation in the premium segment to accelerate in the next few years.** First, consumers tend to buy better branded products aided by their increasing brand awareness. Second, leading brands' product availability are increasing with improved channel penetrations. Third, leading brands have better resources in advertisement and promotion with operating leverage. We forecast the market share of the top five brands will increase to 66% in 2020 from 54% in 2017.

Figure 12: Market share of premium segment by sales (2017)



Source: Deutsche Bank, Euromonitor

Figure 13: Market share of premium segment by sales (2020E)



Source: Deutsche Bank, Euromonitor

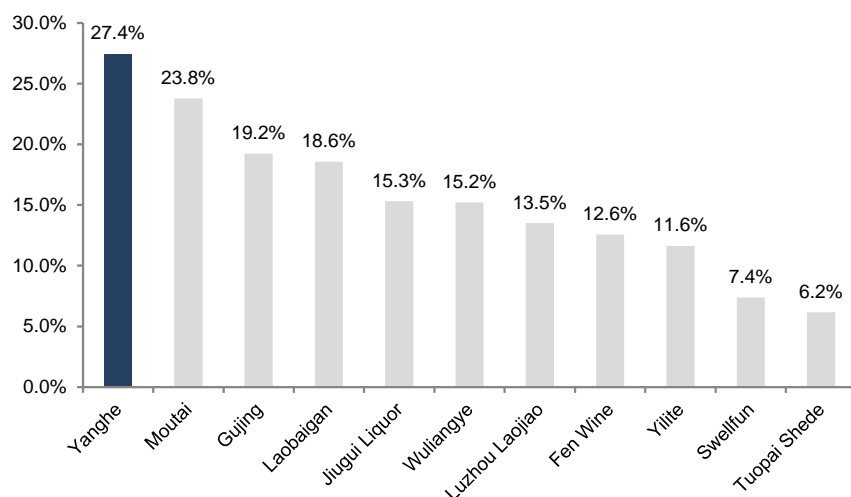


# Yanghe: a leader in the premium liquor segment

## Summary: outperforming peers in channels, branding and products

Yanghe is the largest player in the premium segment (priced at RMB300-600 per bottle) and the third-largest company by sales in China’s liquor industry. Its growth was the fastest among liquor name in 2007-17 (Figure 14). Yanghe derived more than 50% of sales from the premium segment in 2017. **Yanghe’s leading position in the premium segment is helped by its strong channels, good branding and diversified products.** We expect Yanghe to continue to consolidate the premium segment in the next three years.

Figure 14: 2007-17 Sales CAGR – Yanghe has the highest growth rate



Source: Deutsche Bank, company annual reports

## Channels: wide, flat and efficient

Different from most of its peers that have a long history, Yanghe’s main brand “Blue Classic”, which was launched in 2003, is a much younger make. For consumer companies with weaker brand awareness, channel penetration is usually adopted as a more straight forward method to push sales. As such, **Yanghe has been actively building its channels since the launch of “Blue Classic”.**

Different from traditional liquor companies which mainly rely on large distributors, Yanghe’s distributing model is more skewed towards that of large FMCG companies (CRB, Tingyi, and Yili). Under this model, Yanghe’s salespersons are closely involved in retail end promotions, penetrating and obtaining orders, while distributors are mainly responsible for basic functions –

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logistics and cash flow. It mainly uses the “KOL” model and the “4\*3” model (Figure 15).

Figure 15: Yanghe’s in-depth sales model

Products	Major sales Model	Detail
Mid to high-end products	KOL	Marketing in core restaurants and hotels
	4 x 3	Develop customers from core enterprises and companies through: - linking 3 parties (group customers, core restaurants and hotels, and media); - cooperation between 3 departments (KA department, hotel department, and branding department); - building 3 standards for distributor selection; - clarifying the 3 relations of responsibility, right and liability between company and distributors.
Low to middle end products	In-depth distribution	Cooperate with distributors to develop retail ends such as supermarkets and tobacco & alcohol stores.

Source: Deutsche Bank, Yanghe’s prospectus

For example, Yanghe has more than 350 salespersons in Anhui. Prior to 2015, it focused on city-level markets before expanding to county-level areas. In Hefei, it covers 70% of liquor specialty stores with more than 30 salespersons and 40 promoters. Meanwhile, it classifies retailers into three categories, i.e., flagship stores, key stores and ordinary stores based on location, traffic and demand. Salespersons conduct in-store advertisement and promotions of different magnitudes. Through these measures, it achieved sales of RMB1.7bn in 2017 in Anhui.

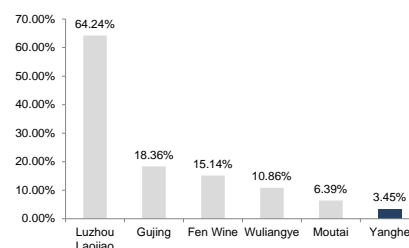
By the end of 2017, Yanghe had built a nationwide channel with over 5,000 salespersons, 8,000 distributors, and 30,000 ground promoters. This channel covers 33 provinces and municipalities, including 330 cities and 2,582 counties nationwide and boasting more than 2m of POS. Yanghe’s salesperson and distributor numbers are significantly higher than those of other leading liquor brands (Moutai, Wuliangye, Laojiao and Fen wine).

Figure 17: Yanghe has the highest number of salesperson and distributors among liquor names

	Number of Salesperson	Number of Distributors
Moutai	684	3,083
Wuliangye	576	1,131
Luzhou Laojiao*	588	4 major sales companies
<b>Yanghe</b>	<b>5,036</b>	<b>over 8000</b>
Fen Wine	1,058	1,268
Yingjia	828	1534
Kouzi	582	307
Kings’ Luck	561	713
Swellfun	322	48

Source: Deutsche Bank, 2017 company annual reports; note: Luzhou Laojiao: Cooperate with major distributors to set up 4 sales companies with over 8000 salespersons

Figure 16: Sales from top five clients – Yanghe has most diversified distributors



Source: Deutsche Bank, 2017 company annual reports

**Such in-depth distribution model helps Yanghe achieve high sales growth and react fast to retail ends.** This model enabled Yanghe to achieve a sales CAGR of 27% in 2007-17 (Figure 14), the highest growth among the liquor companies in China. Meanwhile, with a flat distribution network, Yanghe’s management is able to react fast to retail ends. For example, during the liquor sector’s de-stocking cycle in 2012-2014, Yanghe’s sales declined by 15%, whereas that of

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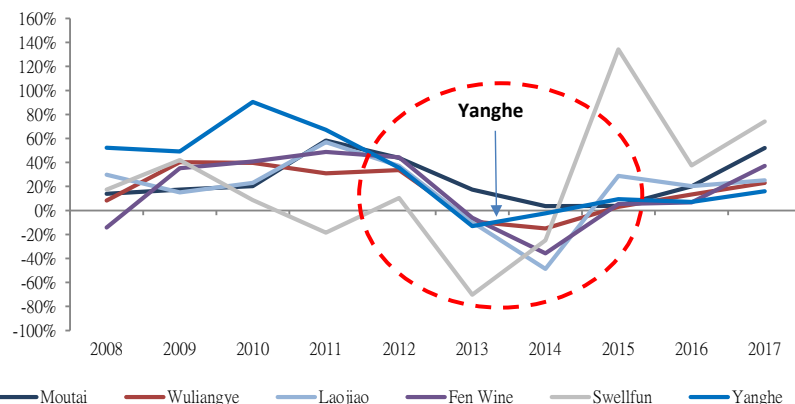
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Wuliangye, Laojiao, and Fen fared worse with declines of 23%, 54%, and 40%, respectively (Figure 18).

Figure 18: Major baijiu manufacturers' sales growth in 2007-2017



Source: Deutsche Bank

## Branding: well positioned and increasing awareness

Although Yanghe's main brand "Blue Classic" is relatively new -- launched in 2003 -- it has become a leading brand through niche positioning and efficient branding investment. Its key product "Blue Classic" series has the slogan "The sea is the world's largest, but the sky is deeper than the sea; yet men's sentiment is more profound than the sky" (世界上最宽广的是海，比海更高远的是天空，比天空更博大的是男人的情怀)". The slogan reflects Yanghe's "consumer-oriented" culture -- it aims to communicate directly with consumers and share the aspirations of consumers, whereas other premium liquor brands focus more on connecting their brand names with culture, patriotism and luxury. **This niche positioning differentiates Yanghe from other brands and enhance consumer awareness**, in our view.

Figure 19: Key slogans of major liquor names

Company	Key slogan
Yanghe	The sea is the world's largest, but the sky is deeper than the sea; yet men's sentiment is more profound than the sky. Yanghe Blue Classic, men's sentiment
Moutai	National liquor Moutai, champion of the liquor. 国酒茅台，玉液之冠。
Wuliangye	Wuliangye from China to the world. 中国的五粮液，世界的五粮液。
Luzhou Laojiao	Luzhou Laojiao, China's honor and pride. 中国荣耀，泸州老窖。
Fen Wine	Start noble life, China liquor spirit. 开启尊贵生活，中国酒魂。
Gujing Distillery	Meeting distinguished friends in parties and drinking Gujing Gong liquor with confidants. 高朋满座喜相逢，酒逢知己古井贡。
Swellfun	The first liquor distillery in China. 第一坊。

Source: Deutsche Bank, company websites, baidu.com

Meanwhile, the "Blue Classic" brand awareness has continued to improve, helped by the company's high A&P spending and efficient usage. Yanghe spent RMB1.2bn in 2017 on A&P expense, lower than that for its super-premium brand but higher than all other premium brands (Figure 20). It displays the brand in various out-door areas. It sponsors various TV programs



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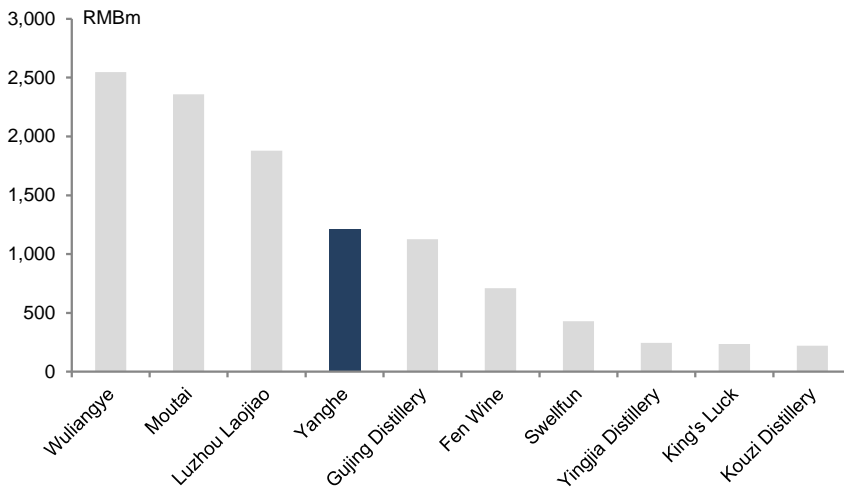
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and public events to enhance brand awareness, such as the G20 Hangzhou Summit in 2016, the “Chinese Football Association Super League” in 2017, and the Shanghai Cooperation Qingdao Summit in 2018. In Jiangsu, Yanghe’s logo can be seen in many places, such as expressways, bus stations, office buildings and shopping malls.

Figure 20: A&P expense: Yanghe’s A&P expense is higher than other premium peers



Source: Deutsche Bank, company annual reports

Figure 21: Major TV program/events that Yanghe sponsored

Time	Major TV program/events
Dec-09	Yanghe "Dream Blue" was designated by APEC Singapore 2009 Summit.
2010-2013	Sponsored CCTV Young Singers Grand Prix.
Sep-15	Title sponsored the CCTV Live of the military parade marking the 70th anniversary of the victory of the Anti-Japanese War.
Sep-16	Yanghe "Dream Blue" was authorized the title of "G20 Hangzhou Summit Selected Products".
Nov-16	Yanghe "Dream Blue" was designated by Third World Internet Conference.
2017	Sponsored 2017 Chinese Football Association Super League.
May-17	Yanghe "Dream Blue" was served in Belt and Road Forum for International Cooperation.
Jun-18	Yanghe "Dream Blue M9" was designated by Shanghai Cooperation Qingdao Summit.

Source: Deutsche Bank, company annual reports, baidu.com

**In our view, the “Yanghe” brand has grown to become a top premium brand.** It had similar rankings as Moutai and Wuliangye in “BrandZ top 100” and “Brand Finance Spirits 50” in 2017-18, outperforming other mid- to high-end peers such as Fen Wine, Gujing Distillery and King’s Luck in terms of brand value.

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Figure 22: Yanghe's brand ranking – only behind Moutai

China liquor brands in the BrandZ China Top 100 (2018)			Top 10 of Brand Finance Spirits 50 (2017)		
Rank	Brands	Brand Value (USDm)	Rank	Brands	Brand Value (USDm)
7	Moutai	23,175	1	Moutai	11,548
46	Wuliangye	2,192	2	Johnnie Walker	4,548
49	Yanghe	2,030	3	Yanghe	4,281
56	Luzhou Laojiao	1,766	4	Jack Daniel's	3,055
66	National Cellar 1573	1,021	5	Hennessy	2,711
84	Gujing Gong Jiu	604	6	Luzhou Laojiao	2,509
			7	Bacardi Limited	2,185
			8	Smirnoff	2,033
			9	Wuliangye	1,975
			10	Absolut.	1,759

Source: Deutsche Bank, brandz.com, brandfinance.com

## Products: less inherited, but more innovative

**Yanghe's products are innovative, which fits the changing demand trend of consumers.** Moutai and Wuliangye's flagship products "Feitian Moutai" and "Wuliangye crystal bottle" have maintained consistent tastes – almost unchanged for more than 50 years. However, Yanghe's "Blue Classic" series is evolving as it specifically designs its products to meet consumer taste preferences. Yanghe underwent 4,325 of consumer tasting tests before it launched the "Blue Classic" series in 2003. Based on the tasting results, it positions "Blue Classic" as a mellow taste beverage, with a specifically sweet, mellow, soft, clear and fragrant taste. This differs from traditional liquor that focuses on aroma.

**Some investors argue Yanghe's innovative beverages do not offer as much moat as that of traditional brands, but we believe this is necessary for long-term growth** (similar for other FMCG products). Consumer tastes evolve over years. For example, 'yellow' wine was a mainstream alcoholic drink during the Qing Dynasty and in the early 20th century. This changed to baijiu after 1949. We believe liquor companies need to keep their product tastes updated to see sustainable growth. **Yanghe's culture of innovation should make it more resilient to changing consumer tastes in the long term.**

**"Weifenzi" is another example of innovation.** Low alcohol content baijiu is now a trend due to consumers' growing health consciousness. According to the Ministry of Commerce, consumers in higher-income regions (such as Guangdong and Jiangsu) prefer low-alcohol baijiu. Accordingly, Yanghe launched 'Weifenzi' baijiu to meet this trend in 2014. "Weifenzi" is a low-alcohol baijiu but tastes the same as a high-alcohol baijiu. The low-alcohol baijiu contains nucleotides analogues, which protects the liver. Although 'Weifenzi' has not contributed meaningful sales, it is a good trial and reflects Yanghe's innovation culture.

Figure 23: Yanghe's SKUs: a diversified product portfolio

Series	Chinese	Products	Alcohol Content	Volume (ml)
Dream Blue	梦之蓝	M1, M3, M6, M9, Shou Gong Ban	40.8° · 45° · 52°	100, 500
Sea Blue	海之蓝	Sea Blue	42° · 52°	375, 480, 500, 520, 1000
Sky Blue	天之蓝	Sky Blue	42° · 52°	375, 480, 500, 520, 1000
Sujiu	苏酒	Shuanggou Sujiu (Pu Su), Shuanggou Mianrou (Lv Su)	40.8° · 42°	480, 500
Yanghe	洋河	Lande Youhuo, Qingci, Lanci, Qiongliang, Daqu	42° · 52° · 55°	100, 375, 480, 500
Rouhe Shuanggou	柔和双沟	Gold, Silver, Red	42°	450
Weifenzi	微分子	No Alarm, V KE, V, v	33.8° · 43.8°	500
Sui Gao Yao	掣高邈	Sui Zhi Lan, Gao Zhi Lan, Yao Zhi Lan	40.8° · 42°	500
Shuanggou Zhenbaofang	双沟珍宝坊	Shuanggou Liqian, Difang, Shengfang, Junfang	41.8° · 42°	500
Yanghe Lao Zi Hao	洋河老字号	Zitan, Hongtian, Jintan, Youqu, Touqu, Tequ	42°	500
Shuanggou Daqu	双沟大曲	Da Qing Hua, Xiao Qing Hua	42°	480

Source: Deutsche Bank, company website

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# Resilient growth with high visibility

**Summary: new regions, product mix upgrades, and new category to drive growth**

Although Yanghe has become the third-largest liquor company by sales, its major sales is still derived from Jiangsu. It also derives around 50% of sales from mid-range products. We see a great potential for Yanghe to achieve sales growth through geography expansion and product mix upgrades. More importantly, it has high growth visibility, as we believe Yanghe can easily replicate the successful experience in Jiangsu in other regions. We forecast a 22% sales CAGR in 2018-20E.

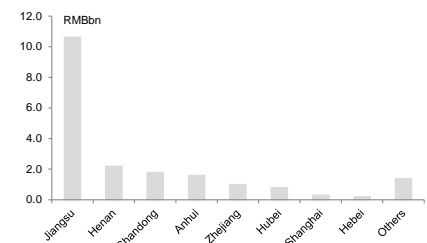
## Geography: penetrating from Jiangsu to new Jiangsu

Yanghe is headquartered in Suqian, a city in Jiangsu. It derived 53% of sales from Jiangsu in 2017. Following its success in increasing penetration in Jiangsu, management is now allocating more resources to other provinces. **It targets to increase the sales portion from non-Jiangsu markets to 70% in 2020, implying the non-Jiangsu segment could grow at least 30% faster than the Jiangsu region.**

**Yanghe's focused markets are mainly in regions closed to Jiangsu, including Shandong, Henan, Anhui, Zhejiang and Hubei.** These regions have sizable market potential while competition is not as intensive as that in traditional liquor regions such as Sichuan and Guizhou. Except in Anhui and Zhejiang, there are no listed liquor brands in these regions and local liquor names mostly focus on the mid- to low-end categories. These regions have a total population of 374m, which is 4.6 times of Jiangsu, and the overall per cap income is similar to Jiangsu's (Figure 25).

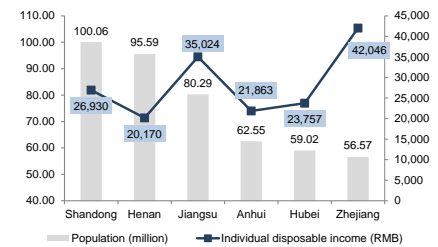
**Yanghe launched a "new Jiangsu market" strategy to expand its new market in 2014.** The strategy refers to potential markets in county and city levels that could contribute meaningful revenue (annual sales should be over RMB8m for county-level markets and over RMB15m for city-level markets). Until 1Q18, there were 495 "new Jiangsu markets" which contributed 70% of Jiangsu revenue. According to management, it will replicate its successful model in Jiangsu in the new Jiangsu markets.

Figure 24: Sales by province (2017)



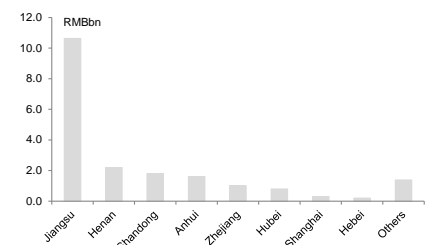
Source: Deutsche Bank, company annual reports

Figure 25: New regions' population and per cap income



Source: Deutsche Bank, Wind

Figure 26: Sales by province (2017)



Source: Deutsche Bank, company annual reports

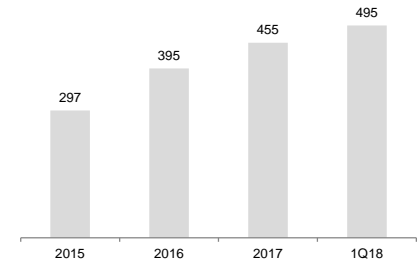
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Considering Yanghe’s strong branding, channel operation and diversified products, we believe the strategy will be successful. On branding, Yanghe’s “Blue classic” has better brand awareness than most local brands in the premium segment, and it is able to spend higher advertisement dollars in future, helped by its large scale. On channel, Yanghe’s successful experience in in-depth model, channel profit allocation and execution could be replicated in new regions. On product, given its key products are from the mid-range to premium segments, we believe Yanghe has flexibility to penetrate into new markets based on local consumption.

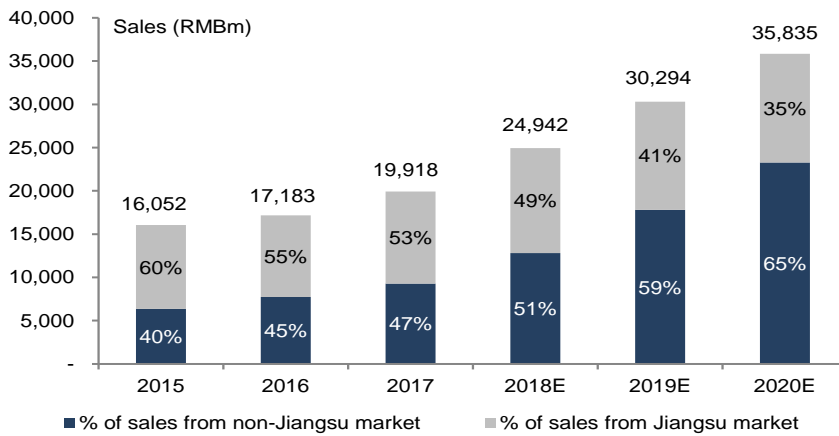
We forecast Yanghe’s sales from non-Jiangsu markets will record a 36% CAGR from RMB9.3bn in 2017 to RMB23.3bn in 2020, and expect this to contribute 65% of its total sales in 2020.

Figure 27: Number of new Jiangsu markets



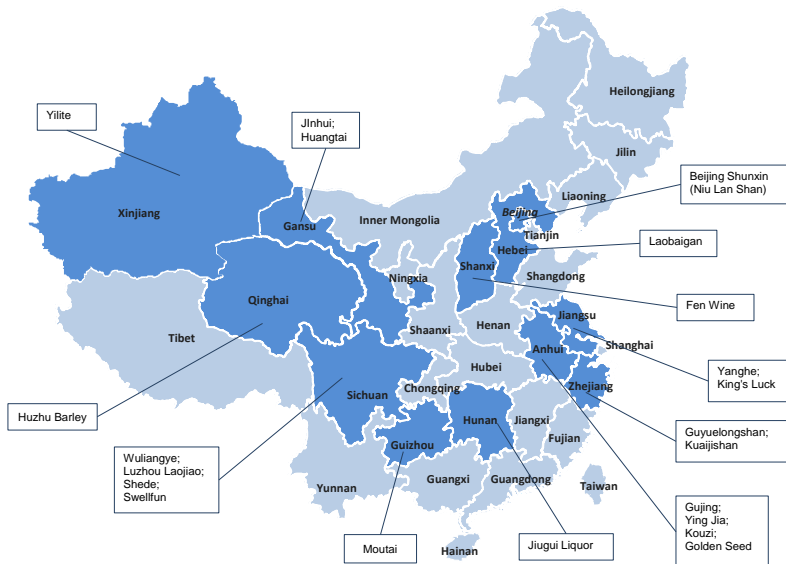
Source: Deutsche Bank, company meeting notes, baidu.com

Figure 28: Sales of non-Jiangsu markets – to increase from 47% in 2017 to 65% in 2020E



Source: Deutsche Bank estimates, company annual reports

Figure 29: Listed baijiu companies by province (PRC)



Source: Deutsche Bank, Wind



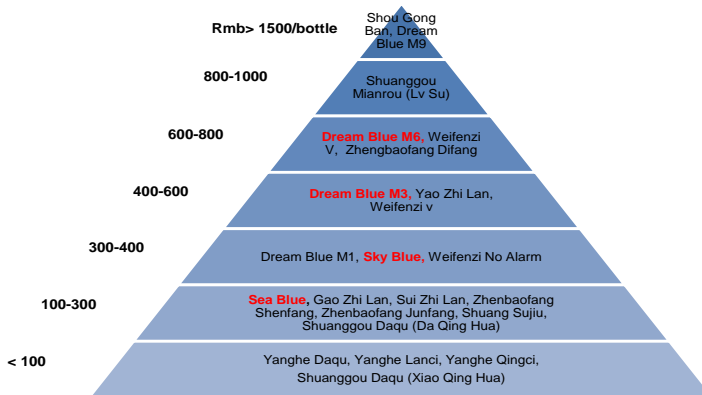
## Product mix: moving up from mid-range to premium segment

Yanghe has a diversified product portfolio, comprising mid-range, premium and super-premium, with “Sea Blue”, “Sky Blue”, and “Dream Blue M3” priced at RMB150, RMB300, and RMB500 (all with a 52% alcoholic content) respectively. It also has super-premium SKUs such as “Dream Blue M9” and “Dream Blue Shou Gong Ban” priced at RMB1,699 and RMB1,788 respectively (Figure 30). In 2017, “Sea Blue”, “Sky Blue”, and “Dream Blue” accounted for 30%, 20% and 22% of total sales respectively.

Yanghe’s historical growth indicates a mix upgrade trend. Yanghe’s key products “Dream Blue”, “Sky Blue” and “Sea Blue” are positioned as premium, mid-premium and mid-range, respectively (Figure 30). Its sales growth was driven, in order, by “Sea Blue” from 2004 (80% CAGR in 2004-11), “Sky Blue” from 2008 (70% in 2008-12), and “Dream Blue” from 2017 (50% yoy in 2017).

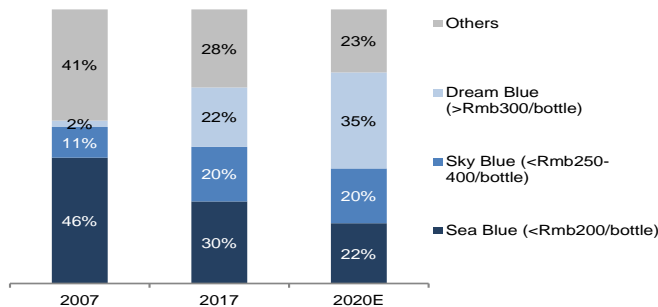
Sales contributions from “Sea Blue” declined from 46% in 2007 to 30% in 2017 and from “Dream Blue” increased from 2% in 2007 to 22% in 2017. We forecast the sales portion of “Dream Blue” will continue to increase to 35% in 2020.

Figure 30: Major products in different price range



Source: Deutsche Bank; note

Figure 31: Sales proportion from major Yanghe brands



Source: Deutsche Bank, baidu.com, jianning.com, tjlx.com

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**For the next three year, we expect the premium segment to be the fastest growing category for Yanghe:**

- Consumers' growing income continues to drive premium products demand. Our channel checks indicate that the mainstream price range for social dining in south Jiangsu has moved up to over RMB300-500 from RMB100-300 before 2016.
- Yanghe is pushing premium products through allocating more A&P expense and providing more channel incentives. Meanwhile, as Yanghe's "Sea/Sky/Dream" series are sub brands of "Blue classic", consumers could easily move from "Sea" to "Sky", and from "Sky" to "Dream" when they have a higher budget.
- The retail price hikes of super-premium brands Moutai, Wuliangye and Guojiao 1573's since 2017 should result in lesser competition for premium products.

**We forecast Yanghe's sales proportion from "Dream Blue" to increase from 20% in 2017 to 35% in 2020.** This will contribute RMB8bn incremental sales from 2017 and lead to a 2ppt gross margin expansion in 2017-20E.

**Strong balance sheet supports long-term diversification**

In its 2017 annual report, Yanghe indicated its aspiration to become a leading company in the alcohol industry, implying it will not limit its sales to the current category of aromatic flavor liquor. True to its words, it acquired 12.5% interest in VSPT Group, the second-largest wine brand in Chile, in 2018.

We have not factored in potential growth of these new categories, as management remains focused on growth from its new Jiangsu markets and product mix upgrades in the near term. However, we see long-term growth potential for Yanghe. With RMB16bn of cash/finance asset on book, Yanghe could continue to expand through M&As in the long term.

**Figure 32: Yanghe's major M&As**

Time	Major M&A items
Apr-10	Acquired a 40.6% stake in Shuanggou Distillery at a consideration of RMB536m.
Jan-11	Acquired the remaining 59.4% stake in Shuanggou Distillery. Then Shuanggou Distillery became a wholly-owned subsidiary of Yanghe.
Mar-13	Acquired Hubei Lihuachun Distillery for RMB3m.
Dec-14	Invested RMB30m for a 10% stake in Suning Consumer Finance Company.
Jan-14	Acquired a 100% stake in Ningxiang Guluochun Distillery at a consideration of RMB2m.
Mar-14	Acquired a 100% stake in Haerbin Binzhou Distillery at a consideration of RMB2m.
Jun-16	Acquired Guizhou Gui Jiu 100% equity at a consideration of about RMB190m.
Aug-17	Acquired Guizhou Welcome Drink 100% equity.
Jan-18	Acquired a 12.5% stake in VSPT at a consideration of USD66m.

Source: Deutsche Bank, company annual reports



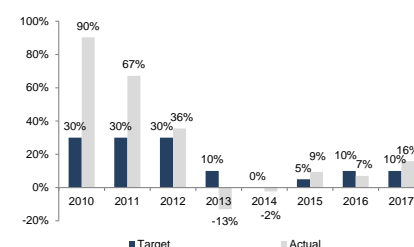
# Financial forecast

## 2018E: 25% sales growth and 28% earnings growth

We forecast Yanghe to report 25% sales growth in 2018, driven by: 1) 10% volume growth, mainly contributed by its non-Jiangsu market expansion and stable volume in Jiangsu; and 2) an estimated 13% ASP increase due to product mix upgrades and price hikes in 1Q and 3Q. Management has guided for 20% sales growth in 2018 (its historically growth has outperformed its guidance in the past, except in 2013-14) (Figure 33).

We forecast Yanghe to report 28% earnings growth in 2018, with 70bps yoy net margin improvement. This is driven by an estimated 30bps gross margin expansion helped by ex-factory price hikes and product mix change, and an estimated 140bps decline in SG&A/sales benefited from operation leverage. Our 2018 forecast implies 24% sales growth and 27.7% earnings growth in 2H18.

Figure 33: Sales growth target vs actual



Source: Deutsche Bank, company annual reports

## 2019-20E: 20% sales CAGR and 22% earnings CAGR

We forecast a 20% sales CAGR for Yanghe from RMB24.9bn in 2018 to RMB35.8bn in 2020, mainly driven by:

- 10.5% volume CAGR over the same period, helped by a CAGR of over 30% in non-Jiangsu markets and likely flat growth in the Jiangsu province.
- 9% ASP CAGR over the same period, a result of continued product mix upgrades and higher sales proportion from non-Jiangsu markets, where the ASP is usually higher than that in Jiangsu due to different product mix.

We expect Yanghe's net margin to expand from 34% in 2018 to 35.4% in 2020, driving net profit to register a 22.3% CAGR, from RMB8.5bn in 2018 to RMB12.7bn in 2020E. The margin expansion is attributable to a likely 150bps improvement in gross margin and a 50bps saving in SG&A.

For cash conversion cycle, we estimate its inventory turnover days will continue to decline from 584 days in 2017 to 520 days in 2020, helped by improved inventory management. We expect the number of AR turnover days to maintain stable at 3, while AP days to return to its long-term average of more than 100.

Figure 34: Cash conversion cycle

Cash conversion Cycle	2015	2016	2017	2018E	2019E	2020E
Inventory days	610	654	584	550	530	520
AR days	2	3	4	3	3	3
AP days	162	134	67	80	100	115
<b>Cash conversion days</b>	<b>451</b>	<b>523</b>	<b>521</b>	<b>473</b>	<b>433</b>	<b>408</b>

Source: Deutsche Bank. Note: All the turnover days are calculated on the average balance. AR days are based on sales, AP and inventory days are based on the total of cost and taxes and surcharges.

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Figure 35: Key ratios

(RMBm)	2017	2018E	2019E	2020E
<b>YoY</b>				
Sales	15.9%	25.2%	21.5%	18.3%
Gross profit	13.3%	25.8%	23.0%	19.7%
EBIT	13.7%	28.3%	23.1%	20.0%
Net profit	13.7%	27.9%	23.9%	20.7%
<b>Margins (%)</b>				
GP Margin	60.7%	61.0%	61.7%	62.5%
SG&A/Sales	19.7%	18.3%	18.0%	17.8%
EBIT Margin	44.3%	45.3%	46.0%	46.6%
Net margin	33.3%	34.0%	34.7%	35.4%
<b>Total asset turnovers</b>				
Total asset (times)	0.5	0.5	0.5	0.5
AR days	4.1	3.5	3.5	3.4
AP days	61.2	189.0	162.7	234.5
Inventory days	702.6	987.0	875.1	938.8
<b>Gearing (%)</b>				
Net debt/equity	-5.9%	-18.8%	-31.0%	-41.4%
Asset/equity	146.7%	152.8%	148.0%	150.5%
<b>Return</b>				
ROA	16.2%	17.8%	18.9%	19.5%
ROE	23.9%	26.6%	28.3%	29.2%

Source: Deutsche Bank estimates, company annual reports

Figure 36: Income statement

(RMBm)	2017	2018E	2019E	2020E
<b>Revenue</b>	<b>19,918</b>	<b>24,942</b>	<b>30,294</b>	<b>35,835</b>
Less: Cost of sales	(6,681)	(6,093)	(7,169)	(8,223)
Less: Sales tax	(1,152)	(3,642)	(4,423)	(5,232)
<b>Gross profit</b>	<b>12,085</b>	<b>15,207</b>	<b>18,702</b>	<b>22,380</b>
Less: Selling expense	(2,387)	(2,777)	(3,312)	(3,847)
Less: G&A	(1,532)	(1,794)	(2,149)	(2,519)
Less: Impairment	(23)	(10)	(10)	(10)
Add: Investment income	624	625	625	625
Add: Non operating income	48	60	72	86
<b>EBIT</b>	<b>8,814</b>	<b>11,311</b>	<b>13,928</b>	<b>16,716</b>
Less: Finance cost	34	32	125	245
<b>Profit before tax</b>	<b>8,848</b>	<b>11,343</b>	<b>14,054</b>	<b>16,960</b>
Less: income tax	(2,229)	(2,858)	(3,541)	(4,273)
Less: MI	8	(8)	(11)	(13)
<b>NPAT</b>	<b>6,627</b>	<b>8,477</b>	<b>10,502</b>	<b>12,675</b>

Source: Deutsche Bank estimates, company annual reports

Figure 37: Balance sheet

(RMBm)	2017	2018E	2019E	2020E
<b>Current assets</b>				
Cash and cash equivalents	1,751	6,419	12,389	19,398
Trade and bills receivables	278	429	397	580
Prepayments	87	107	124	144
Inventories	12,862	16,476	17,188	21,149
Other current assets	13,549	13,549	13,549	13,549
<b>Subtotal</b>	<b>28,527</b>	<b>36,980</b>	<b>43,646</b>	<b>54,820</b>
<b>Non-current assets</b>				
PPE	8,484	8,518	8,828	9,089
Goodwill	276	276	276	276
Intangible assets	1,654	1,684	1,702	1,699
Available-for-sale financial assets	3,460	3,460	3,460	3,460
Other non-current assets	858	1,258	1,258	1,258
<b>Subtotal</b>	<b>14,732</b>	<b>15,196</b>	<b>15,524</b>	<b>15,781</b>
<b>Total assets</b>	<b>43,258</b>	<b>52,176</b>	<b>59,170</b>	<b>70,602</b>
<b>Current liabilities</b>				
Trade and bills payables	6,740	9,338	9,996	12,763
Advances from customers	4,200	5,877	6,362	8,116
Taxes and surcharges payable	2,290	2,290	2,290	2,290
Other current liabilities	210	210	210	210
<b>Subtotal</b>	<b>13,439</b>	<b>17,715</b>	<b>18,857</b>	<b>23,378</b>
<b>Non-current liabilities</b>				
Long-term loans	0	-	-	-
Payables for specific projects	199	199	199	199
Deferred income	107	107	107	107
Other non-current liabilities	18	18	18	18
<b>Subtotal</b>	<b>325</b>	<b>324</b>	<b>324</b>	<b>324</b>
<b>Total liabilities</b>	<b>13,763</b>	<b>18,039</b>	<b>19,182</b>	<b>23,703</b>
<b>Equity</b>				
Share capital	1,507	1,507	1,507	1,507
Reserves	28,008	32,642	38,482	45,380
MI	(20)	(12)	(1)	12
<b>Total equity</b>	<b>29,495</b>	<b>34,137</b>	<b>39,988</b>	<b>46,899</b>

Source: Deutsche Bank estimates, company annual reports

Figure 38: Cash flow statement

(RMBm)	2017	2018E	2019E	2020E
<b>Cash flows from operating activities</b>				
Profit before tax	8,848	11,343	14,054	16,960
Finance cost	12	-	-	-
D&A	690	777	816	881
Impairment	23	10	10	10
Income tax	(2,229)	(2,858)	(3,541)	(4,273)
Working capital changes	236	480	437	346
Other changes	(696)	0	(0)	-
<b>Subtotal</b>	<b>6,883</b>	<b>9,752</b>	<b>11,776</b>	<b>13,924</b>
<b>Cash flows from investing activities</b>				
Capital expenditure	(325)	(848)	(1,151)	(1,147)
Net cash outflow on acquisition of subsidiaries/business	(1)	(400)	-	-
Other changes	(3,835)	7	7	8
<b>Subtotal</b>	<b>(4,161)</b>	<b>(1,241)</b>	<b>(1,144)</b>	<b>(1,139)</b>
<b>Cash flows from financing activities</b>				
Changes in bank borrowing	(0)	(0)	-	-
Equity financing	-	-	-	-
Dividend paid	(3,169)	(3,843)	(4,662)	(5,776)
Other changes	(248)	0	-	-
<b>Subtotal</b>	<b>(3,417)</b>	<b>(3,843)</b>	<b>(4,662)</b>	<b>(5,776)</b>
<b>Cash and bank</b>				
Beginning	2,457	1,751	6,419	12,389
Net changes	(695)	4,668	5,970	7,009
Impact from exchanges	(12)	-	-	-
Bank overdrafts	2	-	-	-
Ending	1,751	6,419	12,389	19,398

Source: Deutsche Bank estimates, company annual reports





# Valuation and risks

## Initiating with Buy; TP at RMB150

We use a DCF methodology to derive our 1-year target price of RMB150, factoring in 9.5% WACC (3.9% risk free rate, 5.6% equity risk premium, 1.0x beta, debt free structure) and 2% terminal growth, which is in line with other staple companies under our coverage. The methodology is same with most staple companies under our coverage, and we think the company's future cash flow has enough visibility. **We initiate with Buy.**

Our 1-year target price implies an 18x 2020E PE, or a 0.65x PEG based on its net profit CAGR at 24% in 2018-20E. This is in line with other listed baijiu peers at PEG of 0.64. The target PE is also in line with Yanghe's average of 17x forward P/E in the past nine years. Meanwhile, given Yanghe has better visibility compared to a few years ago, a national distribution network and a well-established branding, we think it is fair to trade at higher valuations.

Figure 39: DB forecast vs consensus

RMBm	DB forecast			Consensus			Difference		
	2018E	2019E	2020E	2018E	2019E	2020E	2018E	2019E	2020E
Gross sales	24,942	30,294	35,835	24,646	29,479	34,877	1.2%	2.8%	2.7%
Net profit	8,477	10,502	12,675	8,397	10,322	12,409	0.9%	1.7%	2.1%

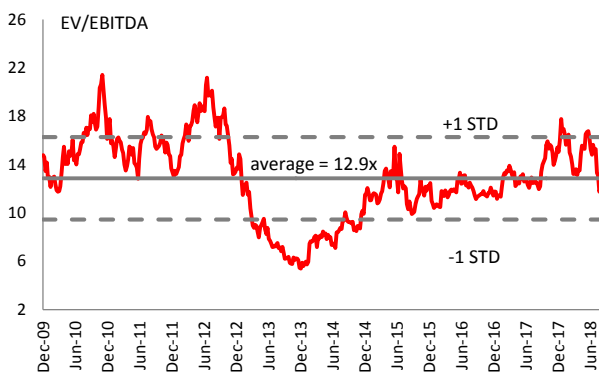
Source: Deutsche Bank

Figure 40: Sensitivity test

WACC	Long-term growth	1.0%	1.5%	2.0%	2.5%	3.0%
		7.5%	184	193	204	217
8.5%	159	165	173	181	191	
9.5%	141	145	150	156	163	
10.5%	126	129	133	137	142	
11.5%	114	117	119	122	126	

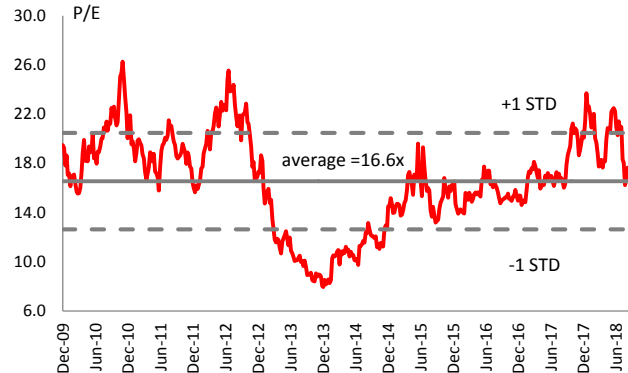
Source: Deutsche Bank

Figure 41: 1-year forward EV/EBITDA



Source: Deutsche Bank, Bloomberg

Figure 42: 1-year forward PE



Source: Deutsche Bank, Bloomberg

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Figure 43: Peer comparison

Company	Ticker	Recom	Listing Curr	Price	Mkt Cap US\$m	PE (x)			PB (x)			EV/EBITDA			Div Yield (%)			PEG		
						Hist	FY1Y	FY2Y	Hist	FY1Y	FY2Y	Hist	FY1Y	FY2Y	Hist	FY1Y	FY2Y	Hist	FY1Y	FY2Y
Jiangsu Yanghe	002304.SZ	Buy	CNY	105.00	23,336	20.2	18.7	15.1	5.8	4.6	4.0	15.0	13.3	10.4	2.90	2.90	3.70	1.47	0.67	0.63
Kweichow Moutai	600519.SS	Buy	CNY	630.00	116,447	22.2	21.8	18.6	9.6	6.9	5.8	14.0	13.7	11.3	2.30	2.49	2.92	0.36	0.64	1.06
Wuliangye Yibin	000858.SZ	Buy	CNY	59.65	33,993	20.8	16.9	13.1	5.7	3.7	3.1	12.5	9.9	7.2	2.51	3.09	3.99	0.49	0.44	0.45
Luzhou Laojiao	000568.SZ	NR	CNY	40.83	8,729	36.7	17.3	13.6	6.4	3.5	3.1	26.4	11.4	9.1	3.05	3.61	4.60	1.20	0.49	0.52
Shanxi Fen Wine	600809.SS	NR	CNY	43.80	5,557	52.3	24.6	18.2	9.4	5.9	4.8	32.1	16.2	12.4	1.36	1.77	2.37	0.93	0.38	0.52
Gujing Distillery	000596.SZ	NR	CNY	71.99	4,754	28.8	23.4	17.8	5.1	4.7	3.8	19.1	12.6	10.1	1.38	1.49	1.91	0.75	0.56	0.63
Yingjia Distillery	603198.SS	NR	CNY	14.46	1,690	21.2	14.8	12.8	3.4	2.7	2.5	12.4	9.0	7.8	4.82	4.13	4.48	-8.84	1.28	0.97
Sichuan Swellfun	600779.SS	NR	CNY	37.53	2,682	68.2	28.7	19.2	14.5	9.3	7.2	46.4	20.6	13.6	1.64	2.24	3.36	1.38	0.31	0.39
Tuopai Shede	600702.SS	NR	CNY	25.75	1,269	109.6	24.2	16.2	6.3	3.1	2.7	62.4	15.5	10.1	0.17	0.81	1.17	1.39	0.16	0.33
Guyuelongshan	600059.SS	NR	CNY	7.13	844	47.0	32.2	25.9	1.9	1.4	1.4	22.8	15.3	12.9	1.39	1.67	1.95	1.36	2.23	1.32
Jiugui Liquor	000799.SZ	NR	CNY	18.12	862	50.6	22.1	14.9	4.4	2.8	2.5	34.0	12.4	8.6	0.82	1.12	1.43	0.81	0.38	0.32
Yilite	600197.SS	NR	CNY	17.35	1,111	29.2	16.2	12.9	4.8	2.9	2.4	17.6	NA	NA	1.44	1.50	1.79	1.06	0.55	0.49
<b>Average</b>						<b>42.2</b>	<b>21.7</b>	<b>16.5</b>	<b>6.4</b>	<b>4.3</b>	<b>3.6</b>	<b>26.2</b>	<b>13.6</b>	<b>10.3</b>	<b>1.98</b>	<b>2.24</b>	<b>2.81</b>	<b>0.20</b>	<b>0.68</b>	<b>0.64</b>

Source: Deutsche Bank, Bloomberg. Stock price is on 12 Sep 2018. We use DB forecasts for those companies we covered and Bloomberg consensus for other companies.

## Risks

### Food safety risk

Food safety is always a big concern for food & beverage companies. A food safety incident could harm the company's reputation, reduce its sales, and cause a collapse in stock prices. In November 2012, Jiu Gui Liquor reportedly had plasticizer contained in its products which was 2.6x higher than standards based on the test results of Shanghai Intertek. The incident caused the entire baijiu segment to witness a stock price collapse the next day. Although no baijiu companies were punished, if such incidents were to happen again, there would be adverse impacts on stock prices.

### Government policy change

Since the central government put forward an eight-point rule in 2012, local governments have implemented strict control on entertainment consumption of liquor. In 2017, several local governments tightened the regulation, with some banning liquor consumption. Although we have seen baijiu consumption moved from government to business entities, the government may still implement more adverse policies on baijiu consumption, which could lead to another de-stocking cycle.

### Consumer preference shift

Yanghe's major business is producing and selling baijiu. Due to consumers' increasing health consciousness and changing preferences, consumers may choose other beverages to replace baijiu, which could lead to an overall decline in the whole industry.

### Macro FAI slowdown

Macro fixed asset investment growth is correlated with FMCG consumption. A growth slowdown could dampen consumer confidence and consumption capability, leading to lower demand.



# Company background

## Company description.

Headquartered in Suqian, Jiangsu Province, Yanghe Brewery is a national large-scale liquor production enterprise in China with two major liquor brands “Yanghe” and “Shuanggou”. The company was established in 2002 by Yanghe Group and listed on the Shenzhen Stock Exchange in 2009. In 2017, Yanghe achieved total sales of RMB19.9bn, which ranked third in China’s liquor industry.

## Restructured to a mixed ownership from 2002

Yanghe is one of the few liquor companies that completed a mixed ownership reform at early stages. Its reform mainly included two stages:

- In 2002, Yanghe was established by Jiangsu Yanghe Group (100% controlled by the local government), six distributors, institutional investors, and 14 senior management members. Yanghe Group and management held 51.1% and 8.41% interest in Yanghe, respectively.
- In 2006, Yanghe issued new shares to Blue Sky Trading and Blue Sea Trading, both of which were owned by the management team. This diluted the local government’s stake to 38.61%, and the management team together held 30.79%.

In 2009, Yanghe completed its IPO and issued 45m new share priced at RMB60/share. After the IPO, the local government and management team’s (existing and old) stakes were diluted to 34.05% and 27.72%, respectively. Currently, the government and the management team own 34.16% and 22.63% (including the shareholding by Jiangsu Blue Alliance) equity of the company, respectively.

Yanghe’s mixed ownership reform is much earlier than most large listed liquor companies. The management team also has a higher stake in the listed company. (Figure 44). We believe mix ownership is the core reason for Yanghe’s entrepreneur culture, which leads to its innovative products, in-depth channel and highly efficient operations. We expect Yanghe’s growth to outperform its peers with this aligning management interest.

Figure 44: Major liquor companies’ mixed ownership reform

Company	Management shareholding	Mixed ownership reform progress
Yanghe	22.63%	Completed mixed ownership reform in 2006.
Moutai	0.00%	Under discussion
Wuliangye	0.01%	Completed private placement in April 2018
Luzhou Laojiao	0.04%	Completed private placement in Sep 2017
Fen Wine	0.02%	Introduced strategic investor China Resources Co. Ltd. in Feb 2018.

Source: Deutsche Bank, company annual reports. Shareholding data is based on the company’s 2017 annual report.

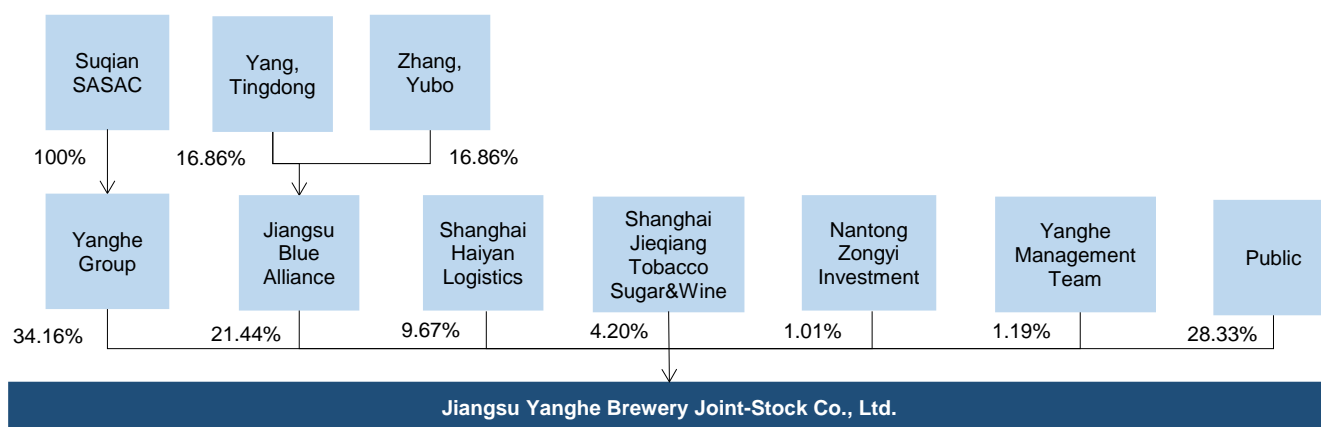
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Figure 45: Yanghe's shareholding structure



Source: Deutsche Bank, company financial reports. Shareholding data is based on the company's 1H18 report and 2017 annual report.

Figure 46: Company history

Year	Key milestones
1949	Yanghe Distillery was founded in July 1949.
May-97	Yanghe Distillery was restructured into Yanghe Group, wholly-owned by Suqian SASAC.
Dec-02	Yanghe Brewery was jointly established by Yanghe Group, six enterprises and 14 individuals.
2002	CEO Zhang Yubo put forth the concept of "mellow liquor", creating a new type of mellow liquor. In the same year, Yanghe was recognized as a national-level trademark.
2003	Launched Yanghe Blue Classic series.
2005	Shuanggou was recognized as a national-level trademark.
2008	Yanghe "Blue Classic" was recognized as a national-level trademark.
Nov-09	Yanghe Brewery was listed on the Shenzhen stock exchange.
Apr-10	Bought a 40.59% stake in Shuanggou Distillery from Suqian Guofeng Asset Management Co., for RMB536m.
Jun-10	Yanghe Brewery and Shuanggou Distillery jointly established Sujiu Industry.
Jan-11	Shuanggou Distillery became a wholly-owned subsidiary company of Yanghe.
2011	Yanghe's sales passed the RMB10bn mark, reaching RMB12.7bn. This made the company the first industrial enterprise in Suqian, and the third producer of baijiu in China to reach the RMB10bn threshold.
Mar-13	Acquired Hubei Lihuachun Distillery for RMB3m.
Apr-13	Mr Zhang Yubo resigned as CEO. Mr Wang Shoubin was appointed as the company's new CEO.
Jan-14	Acquired 100% stake in Ningxiang Guluochun Distillery for RMB2m.
Mar-14	Acquired 100% stake in Haerbin Binzhou Distillery for RMB2m.
May-14	Set up Jiangsu Kelite Biotechnology Research Institute Company for RMB10m.
Jul-14	Set up Sujiu Group Jiangsu Asset Management Co. for RMB200m.
Dec-14	Invested RMB30m for a 10% stake in Suning Consumer Finance Company.
Feb-15	Appointed Wang Yao as the new Chairman, replacing Zhang Yubo, who was appointed as Yanghe Group's Chairman. Also, the company appointed Zhong Yu as the new Managing Director, replacing Wang Shoubin, who was appointed as Yanghe Group's CEO.
Jun-16	Acquired Guizhou Gui Jiu 100% equity with a consideration of about RMB190m.
Nov-16	Yanghe was selected as "National Brands" by CCTV.
May-17	Launched "Dream Blue Handcraft Class" to target high-end customers.
Aug-17	Acquired Guizhou Welcome Drink 100% equity.

Source: Deutsche Bank, company website, company annual reports

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Figure 47: Management background

Name	Position	Age	Period of service	Profile
Wang Yao	Chairman	53	2015.2.10-2021.1.29	<ul style="list-style-type: none"> <li>• Master of engineer, MBA;</li> <li>• Senior Engineer of the researcher level;</li> <li>• Representative of the 19th National Congress of the Communist Party of China; Craft master of Chinese liquor.</li> </ul>
Zhong Yu	Deputy Chairman, President	54	2015.2.10-2021.1.29	<ul style="list-style-type: none"> <li>• Master Degree; Senior Engineer;</li> <li>• Master of Chinese liquor.</li> </ul>
Han Feng	Director	56	2015.2.10-2021.1.29	<ul style="list-style-type: none"> <li>• Master Degree;</li> <li>• Also Chairman and Secretary of the Party Committee of Suqian Industry Development Group Co., Ltd.;</li> <li>• Chairman, General Manager of YH Group and Jiangsu Shuanggou Group.</li> </ul>
Cong Xuenian	Director, VP, Secretary of the Board, CFO	52	2015.2.10-2021.1.29	<ul style="list-style-type: none"> <li>• Master Degree; Senior Economist;</li> <li>• Also chairman of Su Wine Fortune management Co., Ltd. and director of Blue Alliance.</li> </ul>
Zhou Xinhui	Director, VP, Chief Engineer	56	2015.2.10-2021.1.29	<ul style="list-style-type: none"> <li>• Master Degree; Senior Engineer;</li> <li>• Member of the Expert group of Liquor professional Committee of China Food Industry Association;</li> <li>• Chief wine taster of China; Master of Chinese Wine Critic.</li> </ul>
Liu Huashuang	Director	48	2018.1.29-2021.1.29	<ul style="list-style-type: none"> <li>• MBA; Also vice chairman of Su wine trade group Limited by Share Ltd.</li> </ul>
Wang Kai	Director	41	2017.5.19-2021.1.29	<ul style="list-style-type: none"> <li>• Bachelor Degree; Intermediate Economist;</li> <li>• One of the directors of Yanghe and vice general manager of Shanghai Haiyan Logistics Development Co., Ltd.</li> </ul>
Feng Pantai	Chairman of Supervisory Committee	58	2015.2.10-2021.1.29	<ul style="list-style-type: none"> <li>• Senior Economist;</li> <li>• Also director of Blue Alliance.</li> </ul>
Chen Yiqin	Member of Supervisory Committee	57	2015.2.10-2021.1.29	<ul style="list-style-type: none"> <li>• Auditor, Certified Public Accountant;</li> <li>• Also chairman of the supervisory committee of Suqian Industry Development Group Co., Ltd.</li> </ul>
Chen Taiqing	Member of Supervisory Committee	53	2015.2.10-2021.1.29	<ul style="list-style-type: none"> <li>• Master degree; Senior Political Engineer;</li> <li>• General Manager and Secretary of the Party Committee of Jiangsu Shuanggou Distillery Stock Co., Ltd.</li> </ul>
Chen Taisong	Member of Supervisory Committee	50	2015.2.10-2021.1.29	<ul style="list-style-type: none"> <li>• Master degree;</li> <li>• Also Chairman of the Supervisory Committee of Su wine trade group Limited by Share Ltd.</li> </ul>
Zhou Wenqi	Member of Supervisory Committee	52	2015.2.10-2021.1.29	<ul style="list-style-type: none"> <li>• Senior Accountant;</li> <li>• Also CFO of ShangHai Jieqiang Tobacco Sugar&amp;Wine (Group) Co., Ltd.</li> </ul>
Lin Qing	VP	43	2015.2.10-2021.1.29	<ul style="list-style-type: none"> <li>• Master degree; Senior Accountant; Certified Public Accountant.</li> </ul>
Zhen Bujun	VP	51	2015.2.10-2021.1.29	<ul style="list-style-type: none"> <li>• MBA, Senior Engineer;</li> <li>• Also General Manager and Secretary of the Party Committee of Siyang branch.</li> </ul>
Zhu Wei	VP	41	2015.2.10-2021.1.29	<ul style="list-style-type: none"> <li>• Master degree; Also general manager of Su wine trade group Limited.</li> </ul>

Source: Deutsche Bank, company annual reports

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Figure 48: Yanghe's major SKU and price

Series	Product	SKU	Retail Price (RMB/bottle)
<b>Price &gt; RMB800/bottle</b>			
Dream Blue	Shou Gong Ban	52°, 500ml	1,788.00
Dream Blue	M9	52°, 500ml	1,699.00
Dream Blue	M9	45°, 500ml	1,599.00
Sujiu	Shuanggou Mianrou (Lv Su)	40.8°, 480ml	919.00
<b>RMB600/bottle &lt; price &lt; RMB800/bottle</b>			
Dream Blue	M6	45°, 500ml	678.00
Dream Blue	M6	52°, 500ml	706.00
Weifenzi	V	33.8°, 500ml	758.00
Shuanggou Zhenbaofang	Difang	45°, 500ml	618.00
<b>RMB300/bottle &lt; price &lt; RMB600/bottle</b>			
Dream Blue	M1	45°, 500ml	368.00
Dream Blue	M1	52°, 500ml	388.00
Dream Blue	M3	40.8°, 500ml	499.00
Dream Blue	M3	52°, 500ml	519.00
Sky Blue	Sky Blue	42°, 520ml	339.00
Sky Blue	Sky Blue	52°, 520ml	369.00
Sui Gao Yao	Yao Zhi Lan	40.8°, 500ml	409.00
Weifenzi	v	43.8°, 500ml	459.00
Weifenzi	No Alarm	43.8°, 500ml	328.00
<b>Price &lt; RMB300/bottle</b>			
Sea Blue	Sea Blue	42°, 520ml	153.00
Sea Blue	Sea Blue	52°, 520ml	173.00
Sui Gao Yao	Gao Zhi Lan	42°, 500ml	219.00
Sui Gao Yao	Sui Zhi Lan	42°, 500ml	109.00
Shuanggou Zhenbaofang	Shenfang	42°, 500ml	259.00
Shuanggou Zhenbaofang	Junfang	41.8°, 500ml	109.00
Shuanggou Zhenbaofang	Junfang	52°, 500ml	129.00
Shuanggou Daqu	Da Qing Hua	42°, 480ml	199.00
Shuanggou Daqu	Xiao Qing Hua	42°, 480ml	99.00
Sujiu	Shuanggou Sujiu (Pu Su)	42°, 500ml	109.00
Yanghe	Lanci	42°, 480ml	89.00
Yanghe	Qingci	42°, 480ml	79.00
Yanghe	Daqu	42°, 500ml	49.00
Yanghe	Daqu	52°, 500ml	59.00

Source: Deutsche Bank, Yanghe company website, JD.com, Tmall.com, Yhd.com

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# Appendix 1

## Important Disclosures

\*Other information available upon request

### Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Yanghe	002304.SZ	105.00 (CNY) 12 Sep 18	NA

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### Historical recommendations and target price: Yanghe (002304.SZ)

(as of 9/12/2018)



#### Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

#### Current Recommendations

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

\*New Recommendation Structure as of September 9,2002

\*\*Analyst is no longer at Deutsche Bank

1. 26/02/2018: No Recommendation, Target Price Change CNY0.00  
 Anne Ling

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### Equity rating key

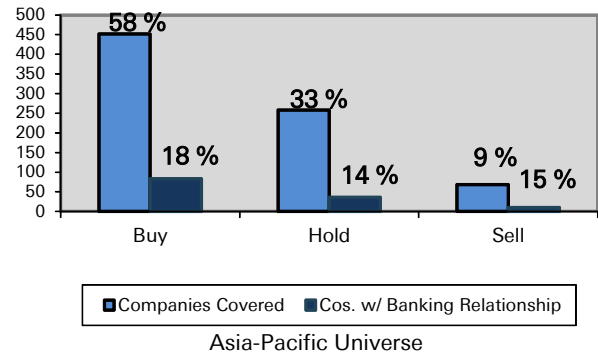
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**Sell:** Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

**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.

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