

20 November 2018

China

EQUITIES

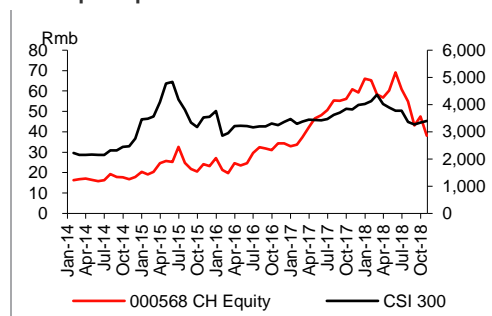
000568 SZ	Not rated	
Stock price as of 16/11/2018 Rmb	40.29	
GICS sector	Consumer Staples	
Market cap	Rmb m	59,015
Avg Value Traded (3m)	Rmb m	553
12m high/low	Rmb	75.26/35.05
PER FY19	x	13.8
P/BV FY 19	x	3.1

Historical financials

YE Dec (RMBm)	2015A	2016A	2017A
Revenue	6,900	8,304	10,395
% growth	28.9	20.3	25.2
EBITDA	2,037	2,639	3,491
% growth	62.2	29.5	32.3
EPS	105.00	137.50	179.80
% growth	67.4	30.9	32.7
EBIT Margin	27.2	29.9	32.0

Source: Company data, FactSet, November 2018

Share price performance vs. CSI300



Source: Macquarie Research, November 2018

Share Price Driver

Thematic
Growth
Value
Event

Source: Macquarie Research, November 2018

Analysts

Macquarie Capital Limited



Linda Huang, CFA +852 3922 4068
linda.huang@macquarie.com



Cici Yu +86 21 2412 9078
cici.yu@macquarie.com

MacVisit: Luzhou Laojiao

Invest in the future, learn from the past

Key points

- ▶ Premium liquor National Cellar 1573 is making a comeback, boosting sales and gross profit margin, according to management.
- ▶ The company is investing heavily in marketing expenses, while controlling channel inventory to be less than 2 months.
- ▶ Capacity expansion ongoing; high dividend payout ratio.

Outlook

- We visited Luzhou Laojiao and talked with management. As one of China's oldest liquor manufacturers, its premium product National Cellar 1573 is sold at a retail price of Rmb1,099/bottle on par with Wuliangye Yibin's (A-Share) (000858 CH, Rmb50.69, Neutral, TP: Rmb52.30) Puwu.
- As pledged at its annual general meeting in June 2018, the company aims to regain its top 3 spot in the Baijiu industry in 2020 and lift its revenue to Rmb30bn in 2020E (Rmb10.4bn in 2017). National Cellar 1573, mid-range products, and health and other innovative liquors are each expected to make a one-third contribution to revenue.

Key findings

- **National Cellar 1573 comes back, boosting sales and gross profit margin.** Amid the recovery of the baijiu industry and consumption upgrade trend, the sales percentage of its high-end products leapfrogged to 52% in 1H18 from 22% in 2015. According to industry experts, 1573 won back its historical market share in 2017 and gained more in 2018. As a result, GPM rose to 73.9% in 1H18 from 49.4% in 2015. Meanwhile, the ex-factory price of 1573 was lifted twice in 2017, by 6% and 9% in March and July, respectively. The company plans to become more prudent on price hikes and to conduct a pricing strategy following Wuliangye.
- **Invest in the future, while learning from the past.** To expand in the high-end market, the company continues to invest in marketing. As a result, its A&P expenses ratio continued to increase 2.4ppt YoY to 22.5% in 9M18, higher than 5.4% of Moutai and 10.5% of Wuliangye. However, gross margin expansion driven by product mix upgrade more than offset the increase in SG&A, and operating margin improved 3.2ppt YoY to 40.7%. Moreover, post the hiccup in the baijiu industry and ineffectual pricing strategy, Laojiao rebuilt its sales team in 2014 by product in lieu of regions. The company learned lessons and is managing channel inventory under 2 months currently.
- **Capacity expansion ongoing; high dividend payout ratio.** In September 2017, it raised Rmb3bn through non-public share offerings to expand 35k tons of basic liquor capacity and 100k tons of storage capacity by the end of 2020. Stripping out this Rmb3bn from cash and equivalents, its net gearing ratio would be 36% in FY17. The company also paid out 71.6% of net profit last year, up 2.8ppt from 68.8% in FY16. This is higher than the 51.0% and 52.2% payout ratios of Moutai and Wuliangye in FY17, respectively.

Financials, valuations, and risks

- 9M18 revenue of Rmb9,263m, up 27% YoY, with net profit up 38% YoY to Rmb2,743m. 3Q18 sales grew 31% and net profit rose 45%. The stock is trading at a 14x FY19E PER, compared with domestic peers' 15x FY19E, both based on Bloomberg consensus estimates.

Please refer to page 6 for important disclosures and analyst certification, or on our website

www.macquarie.com/research/disclosures.

Ownership (As of September 30th, 2018)

- Luzhou Laojiao Group (SOE), 26.02%
- Luzhou Xinlu Investment company(SOE), 24.99%
- China Securities Finance Corporate, 2.31%
- Hong Kong Securities Clearing Co. Ltd., 2.02%
- E-fund Securities Investment Fund.,1.69%

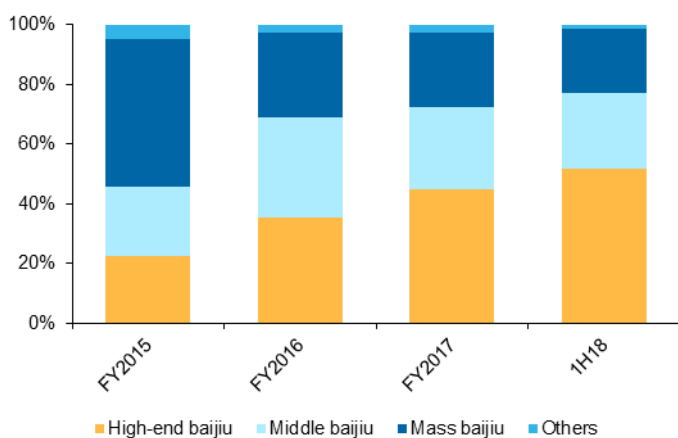
Balance sheet data and refinancing (As of September 30th, 2018)

- Cash and bank balance of Rmb8,384m
- Fixed asset and construction in process of Rmb2,979m
- No short-term and long-term debt
- Net cash/equity ratio at 51.7%

Latest results highlights (3Q18)

- Revenue grew by 31% to Rmb2,843m in 3Q18.
- Gross margin expanded by 22bps to 81.5% in 3Q18.
- EBIT margin increased by 111bps to 35.5%.
- Net profit increased by 45% to Rmb772m.

Fig 1 Revenue breakdown by product (Rmb m)



Source: Company data, November 2018

History and corporate governance

- 1915 Luzhou Laojiao Tequ won the Panama International Fair gold medal.
- 1994 Luzhou Laojiao Co., LTD was established and listed on the Shanghai Stock Exchange.
- 2009 the controlling shareholder was changed to Luzhou Laojiao Group, and the actual controller remained as Luzhou State-owned Assets Supervision and Administration Commission(SASAC).

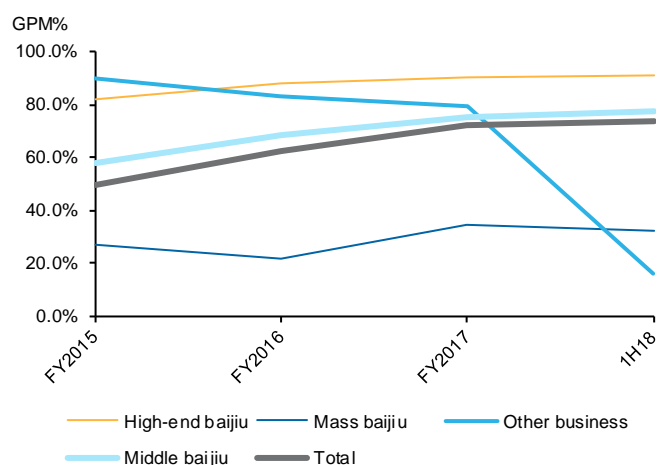
Management and Directors background

- Mr. Liu Miao, aged 49, was appointed Chairman in June 2015. He previously served as General Manager Assistant, Deputy General Manager, and General Manager of sales subsidiary at the company.
- Mr. Lin Feng, aged 45, was appointed General Manager in June 2015. He was in charge of sales subsidiary, the marketing department and the HR department consecutively.
- Mr. Wang Hongbo, aged 54, serves as Deputy General Manager and Broad Secretary. Prior to joining Luzhou Laojiao, he was Director of the Bureau of Commerce of Luzhou.

Latest results highlights (FY17)

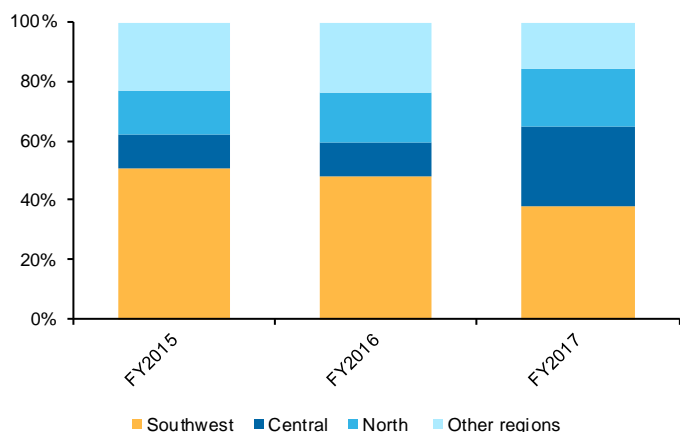
- Revenue grew by 20.5% to Rmb10.4bn in FY17.
- Gross margin expanded by 950bps to 71.9% from 62.4% in FY16.
- EBIT margin was trimmed by 207bps to 32% from 29.9%.
- Net profit increased by 30.7% to Rmb2558m.

Fig 2 Gross margin by product



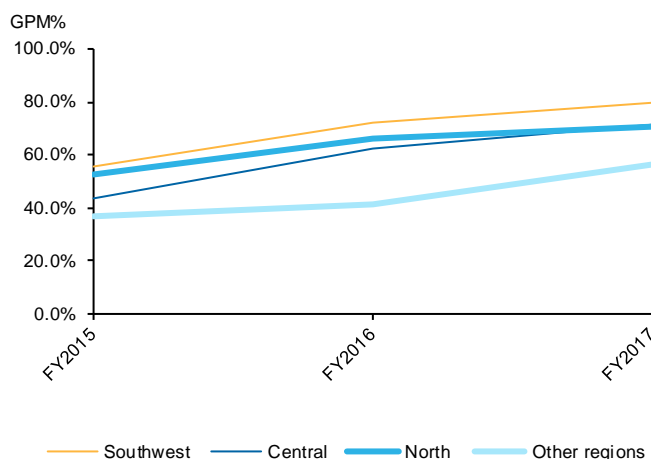
Source: Company data, November 2018

Fig 3 Revenue breakdown by region (Rmb m)



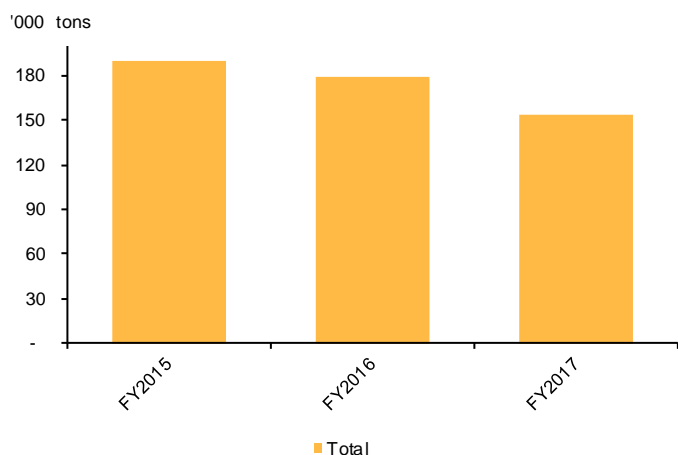
Source: Company data, November 2018

Fig 4 Gross margin by region (%)



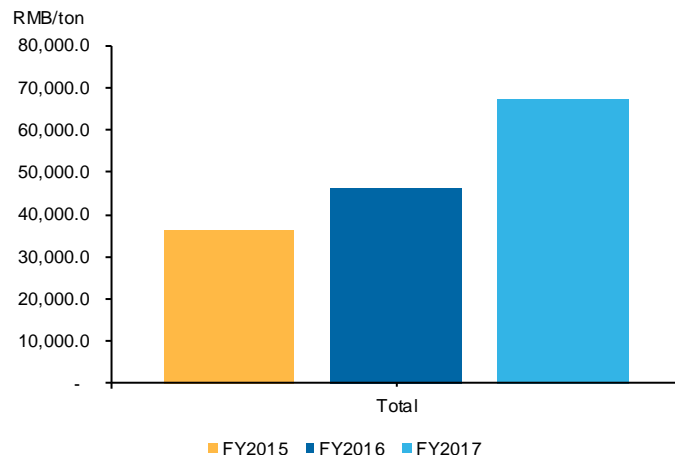
Source: Company data, November 2018

Fig 5 Sales volume ('000 tons)



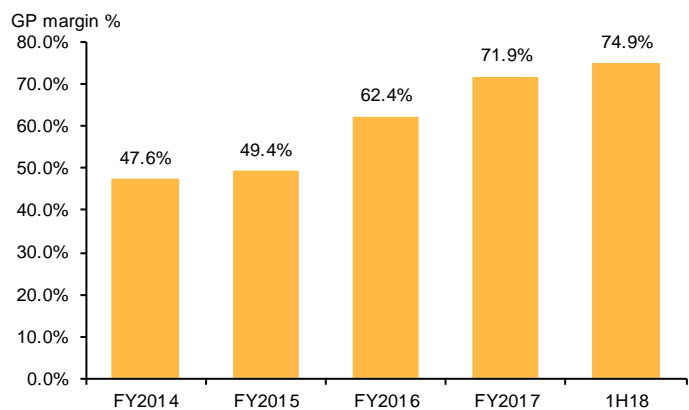
Source: Company data, November 2018

Fig 6 Average selling price (RMB/ton)



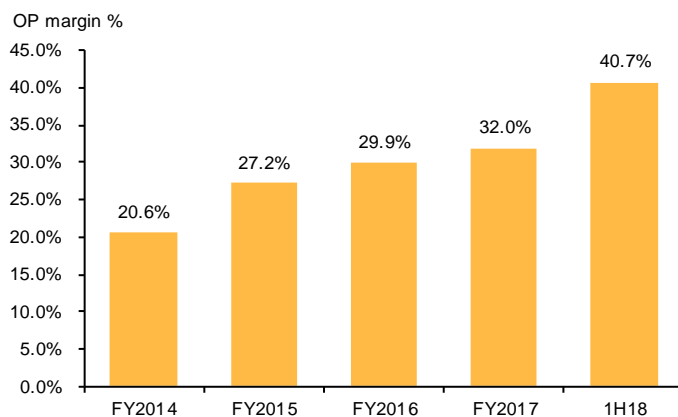
Source: Company data, November 2018

Fig 7 Gross margin trend (%)



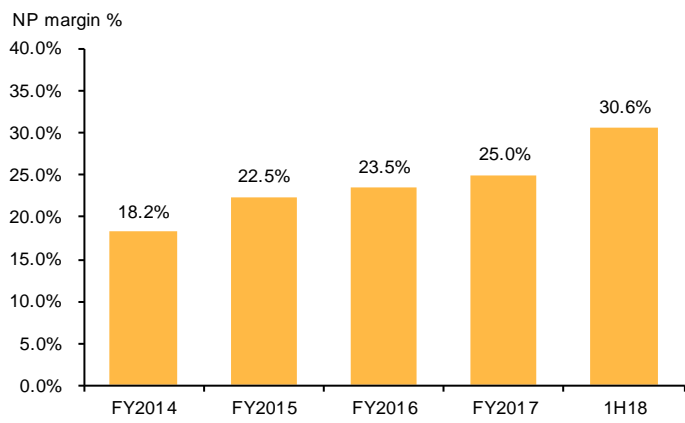
Source: Company data, November 2018

Fig 8 Operating margin trend (%)



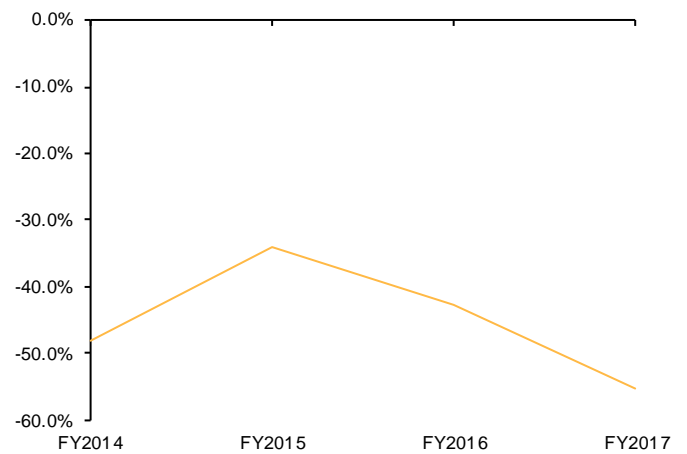
Source: Company data, November 2018

Fig 9 Net profit margin trend (%)



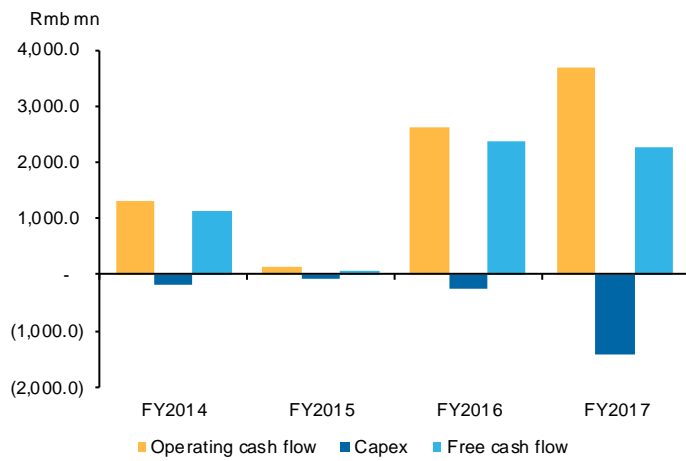
Source: Company data, November 2018

Fig 10 Net debt to equity ratio (%)



Source: Company data, November 2018

Fig 11 Free cash flow (Rmb m)



Source: Company data, November 2018

Luzhou Laojiao (000568 CH, not rated)

Interim Results					Annual Results						
		2H16A	1H17A	2H17A	1H18A		2014A	2015A	2016A	2017A	
Revenue	m	4,034	5,116	5,279	6,420	Revenue	m	5,353	6,900	8,304	10,395
Gross profit	m	2,655	3,508	3,969	4,810	Gross profit	m	2,549	3,408	5,184	7,477
Cost of goods sold	m	1,379	1,608	1,310	1,611	Cost of goods sold	m	2,804	3,492	3,120	2,918
EBITDA	m	1,069	2,006	1,484	2,696	EBITDA	m	1,256	2,037	2,639	3,491
Depreciation	m	77	81	80	79	Depreciation	m	146	154	150	161
Amortisation	m	4	4	4	4	Amortisation	m	9	8	8	8
EBIT	m	992	1,921	1,400	2,613	EBIT	m	1,101	1,875	2,481	3,321
Net interest income	m	30	36	71	105	Net interest income	m	91	58	59	107
Forex gain/loss	m	0	0	0	0	Forex gain/loss	m	0	0	0	0
Other pre-tax profit	m	-430	2	3	(10)	Other pre-tax profit	m	25	33	(10)	6
Pre-Tax Profit	m	1,002	1,960	1,474	2,708	Pre-Tax Profit	m	1,218	1,967	2,530	3,434
Tax expenses	m	(205)	(450)	(381)	(672)	Tax expenses	m	(241)	(416)	(580)	(832)
Net profit	m	797	1,509	1,093	2,036	Net profit	m	976	1,551	1,950	2,602
Minority interest	m	-18	42	2	69	Minority interest	m	96	78	22	44
Reported Earnings	m	815	1,467	1,091	1,967	Reported Earnings	m	880	1,473	1,928	2,558
Reported Earnings	m	815	1,467	1,091	1,967	Reported Earnings	m	880	1,473	1,928	2,558
EPS (rep)	¢	58	105	75	134	EPS (rep)	¢	63	105	138	180
EPS (adj)	¢	58	105	75	134	EPS (adj)	¢	63	105	138	180
EPS grow th yoy (adj)	%	81	32	29	28	EPS grow th yoy (adj)	%	(74)	67	31	33
						PE (rep)	x	32	26	24	37
						PE (adj)	x	32	26	24	37
EBITDA margin	%	26.5	39.2	28.1	42.0	Total DPS	¢	44.0	50.0	50.0	50.0
EBIT margin	%	24.6	37.6	26.5	40.7	Payout ratio	%	69.8	47.6	36.4	27.8
Revenue grow th	%	26	20	31	25	Weighted average shares	m	685	685	685	685
EBIT grow th	%	75	29	41	36						
		2014A	2015A	2016A	2017A						
Profit and Loss Ratios						Cash Flow Analysis					
Revenue growth	%	(48.7)	28.9	20.3	25.2	Net income	m	976	1,551	1,950	2,602
EBITDA grow th	%	(73.0)	62.2	29.5	32.3	Depreciation & Amortisation	m	154	162	158	169
EBIT Grow th	%	(75.6)	70.3	32.3	33.9	Other non-cash adjustments	m	1,779	(1,628)	464	(1,057)
Gross profit margin	%	47.6	49.4	62.4	71.9	Changes in non-cash capital	m	(1,603)	68	54	1,979
EBITDA margin	%	23.5	29.5	31.8	33.6	Operating cash flow	m	1307	153	2625	3693
EBIT margin	%	20.6	27.2	29.9	32.0	Acquisitions	m	0	0	0	0
Net profit margin	%	18.2	22.5	23.5	25.0	Capex	m	(164)	(79)	(237)	(1,416)
Payout ratio	%	69.8	47.6	36.4	27.8	Asset sales	m	0	0	0	0
						Other	m	21	(31)	1	19
Balance Sheet Ratios						Investing cash flow	m	(143)	(110)	(236)	(1,396)
ROE	%	9	15	18	20	Dividends	m	(1,803)	(1,214)	(1,175)	(1,387)
ROA	%	7	12	15	16	Equity raised	m	0	0	0	0
Net debt/equity	x	(0.5)	(0.3)	(0.4)	(0.55)	Debt movements	m	0	0	0	0
						Other	m	(21)	23	5	2,714
						Financing cash flow	m	(1,825)	(1,191)	(1,169)	1,326
						Forex	m	(1)	(0)	0	(0)
						Net change in cash/debt	m	(662)	(1,148)	1,219	3,623
						Free cash flow	m	1,143	74	2,388	2,277
						Balance Sheet					
						Cash		4,710	3,540	4,765	8,450
						Receivables		1,779	2,495	2,176	2,722
						Inventories		2,827	2,860	2,488	2,812
						Investments		0	0	0	0
						Fixed asset		1,372	1,293	1,363	2,697
						Intangible asset		251	244	235	231
						Other assets		2,232	2,750	2,647	2,844
						Total assets		13,171	13,182	13,674	19,756
						Payables		758	993	1,236	2,268
						Short term debt		0	0	0	0
						Long term debt		0	0	0	0
						Other liabilities		2,620	1,826	1,314	2,176
						Total liabilities		3,377	2,819	2,549	4,443
						Share capital		1,402	1,402	1,402	1,465
						Surplus reserves		1,402	1,402	1,402	1,465
						Undistributed profits		6,242	6,593	7,398	8,527
						Other		747	964	922	3,856
						Total S/H equity		9,793	10,362	11,125	15,313
						Total liab & S/H equity		13,171	13,182	13,674	19,756

All figures in CNY unless noted.

Source: Company data, Wind, Bloomberg, November 2018

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand

Outperform – return >3% in excess of benchmark return
Neutral – return within 3% of benchmark return
Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield, which is currently around 9%.

Macquarie – Asia/Europe

Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Mazi Macquarie – South Africa

Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie - Canada

Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

Macquarie - USA

Outperform (Buy) – return >5% in excess of Russell 3000 index return
Neutral (Hold) – return within 5% of Russell 3000 index return
Underperform (Sell) – return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high-highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low-medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to Asia/Australian/NZ/Canada stocks only

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
Excluded: nonrecurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / epowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders' funds

Gross cashflow = adjusted net profit + depreciation
*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 30 September 2018

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	51.56%	59.51%	45.05%	46.88%	67.86%	46.70%	(for global coverage by Macquarie, 3.70% of stocks followed are investment banking clients)
Neutral	33.20%	28.92%	37.36%	47.70%	25.00%	42.73%	(for global coverage by Macquarie, 2.04% of stocks followed are investment banking clients)
Underperform	15.23%	11.57%	17.58%	5.42%	7.14%	10.57%	(for global coverage by Macquarie, 0.47% of stocks followed are investment banking clients)

000858 CH vs CSI 300, & rec history



(all figures in CNY currency unless noted)

Note: Recommendation timeline – if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, November 2018

12-month target price methodology

000858 CH: Rmb52.30 based on a PER methodology

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Asia Research

Head of Equity Research

Jake Lynch (Asia – Head)	(852) 3922 3583
Hiroyuki Sakaida (Japan – Head)	(813) 3512 6695
Conrad Werner (ASEAN – Head)	(65) 6601 0182

Automobiles, Auto Parts

Janet Lewis (China, Japan)	(813) 3512 7856
Allen Yuan (China)	(8621) 2412 9009
James Hong (Korea)	(813) 3512 7476
Amit Mishra (India)	(9122) 6720 4084

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Keisuke Moriyama (Japan)	(813) 3512 7476
Chan Hwang (Korea)	(822) 3705 8643
Suresh Ganapathy (India)	(9122) 6720 4078
Jayden Vantarakis (Indonesia)	(6221) 2598 8310
Anand Pathmakanthan (Malaysia)	(603) 2059 8833
Gilbert Lopez (Philippines)	(632) 857 0892
Ken Ang (Singapore)	(65) 6601 0836
Peach Patharavanakul (Thailand)	(662) 694 7753

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Harunobu Goroh (Japan)	(813) 3512 7886
Yasuhiro Nakada (Japan)	(813) 3512 7862
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Sumangal Nevatia (India)	(9122) 6720 4093
Jayden Vantarakis (Indonesia)	(6221) 2598 8310
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Gilbert Lopez (Philippines)	(632) 857 0892
Conrad Werner (Singapore)	(65) 6601 0182

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Robert Pranata (Indonesia)	(6221) 2598 8366
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Chalinee Congmuang (Thailand)	(662) 694 7993

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Corinne Jian (Greater China)	(8862) 2734 7522
Conrad Werner (ASEAN)	(65) 6601 0182
Bo Denworalak (Thailand)	(662) 694 7774

Infrastructure, Industrials, Transportation

Patrick Dai (China)	(8621) 2412 9082
Eric Zong (China, Hong Kong)	(852) 3922 4749
Kunio Sakaida (Japan)	(813) 3512 7873
James Hong (Korea)	(822) 3705 8661
Corinne Jian (Taiwan)	(8862) 2734 7522
Inderjeetsingh Bhatia (India)	(9122) 6720 4087
Azita Nazrene (ASEAN)	(65) 6601 0560

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Marcus Yang (Greater China)	(8862) 2734 7532
John Wang (China, Hong Kong)	(852) 3922 3578
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Frank Chen (China, Hong Kong)	(852) 3922 1433
Alankar Garude (India)	(9122) 6720 4134

Oil, Gas and Petrochemicals

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Anna Park (Asia)	(822) 3705 8669
Yasuhiro Nakada (Japan)	(813) 3512 7862
Corinne Jian (Taiwan)	(8862) 2734 7522
Ben Shane Lim (Malaysia)	(603) 2059 8868
Yupapan Polpornprasert (Thailand)	(662) 694 7729

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Xiang Gao (China, Hong Kong)	(8621) 2412 9006
Corinne Jian (China)	(8862) 2734 7522
Alankar Garude (India)	(9122) 6720 4134
Richardo Walujo (Indonesia)	(6221) 259 88 369

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Richard Danusaputra (Indonesia)	(6221) 2598 8368
Aiman Mohamad (Malaysia)	(603) 2059 8986
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Jeffrey Ohlweiler (Greater China)	(8862) 2734 7512
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Lynn Luo (Greater China)	(8862) 2734 7534
Patrick Liao (Greater China)	(8862) 2734 7515
Verena Jeng (Greater China)	(852) 3922 3766
Jin Guo (Greater China)	(8621) 2412 9054
Daniel Kim (Korea)	(822) 3705 8641
Abhishek Bhandari (India)	(9122) 6720 4088
Farrah Aqlima (Malaysia)	(603) 2059 8987

Telecoms

Allen Chang (Greater China)	(852) 3922 1136
Prem Jearajasingam (ASEAN)	(603) 2059 8989
Nathania Nurhalim (Indonesia)	(6221) 2598 8365
Kervin Sisayan (Philippines)	(632) 857 0893

Utilities, Renewables

Hiroyuki Sakaida (Japan)	(813) 3512 6695
Patrick Dai (China)	(8621) 2412 9082
Inderjeetsingh Bhatia (India)	(9122) 6720 4087
Karisa Magpayo (Philippines)	(632) 857 0899

Strategy, Country

Viktor Shvets (Asia, Global)	(852) 3922 3883
David Ng (China, Hong Kong)	(852) 3922 1291
Hiroyuki Sakaida (Japan)	(813) 3512 6695
Chan Hwang (Korea)	(822) 3705 8643
Jeffrey Ohlweiler (Taiwan)	(8862) 2734 7512
Inderjeetsingh Bhatia (India)	(9122) 6720 4087
Conrad Werner (ASEAN, Singapore)	(65) 6601 0182
Jayden Vantarakis (Indonesia)	(6221) 2598 8310
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Amelia Mehta (Asia)	(65) 6601 0211
Alan Chen (Asia)	(852) 3922 2019
Sandeep Bhatia (India)	(9122) 6720 4101
Tim Huang (Indonesia)	(6221) 2598 8303
Thomas Renz (Geneva)	(41 22) 818 7712
Tomohiro Takahashi (Japan)	(813) 3512 7823
John Jay Lee (Korea)	(822) 3705 9988
Nik Hadi (Malaysia)	(603) 2059 8888
Gino C Rojas (Philippines)	(632) 857 0861

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Paul Colaco (San Francisco)	(1 415) 762 5003
Eric Lin (Taiwan)	(8862) 2734 7590
Angus Kent (Thailand)	(662) 694 7601
Mothlib Miah (UK/Europe)	(44 20) 3037 4893
Christina Lee (US)	(44 20) 3037 4873

Sales Trading

Mark Weekes (Asia)	(852) 3922 2084
Stanley Dunda (Indonesia)	(6221) 515 1555

Sales Trading cont'd

Suhaida Samsudin (Malaysia)	(603) 2059 8888
Michael Santos (Philippines)	(632) 857 0813
Chris Reale (New York)	(1 212) 231 2555
Marc Rosa (New York)	(1 212) 231 2555
Justin Morrison (Singapore)	(65) 6601 0288
Brendan Rake (Thailand)	(662) 694 7707
Mike Keen (UK/Europe)	(44 20) 3037 4905