



China

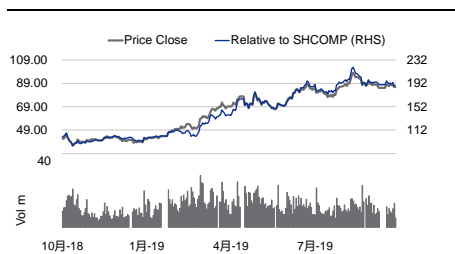
ADD

Consensus ratings\*: Buy 26 Hold 5 Sell 0

Current price:	Rmb86.12
Target price:	Rmb122.0
Previous target:	Rmb
Up/downside:	41.7%
CGS-CIMB / Consensus:	21.4%
Reuters:	000568.SZ
Bloomberg:	000568 CH
Market cap:	US\$17,826m Rmb126,144m
Average daily turnover:	US\$129.7m Rmb916.1m
Current shares o/s:	1,465m
Free float:	99.7%
*Source: Bloomberg	

Key changes in this note

➤ N/A



Source: Bloomberg

<b>Price performance</b>	1M	3M	12M
Absolute (%)	-1.9	2	105.1
Relative (%)	-1.9	.4	88.9

<b>Major shareholders</b>	% held
Luzhou Laojiao Group Co. Ltd	26.0

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# Luzhou Laojiao

## Successful channel reforms

- We like Luzhou Laojiao for its successful distribution channel reforms, strong profitability improvement and potential ASP hike for its star brand – Cellar 1573.
- We forecast a 27% EPS CAGR in FY18–21F, driven by a 23%/24% sales CAGR from its high-end and mid-range product segments, respectively.
- We initiate with an Add rating and DCF-based TP of Rmb122 (WACC:9.6%)

### New distribution network starting to reap benefits

Since 2015, Laojiao has taken four years to restructure its distribution network, providing stronger market support for its distributors and restoring its high-end brand image. Now Laojiao has around 3,000 distributors with over 8,000 of its own salespeople. Its brand value rose by 40% yoy to US\$5.3bn in 2019, according to Brand Finance. Backed with this strong distribution network, we expect Laojiao's channel reforms to start to bear fruit and its sales to grow at a 19% CAGR in FY18–21F. We also expect its high S&D expenses ratio of 26% in 2018 to gradually fall back by 5%pts to 21% in 2021F, leading to OPM expansion of 8.4%pts from 34.2% in FY18 to 42.4% in FY21F.

### Product portfolio premiumization to capture consumption upgrade

Laojiao's product structure has been continually been upgraded. Its high-end baijiu (i.e. Cellar 1573) sales grew rapidly by 37% yoy to Rmb6.4bn, accounting for 50% of baijiu sales in FY18; while its middle-range baijiu was up by 28% yoy to Rmb3.7bn, contributing 22% of sales. Laojiao has gradually lifted its retail selling price (RSP) YTD because of strong market demand and low channel inventory. According to JD.com, its RSP for major products has risen by 7% to 38% YTD, and Laojiao has successfully captured the consumption upgrade trend.

### ASP hike could be a near-term catalyst

Laojiao's price strategy is closely pegged with that of Wuliangye, which successfully increased its ex-factory price by 12.6% through launching the 8<sup>th</sup> generation of Wuliangye in June 2019. We expect Laojiao to follow Wuliangye, increasing its ex-factory price of Cellar 1573 in the near future. Meanwhile, due to a supply shortage of premium baijiu in the RSP range of Rmb1,000–2,000/bottle, we expect Cellar 1573 to ramp up by 7% volume CAGR and 15% ASP CAGR in FY18–21F.

### Initiate coverage with an Add rating and DCF-based TP of Rmb122

We initiate coverage on Laojiao with an ADD rating and DCF-based TP of Rmb122 (WACC: 9.6%), implying 38x/31x FY19F/20F P/E. Laojiao is currently trading at 27x FY19F P/E, 2.0 s.d. above its historical average of 19x since its listing in 2009. In the past, Laojiao's valuation was largely in line with, or slightly below, the industry average. We believe that Laojiao deserves to trade at premium vs. its peers owing to a potential ASP hike for its super-premium Cellar 1573 products and strong sales growth momentum, boosted by its profit-sharing distribution model. Downside risks are as follows: 1) over 67% of its sales are derived from its top five customers, which indicates the key distributors have strong bargaining power and influence on Laojiao's distribution channels, which might be a tail risk in the long term; and 2) a macroeconomic slowdown may affect super-premium baijiu consumption.

### Financial Summary

	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Revenue (Rmbm)	10,395	13,055	16,264	18,930	22,097
Operating EBITDA (Rmbm)	3,330	4,502	6,107	7,647	9,594
Net Profit (Rmbm)	2,558	3,486	4,697	5,802	7,222
Core EPS (Rmb)	1.75	2.38	3.21	3.97	4.94
Core EPS Growth	26.9%	36.2%	34.7%	23.5%	24.5%
FD Core P/E (x)	48.14	36.12	26.82	21.72	17.45
DPS (Rmb)	1.25	1.55	2.09	2.58	3.21
Dividend Yield	1.45%	1.80%	2.43%	3.00%	3.73%
EV/EBITDA (x)	35.39	25.97	19.10	15.11	11.85
P/FCFE (x)	52.35	44.52	37.07	25.56	19.09
Net Gearing	(55.2%)	(54.7%)	(51.7%)	(52.1%)	(54.5%)
P/BV (x)	8.31	7.44	6.78	6.12	5.45
ROE	19.6%	21.7%	26.5%	29.6%	33.0%
% Change In Core EPS Estimates				1.00	0.99
CGI/consensus EPS (x)					1.02

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

# Successful channel reforms

## Investment summary

### Laojiao expects to be the next baijiu company to tap RSP above Rmb1,000 per bottle after Wuliangye >

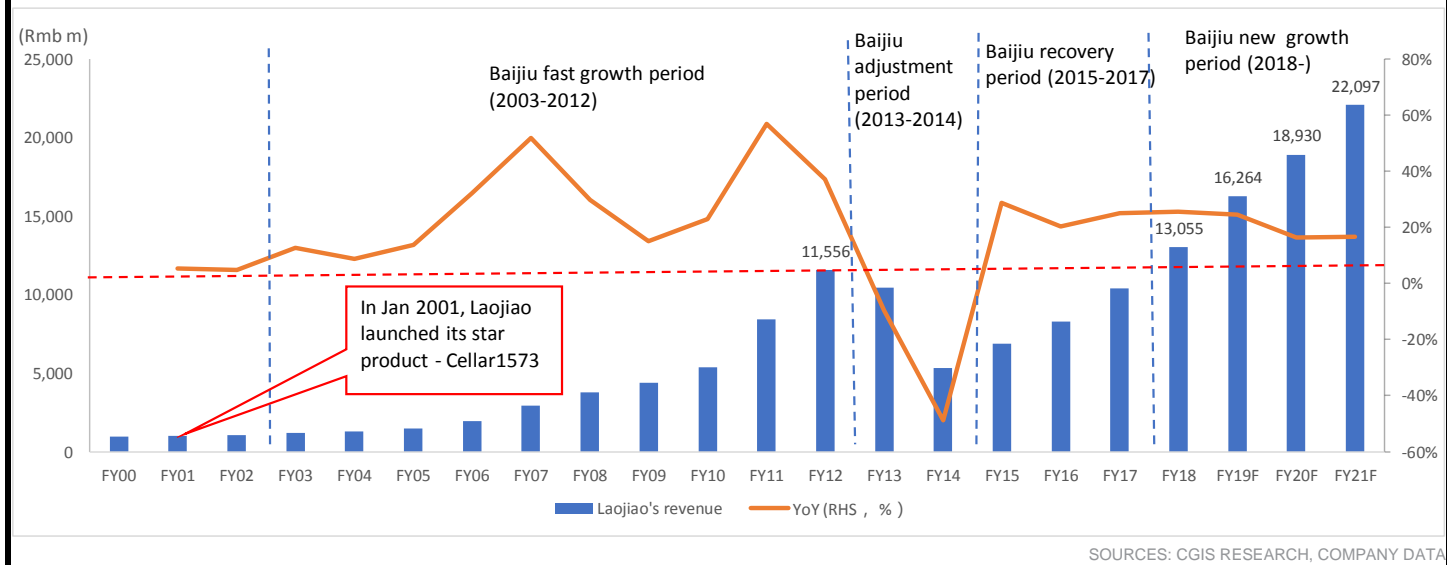
In the current new growth cycle of the China baijiu sector, starting from 2018, with the consumption upgrade trend, top tier brand Moutai increased its retail selling price (RSP) of 53° Feitian MT to Rmb2,700 per bottle from Rmb1,499 per bottle. This has triggered strong customer demand for other baijiu products with a strong brand name but a more reasonable RSP in the range of Rmb1,000–2,000 per bottle in the super premium baijiu market. In Jun 2018, another top-tier baijiu brand, Wuliangye, successfully launched its new 52° Wuliangye on the market with an RSP of Rmb1,000–1,300 per bottle, from the previous Rmb920–950 per bottle. Wuliangye has partially filled in the price gap for the RSP range of Rmb1,000–2,000 per bottle through this product upgrade. Wuliangye increased its ex-factory price from Rmb789/bottle to Rmb889/bottle, up 13%. We expect total sales volume of 52° Wuliangye to reach 18,000 tonnes in 2019F, up 15% YoY.

We believe Luzhou Laojiao (Laojiao) can raise its ex-factory price after Wuliangye's price increase, supported by its strong brand name and sufficient production capacity for Cellar 1573. Currently, the ex-factory price for Laojiao Cellar 1573 is Rmb780/bottle, with a first-layer wholesale price of Rmb820/bottle and an RSP of Rmb919/bottle. We expect Laojiao's sales to grow at a 19% CAGR from Rmb13bn in 2018 to Rmb22bn in 2021F, driven mainly by ASP improvement through product upgrades and volume growth.

**Figure 1: Core super-premium baijiu products with strong brand names in the China consumer market**



SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

**Figure 2: 2002–21F Laojiao sales performance in the different baijiu phases**


### Laojiao Cellar 1573 brand with strong revenue resilience

The intrinsic value of Laojiao's baijiu comes from its wholly-owned 10,086 aged cellars, 1,619 of which are more than 100 years old. The oldest ones can be traced back to the Wanli Period of the Ming Dynasty in 1573 A.D.

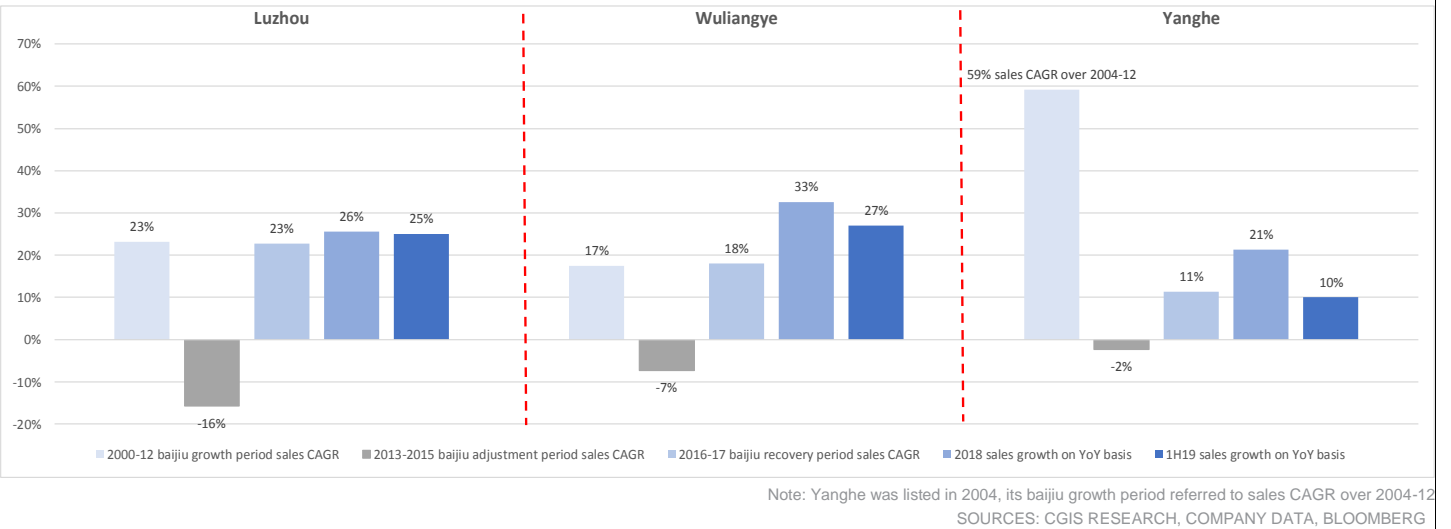
To promote Luzhou's intrinsic value in the baijiu market, the company launched a high-end Cellar 1573 (国窖1573) product in Jan 2001. This was followed by a large marketing campaign to promote and strengthen its Laojiao brand among consumers as one of the top high-end brands.

The strategy was quite successful, as Laojiao achieved a 23% sales CAGR in 2000–2012, 5.8%pts higher than Wuliangye's 17% CAGR. Laojiao also gradually raised its ex-factory price of Cellar 1573 from Rmb268 per bottle in 2002 to Rmb889 per bottle in 2012; and in 2012, the RSP of Cellar 1573 reached Rmb1,389 per bottle in the end consumer market, 25% higher than 52° Wuliangye's RSP of Rmb1,109 per bottle at the time. In the last baijiu growth cycle, we think Laojiao successfully built up its high-end brand image nationwide and established a solid customer base for long-term market development.

However, in the 2013–15 baijiu sector restructuring period, Laojiao management misjudged the negative impact on high-end baijiu consumption of the government's anti-corruption measures and implemented an inappropriate marketing strategy to cope with oversupply in the baijiu market; eventually Laojiao's sales declined at a 16% CAGR in 2012–15; and sales volume of the high-end Cellar 1573 brand slumped from a peak of over 4,000 tonnes in 2012 to a trough of about 900 tonnes in 2014.

Since it is a popular high-end baijiu brand, Laojiao exhibited strong earnings recovery during the 2016–17 baijiu recovery period. After consistently adjusting its pricing strategy to cope with market demand and stabilizing its first-tier wholesale price and retail selling price, Laojiao recovered with a 23% sales CAGR in 2015–17, much faster than its peers; Wuliangye had a sales CAGR of 18% and Yanghe 11%. In the new baijiu growth cycle since 2018, Laojiao continued its strong sales growth of 26% yoy in 2018 and 25% yoy in 1H19, while Wuliangye grew by 33% yoy in 2018 and 27% in 1H19; and Yanghe achieved sales growth of 21% yoy in 2018 and 10% yoy in 1H19.

**Figure 3: Luzhou, Wuliangye and Yanghe sales growth comparison in the different baijiu growth phases**



Now the RSP of Laojiao’s high-end brand – Cellar 1573 – is about Rmb919 per bottle according to JD.com, much lower than its previous RSP of Rmb1,389 per bottle in last baijiu growth cycle in 2012. After reviewing Laojiao’s ex-factory price increase on Cellar 1573 since 2014, we found its pricing strategy closely followed that of Wuliangye. In Jun 2019, Wuliangye raised its ex-factory price of 52° Wuliangye from Rmb789 to Rmb889 per bottle through product upgrades, and eventually its RSP stabilized at Rmb1,000–1,300 per bottle. We think it is likely for Laojiao to increase its ex-factory price by upgrading Cellar 1573 and closely monitoring its channel inventory, supported by its high brand recognition and reasonable sales volume.

**Figure 4: Laojiao’s ex-factory price hike on 52° Cellar 1573 is closely pegged to 52° Wuliangye**

52°Wuliangye		52°Cellar1573	
Date on price hike	Exfactory price (Rmb per bottle)	Date on price hike	Exfactory price (Rmb per bottle)
Dec 2014	from Rmb576 to Rmb609	Jul 2015	from Rmb560 to Rmb620
Aug 2015	from Rmb609 to Rmb659	Aug 2016	from Rmb620 to Rmb640
Mar 2016	from Rmb659 to Rmb679	Nov 2016	from Rmb640 to Rmb680
Sep 2016	from Rmb679 to Rmb739	Aug 2017	from Rmb680 to Rmb740
Jan 2018	from Rmb739 to Rmb789	Jan 2019	from Rmb740 to Rmb760
Jun 2019	from Rmb789 to Rmb889	Mar 2019	from Rmb760 to Rmb780

SOURCES: CGIS RESEARCH, COMPANY DATA, JIUYEJIA, WIND

**Figure 5: Laojiao has consistently adjusted its price strategy in response to market demand**

Date	Details on price hike
Jan 2016	Stopped supplying in order to reduce channel inventory, stabilise the retail selling price of Cellar1573 and attract more distributors
Oct 2016	For unplanned orders, the exfactory price of 52°Cellar1573 increased by Rmb40 per bottle to Rmb660 per bottle
Dec 2016	For unplanned orders, the exfactory price of 52°Cellar1573 increased by Rmb80 per bottle to Rmb740per bottle
Feb 2017	The retail selling price of 52°Cellar1573 increased to Rmb899 per bottle.
Mar 2017	The exfactory price of 52°Cellar1573 was up to Rmb680 per bottle for planned orders, and up to Rmb740 per bottle for unplanned orders.
Jul 2017	The exfactory price of 52°Cellar1573 was up to Rmb740 per bottle for planned orders, and up to Rmb810 per bottle for unplanned orders.
Oct 2017	The retail selling price of 52°Cellar1573 in supermarkets and hard liquor distribution channels increased to Rmb969 per bottle.
Oct 2017	The retail selling price of Cellar1573 produced during 2001 and 2012 increased by Rmb200-1190 per bottle.
May 2018	The first tier wholesaler price of 38°/52°Cellar1573 increased from Rmb550/740 per bottle to Rmb630/840 per bottle
Jun 2018	The first tier wholesaler price of 38° Cellar1573 increased to Rmb650per bottle and its retail selling price was guided as Rmb739 per bottle. The retail selling price of classic 52°Cellar1573 produced during 2014-2017 was adjusted to Rmb1499/1399/1299/1199 per bottle.
Jul 2018	Stopped accepting distributors' orders and stop supplying any Cellar1573 products to channels, in order to stabilise the retail selling price.
Jan 2019	Laojiao advised the first-tier wholesaler price, the retail selling price of classic 52°Cellar1573 were respectively Rmb810 per bottle and Rmb1099 per bottle.
Jan 2019	Stopped accepting any classic 52°Cellar1573 from distributors to stabilise the first-tier wholesaler price and RSP
Mar 2019	Stopped accepting any classic 52°Cellar1573 from end customers to stabilise RSP
May 2019	Stopped supplying any 52°Cellar1573 products in Shandong and Hunan provinces and suggest the retail selling price of 38°/52°Cellar 1573 increased to Rmb640/Rmb919 per bottle, respectively
Jul 2019	Stopped supplying any unconventional bottle size of Cellar1573 products; Stop supplying any territory which 1H19 sales revenue was less than Rmb3m;for the territory which has sales over Rmb3m in 1H19, Luzhou suggested the retail selling price per 500ml increased by around Rmb150.
Sep 2019	Cancelled any scheduled September orders related on any classic 52°Cellar1573 to distributors

SOURCES: CGIS RESEARCH, COMPANY DATA, JIUYEJIA, WIND,TJKX.COM

## Successful distribution channel reforms ➤

### Laojiao restructured its distribution model and strengthened channel control

The disadvantage of Laojiao's region-oriented model emerged during the baijiu adjustment cycle in 2013–2014 because of the lack of immediate market information on consumer demand. Laojiao also had less power to control channel inventory and could not react quickly to market demand changes. So when market demand fell, Laojiao unexpectedly increased the ex-factory price of its star product – Cellar 1573 – from Rmb889 to Rmb999 per bottle in Aug 2013 and increased supply to its distributors. As a result, Laojiao's products flooded its distribution channels and its first-tier wholesaler price and retail price fell off the cliff in the 2013–14 baijiu adjustment period, seriously impacting Laojiao's distribution network.

In this severe environment, the company took several measures to destock its high channel inventory and renew distributors' faith in Laojiao. First, Laojiao cut its ex-factory price from Rmb999 to Rmb560 per bottle in Jul 2014. Second, in Sep 2014, Laojiao suspended supply to its distributors to give them more time to clear out inventory. To accelerate destocking and help channel inventory revert to a normal level, in Feb 2015, Laojiao implemented a cash buy-back scheme to buy back Cellar 1573 inventory in distributors' hands at Rmb550 per bottle, with an Rmb20 incentive to further clear channel inventory and strengthen its distributor relationship. These moves were considered to be quite effective and helped build a solid foundation for Laojiao's later rapid recovery.

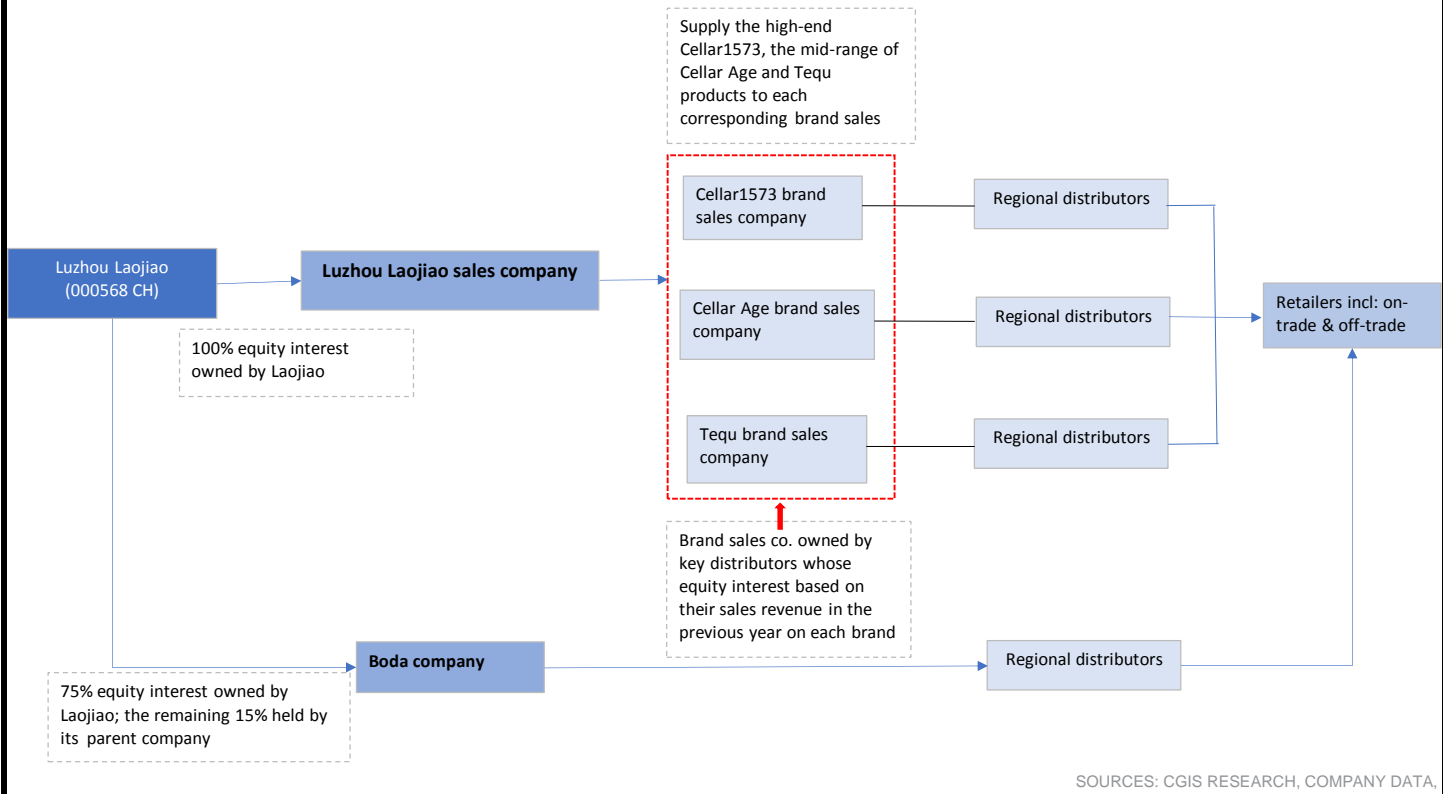
In June 2015, Laojiao formed a new management team led by Liu Miao, the chairman, and Lin Feng, the CEO. Both came from a marketing background with over two decades working experience in Laojiao's sales team. They gradually restructured Laojiao's distribution network and transformed it to a brand-oriented model. The layout structure looks similar to the previous region-oriented model. But a detailed analysis of the brand-oriented model shows that Laojiao has better channel control through individual brand management, and distributors have less autonomy, because since 2014 Laojiao has continually expanded its sales team from c.1,400 sales persons in 2014 to over 8,000 now, concentrating on product promotion and new market development.

**Figure 6: Number of sales people and domestic distributors for each baijiu company (as at end-2018)**

	No. of Sales person	No. of domestic distributors
Moutai	843	2987
Wuliangye	658	1216
Yanghe	5259	over 8000
Luzhou Laojiao	738, with over 8000 sales persons in its three brand sales companies	3000
Fen wine	1058	1268
Swellfun	322	50

SOURCES: CGIS RESEARCH, COMPANY DATA

**Figure 7: Luzhou brand-oriented distribution model implemented since 2015**



SOURCES: CGIS RESEARCH, COMPANY DATA,

Figure 8: Laojiao's region-oriented distribution model implemented in 2006-14

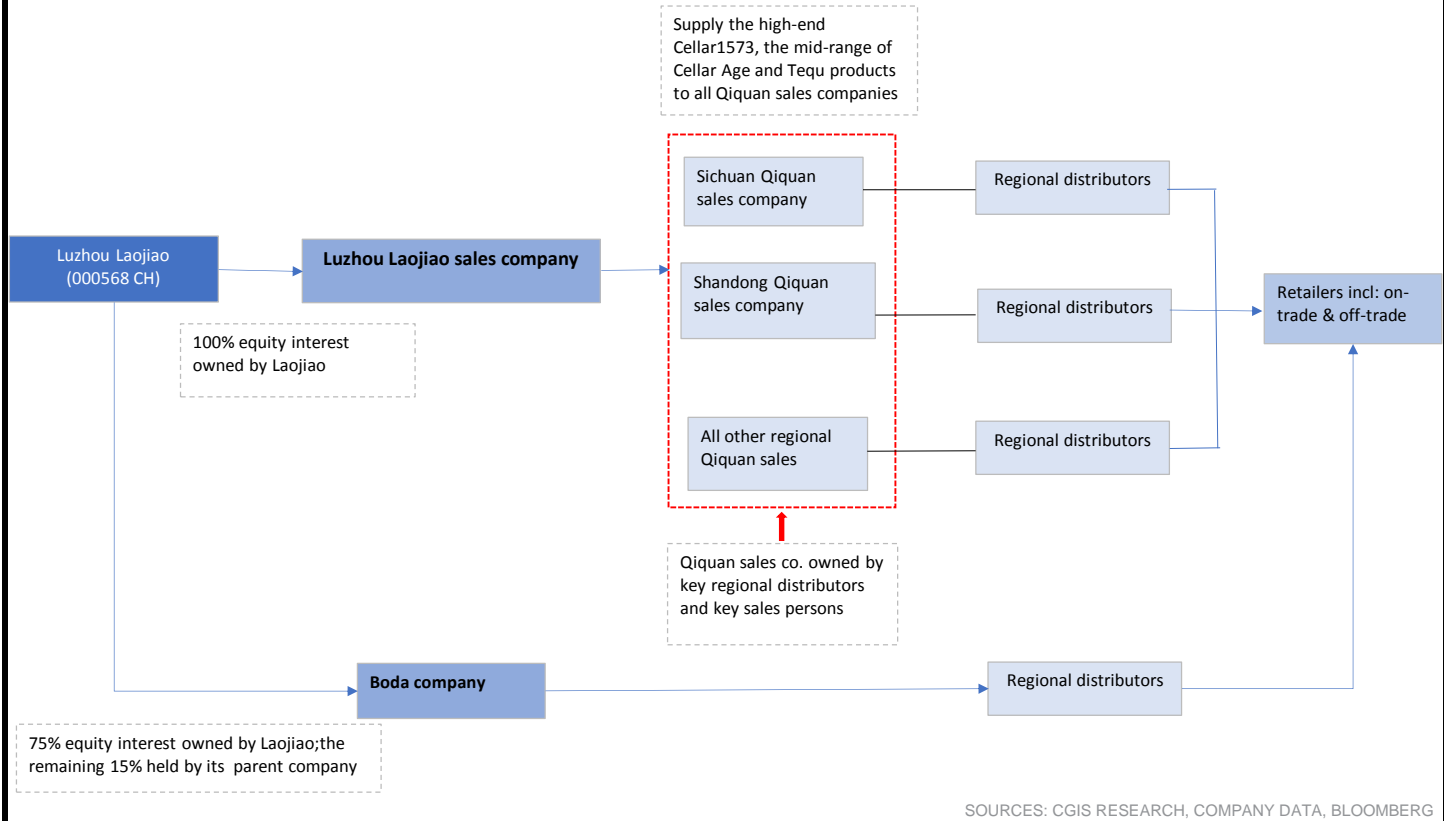


Figure 9: Features of Laojiao's distribution model

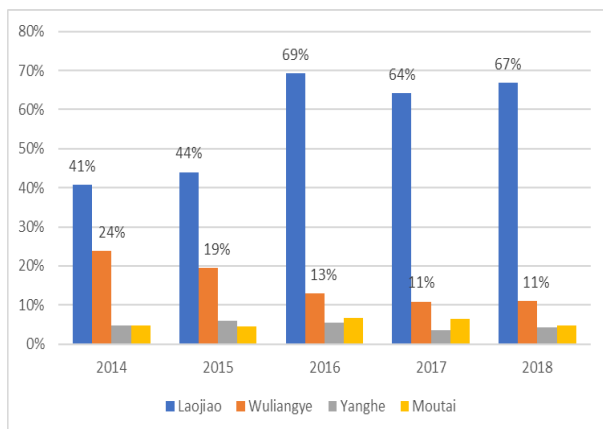
	Brand-oriented distribution model	Region-oriented distribution model
Period of implementation	From 2015 till now	2006-2014
Model methodology	According to Laojiao's different brands, each brand sales company such as Cellar1573 brand sales co. has set up. These companies are wholly owned by key distributors on the corresponding brand franchised companies, new distributors who can invest cash in these companies as well based on their previous sales revenue.	According to Laojiao's different regional markets, regional Qiquan sales companies were established such as Sichuan Qiquan sales co; Shandong Qiquan sales co. These companies were wholly owned by key distributors whose equity interest was determined based on the sales revenue in the previous year and sales persons who can participate in the shareholding.
Laojiao's responsibility	Laojiao provides operation guidance regarding on each brand management such as first-tier wholesaler price, retail selling price, supply volume etc. In some area, the subsidiaries of Laojiao directly take charge of individual products' marketing and distribution.	Laojiao standardised and supervised the operation of Qiquan sales companies through all kinds of contracts and profit allocation. Qiquan sales companies then managed lower-tier distributors in their individual regional markets
Deliver routes	Laojiao's wholly owned sales company delivers products to each brand sales company, then brand sales companies delivered to distributors, subsidiaries of these brand sales companies, then to retailers	Laojiao's wholly owned sales company delivered products to Qiquan sales companies, then Qiquan sales companies delivered to all level of distributors, then to retailers
Marketing	Laojiao self takes charge of product promotion and new market development.	Qiquan sales companies were in charge of product promotion and market penetration . So Laojiao was less sensitive on market demand changes in customer ends.

SOURCES: CGIS RESEARCH, COMPANY DATA

... potential tail risk in the long term

Laojiao helped a couple of large distributors set up three sales companies in charge of three different brand products: Cellar 1573, Cellar Age and Tequ. The shareholders of these three sales companies are large-scale distributors. Laojiao recruited sales people for these three sales companies to help carry out its sales strategies and policies. We expect these three sales companies to be among Laojiao's top five distributors.

Compared with Moutai and Wuliangye's general wholesale model, and Yanghe's go-to-market model, Laojiao's model may have some potential tail risks in the long term. The revenue contribution from its top five customers is considerably higher than that of its peers, about 67% in 2018, whereas Wuliangye's was 11%, and Moutai and Yanghe were both about 5%. So the bargaining power of Laojiao's top five distributors is relatively strong. This might not be a big issue when the baijiu industry is in a growth period, since the interests of Laojiao and its distributors will be well aligned to seek maximum sales growth through a stronger brand image, market development, etc. Distributors will consistently follow Laojiao's guidance on marketing strategies. However, if there is a downturn in the baijiu industry, the disadvantage of top five distributors' strong bargaining power may become noticeable, such as unfair profit allocation between large and small distributors; and steps taken by large distributors in reaction to a sector downturn that are not in line with Laojiao's interests.

**Figure 10: Revenue proportion from the top five customers**


SOURCES: CGIS RESEARCH, COMPANY DATA

**Figure 11: Laojiao's brand value up by 40%, ranking it among the top four in 2019**

2019 Rank	Brand	Country	2019 Brand value (US\$, m)	Brand value change on YoY basis
1	Moutai	China	\$30,470	43.4%
2	Wuliangye	China	\$16,038	9.6%
3	Yanghe	China	\$9,060	16.2%
4	Luzhou Laojiao	China	\$5,371	40.4%
5	Johnnie Walker	United Kingdom	\$4,644	8.1%
6	Jack Daniel's	United States	\$4,335	23.3%
7	Hennessy	France	\$3,869	17.0%
8	Bacardi	Cuba	\$3,657	53.8%
9	Smirnoff	Russia	\$3,497	8.1%
10	Gujing Gong Jiu	China	\$2,703	10.3%

SOURCES: CGIS RESEARCH, BRAND FINANCE

**Figure 12: Laojiao distribution model compared with that of its key peers**

	Profit-share model with distributors	General wholesale model of China's baijiu industry	Go-to market model
<b>Description</b>	<ul style="list-style-type: none"> <li>* Baijiu distributors set up their own sales companies based on Laojiao's guidance.</li> <li>* Laojiao builds sales teams in these sales companies and takes charge of developing new markets, brand promotion, product display and product distribution to the end-consumer.</li> <li>* Distributor network is flattened.</li> </ul>	<ul style="list-style-type: none"> <li>* Use of wholesalers network comprising multiple tiers of third parties to reach target customer segments.</li> <li>* Wholesalers are entirely responsible for marketing, promotion and distribution in their respective territories.</li> </ul>	<ul style="list-style-type: none"> <li>* first implemented by Yanghe.</li> <li>* Yanghe develops new markets for distributors and takes charge of brand promotion, product display and other services.</li> <li>* Distributors are responsible for basic functions such as market management, logistics, warehouse and cash flow in their respective territories.</li> <li>* Front-line salespeople are managed and evaluated by Yanghe using the Amoeba operating model.</li> </ul>
<b>Distributors' margin</b>	<ul style="list-style-type: none"> <li>* Laojiao earn fairly low margins, as it need take charge of marketing related expenses and sales team build-up in the early stage.</li> </ul>	<ul style="list-style-type: none"> <li>* Wholesalers have strong bargaining power and earn high channel distribution margins.</li> <li>* As each party in the wholesaler pyramid model wants a piece of the profits, baijiu companies frequently offer discounts and promotions to retailers and consumers.</li> </ul>	<ul style="list-style-type: none"> <li>* Distributors have small bargaining power and earn fairly low channel distribution margins.</li> </ul>
<b>Advantage</b>	<ul style="list-style-type: none"> <li>* Laojiao has strong control of channel inventory through controlling the supply volume in each sales company.</li> <li>* Laojiao has the ability to coordinate its sales interactions via production and marketing strategies.</li> <li>* Laojiao gets direct feedback from its end-customers, enabling it to evaluate the effectiveness of its marketing strategy and tailor its development of new products to consumer interests.</li> </ul>	<ul style="list-style-type: none"> <li>* Wholesalers have sufficient cash flow and established local distribution networks to achieve rapid and extensive coverage in many cities at low expense.</li> </ul>	<ul style="list-style-type: none"> <li>* The baijiu manufacturer (e.g. Yanghe) has access to valuable and targeted point-of-sale information that enables it to make intelligent decisions about pricing, promotions and shelf space.</li> <li>* Yanghe can easily to promote a new and small-volume SKUs in Yanghe's own distribution network.</li> </ul>
<b>Disadvantage</b>	<ul style="list-style-type: none"> <li>* Requires huge investment to build the distribution network, which can only be justified for brands with large scale and high profit margins.</li> <li>* Lack of assistance from local distributors at the early stage makes it difficult to penetrate the regional market, given the high barriers to entry built by local brands.</li> </ul>	<ul style="list-style-type: none"> <li>* Baijiu manufacturing companies have minimal information about product sales, pricing and distribution, as it is difficult to track wholesalers' sales to products to retailers. Such information (on consumer purchasing behaviour, demographics) could help the baijiu manufacturers to better compete.</li> <li>* Baijiu companies focus on pushing products through the channels, which could easily cause wholesalers to hold too much inventory.</li> <li>* The wholesalers tend to focus on high-volume products and neglect new, small -volume SKUs.</li> </ul>	<ul style="list-style-type: none"> <li>* Baijiu manufacturer must invest significant human resources and capital to build its own distribution network to reach target customers.</li> </ul>
<b>Representative baijiu manufacturer</b>	Luzhou Laojiao	Moutai, Wuliangye	Yanghe, Anhui Gujing Distillery

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

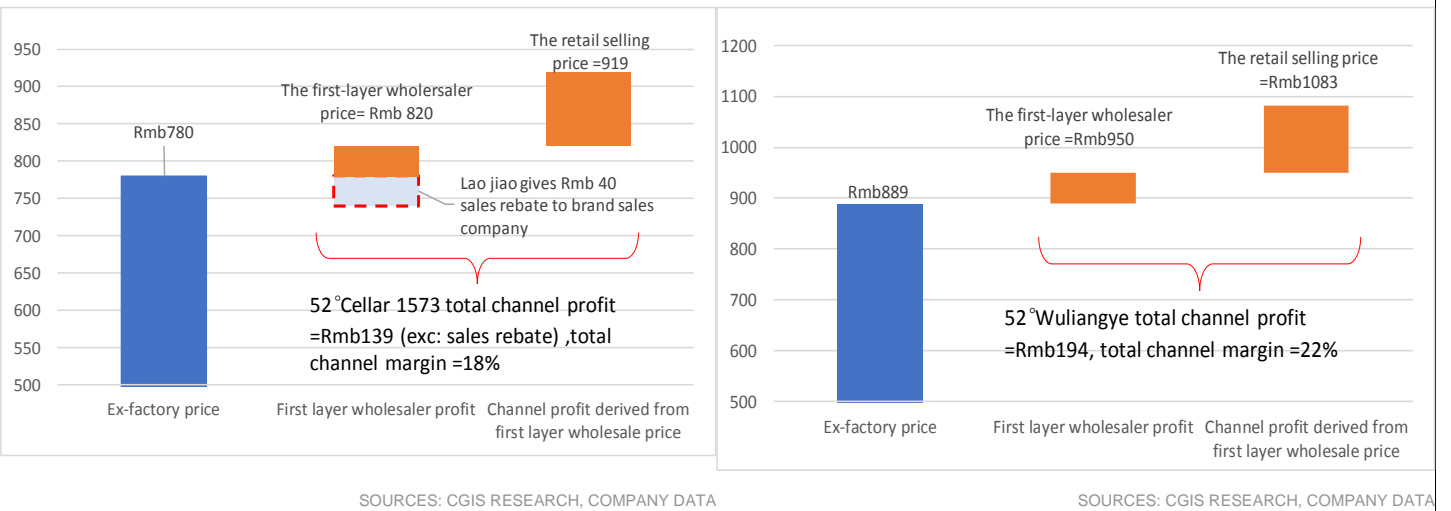
### Distributors supported Laojiao's fast growth in the last baijiu growth cycle

From 2006 to 2014, Laojiao applied a region-oriented model to encourage its key regional distributors and sales people to set up in their respective operating territories. At the time, Laojiao acted as a pure baijiu manufacturer, and all product promotion and market expansion responsibilities were delegated to its distributors. The distributors received a wide range of incentives and helped Laojiao grow rapidly at a 35% sales CAGR in 2006–12, the last baijiu growth cycle. Its high-end baijiu products were well promoted to consumers by its distributors, and the revenue contribution from baijiu sales improved by 12%, to 67% in 2012 from 55% in 2006.

### Currently, Laojiao's channel profit is lower than Wuliangye's

The retail price of Laojiao's star product – 52° Cellar 1573 – has rebounded back to Rmb919 per bottle, according to JD.com, and its total channel profit is estimated at Rmb140 per bottle, with around a 5.1% distributor GP margin, 1.8% lower than Wuliangye's 6.9%, mainly because Wuliangye successfully increased its ex-factory price and the overall pricing system through product upgrades.

Figure 13: 52° Cellar 1573 channel profit based on our estimates Figure 14: 52° Wuliangye's channel profit based on our estimates



### Margin expansion as a catalyst ➤

Laojiao reclassified its baijiu categories based on its brand name in 2013; all products under Cellar 1573 are in the premium segment, the Cellar Age and Tequ brands are in the mid-range segment, and the Touqu and Er Qu brands are in the low-end segment.

### Gross profit margin expansion driven by product portfolio upgrading

We expect Laojiao's margin expansion to come from two areas. First, we can see a clear product structure upgrading trend in Laojiao's baijiu sales. Its premium baijiu grew at a 17% sales CAGR in 2013–18, and its sales attribution improved by 21%, from 28% in 2013 to 50% in 2018. Mid-range sales grew relative slowly at a 3% sales CAGR in 2013–18, with sales attribution declining from 32% in 2013 to 29% in 2018. Low-end sales fell by a 7% CAGR, with its contribution reduced from 40% in 2013 to 22% in 2018. We expect Laojiao's product portfolio to continue its premiumization trend and for its premium baijiu contribution to reach 70% in 2023F, when Laojiao completes its scheduled capacity expansion. In 2019F–21F, we expect Laojiao's GPM to improve by 2%, from 78% in 2018 to 80% in 2021F.

Second, Laojiao started to expand its capacity in 2016. Phase One involves the construction of about 7,000 new cellars (around 35kt capacity) for base liquor and is scheduled to be completed in 2020. Phase Two is expected to be completed by 2025, with 100kt capacity of base liquor. According to Laojiao management, the new capacity will free some of the older cellars, which are currently used for low-end products, to produce liquor for the Cellar 1573 brand and Cellar Age brand. Laojiao estimates that the production capacity of Cellar 1573 will grow to 15,000 tonnes in 2020F and 25,000t in FY25F (2018: 7,000 tonnes).

Figure 15: Laojiao's premium baijiu sales grew faster than its mid-range and low-end baijiu segment

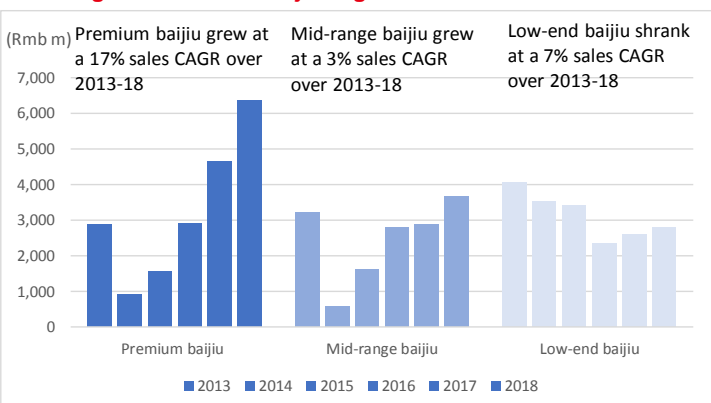
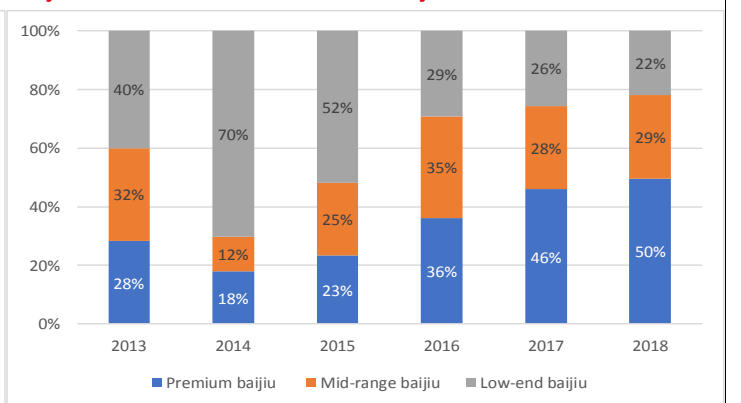
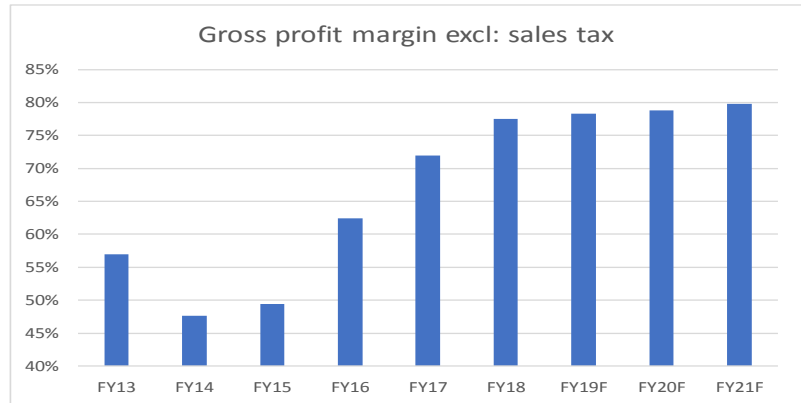


Figure 16: Laojiao's product structure upgrading, where premium baijiu sales attributed 50% of total baijiu sales in 2018



**Figure 17: Laojiao gross profit margin continually improved since 2014**

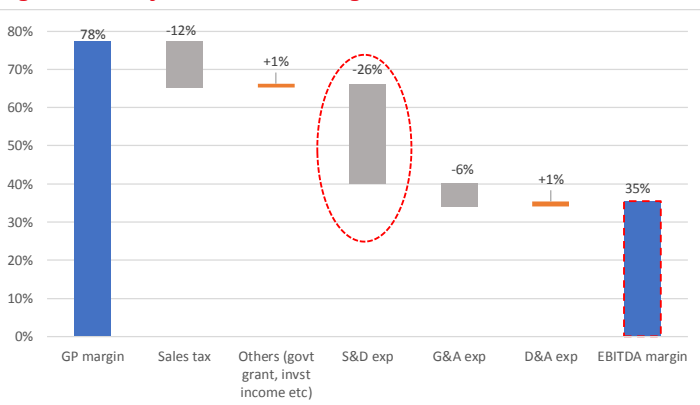


SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

**EBITDA margin improvement driven by better control of expenses**

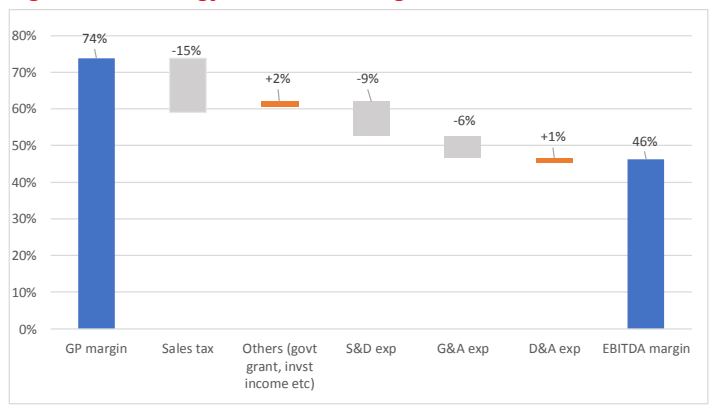
Compared with Wuliangye and Yanghe’s EBITDA margin breakdown analysis, Laojiao’s EBITDA margin was 35% in 2018, 11% and 12% lower than Wuliangye’s and Yanghe’s, respectively, mainly because Laojiao’s S&D expenses ratio was 26%, 17% and 15% higher than Wuliangye’s and Yanghe’s. In 2001, Laojiao launched its star brand – Cellar 1573 – and put a large effort into establishing brand awareness among consumers; therefore, its S&D expenses ratio immediately jumped by 6% to 23% in 2001 from 17% in 2000. This high S&D expenses ratio remained until Laojiao adopted its profit-sharing model with its distributors in 2006. Its S&D expenses ratio gradually declined to 6% in 2012. In the baijiu adjustment period (2013–14) and baijiu recovery period (2015–17), Laojiao continued to dedicate a large investment to its distribution network reconstruction. We think Laojiao’s large-scale input in the distribution network reconstruction stage is largely completed. Laojiao achieved 36% earnings growth in 2018 and 40% earnings growth in 1H19, despite the fact that its S&D expenses ratio remained at relatively high level. Its distribution channel cost input has entered the optimization stage, as cost effectiveness and efficiency will gradually improve, and its S&D expenses ratio should steadily decline, thus improving its net profit margin. We estimate that Laojiao’s net profit margin will improve by 6%pts from 27% in FY18 to 33% in FY21F.

**Figure 18: Laojiao’s EBITDA margin in 2018**



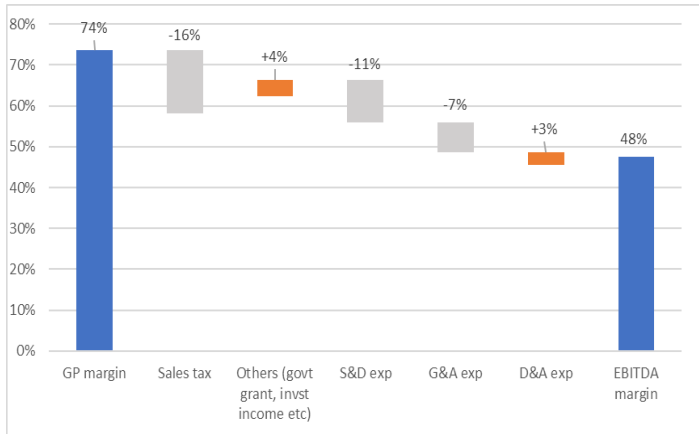
SOURCES: CGIS RESEARCH, COMPANY DATA

**Figure 19: Wuliangye’s EBITDA margin in 2018**



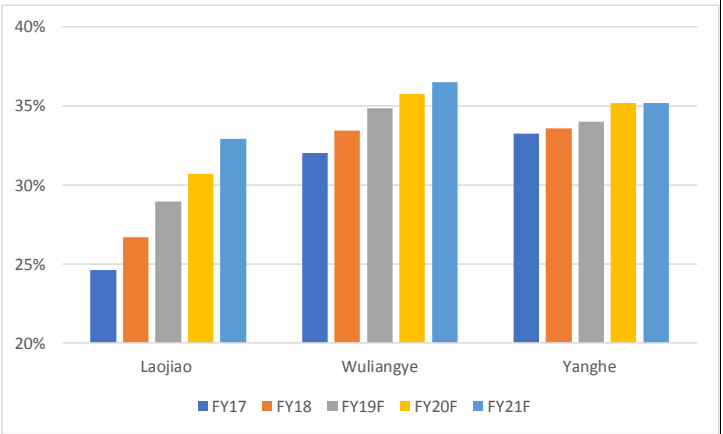
SOURCES: CGIS RESEARCH, COMPANY DATA

Figure 20: Yanghe's EBITDA margin in 2018



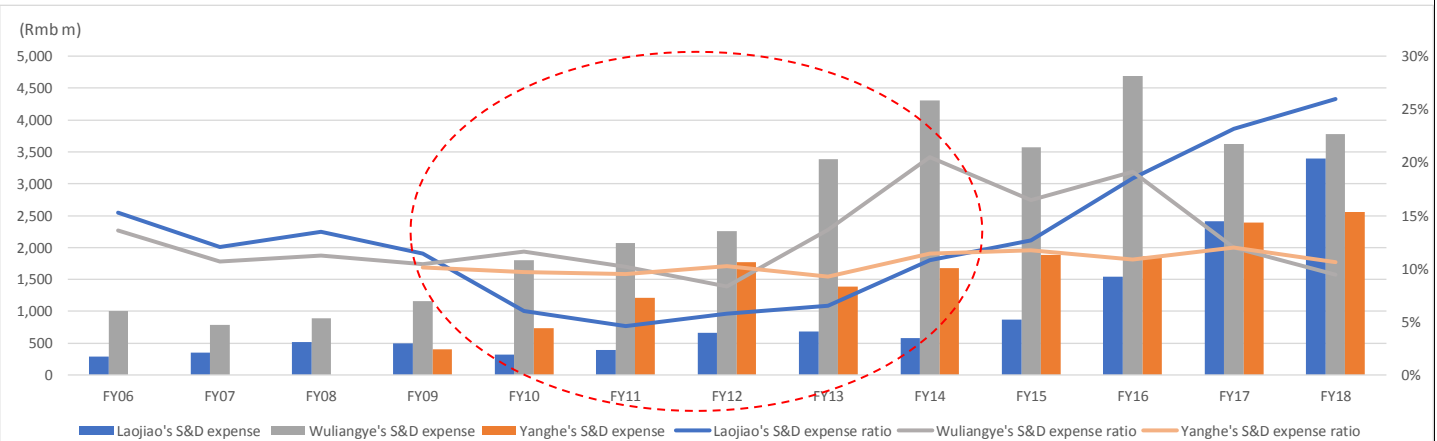
SOURCES: CGIS RESEARCH, COMPANY DATA

Figure 21: Laojiao's net profit margin expected to largely improve based on our estimates



SOURCES: CGIS RESEARCH, COMPANY DATA

Figure 22: S&D expense comparison among Laojiao, Wuliangye and Yanghe from 2006-18



SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

### Initiate with Add rating and DCF-based TP of Rmb122 ➤

We initiate coverage on Laojiao with an ADD rating and DCF-based TP of Rmb122 (WACC: 9.6%), implying 38x/31x FY19F/20F P/E. Laojiao is currently trading at 27x FY19F P/E, 2.0 s.d. above its historical average of 19x since its listing in 2009.

We think Laojiao deserves trading at premium supported by its potential ex-factory price hike on its super-premium Cellar1573 products, continuous mix upgrade and margin expansion. Since early 2019, Moutai's retail selling price has remained at Rmb2000–2900 per bottle. This has led to strong customer demand for premium baijiu products with a strong brand name and an RSP range of Rmb1000–2000 per bottle. We believe Laojiao is the most suitable name to fit in this price range, together with Wuliangye. We expect Laojiao and its distributors to seize this chance to rapidly expand into the super-premium baijiu market.

Meanwhile, we expect Laojiao's profitability to significantly improve owing to 1) its continuous product mix premiumization; and 2) the completion of its distribution channel reconstruction, so there will be no need to incur large channel expenses for its key distributors anymore, and its brand-oriented distribution model will start to bear fruit. Its cost effectiveness and efficiency are expected to improve, reducing its S&D expenses ratio to a normal level.

## Company Profile

### Oldest cellars in China >

Luzhou Laojiao (泸州老窖) positioned itself as cellar age baijiu specialist in the China baijiu market from the beginning. According to Laojiao's company website, the older the cellar, the more the microbes multiply, the more fragrant the baijiu, and the higher the conversion rate of quality base liquor. According to sina.com, Laojiao has over 10,086 cellars, 1,619 of which are more than 100 years old. The oldest ones can be traced back to the Wanli Period of the Ming Dynasty in 1573 A.D.

Figure 23: Laojiao's cellars with over 600 kinds of microbes



SOURCES: CGIS RESEARCH, COMPANY DATA

Figure 24: Red glutinous sorghum is the only kind of grain used in Laojiao's ancient, traditional and authentic way of brewing baijiu



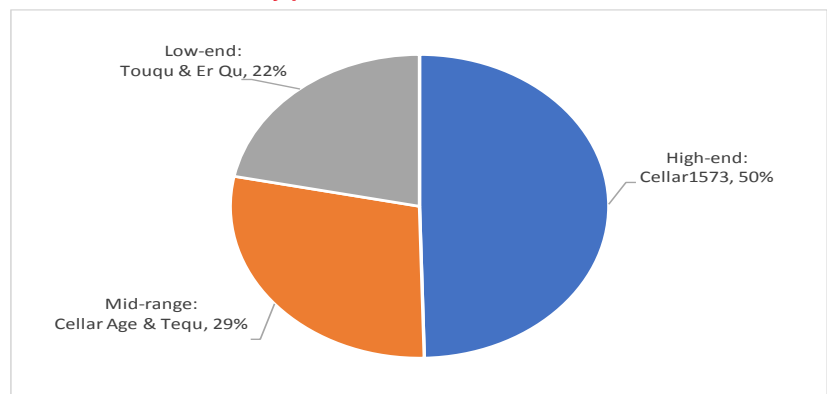
SOURCES: CGIS RESEARCH, COMPANY DATA

Besides its star brand – Cellar 1573 – targeting the super-premium baijiu market (RSP >Rmb600/bottle), in 2010, Laojiao launched another brand – Cellar Age – with an RSP of Rmb250–600 per bottle, depending on its production cellar age, which is aimed at the premium baijiu market (RSP of Rmb300–600/bottle). Sales of Cellar Age products reached Rmb2bn in 2018, accounting for 15% of total sales.

As Figure 25 shows, there is a certain market overlap between the Cellar Age brand and the Tequ brand. For the mid-range baijiu consumption market (RSP of Rmb100–300/bottle), Laojiao does not have a distinctive brand. Its Touqu and Er Qu brands are obviously aimed at the low-end baijiu market (RSP <Rmb100/bottle).

Sales of Laojiao's low-end product segments declined by a 7% CAGR in 2013–18. We think Laojiao's current brand management strategy is to underpin its premium and super-premium brand recognition in less penetrated markets, such as eastern and southern China. Sales volume for the low-end product segment is expected to fall moderately with an ASP hike.

Figure 25: Sales breakdown by product



SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

**Figure 26: Laojiao's product categories based on Laojiao's self-classification**

Retail selling price (RSP) per 500ml unit



SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

**Figure 27: Retail prices of major baijiu products on JD.com over the past few months**

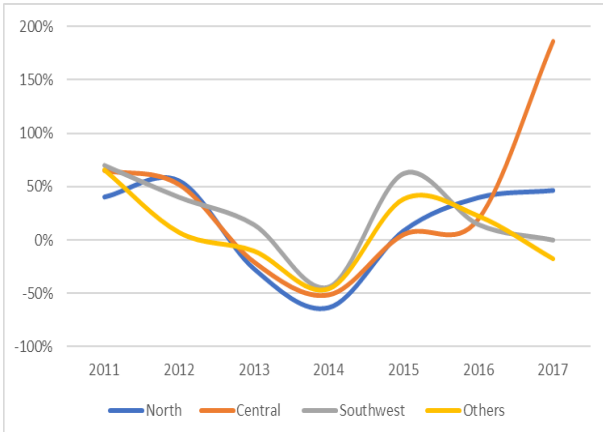
Product Name		Alcohol content	Size per unit	Retail selling price (Rmb per unit)																
In Chinese	In English	(%)	(ml)	30/08/2018	28/9/2018	29/10/2018	29/11/2018	29/12/2018	29/01/2019	12/2/2019	13/3/2019	4/4/2019	4/30/2019	5/30/2019	6/30/2019	7/31/2019	8/31/2019	9/27/2019		
<b>Moutai</b>																				
飞天茅台	53°Feitian Moutai	53	500ml	2,038	1,988	Out of stock	Out of stock	Out of stock	Out of stock	Out of stock	Out of stock	Out of stock	Out of stock	Out of stock	Out of stock	Out of stock	Out of stock	Out of stock	Out of stock	
飞天茅台	43°Feitian Moutai	43	500ml	988	988	989	938	938	938	969	988	988	988	988	1,195	979	1,195	1,195	1,195	
茅台王子酒	53°Prince	53	500ml	158	159	158	158	158	158	155	141	228	228	158	156	158	158	138	138	
茅台王子黑金	53°Prince Black	53	500ml	298	298	218	258	258	258	177	298	298	298	281	228	298	218	218	218	
茅台金王子	53°Prince Gold	53	500ml	388	388	388	338	338	338	316	388	405	405	238	238	238	238	228	228	
茅台迎宾	53°Yingbin	53	500ml	98	98	97	98	98	98	98	98	128	128	88	98	98	79	88	88	
茅台迎宾中国红	53°Yingbin Red	53	500ml	169	169	148	168	168	168	168	168	198	198	138	128	158	158	138	138	
茅台汉酱-铂金蓝	51°Hanjiang Blue	51	500ml	569	569	569	569	569	569	359	569	569	569	498	598	498	428	458	458	
茅台汉酱	51°Hanjiang	51	500ml	399	399	399	318	318	318	306	374	498	498	358	358	358	358	358	358	
茅台赖茅-传承蓝	53°Laimao Blue	53	500ml	343	343	343	458	458	458	343	343	368	368	325	388	369	408	408	408	
茅台赖茅-金樽	53°Laimao Gold	53	500ml	699	688	688	699	699	699	688	758	668	668	591	608	608	649	608	608	
茅台赖茅-红御	53°Laimao Red	53	500ml	558	508	508	558	558	558	499	499	502	502	448	471	488	508	525	525	
<b>Wuliangye</b>																				
普五	52°Wuliangye	52	500ml	1,025	1,059	1,019	959	917	917	917	886	917	917	966	1,000	1,167	1,083	1,117	1,117	
五粮液39度	39°Wuliangye	39	500ml	600	610	566	594	594	594	602	567	595	595	608	628	627	662	628	628	
五粮液虎符令	52°Tiger Wuliangye	52	500ml	1,200	1,200	1,198	1,199	1,199	1,200	1,100	Out of stock	Out of stock	1,099	1,081	1,083	1,100	1,100	1,100	1,100	
五粮液豪华装	52°Luxury Wuliangye	52	500ml	900	912	900	906	906	906	979	No display	No display	No display	No display	No display	No display	No display	No display	No display	
五粮液1618	52°Wuliangye 1618	52	500ml	950	922	883	901	901	901	917	882	900	931	948	983	996	1,050	1,065	1,065	
五粮液	68°Wuliangye	68	500ml	788	799	799	769	769	769	809	796	733	733	798	849	848	899	839	839	
五粮春	50°WL Spring	50	500ml	241	257	240	231	231	231	249	265	265	265	257	265	257	265	268	268	
五粮春	45°WL Spring	45	500ml	188	200	183	180	180	180	209	208	218	218	207	216	207	216	216	216	
五粮春	35°WL Spring	35	500ml	173	184	166	178	178	178	186	Out of stock	207	207	195	207	207	207	207	207	
五粮液-红淡雅	50°WL Mellow Red	50	500ml	67	67	62	66	70	70	83	62	70	70	65	70	57	67	68	68	
五粮液-红淡雅	42°WL Mellow Red	42	500ml	68	67	67	70	66	66	65	56	65	65	64	69	67	79	67	67	
五粮液-金淡雅	50°WL Mellow Golden	50	500ml	145	134	133	142	142	142	159	135	150	150	102	133	117	111	108	108	
五粮液-臻选6	50°WL Mellow Zhenxuan6	50	500ml	218	217	194	198	198	198	218	198	218	218	213	216	213	185	210	210	
五粮液头曲	52°WL Touqu	52	500ml	123	118	103	100	100	100	150	100	133	133	116	150	112	133	159	159	
五粮液特曲	52°WL Tequ	52	500ml	228	229	200	215	215	215	248	248	Out of stock	Out of stock	231	222	232	238	238	238	
五粮液特曲精品	52°WL Tequ special	52	500ml	275	276	275	283	283	283	317	317	317	317	315	331	315	331	331	331	
尖庄曲酒	52°Jianzhuang	52	500ml	22	31	22	21	21	21	33	33	30	30	48	35	33	34	33	33	
<b>Yanghe</b>																				
梦之蓝-手工班	52°Blue Dream Handmade	52	500ml	1,788	1,788	1,788	1,788	1,788	1,788	1,788	1,788	1,688	1,778	1,788	1,788	1,778	1,778	no stock	no stock	
梦之蓝M9	52°Blue Dream M9	52	500ml	1,699	1,699	1,569	1,599	1,599	1,599	1,399	1,579	1,568	1,399	1,499	1,699	1,568	1,428	1,649	1,649	
梦之蓝M9	45°Blue Dream M9	45	500ml	1,599	1,509	1,509	1,509	1,509	1,509	1,399	1,579	1,498	1,399	1,399	1,599	1,468	1,459	1,549	1,549	
梦之蓝M6	52°Blue Dream M6	52	500ml	699	769	759	709	709	709	695	769	703	759	699	769	689	699	725	725	
梦之蓝M6	45°Blue Dream M6	45	500ml	659	709	699	649	649	649	650	709	679	699	709	709	649	639	680	680	
梦之蓝M3	52°Blue Dream M3	52	500ml	498	569	516	517	517	517	528	574	529	484	492	567	504	465	562	562	
梦之蓝M3	45°Blue Dream M3	45	500ml	458	512	461	462	462	462	498	509	498	449	432	507	462	440	487	487	
梦之蓝 M1	52°Blue Dream M1	52	500ml	348	344	339	330	330	330	297	387	334	334	388	388	362	370	415	415	
梦之蓝 M1	45°Blue Dream M1	45	500ml	399	333	319	295	295	295	297	312	309	309	333	319	390	359	395	395	
天之蓝	52°Blue Sky	52	520ml	345	342	338	340	340	340	354	340	361	361	365	335	355	365	391	391	
海之蓝	52°Blue Sea	52	520ml	158	154	154	144	144	144	142	160	168	168	163	168	154	153	174	174	
洋河微分子	43.8°Yanghe Micromolecule	43.8	500ml	308	308	288	306	306	306	369	285	262	262	299	287	285	262	267	267	
洋河大曲	55°Yanghe Daqu	55	500ml	54	51	50	54	54	54	53	51	54	54	58	58	52	50	58	58	
洋河大曲-新天蓝	52°Yanghe Daqu Blue	52	500ml	58	53	46	63	63	63	55	62	59	59	58	67	55	53	63	63	
洋河小曲	42°Yanghe Xiaoqu	42	480ml	35	35	33	34	34	34	35	No display	No display	No display	No display	35	33	36	35	35	
洋河特曲	52°Yanghe Tequ	52	500ml	99	99	99	113	113	113	113	113	75	75	113	113	112	75	71	71	
洋河-洋小二	46°Yangxiaer	46	500ml	58	48	58	54	54	54	65	65	No display	No display	78	78	78	78	75	75	
双沟-珍宝坊君坊	41.8°Shuanggou - Zhenbaofang	41.8	500ml	108	129	114	103	103	103	119	119	121	121	111	114	119	109	114	114	
双沟-普苏	42°Shuanggou - Pusu	42	500ml	103	108	98	99	99	99	106	98	98	98	103	103	103	93	103	103	
双沟大曲-小青花	42°Shuanggoudaqu - Xiaoqinghua	42	480ml	98	98	94	98	98	98	93	108	77	77	81	83	83	90	82	82	
<b>Luzhou Laojiao</b>																				
国窖1573	52°Cellar1573	52	500ml	879	843	899	860	860	860	840	969	888	888	909	919	919	919	919	919	
国窖1573	38°Cellar1573	38	500ml	655	631	646	660	660	660	640	733	648	648	648	739	709	739	739	739	
百年泸州老窖 窖龄90年	52° Cellar age of 90yrs	52	500ml	428	381	481	430	430	430	458	Out of stock	478	478	588	465	488	535	535	535	
百年泸州老窖 窖龄60年	52°Cellar age of 60yrs	52	500ml	280	268	278	288	288	288	298	308	338	338	388	338	298	388	388	388	
百年泸州老窖 窖龄30年	52°Cellar age of 30yrs	52	500ml	228	215	215	230	230	230	248	268	268	268	268	228	228	268	248	248	
泸州老窖特曲	52°Laojiao Tequ	52	500ml	228	201	218	248	248	248	235	218	248	248	228	218	258	308	258	258	
泸州老窖特曲	38°Laojiao Tequ	38	500ml	188	171	211	208	208	208	218	205	218	218	205	187	214	288	238	238	
泸州老窖头曲	52°Laojiao Touqu	52	500ml	66	55	56	61	61	61	60	60	70	70	70	75	79	78	88	88	
泸州老窖头曲-六年窖	52°Touqu age of 6yrs	52	500ml	61	61	61	63	63	63	62	62	68	69	69	59	79	83	83	83	

SOURCES: CGIS RESEARCH, COMPANY DATA, JD.COM

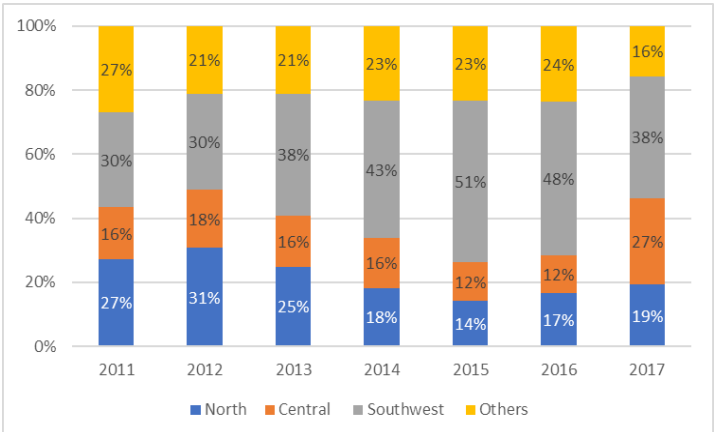
## Consumption upgrades in home market with outstanding sales growth in the central market ➤

Laojiao is a famous Sichuan baijiu producer, so the southwestern market is considered its home market, where the Company has established a solid market position with wide brand recognition, contributing 38% of overall sales for Laojiao in 2017. Despite the southwestern market retaining flattish growth of Rmb4bn in sales in 2017, its gross profit margin increased by 8%pts to 79% in 2017, higher than Laojiao's blended gross profit margin of 72% in 2017.

Central and northern China are relatively competitive baijiu markets, with all kinds of high-end baijiu brands chasing market share. In 2017, Laojiao achieved prominent sales growth of 186% yoy in the central market to Rmb2.8bn, with a GPM of 72%, accounting for 27% of total sales. Northern China sales grew rapidly as well, at 48% yoy in 2017 to Rmb2bn, with a GPM of 71%, contributing 19% of overall sales. With Laojiao's continuous improvement in its distribution channels, we expect its sales in the central and northern markets to progressively expand and its profitability to improve as well.

**Figure 28: Laojiao's sales growth in each geographical market**


SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

**Figure 29: Each geographical market sales contribution**


SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

## Industry overview and outlook

### Rising sales volume to drive growth of premium baijiu market



We expect sales volume of low-end baijiu to continue to decline, but sales volume of the premium and super premium segments to grow rapidly, driven by consumption upgrades and premiumization. For the premium baijiu segments, the first-tier wholesale price for key premium products, such as Moutai, Wuliangye and Cellar 1573, have risen since 2016 through either product mix upgrades or ex-factory price hikes. We expect rising sales volume and an ASP increase to be the key drivers for premium baijiu market growth in 2019F.

**Figure 30: First-tier wholesale price growth on an upward trend**

First-tier wholesaler price (Rmb per 500ml unit)		2016	2017	2018	YTD2019
53°Feitian Moutai	Lowest	830	1080	1500	1750
	Highest	1050	1400	1730	2700
	Range	27%	30%	15%	54%
52°Wuliangye	Lowest	615	710	800	795
	Highest	685	810	830	980
	Range	11%	14%	4%	23%
52°Cellar1573	Lowest	580	630	730	710
	Highest	620	770	760	820
	Range	7%	22%	4%	15%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

According to Euromonitor, the premium and super premium baijiu segments will expand by a sales CAGR of 7% and 11%, respectively, in 2017–21F, while the low-end segment will see sales contract by an 11% CAGR over the same period.

**Figure 31: Sales volume growth by product category during each baijiu industry cycle in China**

China baijiu industry cycle	Adjustment period	Recovery period	New growth period
Sales volume growth	2012-15 CAGR	2015-17 CAGR	2017-21F CAGR
Low-end	7%	-6%	-12%
Mid-range	4%	5%	5%
Premium	-2%	8%	7%
Super premium	-4%	17%	12%
<b>Total baijiu</b>	<b>4%</b>	<b>1%</b>	<b>0%</b>

SOURCES: CGIS RESEARCH, EUROMONITOR

**Figure 32: Sales growth by product category during each baijiu industry cycle in China**

China baijiu industry cycle	Adjustment period	Recovery period	New growth period
Sales value growth	2012-15 CAGR	2015-17 CAGR	2017-21F CAGR
Low-end	10%	-2%	-11%
Mid-range	7%	9%	8%
Premium	1%	10%	7%
Super premium	-11%	17%	11%
<b>Total China Baijiu Industry</b>	<b>-5%</b>	<b>13%</b>	<b>9%</b>

SOURCES: CGIS RESEARCH, EUROMONITOR

Based on retail selling price (RSP), the baijiu industry can be divided into four segments: 1) low-end (RSP per 500ml unit <Rmb100), 2) mid-range (Rmb100–300), 3) premium (Rmb300–600), and 4) super premium (>Rmb600), as shown in Figure 33.

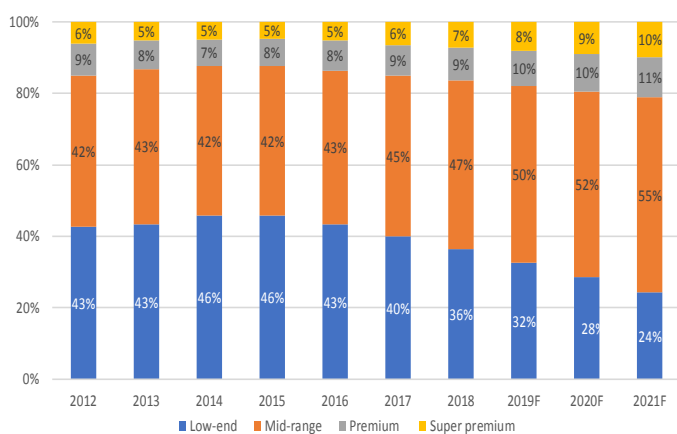
**Figure 33: Major brands in each baijiu category**

Category	Retail selling price (RSP) per 500ml unit	Baijiu Brewery	Popular Brand
Super premium	>Rmb600	Moutai	53°Feitian MT
		Wuliangye	52°WLY
		Luzhou Laojiao	Cellar1573
		Yanghe	M6 , M9
Premium	Rmb300-600	Yanghe	M3, Blue Sky
		Luzhou Laojiao	Cellar age, Tequ
		Guijing	Guijing
		Jiannanchun	Jiannanchun 52°
		Swellfun	Zhennian No.8, Jingtai
		Liangjiu	Liangjiu Red
		Finwine	Qinghua
		Jiugujiu	Jiugujiu Red
Mid-range	Rmb100-300	Yanghe	M1, Blue Sea
		Moutai	Prince
		Wuliangye	WL Spring
		Fenwine	Laobaifen
Low-end	<Rmb100	Luzhou Laojiao	Tequ
		Yanghe	Yanghe, Shuanggou
		Moutai	Yingbin
		Wuliangye	WL Mellow
		Luzhou Laojiao	Touqu Er Qu

SOURCES: CGIS RESEARCH, JD.COM

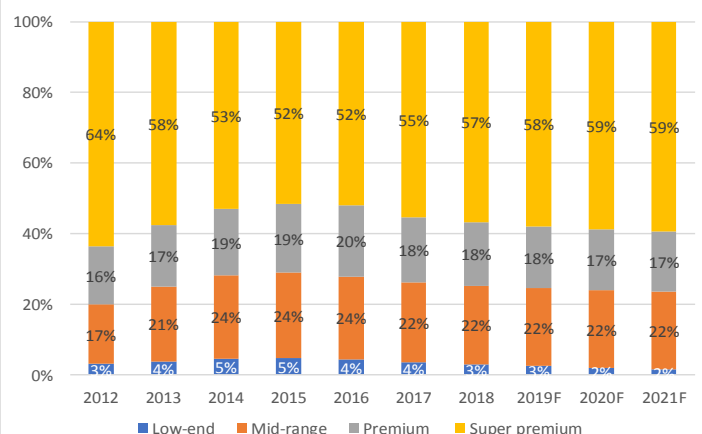
According to Euromonitor, the premium and super premium segments combined accounted for 16% of total sales volume in 2018 (super premium comprised 7% and premium accounted for 9%), but contributed 75% of sales value (premium contributed 18% and super premium comprised 57%).

**Figure 34: Baijiu sales volume breakdown by category, based on Euromonitor estimates**



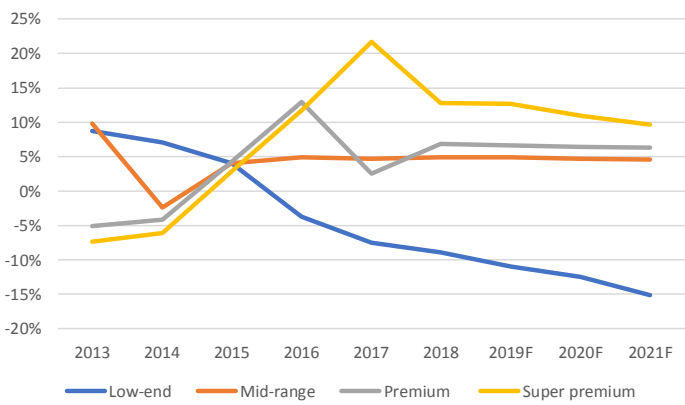
SOURCES: CGIS RESEARCH, EUROMONITOR

**Figure 35: Baijiu sales value breakdown by category, based on Euromonitor estimates**



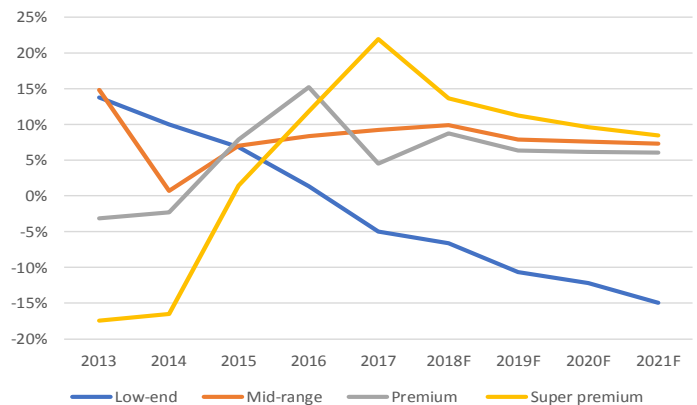
SOURCES: CGIS RESEARCH, EUROMONITOR

**Figure 36: Sales volume – Premium and super premium segments to expand by a CAGR of 7% and 12% in 2017–21F, based on Euromonitor estimates**



SOURCES: CGIS RESEARCH, EUROMONITOR

**Figure 37: Sales value – Premium and super premium segments to expand by a CAGR of 7% and 11% in 2017–21F, based on Euromonitor estimates**



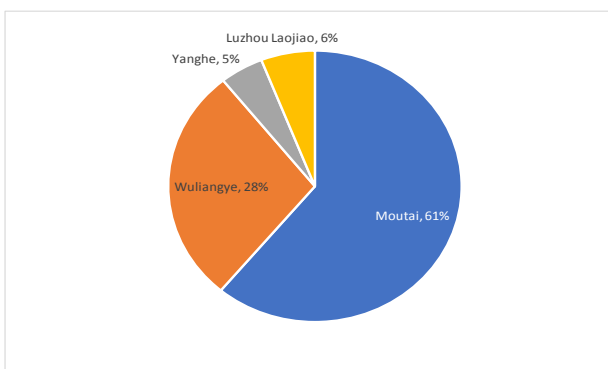
SOURCES: CGIS RESEARCH, EUROMONITOR

### Premium baijiu market expected to consolidate further >

The super premium baijiu market in China is highly concentrated, dominated by Moutai, Wuliangye, Luzhou Laojiao and Yanghe. We estimate that Moutai had a market share of over 60% of the super premium baijiu segment in 2017, based on the revenue of these four companies. We do not believe any competitor has the capability to challenge Moutai's dominant market position in the near term.

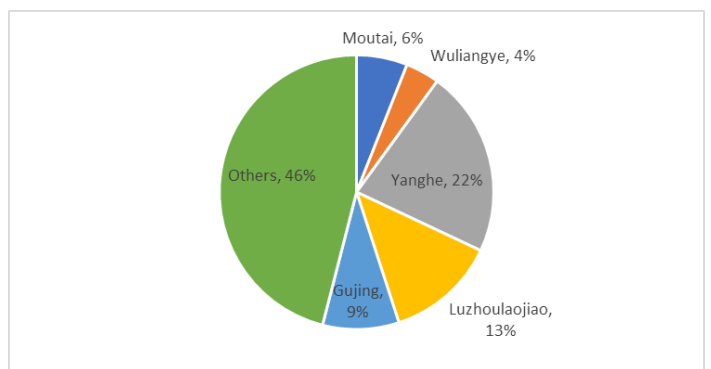
But the premium baijiu market is more fragmented. Apart from national brands, certain regional brands are also popular. According to Euromonitor, sales value of the top five premium brands accounted for 57% of total premium baijiu sales in 2017. We expect the premium baijiu market to consolidate further, with leading players with high brand recognition, flat and wide distribution networks, and strong management execution ability (such as Yanghe) to gain market share.

**Figure 38: Super premium baijiu market share (sales) breakdown (2018), based on our estimates – Moutai dominant with a market share of over 60%**



SOURCES: CGIS RESEARCH ESTIMATES, COMPANY REPORTS

**Figure 39: Premium baijiu market share (sales) breakdown (2017)**

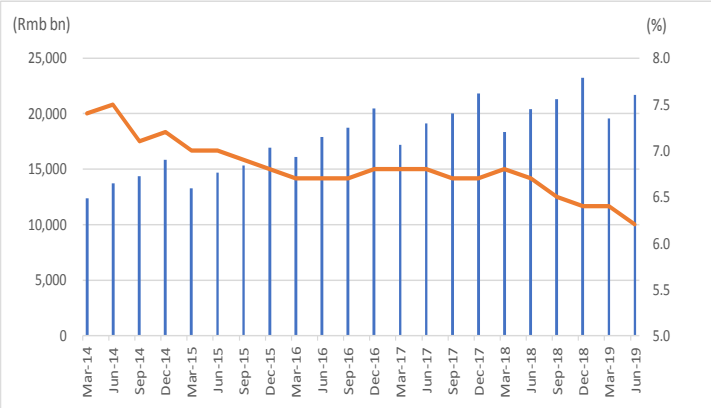


SOURCES: CGIS RESEARCH, EUROMONITOR

### Three drivers for Baijiu's long-term sales growth >

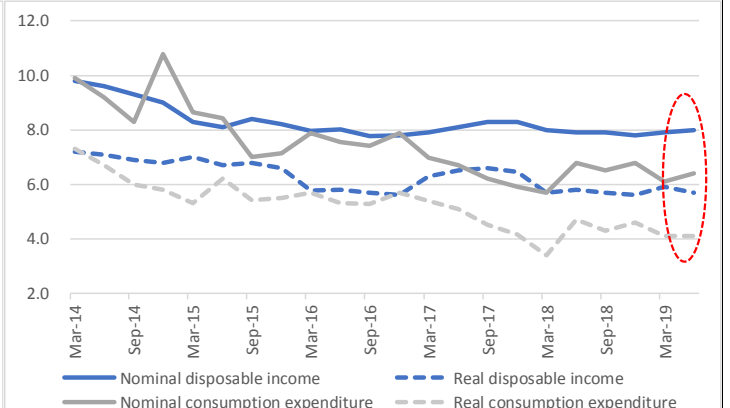
We expect the three major growth drivers of baijiu consumption in China to be: 1) continuous urbanization and a rising middle class; 2) an increasing proportion of younger consumers between 18 and 35; and 3) the expansion of online and offline combined channels, which will provide impetus for private consumption. We expect consumption upgrades and premiumization to remain dominant themes in the China market in the long run.

**Figure 40: Slowdown in China's GDP growth since 2Q18**



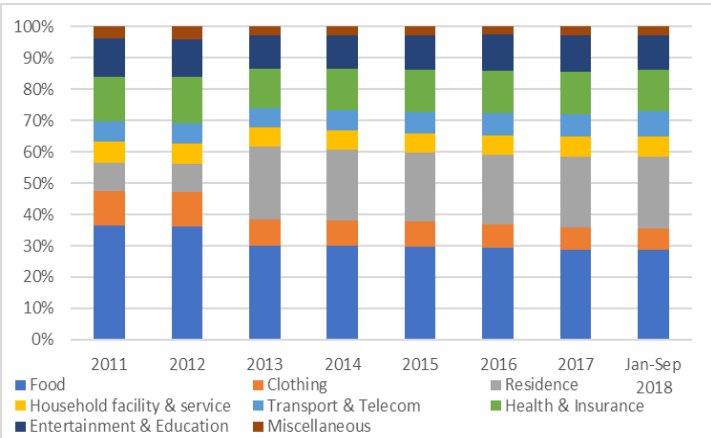
SOURCES: NATIONAL BUREAU OF STATISTICS, CGIS RESEARCH

**Figure 41: China's urban income and consumption expenditure per head (yoy % change)**



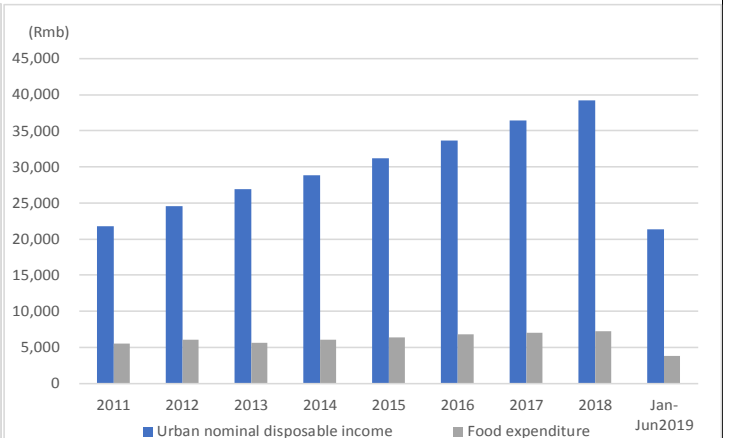
SOURCES: NATIONAL BUREAU OF STATISTICS, CGIS RESEARCH

**Figure 42: China's urban consumption expenditure breakdown (%)**



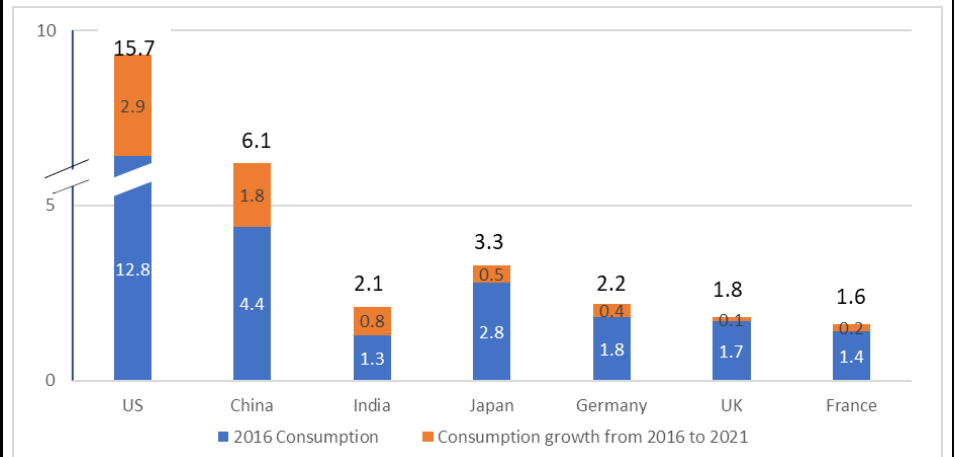
SOURCES: NATIONAL BUREAU OF STATISTICS, CGIS RESEARCH

**Figure 43: China's food consumption expenditure per capita is rising, as urban nominal disposable income per capita is steadily increasing**



SOURCES: NATIONAL BUREAU OF STATISTICS, CGIS RESEARCH

**Figure 44: Consumption expenditure (2016) and growth in 2016–21F by country – China could add US\$1.8tr in new consumption by 2021F, based on a conservative GDP growth assumption of 5.5% by Economist Intelligence Unit**



SOURCES: ECONOMIST INTELLIGENCE UNITS, BCG ANALYSIS, ALIRESEARCH, CGIS RESEARCH

**Consumption structure for baijiu has changed**

The consumption structure of China's baijiu market has changed significantly since 2014, with individuals and private companies becoming more dominant, accounting for 45% and 50%, respectively of total baijiu sales since 2014 (2012: private companies comprised 28% and individuals constituted 22%), while government-led consumption shrank to 5% (2012: >50%). We expect individual

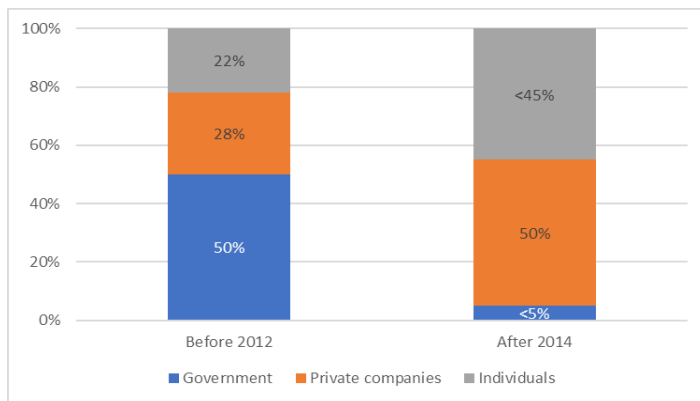
consumption in the premium baijiu segment to continue to rise in the long run, mainly because of the following:

**High net worth households driving consumption upgrades:** The number of high net worth households with investable assets above US\$1m in China continues to expand, and the number is expected to rise by an estimated 2016–21F CAGR of 13% to 4m by 2021F, in tandem with investable assets growth of 15% CAGR to Rmb111tr by 2021F, based on the Boston Consulting Group (BCG) research report titled “China private banking 2017”. These households are expected to contribute significantly to the premium and super premium baijiu markets, as the philosophy of “drinking less, but drinking better” has continued to influence the behaviour of Chinese consumers, particularly upper-middle and high-income consumers.

**Young consumers becoming a new driver in the consumption sector:** Based on BCG’s estimates, the new generation of consumers aged 18 to 35 will contribute consumption expenditure of US\$2.6tr in 2021F from US\$1.5tr in 2016, likely surpassing the consumer group aged over 35, and will account for US\$2.4tr in 2021F vs. US\$1.9tr in 2016. We conducted a market survey of China’s baijiu sector in Nov 2018 with 532 participants. According to our market survey, the primary consumers of baijiu are between 30 and 50. However, our survey found that baijiu is becoming more popular with the younger generation, with consumers aged 20 to 30 years and those below 20 starting to drink baijiu. About 45% of respondents between 20 and 30 said they drink baijiu.

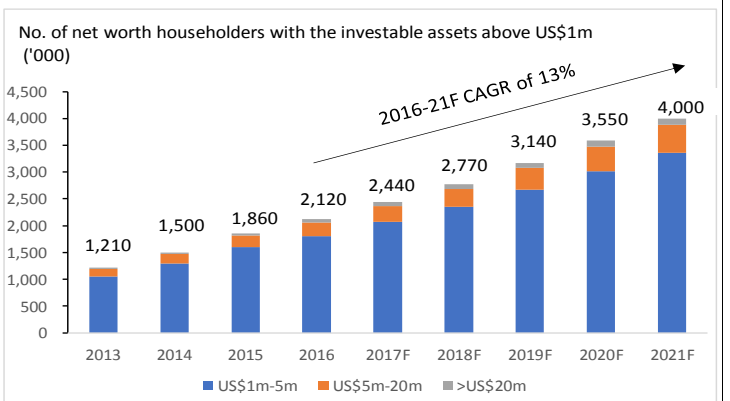
**Premiumisation upside from lower-tier cities:** Based on McKinsey & Company’s estimates, by 2022F, the middle class in lower-tier cities will account for over 30% of China’s middle-class population, compared with 15% in 2002. Thus, we see high potential for upgrades in the baijiu product mix in lower-tier cities over the next 3–5 years.

**Figure 45: Individuals and private companies have become the largest baijiu consumers by sales since 2014**



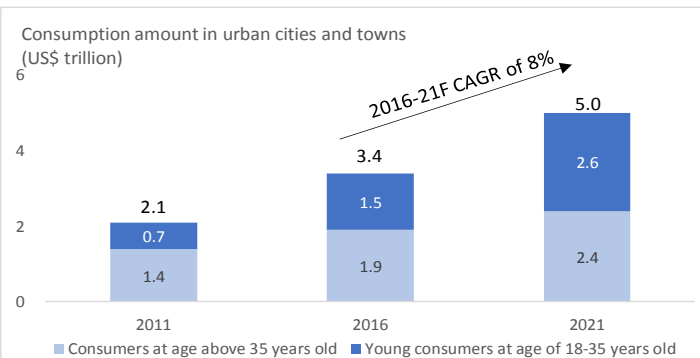
SOURCES: CGIS RESEARCH, CHYXX.COM

**Figure 46: The number of high net worth households with investable assets above US\$1m in China is expected to reach 4m in 2021F, based on BCG estimates**



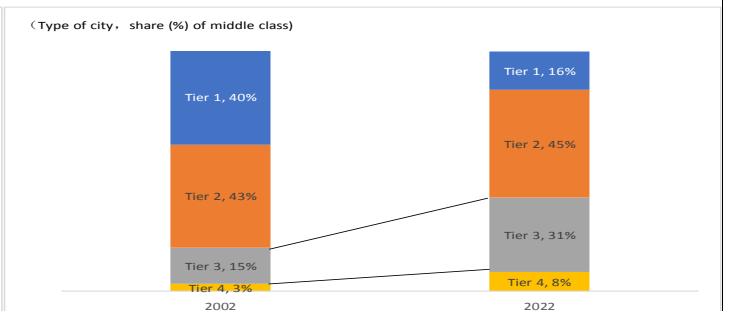
SOURCES: BCG, CGIS RESEARCH

**Figure 47: Urban consumption expenditure by consumer age bracket – young consumers aged 18–35 have huge consumption power**



SOURCES: CGIS RESEARCH, BCG

**Figure 48: The proportion of middle-class population from lower-tier cities is expected to increase by 2022F, based on McKinsey & Company estimates**



Note: McKinsey defines based on 2010 nominal GDP. Tier-1 cities >Rmb932bn, Tier 2 cities at Rmb120-932bn, Tier 3 cities at Rmb22-120bn, Tier 4 cities <Rmb22bn.

McKinsey defines different class of urban households by annual disposal income per urban household, in 2010 real terms; Affluent>Rmb229,000, upper middle class at Rmb106,000-229,000, mass middle class at Rmb60,000-106,000, Poor<Rmb60,000

SOURCES: CGIS RESEARCH, MCKINSEY & COMPANY

## Financial review and outlook

### Ongoing product premiumization to boost margins

In 1H19, Laojiao recorded 25% yoy sales growth to Rmb8.0bn, with net profit up by 40% yoy to Rmb2.8bn. These result were attributed mainly to strong sales growth of its premium and mid-range baijiu segments, which grew by 30% and 35%, respectively, on a yoy basis. Its low-end baijiu segment maintained flattish 0.7% yoy sales growth. As a result, the revenue contribution from the premium and mid-range segments grew 2%pts to 54%, and 2%pts to 28%, respectively; while the low-end segment shrank by 4%pts to 17% in 1H19.

Because Laojiao's product structure focused on premiumization, its GPM, excluding sales tax, improved by 4.8%pts to 80% in 1H19. The G&A expenses ratio declined by 1%, which was wholly offset the impact of S&D expenses rising by 0.6%pt. The net profit margin was up by 3.7%pts to 34% in 1H19.

**Figure 49: Financial review of Laojiao in 1H19**

	Q118	Q218	Q318	Q418	Q119	Q219	FY18	FY19F	YoY	1H18	1H19	YoY
Revenue	3,370	3,050	2,843	3,793	4,169	3,844	13,055	16,264	25%	6,420	8,013	25%
YoY (%)	26%	25%	31%	22%	24%	26%	26%	25%		25%	25%	
Gross Profit incl: sales tax	2,173	1,917	1,977	2,449	2,819	2,540	8,516	10,738	26%	4,090	5,360	31%
Other operating income	25	43	34	19	51	60	122	117	-4%	68	111	63%
Sale and distribution expense	-613	-578	-891	-1,310	-706	-833	-3,393	-3,901	15%	-1,191	-1,539	29%
General Administrative expense	-140	-215	-181	-261	-163	-200	-785	-896	14%	-355	-363	2%
Operating profit	1,444	1,168	939	897	2,002	1,567	4,460	6,058	36%	2,611	3,569	37%
Net Profit	1,059	908	772	735	1,515	1,235	3,486	4,697	35%	1,967	2,750	40%
YoY (%)	33%	36%	45%	31%	43%	36%	36%	35%		34%	40%	
<b>Margins</b>									<i>ppt chg</i>			<i>ppt chg</i>
Gross profit margin excl:sales ta	75%	75%	81%	79%	79%	80%	78%	78%	0.8%	75%	80%	4.8%
Sales tax	10%	12%	12%	14%	12%	14%	12%	12%	0.0%	11%	13%	1.6%
S&D expense ratio	18%	19%	31%	35%	17%	22%	26%	24%	-2.0%	19%	19%	0.6%
G&A expense ratio	4%	7%	6%	7%	4%	5%	6%	6%	-0.5%	6%	5%	-1.0%
Operating profit margin (%)	43%	38%	33%	24%	48%	41%	34%	37%	3.1%	41%	45%	3.9%
Net profit margin (%)	31%	30%	27%	19%	36%	32%	27%	29%	2.2%	31%	34%	3.7%

SOURCES: CGIS RESEARCH, COMPANY DATA

### Earnings expected to grow at a 27% CAGR in 2018–21F

We forecast that Laojiao's sales will grow at a CAGR of 19% in 2018–21F, driven mainly by Laojiao's baijiu product structure upgrading. We expect sales of its high-end brand – Cellar 1573 – to grow at a 23% CAGR in 2018–21F, driven by a 15% ASP hike and 7% volume growth. We expect sales of its mid-range brands – Cellar Age and Tequ – to rise by a 24% CAGR in 2018–21F, driven by 18% volume growth and a 5% ASP hike. For its low-end brands, we expect sales volume to continue to shrink by a 4% CAGR and its ASP to rise by a 5% CAGR in 2018–21F; sales of low-end brands should retain flattish at a 1% sales CAGR in 2018–21F. We expect Laojiao's gross profit margin to improve by 2.3%pts to 79.8% in 2021F from 77.5% in 2018.

In our view, Laojiao should have completed its distribution channel reconstruction over the past few years, and costs related to channel changes should fall accordingly. We estimate that Laojiao's S&D expenses ratio will gradually decline by 5%pts from 26% in 2018 to 21% in 2021F and the operating leverage increase to bring down the G&A expense ratio by 1.3%pts to 4.7% in 2021F, from 6% in 2018. We forecast that Laojiao's net profit will go up by a 27% CAGR in 2018–21F and that its net profit margin will increase by 6.0%pts to 32.7% in 2021F, from 26.7% in 2018.

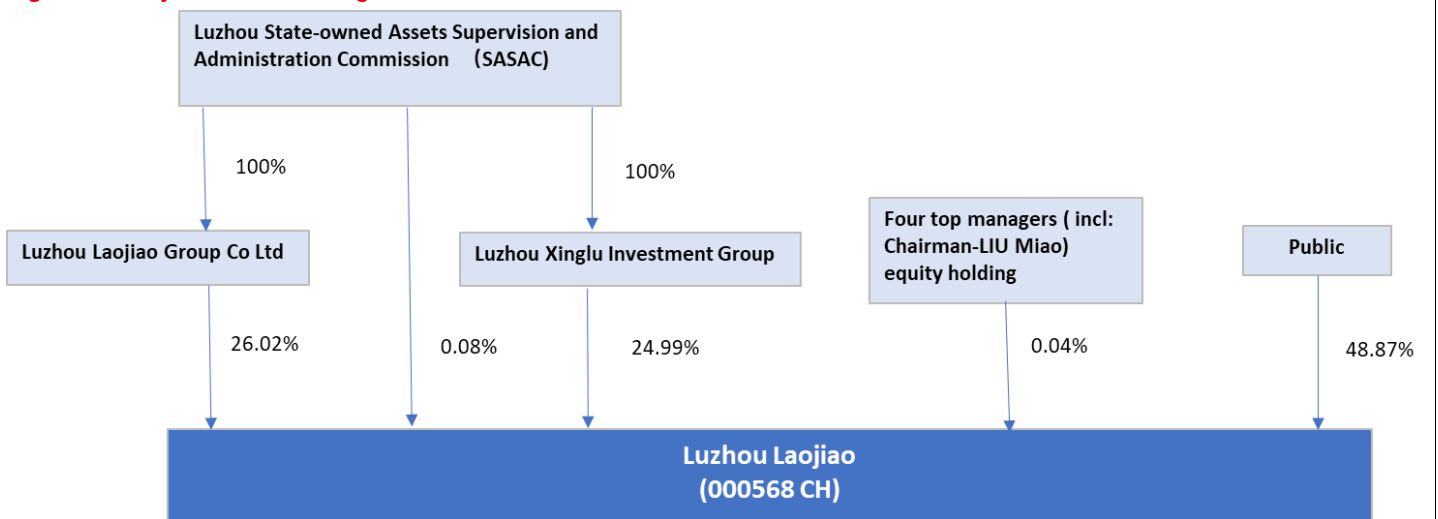
**Figure 50: Our key assumptions for Laojiao's earnings forecasts**

	2016	2017	2018	2019F	2020F	2021F
<b>Baijiu sales by product categories</b>						
High- end	2,920	4,648	6,378	8,725	10,102	11,807
YoY ( % )	89%	59%	37%	37%	16%	17%
Mid-range	2,791	2,875	3,675	4,630	5,834	7,045
YoY ( % )	72%	3%	28%	26%	26%	21%
Low-end	2,363	2,592	2,807	2,664	2,709	2,913
YoY ( % )	-31%	10%	8%	-5%	2%	8%
<b>Revenue (Rmb m)</b>						
	<b>8,304</b>	<b>10,395</b>	<b>13,055</b>	<b>16,264</b>	<b>18,930</b>	<b>22,097</b>
YoY ( % )	20%	25%	26%	25%	16%	17%
<b>Gross profit margin excl:sales ta</b>						
	62.4%	71.9%	77.5%	78.3%	78.8%	79.8%
<b>S&amp;D expense ratio</b>						
	18.5%	23.2%	26.0%	24.0%	22.5%	21.0%
<b>G&amp;A expenes ratio</b>						
	6.5%	5.5%	6.0%	5.5%	5.0%	4.7%
<b>Operating profit (Rmb m)</b>						
	2,482	3,322	4,460	6,058	7,505	9,360
<b>Operating profit margin</b>						
	29.9%	32.0%	34.2%	37.2%	39.6%	42.4%
<b>Net profit (Rmb m)</b>						
	<b>1,928</b>	<b>2,558</b>	<b>3,486</b>	<b>4,697</b>	<b>5,802</b>	<b>7,222</b>
YoY ( % )	30.9%	32.7%	36.3%	34.8%	23.5%	24.5%
<b>Net profit margin</b>						
	23.2%	24.6%	26.7%	28.9%	30.6%	32.7%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

## Background

Luzhou Laojiao, located in southern Sichuan, is a typical representative of strong fragrance baijiu in China, along with Wuliangye. Laojiao is famous for its ancient cellars; the oldest one can be traced back to AD1573 (Ming Dynasty). Its star product – Cellar 1573 – originated from the 1573 treasure-class cellars. In 2018, Laojiao had annual production of about 156kt and about 3,000 distributors, according to Laojiao management. The Luzhou State-owned Assets Supervision and Administration Commission (SASAC) has a 51.09% equity interest in Laojiao through both direct and indirect holdings.

**Figure 51: Laojiao's shareholding structure in 2018**


SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

**Figure 52: Key top management profiles**

Name	Position	Description
LIU Miao	Chairman, Party Secretary	He joined in Luzhou lao jiao since 2008 and took couples of responsibilities such as Head of procurement department, Head of strategy department, CEO of Luzhou lao jiao sales company ( a subsidairy of Luzhou lao jiao). Now he is also director of Luzhou Xinglu Investment Group.
LIN Feng	CEO, Vice Party Secretary	He previously took several key roles in Luzhou lao jiao such as the head of Luzhou lao jiao marketing deparment, CEO of sales company, the head of human resource department.
WANG Hongbo	Director, executive VP, Board secretary	Before joining in Luzhou Laojiao in 2015, He had several roles in governement such as head of Luzhou Commerce Bureau and official in Luzhou Government.

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

## SWOT analysis

**Figure 53: SWOT analysis of Laojiao**

<b>Strengths</b> 1. Strong brand recognition in nationwide. 2. have over 6% market share in the super- premium baijiu market, based on our estimates. 3. The strong cash position will give Laojiao's strong ability to perform any large M&As and consolidate its market position in the baijiu industry.	<b>Weakness</b> 1. Laojiao is controlled by government; and exposure by political policy such as the price hike which needs to be proved by government firstly. 2. Laojiao has over 67% sales revenue derived from top five customers. These distributors have strong bargain power on the distribution channel. If the economic environment get worsen, it may not have sufficient incentive for distributors to follow Laojiao's operation guidance'
<b>Opportunities</b> 1. China baijiu industry are in the progress of consolidation on the premium segment. The market size of premium segment will grow at a 12% CAGR of FY17-20F based on Euromonitor estimates. 2. Under the strong Cellar1573 brand umbrella, we expect the sales growth in its Cellar Age products would accelerate.	<b>Threats</b> 1. In the consumption upgrade trend, Wuliangye has successfully upgraded its star product and received strong feedback from customer ends. Laojiao's Cellar1573 has not upgraded since it launched to market in 2001. Cellar1573 sales might slow down and lose some market shares in the super-premium market. 2. China low-end baijiu market has been declining in term of sales volume, we expect Laojiao's low end baijiu sales would shrink in volume as well.

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

## Risks

**Macroeconomic slowdown:** China's baijiu consumption structure has changed and is now led by private companies and individuals. If the Purchasing Managers' Index (PMI) deteriorates, consumer confidence could be hit, dampening consumption of baijiu products. Cellar 1573 is targeting the super-premium baijiu consumption market, with an RSP above Rmb600 per 500ml unit. Weaker economic conditions could have a negative impact on demand.

**Government policy changes:** In 2001, the Chinese government adjusted the consumption tax for the baijiu industry, resulting in a higher tax burden for baijiu companies. If the government raises the baijiu consumption tax further, demand for the liquor could be adversely affected.

**Board of Directors' stability:** The key members of the company's Board of Directors are appointed by the government. Board stability may be shaken by political risk.

## Valuation and recommendation

We initiate coverage on Laojiao with an ADD rating and DCF-based TP of Rmb122 (WACC:9.6%), implying 38x/31x FY19F/20F P/E. Laojiao is currently trading at 27x FY19F P/E, 2.0 s.d. above its historical average of 19x since its listing in 2009.

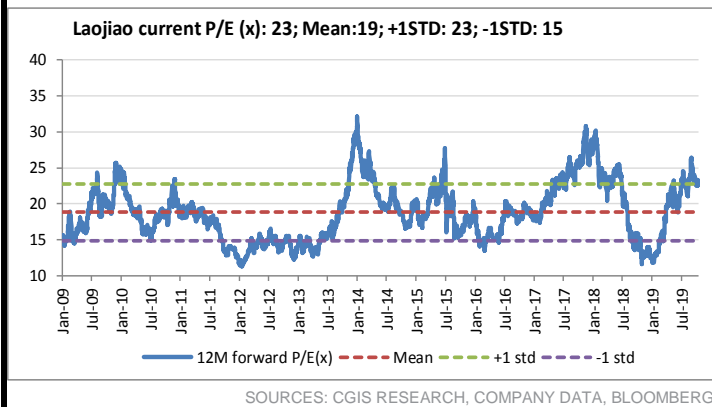
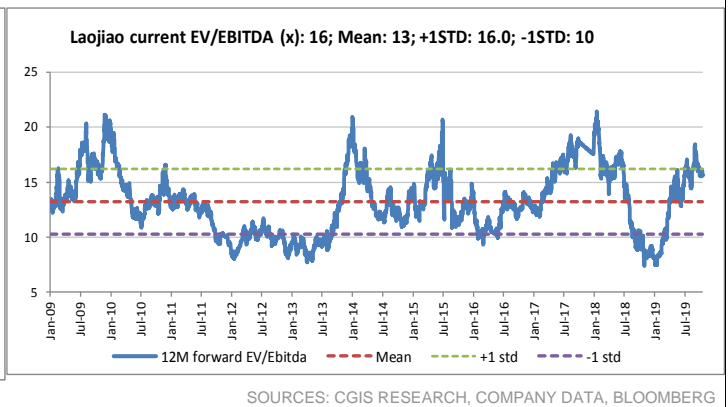
**Figure 54: DCF valuation**

(Rmb, m)	FY19F	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F
Operating EBIT	6,058	7,505	9,360	10,749	12,233	13,798	15,420	17,075	18,733	20,360	21,920
Taxes	-1,547	-1,911	-2,379	-2,649	-3,015	-3,401	-3,801	-4,209	-4,617	-5,018	-5,403
EBIT, tax-affected	4,510	5,594	6,981	8,100	9,218	10,397	11,620	12,867	14,116	15,342	16,518
Add: Depreciation & amortisa	166	259	351	399	448	500	552	567	574	572	562
Add Changes in Working capi	6	333	481	546	615	685	757	829	900	967	1,030
Less Capital Expenditure	-1,500	-1,500	-1,500	-1,500	-1,500	-1,500	-1,500	-567	-574	-572	-562
Free Cash Flow to firm	3,182	4,685	6,313	7,544	8,781	10,082	11,429	13,696	15,016	16,309	17,547
YoY growth	19%	47%	35%	20%	16%	15%	13%	20%	10%	9%	8%

		Key assumptions	
NPV of FY19-23 Cash flow	21,589	Company average beta	0.96
NPV of FY24-29 Cash Flow	40,692	Risk free rate	3.5%
NPV of Terminal Value	106,863	Risk premium	6.5%
Enterprise Value	169,144	Cost of equity	9.6%
Add Net cash/(Net Debt)	9,367	Cost of Debt	4.3%
Less Minority	-160	Debt %	0.3%
Equity value of firm	178,352	Tax rate	25.0%
Share outstanding (m)	1,465	WACC	9.6%
Target price (Rmb)	122	Terminal growth rate	3.0%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

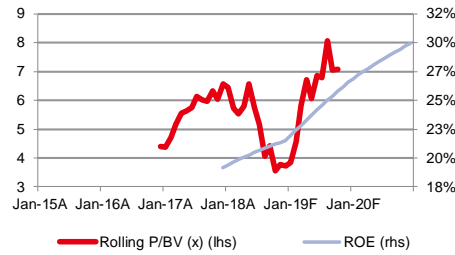
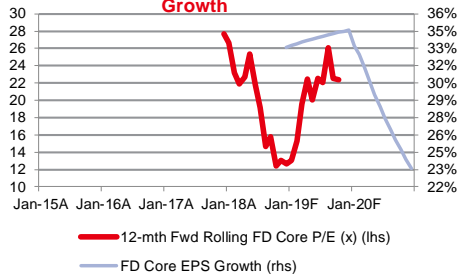
**Figure 55: Laojiao's 12M forward P/E**

**Figure 56: Laojiao's 12M forward EV/EBITDA**


**Figure 57: Peer comparison**

Company Name	Bloomberg Ticker	Recom	Target price Local	Last price Local	Quoted currency	Market cap (US\$, m)	P/E (x)		P/BV (x)		EV/EBITDA (x)		ROE (%)		Dividend Yield (%)	
							2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
Kweichow Moutai Co Ltd-A	600519 CH	ADD	1328	1183.3	Rmb	210,117	34.4	29.0	10.8	8.9	21.5	17.8	34.5	33.7	1.5	1.8
Jiangsu Yanghe Brewery -A	002304 CH	ADD	127	103.8	Rmb	22,100	17.1	14.8	4.1	3.6	11.6	9.8	25.5	26.1	3.5	4.0
Wuliangye Yibin Co Ltd-A	000858 CH	ADD	164	130.3	Rmb	71,491	29.5	24.4	7.0	6.1	19.5	15.8	25.3	26.8	1.7	2.0
Luzhou Laojiao Co Ltd-A	000568 CH	ADD	122	86.1	Rmb	17,831	26.8	21.7	6.8	6.1	19.1	15.1	26.5	29.6	2.4	3.0
Anhui Gujing Distillery Co-A	000596 CH	NR	NA	108.3	Rmb	6,823	24.9	19.8	5.4	4.4	15.0	12.2	23.0	23.5	1.2	1.6
Shanxi Xinghuacun Fen Wine-A	600809 CH	NR	NA	85.5	Rmb	10,533	38.8	31.4	9.9	8.1	24.6	20.3	26.2	26.7	1.2	1.5
Jiugui Liquor Co Ltd-A	000799 CH	NR	NA	37.7	Rmb	1,733	40.6	30.4	5.0	4.4	26.1	18.7	12.2	14.2	0.7	0.8
Beijing Shunxin Agricult-A	000860 CH	NR	NA	51.6	Rmb	5,405	30.6	24.4	4.3	3.7	20.8	16.6	13.7	15.7	0.9	1.2
Xinjiang Yilite Industry-A	600197 CH	NR	NA	15.7	Rmb	977	13.7	12.0	NA	NA	NA	NA	16.1	16.8	NA	NA
Hebei Hengshui Laobaigan-A	600559 CH	NR	NA	12.4	Rmb	1,569	19.4	15.4	3.3	3.0	13.5	11.3	15.2	16.4	1.5	2.0
Shede Spirits Co Ltd-A	600702 CH	NR	NA	31.3	Rmb	1,494	23.2	17.6	3.1	2.6	17.9	12.7	14.1	15.9	0.5	0.7
Sichuan Swellfun Co Ltd-A	600779 CH	NR	NA	45.9	Rmb	3,170	29.7	23.7	10.4	8.7	20.7	16.6	36.7	39.4	2.6	3.1
Anhui Yingjia Distillery C-A	603198 CH	NR	NA	21.7	Rmb	2,456	20.8	19.4	NA	NA	NA	NA	16.6	15.1	NA	NA
Jiangsu King'S Luck Brewer-A	603369 CH	NR	NA	32.3	Rmb	5,733	27.8	22.4	5.6	4.6	19.3	15.3	20.0	21.1	1.2	1.5
<b>Average in China domestic baijiu market</b>							<b>27.0</b>	<b>21.9</b>	<b>6.3</b>	<b>5.4</b>	<b>19.1</b>	<b>15.2</b>	<b>21.8</b>	<b>22.9</b>	<b>1.6</b>	<b>1.9</b>
Tingyi (Cayman Isln) Hldg Co	322 HK	HOLD	11.6	10.7	HK\$	7,670	20.0	17.1	2.7	2.5	6.5	5.7	13.7	15.3	2.5	2.9
Uni-President China Holdings	220 HK	ADD	10.0	8.3	HK\$	4,592	23.6	21.3	2.4	2.4	9.4	8.8	10.3	11.2	4.9	5.5
Want Want China Holdings Ltd	151 HK	ADD	7.5	6.3	HK\$	10,008	20.5	19.1	4.6	4.3	11.5	11.1	23.3	23.5	3.5	3.7
China Mengniu Dairy Co	2319 HK	ADD	36.8	32.1	HK\$	16,092	23.2	19.0	4.0	3.6	17.1	14.4	14.2	15.5	1.0	1.2
Tsingtao Brewery Co Ltd-H	168 HK	ADD	61.0	46.8	HK\$	8,581	26.5	24.3	3.0	2.8	11.8	10.4	10.9	11.4	1.4	1.6
China Resources Beer Holding	291 HK	ADD	51.0	42.2	HK\$	17,452	39.3	32.2	6.1	5.5	24.5	19.3	16.1	18.0	0.7	1.0
Dali Foods Group Co Ltd	3799 HK	NR	NA	5.2	HK\$	9,060	16.1	14.8	3.8	3.6	9.6	8.8	24.4	25.6	4.8	4.0
<b>Average in HK market</b>							<b>24.2</b>	<b>21.1</b>	<b>3.8</b>	<b>3.5</b>	<b>12.9</b>	<b>11.2</b>	<b>16.1</b>	<b>17.2</b>	<b>2.7</b>	<b>2.8</b>
Diageo Plc	DGE LN	NR	NA	3123.0	GBP	94,866	25.4	22.2	9.3	8.7	19.0	17.7	33.9	39.0	2.2	2.3
Anheuser-Busch Inbev Sa/Nv	ABI BB	NR	NA	84.1	EUR	188,788	19.4	19.4	2.6	2.4	13.1	12.7	14.7	13.4	2.1	2.1
Ambev Sa	ABEV3 BZ	NR	NA	18.9	BRL	71,614	24.3	21.9	4.9	4.8	13.2	12.2	20.8	22.3	3.0	4.2
Constellation Brands Inc-A	STZ US	NR	NA	198.5	US\$	37,936	21.6	23.0	3.3	3.1	17.5	17.8	20.2	13.2	1.5	1.5
Carlsberg As-B	CARLB DC	NR	NA	996.4	DKK	22,455	24.5	22.2	3.4	3.3	12.0	11.3	13.9	15.0	2.0	2.2
Molson Coors Brewing Co -B	TAP US	NR	NA	56.3	US\$	12,264	12.8	12.7	0.8	0.8	9.4	9.4	6.9	6.7	3.5	4.1
Heineken Nv	HEIA NA	NR	NA	98.2	EUR	62,891	22.3	20.7	3.6	3.3	12.6	12.1	15.9	15.9	1.7	1.9
Asahi Group Holdings Ltd	2502 JP	NR	NA	5445.0	JPY	24,204	16.5	14.4	2.0	1.8	11.1	10.1	12.8	12.8	1.9	2.2
Kirin Holdings Co Ltd	2503 JP	NR	NA	2301.0	JPY	19,332	27.1	14.4	2.2	2.0	12.7	10.2	8.8	14.3	2.8	3.0
Thai Beverage Plc	THBEV SP	NR	NA	0.9	SG\$	16,102	20.0	18.2	3.7	3.4	18.2	16.8	19.4	19.6	2.5	2.7
Pernod Ricard Sa	RI FP	NR	NA	160.6	EUR	47,390	25.5	22.9	2.7	2.5	17.6	16.1	10.8	11.1	1.7	2.1
United Spirits Ltd	UNSP IN	NR	NA	636.2	INR	6,494	60.7	50.4	14.4	11.6	34.7	30.9	26.9	25.5	0.1	0.3
Brown-Forman Corp-Class B	BF/B US	NR	NA	63.5	US\$	29,818	37.2	35.5	18.6	16.4	27.1	26.0	56.3	49.3	1.0	1.1
Remy Cointreau	RCO FP	NR	NA	124.2	EUR	6,927	38.3	33.2	4.2	4.2	23.3	20.3	11.3	12.8	1.4	1.5
Davide Campari-Milano Spa	CPR IM	NR	NA	8.4	EUR	10,812	35.3	30.8	4.1	3.7	21.5	19.6	12.2	12.4	0.6	0.7
C&C Group Plc	GCC ID	NR	NA	4.1	EUR	1,403	15.6	13.8	2.3	2.0	12.8	11.8	14.3	14.3	3.5	3.9
Bectle Sab De Cv	CUERVO* MM	NR	NA	29.7	MXN	5,656	27.3	23.6	2.2	2.1	18.0	15.4	8.1	9.0	1.8	2.1
Sapporo Holdings Ltd	2501 JP	NR	NA	2766.0	JPY	2,003	25.2	22.4	1.3	1.3	11.4	10.9	5.3	5.9	1.5	1.6
Vina Concha Y Toro Sa	CONCHA CI	NR	NA	1444.9	CLP	1,506	20.6	17.0	1.8	1.7	13.5	11.5	8.7	9.9	1.8	2.2
Treasury Wine Estates Ltd	TWE AU	NR	NA	18.9	AUD	9,302	30.9	26.0	3.7	3.5	18.6	15.9	12.4	14.0	2.1	2.5
<b>Average in International market</b>							<b>26.5</b>	<b>23.2</b>	<b>4.6</b>	<b>4.1</b>	<b>16.9</b>	<b>15.4</b>	<b>16.7</b>	<b>16.8</b>	<b>1.9</b>	<b>2.2</b>

Note: Not rated companies' forecasts are based on Bloomberg consensus estimates, as at 17 Oct 2019.

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

**BY THE NUMBERS**
**P/BV vs ROE**

**12-mth Fwd FD Core P/E vs FD Core EPS Growth**

**Profit & Loss**

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
<b>Total Net Revenues</b>	<b>10,395</b>	<b>13,055</b>	<b>16,264</b>	<b>18,930</b>	<b>22,097</b>
<b>Gross Profit</b>	<b>6,142</b>	<b>8,516</b>	<b>10,738</b>	<b>12,594</b>	<b>14,921</b>
<b>Operating EBITDA</b>	<b>3,330</b>	<b>4,502</b>	<b>6,107</b>	<b>7,647</b>	<b>9,594</b>
Depreciation And Amortisation	-170	-162	-166	-259	-351
<b>Operating EBIT</b>	<b>3,160</b>	<b>4,340</b>	<b>5,941</b>	<b>7,388</b>	<b>9,243</b>
Financial Income/(Expense)	107	215	238	267	311
Pretax Income/(Loss) from Assoc.	0	0	0	0	0
Non-Operating Income/(Expense)	167	103	99	99	99
<b>Profit Before Tax (pre-EI)</b>	<b>3,442</b>	<b>4,668</b>	<b>6,287</b>	<b>7,764</b>	<b>9,662</b>
Exceptional Items					
<b>Pre-tax Profit</b>	<b>3,434</b>	<b>4,659</b>	<b>6,278</b>	<b>7,754</b>	<b>9,653</b>
Taxation	-832	-1,148	-1,547	-1,911	-2,379
Exceptional Income - post-tax					
<b>Profit After Tax</b>	<b>2,602</b>	<b>3,510</b>	<b>4,731</b>	<b>5,843</b>	<b>7,274</b>
Minority Interests	-44	-25	-33	-41	-51
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
<b>Net Profit</b>	<b>2,558</b>	<b>3,486</b>	<b>4,697</b>	<b>5,802</b>	<b>7,222</b>
Recurring Net Profit	2,564	3,492	4,704	5,809	7,229
<b>Fully Diluted Recurring Net Profit</b>	<b>2,564</b>	<b>3,492</b>	<b>4,704</b>	<b>5,809</b>	<b>7,229</b>

**Cash Flow**

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
<b>EBITDA</b>	<b>3,330</b>	<b>4,502</b>	<b>6,107</b>	<b>7,647</b>	<b>9,594</b>
Cash Flow from Invt. & Assoc.					
Change In Working Capital	1,075	671	6	333	481
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow	-650	-874	-1,211	-1,545	-1,969
Net Interest (Paid)/Received	0	0	0	0	0
Tax Paid					
<b>Cashflow From Operations</b>	<b>3,755</b>	<b>4,299</b>	<b>4,902</b>	<b>6,435</b>	<b>8,106</b>
Capex	-1,416	-1,468	-1,500	-1,500	-1,500
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	20	3	0	0	0
<b>Cash Flow From Investing</b>	<b>-1,396</b>	<b>-1,465</b>	<b>-1,500</b>	<b>-1,500</b>	<b>-1,500</b>
Debt Raised/(repaid)					
Proceeds From Issue Of Shares					
Shares Repurchased					
Dividends Paid	-1,387	-1,912	-3,059	-3,779	-4,704
Preferred Dividends					
Other Financing Cashflow	2,714	-5	400	0	0
<b>Cash Flow From Financing</b>	<b>1,326</b>	<b>-1,917</b>	<b>-2,659</b>	<b>-3,779</b>	<b>-4,704</b>
Total Cash Generated	3,684	917	743	1,156	1,902
<b>Free Cashflow To Equity</b>	<b>2,358</b>	<b>2,834</b>	<b>3,402</b>	<b>4,935</b>	<b>6,606</b>
<b>Free Cashflow To Firm</b>	<b>2,358</b>	<b>2,834</b>	<b>3,402</b>	<b>4,935</b>	<b>6,606</b>

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

**BY THE NUMBERS... cont'd**
**Balance Sheet**

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Total Cash And Equivalents	8,450	9,367	10,111	11,266	13,169
Total Debtors	2,737	2,565	2,773	2,681	2,497
Inventories	2,812	3,230	3,363	3,447	3,479
Total Other Current Assets	271	331	396	423	449
<b>Total Current Assets</b>	<b>14,269</b>	<b>15,494</b>	<b>16,641</b>	<b>17,818</b>	<b>19,593</b>
Fixed Assets	1,130	1,029	2,372	3,623	4,781
Total Investments	2,147	2,367	2,367	2,367	2,367
Intangible Assets	231	232	223	213	204
Total Other Non-Current Assets	1,979	3,482	3,482	3,482	3,482
<b>Total Non-current Assets</b>	<b>5,487</b>	<b>7,110</b>	<b>8,444</b>	<b>9,685</b>	<b>10,834</b>
Short-term Debt	0	0	0	0	0
Current Portion of Long-Term Debt					
Total Creditors	3,241	3,499	3,909	4,263	4,617
Other Current Liabilities	1,126	1,916	1,916	1,916	1,916
<b>Total Current Liabilities</b>	<b>4,367</b>	<b>5,416</b>	<b>5,825</b>	<b>6,179</b>	<b>6,533</b>
Total Long-term Debt	0	0	400	400	400
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	76	65	65	65	65
<b>Total Non-current Liabilities</b>	<b>76</b>	<b>65</b>	<b>465</b>	<b>465</b>	<b>465</b>
Total Provisions	0	0	0	0	0
<b>Total Liabilities</b>	<b>4,443</b>	<b>5,481</b>	<b>6,290</b>	<b>6,644</b>	<b>6,998</b>
Shareholders' Equity	15,171	16,965	18,602	20,625	23,143
Minority Interests	141	160	193	234	286
<b>Total Equity</b>	<b>15,313</b>	<b>17,124</b>	<b>18,795</b>	<b>20,859</b>	<b>23,429</b>

**Key Ratios**

	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Revenue Growth	25.2%	25.6%	24.6%	16.4%	16.7%
Operating EBITDA Growth	37.9%	35.2%	35.6%	25.2%	25.5%
Operating EBITDA Margin	32.0%	34.5%	37.6%	40.4%	43.4%
Net Cash Per Share (Rmb)	5.77	6.40	6.63	7.42	8.72
BVPS (Rmb)	10.36	11.58	12.70	14.08	15.80
Gross Interest Cover	N/A	N/A	N/A	N/A	N/A
Effective Tax Rate	24.2%	24.6%	24.6%	24.6%	24.6%
Net Dividend Payout Ratio	71.3%	65.0%	65.0%	65.0%	65.0%
Accounts Receivables Days	78.25	68.49	56.16	49.50	40.01
Inventory Days	227.4	242.9	217.8	196.7	176.1
Accounts Payables Days	52.61	81.72	83.01	75.36	74.59
ROIC (%)	72%	91%	109%	109%	120%
ROCE (%)	26.0%	28.9%	34.7%	38.5%	42.9%
Return On Average Assets	15.0%	15.6%	18.9%	21.2%	24.1%

**Key Drivers**

	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
ASP (% chg, main prod./serv.)	45.5%	33.8%	31.1%	15.2%	11.2%
Unit sales grth (% , main prod./serv.)	-13.9%	-5.0%	-5.0%	1.0%	5.0%
Util. rate (% , main prod./serv.)	N/A	N/A	N/A	N/A	N/A
ASP (% chg, 2ndary prod./serv.)	N/A	N/A	N/A	N/A	N/A
Unit sales grth (% ,2ndary prod/serv)	N/A	N/A	N/A	N/A	N/A
Util. rate (% , 2ndary prod/serv)	N/A	N/A	N/A	N/A	N/A
ASP (% chg, tertiary prod/serv)	N/A	N/A	N/A	N/A	N/A
Unit sales grth (% ,tertiary prod/serv)	N/A	N/A	N/A	N/A	N/A
Util. rate (% , tertiary prod/serv)	N/A	N/A	N/A	N/A	N/A
Unit raw mat ASP (%chg,main)	N/A	N/A	N/A	N/A	N/A
Total Export Sales Growth (%)	N/A	N/A	N/A	N/A	N/A
Export Sales/total Sales (%)	N/A	N/A	N/A	N/A	N/A

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

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We are transferring the rating mechanism from “BUY, SELL, HOLD” to “ADD, REDUCE, HOLD”. Please refer to the definitions below.

**Explanation on Equity Ratings (Existing mechanism (will be replaced by new mechanism by 01/09/19))**

- BUY : share price will increase by >20% within 12 months in absolute terms  
SELL : share price will decrease by >20% within 12 months in absolute terms  
HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

**Explanation on Equity Ratings (New mechanism)**

- ADD : The stock’s total return is expected to exceed 10% over the next 12 months.  
REDUCE : The stock’s total return is expected to fall below 0% or more over the next 12 months.  
HOLD : The stock’s total return is expected to be between 0% and positive 10% over the next 12 months.

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