



### Group 53

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2024/05/26



Investment Summary

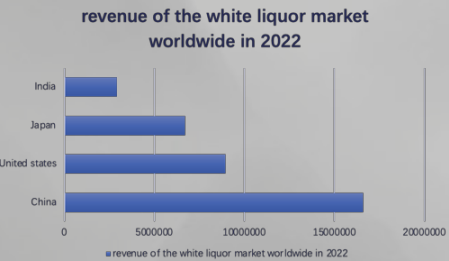
We are recommending a Buy rating for Kweichow Moutai with a price target of 2001, which indicates a 19% potential increase from the closing price of 1,682 yuan on December 31, 2022. The target price is based on a discounted cash flow (DCF) model, sensitivity analysis and free cash flow analysis. Kweichow Moutai holds a prominent position in the alcohol industry due to its distinctive brewing techniques, rich cultural legacy, brand recognition and impact, as well as its focus on product innovation and variety.

Industry Analysis

Industry Overview

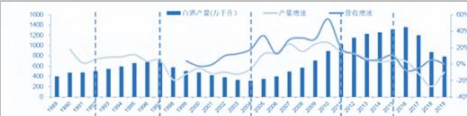
The white liquor industry is a deeply rooted and culturally significant industry in China with the highest revenue (Figure 1). The white liquor industry is cyclical and sensitive to development of economy and changes in government policy, and its cycle is usually four to seven years (Figure 2). Within the industry, there exists a segmented market with high-end product sector which is fine for increasing market concentration and medium- and low-end product sectors, however, are highly competitive. The demand for white liquor has been showing a decreasing trend in recent years and the production of liquor has shown a downward trend since 2018 (Figure 3). In response to the changing market conditions, the white liquor industry has been focusing on channel diversification and product diversification as key strategies. More diversified sales channels are being explored with offline and online platforms (Figure 4). Product diversification is focused on developing new products catering to the diverse customer needs and preferences such as heathier options.

Figure 1: revenue of white liquor market worldwide



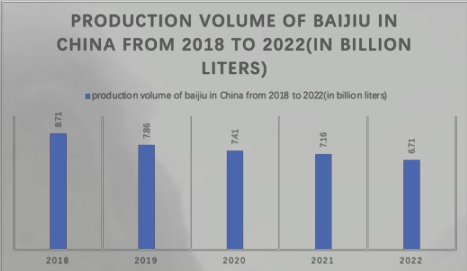
Source: Team analysis

Figure 2: the economic fluctuation and policy changes



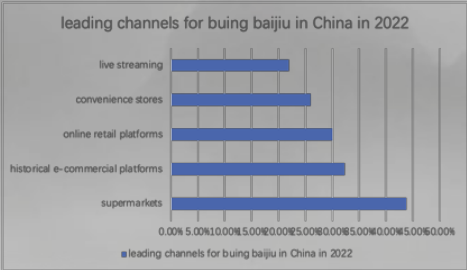
Source: Hongta Security

Figure 3: production volume of baijiu in China from 2018 to 2022



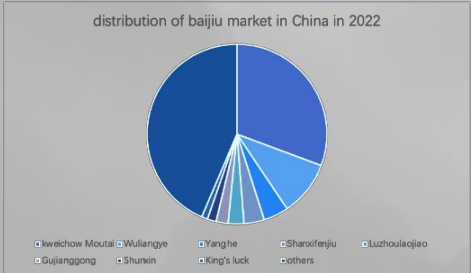
Source: Team analysis

Figure 4: Leading channels for buying baijiu in China



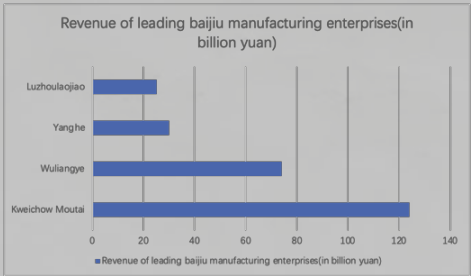
Source: Team analysis

Figure 5: Distribution of baijiu market in China in 2022



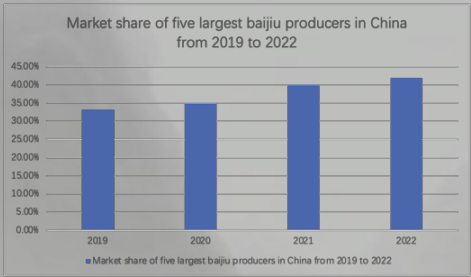
Source: Team analysis

Figure 6: Revenue of leading baijiu manufacturing enterprises



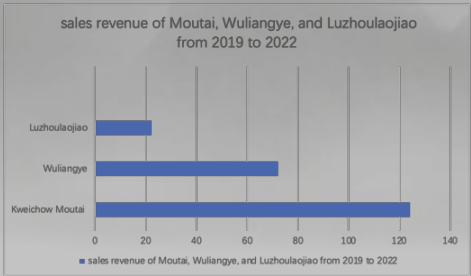
Source: Team analysis

Figure 7: Market share of five largest baijiu producers in China from 2019 to 2022



Source: Team analysis

Figure 8: sales revenue of Moutai, Wuliangye, and Luzhoulaojiao from 2019 to 2022



Source: Team analysis

## Main Players

The Chinese liquor industry is dominated by a few key players, particularly in the high-end segment. Among these, Moutai, Wuliangye, Luzhoulaojiao, and Shanxifenjiu occupy the topmost tier (Figure 5). In addition, Kweichow Moutai obtain a leading postion among main players with 124.1-billion-yuan revenue (Figure 6).

The market share of these first-tier players continues to grow, indicating a trend of industry concentration, particularly in the high-end segment. Leading brands such as Moutai, Wuliangye, and Luzhoulaojiao have established significant market shares and dominant positions due to their superior quality, profound brand heritage, and robust market influence (Figure 7). Comparing the revenue of Moutai with the revenue of Wuliangye and Luzhoulaojiao, Comparing the income of the three, it can be concluded that Moutai’s revenue is far ahead of the other two. To make a further analysis, the revenue of Moutai is 1.6 times that of Wuliangye, and six times of luzhoulaojiao (Figure 8). Moreover , the average return of equity of Moutai is higher than Wuliangye and Luzhoulaojiao (Figure 9).

## Industry challenge

### New generation culture shock

The new generation of consumers (especially Millennials and Generation Z) have significantly different spending habits and cultural values than previous generations (Figure 10). They may prefer a healthier lifestyle and be more cautious about alcohol consumption. In addition, they are more interested in modern and diverse alcohol options, such as craft beers, spirits, whiskey, and innovative mixed beverages (Figure 11). This has led to a decline in the appeal of traditional Chinese Baijiu (Figure 12).

## Regulatory Environment

Government policies in the fight against corruption and regulations of the “three publics” (i.e., official receptions, public overseas trips, and use of public vehicles) have had a significant impact on the demand for premium liquor brands such as Moutai. In the past, Moutai liquor occupied a significant position in the official banquet and gift market. However, since the government has strengthened its regulation of public spending and luxury gifts, there has been a significant decrease in such spending, which has directly impacted Moutai's sales and profitability.

## Market trend

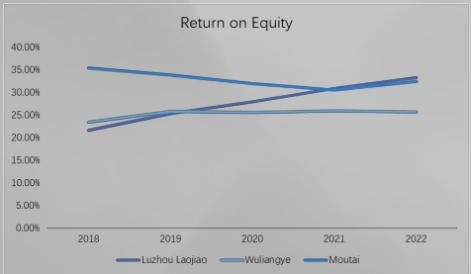
### High-class Product and Social Status Market Trend

becoming a symbol of social status and investment value. Demand for luxury Baijiu as a status symbol remains strong, driven by its cultural significance and limited availability. High-net-worth individuals and collectors view premium value over time. In addition, Kweichow Moutai's strategic positioning in the gifting and business networks continues to reinforce its image as a prestigious and popular brand, reinforcing its role in the social status and investment markets.

### Direct Sale Model Market Trend

Kweichow Moutai has increasingly adopted a direct sales model, including on-site and online stores, to strengthen its control over pricing and distribution while reducing the risk of counterfeiting. This model allows Moutai to interact directly with consumers, offering exclusive products and personalized service. The online sales platform has seen significant growth, thanks to convenience and wider access to younger, tech-savvy consumers. In addition, on-site stores create a premium brand experience that reinforces Moutai's luxury status and ensures product authenticity. This trend supports brand loyalty and drives revenue growth by leveraging direct consumer interaction.

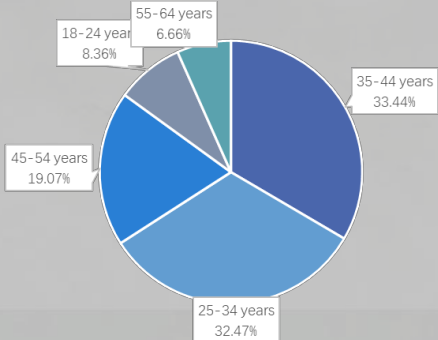
Figure 9: ROE of Moutai, Wuliangye, and Luzhou Laojiao



Source: Team analysis

Figure 10: Distribution of wine consumer in China

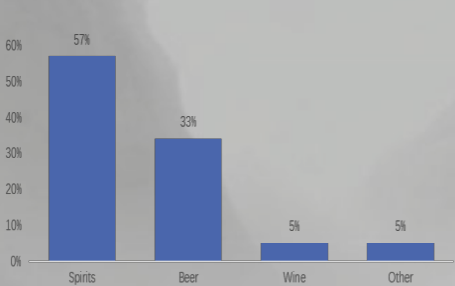
as of 2023, by age group



Source: Team analysis

Figure 11: Distribution of alcohol consumption in

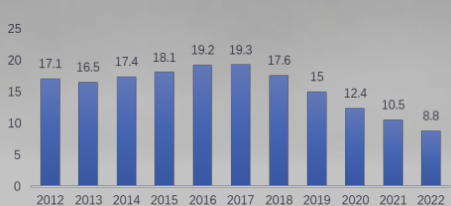
China in 2005, by type of beverage



Source: Team analysis

Figure 12: White consumption volume in China from

2012 to 2022



Source: Team analysis



Figure 13: Poter's Five Forces

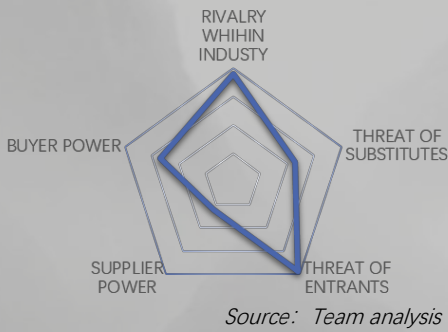


Figure 14: Market share of high-class liquor in China

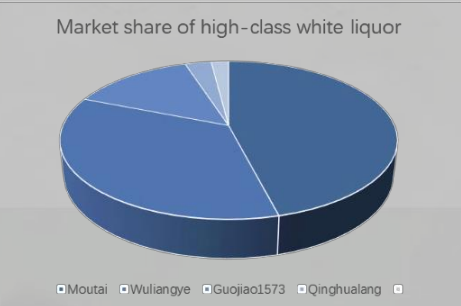


Figure 15: Company product matrix

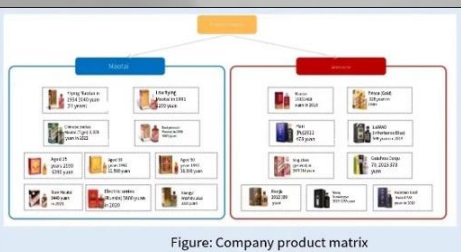


Figure 16: Manufacturing process of Maotai liquor

Compare	Soy sauce flavor	Highly flavored	Pure flavored
Number of fermentation	8	1	2
Take-up times	7	1	2
Pits	Stone	Mud	Cellar
Koji	High-temperature daqu	Medium-high	Low-temperature
Yield of liquor	0.2	0.3	0.4
Brewing cycle	1 year	1.5~2 month	1.5~2 month
Storage time	3 years	3~6 month	1 year

Source: Company Source

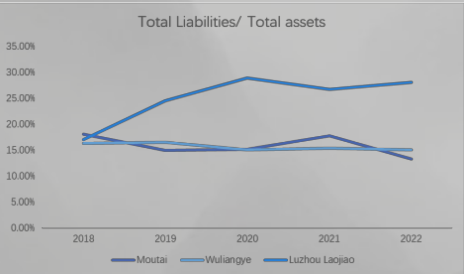
# Company analysis

## Business overview

Kweichow Moutai Co., Ltd. (stock code: 600519) was established in 1999 and listed on the Shanghai Stock Exchange in 2001. Headquartered in Moutai Town, in the north of Guizhou Province, the company is engaged in the production and sales of Moutai liquor and series liquors. Kweichow Moutai Co. Ltd. is a landmark enterprise in the domestic liquor industry (figure 14). With around eight hundred years of history, it has become a typical representative of Maotai-flavored liquor and enjoys the reputation of "National wine". In recent years, 43°,38°,33° Maotai expanded the development space of Maotai family low-alcohol wine, Moutai Prince wine, Moutai welcome wine to meet the needs of middle and low consumers; 15 years, 30 years, 50 years, 80 years old Maotai wine to fill the gap in China's best wine (figure 15). The company's products have formed three series and more than seventy varieties, which have entered the market in an all-round way, thus occupying the commanding heights of the liquor market and dominating the Chinese fine wine market.

The manufacturing process is much longer for that the fermentation cycle of soy sauce flavor wine is complicated as the brewing period is as long as one year, the storage time is as long as 3 years (figure 16). Among three typical body of Maotai, the core is Maotai flavor. The flavor is dominated by soy sauce, based on alcohol and sweet, supplemented by old wine, and the flavor at the bottom of the cellar is special. The process is more complicated compared to Luzhou-flavor type 1 fermentation and clear flavor type which needs only two times of fermentation, paste flavor needs eight times of fermentation. Additionally, it requires seven more withdrawals than other flavors. Thus, the complex and unique brewing technique contributes to the characteristic taste of Maotai liquor.

Figure 17: Kweichow Moutai's operating profit from 2018 to 2022



Source: Team analysis

Figure 18: Major financial data of Kweichow Moutai's financial statement from 2017 to 2022

Major item (RMB 100 million)	2017	2018	2019	2020	2021	2022
Total revenue	582.18	736.39	854.3	949.15	106.19	124.1
Total operating expenses	59.4	65.23	74.3	81.54	89.83	100.93
Operating profit	389.4	513.43	590.41	666.35	747.51	878.8
Total profit	387.4	508.28	587.83	661.97	745.28	877.01

Source: Team analysis

Figure 19: ESG performance highlights



Source: Company source

## Economic moat

### Brand reputation

As a typical representative of Chinese liquor culture, Moutai liquor enjoys a high reputation at home and abroad, has a high brand influence and commercial value, and is an important representative enterprise to promote abroad in China. Therefore, the high respected brand reputation lays the foundation for Maotai to be profitable eventually.

### Financial situation

From the perspective of the of Kweichow Moutai's total liabilities and assets ratio, it is obvious that the data of Moutai is less than other two representative companies in liquor industry and shows a downward trend. Accordingly, the low ratio indicates that the capital resources of Kweichow Moutai Group come from retained earnings capital. Therefore, we believe that Kweichow Moutai belongs to a profit-driven group company dominated by retained earnings capital (figure 17). As retained earnings become the main source of corporate capital, it can reduce the external dependence of corporate financing, and at the same time reducing the financial risk and operating pressure of the company. Meanwhile, because of the high market recognition, it gets rich profits, which significantly boosts the confidence of investors and further enhance its competitive advantage(figure 18).

## Environment, Social and Governance (ESG)

Figure 19 outlines Kweichow Moutai's overall aspects of ESG practice.

### Environment

Guided by Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, the company has been deeply implementing Xi Jinping's thought on ecological civilization, actively practicing the concept of "Clear Waters and Green Mountains as Good as Mountains of Gold and Silver", the total investment in environmental protection reached RMB 381,082,900 in 2022.

Figure 20: Energy Consumption

Energy Consumption			
Index	Unit	Year 2023	Year-on-year variable ratio
Non-renewable energy consumption	Tons of coal equivalent	144,173.82	-8.05%
Renewable energy consumption	Tons of coal equivalent	11,270.18	106.41%
Comprehensive energy consumption	Tons of coal equivalent	155,444.00	-4.16%
Comprehensive energy consumption intensity	Ton <sup>10</sup> million units of industrial output	1.80	-15.89%

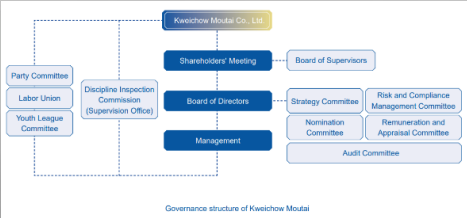
Source: Company Source

Figure 21: Social performance over 2022



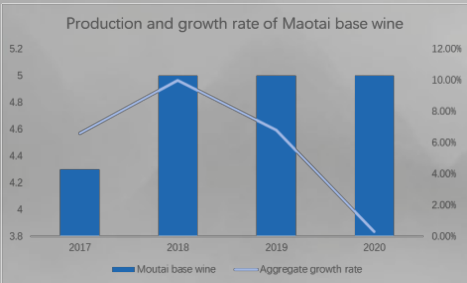
Source: Company Source

Figure 22: Governance structure of Kweichow Moutai



Source: Company Source

Figure 23: Production and growth rate of Moutai base wine



Source: Team analysis

Centering on the overall requirements of ecological priority and green development, the company has deeply advanced various work such as top-level design, pollution prevention and control, and carbon neutrality management (Figure 20). As a result, the company has successfully established an innovative practice and successfully applied for and obtained the national and provincial titles of “Green Factory.”

Social

Kweichow Moutai’s social responsibility includes a commitment to employees’ safety, health and wellness, industry chain construction, and community investments (Figure 21).

Governance

Figure 22 demonstrates the structure of the internal governance system of Kweichow Moutai. Kweichow Moutai continuously centering on the core function of Board of Directors to coordinate the effective operation of Shareholder’s meeting and Management. Furthermore, Moutai has set up committees with distinct functions around the Board of Directors to ensure its science-based decision-making and robust operations.

Challenge for the company

Technical problems of building factories

At present, Kweichow Moutai can only be produced by the Chishui River. On the one hand, the unique production environment has created the reputation and particularity of Kweichow Moutai, but on the other hand, it is difficult for Kweichow Moutai to expand its sales scale and output. In short, although the unique production environment has brought excellent reputation and uniqueness to Kweichow Moutai, it has also limited the expansion of its production scale and the increase of output. In particular, the base liquor of Maotai is in a state of zero growth from 2018 to 2020, resulting in limited supply (Figure 23). Therefore, how to achieve the expansion of production scale and the improvement of output while maintaining its uniqueness has become a significant challenge for Kweichow Moutai.

Figure 24: China Seizes Five Spots on Global Top 50

Consumer Brands (2018)

Rank	Change in annual ranking	Company	Country	2018 revenue (billion U.S. dollars)	Year-on-year change in revenue (%)
1	-	Nestle	Switzerland	93.4	+2.1
2	-	P&G	U.S.	66.3	+2.8
3	-	PepsiCo	U.S.	64.7	+1.8
4	-	Unilever	U.K./Netherlands	60.1	-5.1
5	-	AB Inbev	Belgium	54.6	-3.2
17	-	WH Group	China	21.3	-0.1
34	▲ 9	Yili	China	11.9	+17.8
42	▲ 4	Mengniu Dairy	China	10.4	+14.7
46	▲ 12	Kweichow Moutai	China	9.8	+25.4
49	▲ 1	Tingyi	China	9.1	+3

Source: Team analysis

Diversification of market and consumer needs

Times are changing, consumer and market demand for liquor is also gradually changing, especially in today's consumption downgrade environment, Kweichow Moutai's high pricing dissuade most consumers. A specific product supply is not conducive to the long-term healthy development of Kweichow Moutai. In the face of the above challenges, Kweichow Moutai should increase its investment and efforts in market research to timely understand the changes in consumer demand and market trends. Flexibly adjust brand strategy, product development and marketing activities by establishing a consumer insight mechanism.

New Opportunities and Future Strategies

Brand reputation

Good reputation is a unique resource owned by enterprises, which can enhance the competitiveness of enterprises in all aspects of business operation. With the continuous improvement of the degree of marketization of China's economy, the emergence of the buyer's market, the market competition is increasingly fierce, the product homogeneity becomes larger. The role of the unique resource of corporate reputation will inevitably be further highlighted.

Brand positioning

Kweichow Moutai is famous for its special and demanding production environment. Therefore, the scarcity of origin has brought strong competitiveness to Kweichow Moutai and has given Kweichow Moutai a place among the world's top fifty brands (Figure 24). Through high-end image positioning, emphasizing the connection between historical inheritance and natural environment, coupled with the blessing of the status of national wine, Kweichow Moutai has successfully established a unique brand image and won the recognition and loyalty of consumers.

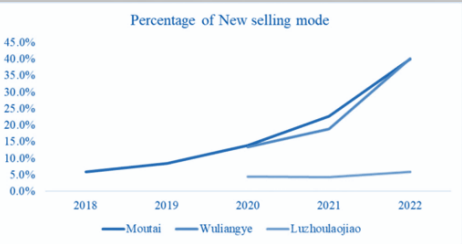


Figure 25: sales

	Moutai liquor sales volume (ton)	Sales of Moutai liquor (in billion yuan)
2018	32463.95	654.87
2019	34562.46	758.02
2020	34312.53	848.30
2021	36261.31	934.65
2022	37901.39	1078.34

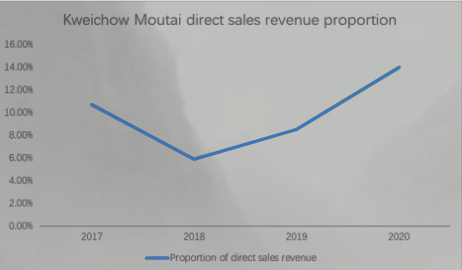
Source: Team analysis

Figure 26: Percentage of New selling mode



Source: lecture11 slide 31

Figure 27: Kweichow Moutai direct sales revenue proportion



Source: Team analysis

## Brand premium

The brand premium is especially important for white liquor. Moutai's brand added value is the key to consumers' willingness to accept soaring prices. To increase the brand premium to obtain more profits is the strategic change that Moutai can develop in the long term. Therefore, it is of great significance to study the brand premium ability and explore the effective strategies to improve the brand ability for Maotai enterprises to make money, reduce enterprise risk and maintain sustainable development.

## Sales strategy

Although Kweichow Moutai's sales volume are increasing year by year (Figure 25), there is still a great need for the transformation of Moutai's single commodity sales strategy and the demand for changing the sale mode. Maotai develops its sales strategy including producing efficiency increased for high-class product and promotion of new selling mode.

### Increase producing efficiency, especially for high-class product

For high-class product, due to its high pricing, under the premise of meeting consumer demand, innovative technology can be introduced to improve production efficiency. High-class products are used to maintain Kweichow Moutai's positioning of high-end luxury products, which is the continuation of traditional Guizhou Moutai.

### Promotion of new selling mode

From 2018 to 2020, the proportion of Moutai's recent sales model continued to increase. Compared with Moutai, the recent sales model of Wuliangye and Luzhou Laojiao appeared late, the operation time was short, and the proportion was small (Figure 26). Moutai's new selling mode has achieved significant sales growth in recent years, especially between 2019 and 2020 which brings positive effect to Kweichow Moutai's future development (Figure 27). Moutai's main sales mode are divided into social channels, that is, supply to traditional dealers, direct sales channels, and self-operated channels. With the decline in sales of the traditional distribution model, Moutai established an online platform to increase the proportion of direct sales revenue to increase terminal supply. Meanwhile, Moutai continues to expand the proportion of supply to commercial supermarkets and e-commerce channels, reduce dealer quotas, and re-measure the ecological balance between the three sales models.

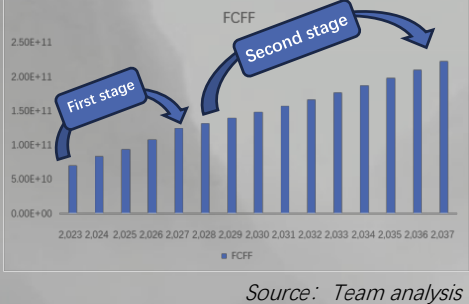
Figure 28: ROE



Figure 29: sales forecast



Figure 30: FCFF analysis



## Financial Forecast

### Dupont Analysis

Kweichow Moutai has consistently achieved high return on equity (ROE) due to its strong brand recognition, political connections, and attractiveness to investors (Figure 28) . Similarly, Kweichow Moutai has higher net profit margins compared to other companies in the white spirits industry. Nevertheless, Kweichow Moutai 's financial leverage and asset turnover are slightly lower.

ROE (Average Equity)	2018	2019	2020	2021	2022
Luzhou Laojiao	21.6%	25.3%	27.9%	30.9%	33.3%
Wuliangye	23.4%	25.8%	25.5%	25.9%	25.7%
Moutai	35.4%	33.9%	32.0%	30.6%	32.5%
Profit/Sales	2018	2019	2020	2021	2022
Luzhou Laojiao	26.9%	29.3%	35.8%	38.5%	41.4%
Wuliangye	35.1%	36.4%	36.5%	37.0%	37.8%
Moutai	51.4%	51.5%	52.2%	52.5%	52.7%
Sales/Avearge Total assets	2018	2019	2020	2021	2022
Luzhou Laojiao	61.6%	61.4%	52.1%	52.8%	53.1%
Wuliangye	51.0%	52.1%	52.0%	53.1%	51.3%
Moutai	50.0%	49.8%	47.9%	45.3%	48.7%
Average Total assets /Average Total equity	2018	2019	2020	2021	2022
Luzhou Laojiao	1.31	1.40	1.50	1.52	1.51
Wuliangye	1.31	1.36	1.34	1.32	1.32
Moutai	1.38	1.32	1.28	1.28	1.27

### Sales forecast

The primary revenue stream for Kweichow Moutai comes from the sale of Moutai and other liquor products. The sales performance of Moutai has shown steady improvement since 2020, rebounding from a low point caused by the impact of the COVID-19 pandemic. With Kweichow Moutai's strong position in the high-end liquor market, exceptional brand reputation, and broad market recognition, we anticipate sales growth rates of 16%, 14%, 14%, 15%, and 15% from 2023 to 2027 (Figure 29) .

## Valuation

We are recommending a Buy rating for Kweichow Moutai with a price target of 2001, which indicates a 19% potential increase from the closing price of 1,682 yuan on December 31, 2022. Our valuation is based on a discounted cash flow (DCF) model, considering factors such as the company's product innovation, partnerships with resorts for business group building, expansion into foreign markets, direct sales approach, and other investment strategies. Additionally, we have conducted sensitivity analysis and free cash flow analysis to further support our valuation.

## FCFF Analysis

In Figure 30, Kweichow Moutai's future free cash flow is shown to be stable and promising, despite potential volatility. This indicates the company's sustainable profitability and operational efficiency. Operating income and net profit are key factors in explaining changes in Kweichow Moutai's FCFF in the volatile liquor market. The company plans to continue enhancing profitability through strategies such as improving word-of-mouth, expanding the industrial chain, and upgrading products. Based on these strategies, the company expects net profit to range between eighty billion and 141 billion yuan in the next five years. Therefore, our baseline forecast predicts an average net profit of \$109 billion from 2023 to 2027.

	2023	2024	2025	2026	2027
Net profit	80,799,777,694	92,941,047,704	106,869,719,350	122,925,554,028	141,625,156,052
+ Net Financial expense*(1-tax rate))	151,471,170	293,902,919	491,673,768	718,335,332	903,078,723
+ Depreciation and Amortization	1,759,365,139	2,048,076,606	2,340,768,455	2,671,295,554	3,083,662,084
- Investment income	30,822,706	42,337,765	57,997,680	79,735,267	82,932,371
+ impairment losses	27,411,636	37,072,836	53,134,789	40,579,000	50,034,830
- Gains/(Loss) from fair value changes	3,862,906	5,306,049	1,070,195	3,711,011	4,079,529
- Gains/(Loss) on disposal of assets	38,801	53,297	87,214	120,112	166,251
- Non-operating income/(expense)	571,926,825	548,785,053	633,096,820	666,741,510	785,438,747
- Changes in Notes and accounts receivable	20,816,004	21,294,645	23,854,202	28,405,714	33,875,839
- Changes in Inventory	5,886,452,158	4,486,253,458	7,016,970,560	8,018,598,371	8,949,114,484
+ Notes and accounts payable	83,318,687	401,405,801	400,807,024	629,413,209	560,683,936
- Capital Expenditure	6,102,264,094	6,540,363,540	7,508,399,259	8,812,792,599	10,205,679,967
Free cash flow the firm (FCFF)	69,909,944,303	83,499,918,319	93,933,420,309	107,945,823,897	124,363,330,049

## DCF valuation

### WACC components

We arrive at a WACC of 7.93% for Kweichow Moutai. A more detailed breakdown of WACC is as the figure shown.

Assumption	Rate	Methodology
Risk-free rate	2.50%	5-year Chinese government bonds yield rate
Equity risk premium	6.60%	CSI300 10-years compounded growth rate
Beta	1.32	Adjusted beta
Cost of equity	7.93%	Calculated via CAPM
cost of debt	0.00%	
Tax rate	21.29%	From annual report
WACC	7.93%	Calculated using a market value D/E ratio

### Terminal Growth

The 2% terminal growth rate effective after 2038 is based on the weighted average of expected GDP.

## Sensitivity Analysis

We also run a sensitivity analysis to determine the effect of changes to our WACC and terminal growth assumptions based on a 7.93% WACC and a 2% terminal growth rate. The reasonable range of values of terminal growth rate locates between 1% and 5%, and the WACC ranges between 5.5% and 10.5%.



Figure 31: Risk Factors Matrix

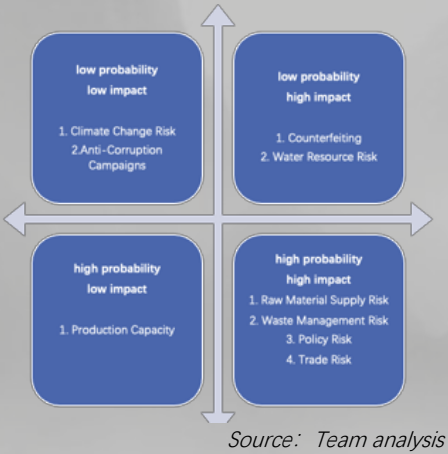


Figure 32: Risk Factors

Risk Factors
Operational Risk
1.Raw Material Supply Risk
2.Counterfeiting
3.Production Capacity

Source: Team analysis

Figure 33: Environment Risk

Environment Risk
1.Water Resource Risk
2. Waste Management Risk
3.Climate Change Risk

Source: Team analysis

Risk Factors

Operational Risk

OR1: Raw Material Supply Risk

The manufacturing of white liquor is heavily dependent on the quality and accessibility of raw materials, particularly sorghum and wheat. Any interruption in the supply chain, such as crop failures due to weather could present a considerable threat to Moutai's business operations.

OR2: Counterfeiting

Widespread counterfeiting of Moutai products can harm brand reputation and erode consumer trust. Manufacturers of genuine products lose revenue to counterfeiters, affecting their profitability and growth. Additionally, it may pose health risks to consumers due to unknown ingredients or production processes.

OR3: Production Capacity

Strict environmental and safety regulations, limited access to raw materials, and unfavorable geographical locations all constrain production capacity, affecting the ability to meet high demand.

Environmental Risks

ER1: Water Resource Risk

Moutai's production relies heavily on clean water resources. Any contamination or depletion of water sources could pose a significant risk to its operations.

ER2: Waste Management Risk

The production of white liquor industry generates solid and liquid waste, which needs to be managed responsibly. Improper waste management could lead to environmental pollution and fines from regulatory authorities.

Figure 34: Political Risk

Political Risks
1. Policy Risk
2.Trade Risk
3.Anti-Corruption Campaigns

Source: Team analysis

ER3: Climate Change Risk

Climate change poses risks to Moutai's supply chain, particularly the agriculture sector. Extreme weather events such as droughts or floods could affect the quality and quantity of raw materials.

Political Risks

PR1: Policy Risk

Changes in government policies, such as taxation, tariffs, or regulations, could have a significant impact on Moutai's operations and profitability.

PR2: Trade Risk

International trade tensions or tariffs could affect Moutai's export market and access to imported raw materials. This could pose risks to its international operations and supply chain.

PR3: Anti-Corruption Campaigns

Government anti-corruption measures can reduce demand from traditional consumer bases, such as government officials and state-owned enterprises.