

Financial and Operating Strategies Analysis: Kweichow Moutai Ltd

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Abstract. Thanks to its exceptional branding recognition, Kweichow Moutai Ltd. manages to retain its upside potential in boosting the enterprise value over the years. As the pioneer in displaying the strength of domination over the consumer beverage market in one of the largest economic entities in the world, the evaluation of the cooperation in its financial and operating strategies provides significant visions to investors. Hence, this paper is designed to analyze the fundamental layers of the enterprise in terms of its overall operational healthiness by going through its financial statements and conducting the SWOT analysis, in addition to providing a quantitative analysis in estimating the enterprise's stock value by using multiple valuations. After a series of analysis, this paper acknowledges the state of the enterprise as the industry giant known for its superb profitability growth, but also finds operational healthiness issues that are hard to oversee.

Keywords: Kweichow Moutai; Fundamental Analysis; Multiple Valuation; SWOT Analysis.

1. Introduction

Kweichow Moutai, "the national liquor" in China, has long been favored by Baijiu lovers for its remarkable grainy taste of red sorghum, but more often it is seen as an appreciating investment asset for its strong premium positioning compared to other alcohols. From the time raw materials are added to the production process, it takes up to at least five years for the final product to be released. For this reason, in addition to the supply limit the company put on its liquors due to the complexity of production methods, strict quality standards, and limited natural resources to make the spirits, Moutai liquor becomes increasingly valuable because of such scarcity—according to the alcohol pricing website “meijiu.com”, every Moutai bottle is estimated to come with a CHY100-200 annual return, that is, a 3.30% to 6.06% yield given the current retail price of CHY 2,000-3,300 for Feitian Moutai, a hit product of the brand.

And the exceptional demand for the alcohol from Chinese consumers does not simply come from the numeric investment value but is also attributed largely to its branding effect. In the early 1950s, the state-run Moutai Distillery was created when the local government purchased and merged numerous distilleries into one, since then it had undergone multiple expansions, up to the recent point where it became China's most valuable non-technology corporation and the biggest beverage company in the world, even surpassing Tencent to become the largest corporation in China by market capitalization in 2022. And besides the historic development and modern-time achievements that gain the enterprise the branding momentum, the fact that it remains state-owned throughout the years posits the enterprise under the support of the socialist economic system and the people that live within, just like other state-owned banking cooperations, insurance companies, crude oil companies or other utilitarian branches that thrive from privileges such that easier access to licensing approvals and government contracts, lower cost to financing funds from state-owned banks, more consumer attraction, etc [1]. The cultivation of the company's branding alongside governmental influences gives an almost automatic oriental effect to the consumers who are thinking of buying high-end Baijiu products.




As for the current state of the company's stock, which values at CNY1,887 per share with a market capitalization of CNY2.3704 trillion as of January 14, 2023, alongside its 64% operating margin and 193% return on invested capital over the past five years, keeps on showing its unparalleled brand strength and stance as the most distinguished blue-chip stock in the A-share market.

This paper, hence, aims at presenting a comprehensive evaluation of the enterprise's performance. In detail, the paper analyzes its financial statements, drawing a grand outlook on the company's current financial state in terms of its financing, investing, and operating activities. The paper then presents the state of its share price relative to its fair share price given by the Multiple Valuation methods. Meanwhile, the paper analyzes the Strengths, Weaknesses, Opportunities, and Threats of the enterprise based on the SWOT analysis model, which showcases the internal and external factors that may impact the enterprise's growth and operational healthiness in the future.

2. Financial Statements Analysis

Based on the life cycle of business, according to Financial Accounting, Sixth Edition, Kweichow Moutai Ltd. is in somewhat an odd state [2]. As illustrated by Fig.1, if only considering the overall trend of its financing, operating, and investing movements on the Cashflow statement(see Table 1), the cooperation clearly adheres to the introductory stage of a business for it being the only stage that has all three activities in an uptrend. Although the date of the enterprise's establishment in terms of both its product and the cooperation, going back to as far as the Qing Dynasty in the 1800s and 1951, suggests that by no chance the company is still in an introductory stage for such a long time of development. But if it neglects the state of its financing cash flow temporarily, one shall see that the cooperation adheres perfectly to the maturity stage for it being the only phase that has both a cooperation's operating and investing cashflow in an uptrend while being positive. And that leaves the question of why exactly the cooperation is still ramping up its financial cash flow in a supposedly decreasing stage based on the Life Cycle model of Business.

Table 1. 2021 Kweichow Moutai Ltd. Cashflow Statement Overview

Type of Cashflow	2019	2020	2021	Three-Year Trend
Operating Cashflow (Bil)	45.21	51.67	64.03	
Investing Cashflow (Bil)	-3.17	-1.81	-5.56	
Financing Cashflow (Bil)	-19.28	-24.13	-26.56	

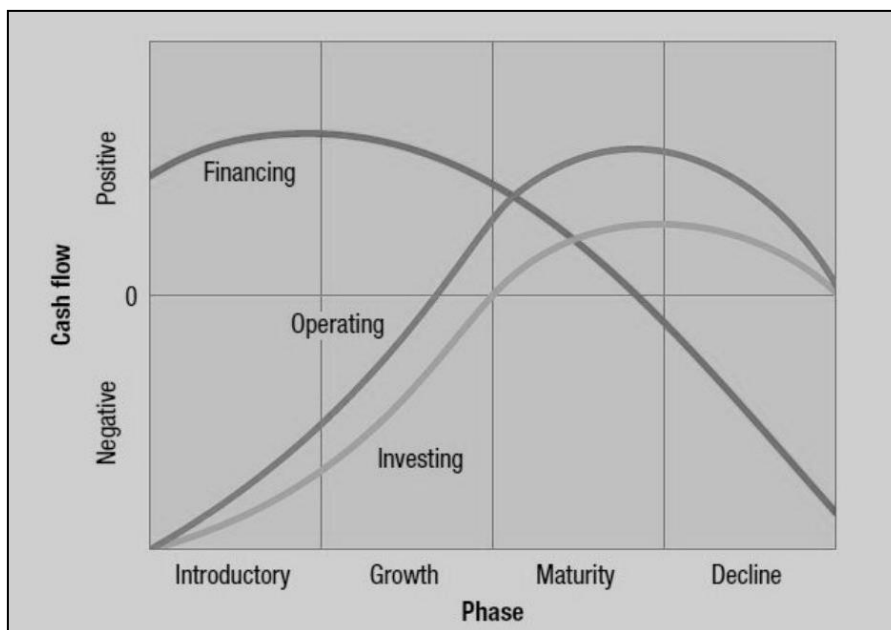


Figure 1. Life Cycle of Business (Credit: Financial Accounting, Sixth Edition)

It occurs that such phenomenon attributes largely to the dividend paid to its investors, found under the Consolidated Statement of Cash Flows on the 2021 annual report of the enterprise, which indicates there is a CNY 400 million boost of "Cash payments for distribution of dividends or profit and interest expenses" from last year and a total of CNY26,476,019,839.37. And in fact, such a generous amount of dividend paid to investors is rare in the industry, according to "The Influence of GuiZhou MaoTai's Dividend Policy on Company Share Price" by Bu Fan [3]. She thinks despite an effective dividend policy can help a company establish a market stance in the sense that a decent payout ratio helps to showcase that the company is operating reasonably well, the common scene is that most companies do not pay as much dividend or any at all, with less than 50% of the companies do pay out dividends out of 2960 companies listed on the Shanghai and Shenzhen stock exchanges, relative to the 70% ratio found on the U.S. stock market. So, this leads to another question of what precisely gives Kweichow Moutai Ltd. the capability to pay out such a sky-high number of dividends.



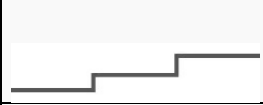


In fact, the payout ratio of Kweichow Moutai Ltd. is a remarkable 45.7 percent, according to financing website Morningstar as of 2023, meaning the enterprise gives out almost half of its earnings to its investors. Though a peek of sight at the composition of shareholders may be enough to give ones a clue about the generosity, as shown in Table 2. As of 2021, China Kweichow Moutai Distillery (Group) Co., Ltd is the largest shareholder of the enterprise, holding 54% of a total of 1,256,197,800 shares by the end of 2021, while the second largest holder only accounts for 7.14%, indicating the enterprise is a typical equity concentrated corporation. Bu Fan argues that such a composition of shareholders may constitute multiple risks to the company's operation. Since when formulating the dividend policy, the policymaker would thoroughly consider the company's long-term capital investment and the retained profits used for capital appreciation rather than dividend payments. But in the case of the enterprise, predominantly large shareholders holding over 50% shares of the stock (which in the case is the enterprise itself), combining other shareholders from subsidiary companies of the enterprise accounting for over 60% of the total shares, will be granted the decision-making power to alter such policy-making and act in their own interests, such as preferring a high cash dividend policy over investment risks. In fact, as a state-owned enterprise, its beneficiary is the Guizhou Provincial State-owned Assets Supervision and Administration Commission, meaning the making of the dividend policy of the enterprise usually takes into account the will of the local government, whose financial state in the year may play a decisive role in the dividend policy making—when the funding is low, Kweichow Moutai Ltd. can still make sure there is money coming in for the government.

Table 2. 2021 Kweichow Moutai Ltd. Annual Report—Composition of Shareholders (Top Five)

Shareholder Name	Number of Shares Held	Proportion (%)
China Kweichow Moutai Distillery (Group) Co., Ltd.	678,291,995	54.00
Hong Kong Securities Clearing Company Ltd. (HKSCC)	89,681,844	7.14
Guizhou Provincial State-owned Capital Operation Co., Ltd.	56,996,777	4.54
Kweichow Moutai Distillery (Group) Technology Development Co., Ltd. (formerly known as Kweichow Moutai Distillery Group Technology Development Co., Ltd.)	27,812,088	2.21
Central Huijin Asset Management Co., Ltd.	10,397,104	0.83

Although, regardless of the risks of being an equity concentrated corporation, Kweichow Moutai Ltd. is still seen as a dignified option for investment judging on other parts of the financial statements, as shown in Table 3. For one thing, despite recording the slowest pace in five years, the enterprise still manages to have both its revenue and net income rose by 12%, in line with the enterprise's expectation in 2021, given the overall gloomy economic state in China with the general consumer staple industry still recovering from the whole covid situation. And the diluted EPS also records a 12% growth, with its share price increased by almost eight-fold since 2016. As Tara Nurin from Forbes writes in "Sales of Chinese Baijiu Go Gangbusters During the Covid-19 Pandemic", "(T)he numbers would have shocked financial analysts in a normal or even strong market period; the fact it's happening during the worst health crisis in a generation is nothing short of mind-blogging."

Table 3. 2021 Kweichow Moutai Ltd. Income Statement Overview

Subject	2019	2020	2021	Three-Year Trend
Revenue (Bil)	88.85	97.99	109.46	
Operating Income (Bil)	59.07	66.47	73.77	
Net Income (Bil)	41.21	46.70	52.46	
EBITDA(Bil)	60.30	67.77	76.11	
Diluted EPS	32.80	37.17	41.76	

3. Market Analysis

3.1 Multiple Valuations

Multiple Valuation is a typical method adopted by appraisers to value an entity based on multiples of other comparable entities. For example, if to use the P/E ratio as the multiple to conduct the analysis, by finding the benchmark value of the multiple derived from the average of multiples coming from other chosen comparable companies, then by multiplying the benchmark value by the EPS value of the target company, one is able to give a quick estimate of the target company's stock value, in terms of whether the stock is undervalued or overvalued relative to the selection of comparables of the enterprise. Using such method, this paper provides a quantitative answer to estimate the value of the share price of Kweichow Moutai Ltd.

However, the problem lies in selecting the real competitors. It is somewhat difficult to find the proper ones to conduct multiple valuations for the mega enterprise, considering the unmatched market capitalization and profitability Kweichow Moutai Ltd. has. Regardless, the three comparable companies this paper chooses to conduct the analysis are, respectively, the Luzhou Laojiao Ltd., the Wuliangye Yibin Ltd., and the Shanxi Xinghuacun Fen Wine Factory Ltd. The reasoning behind the selection comes from multiple literature reviews, regarding a number of precedent researches that aim at finding factors that impact the precision of multiple valuations in terms of its peer group selection, captured and summarized by the following section.

3.2 Literature Reviews

3.2.1 ROE/ROA

- Alford, A.W. discovers how a similar return on equity and total asset of companies of the same industry suggests effective comparable peer groups for multiples valuation [4].

- Dittmann and Weiner form a large database of companies from multiple European Union member states and find out how the forecast errors of multiples valuation are minimized when the chosen comparable companies have similar ROAs [5].

3.2.2 Accounting Regime

- Alford's studies are known to focus only on one country for his multiple valuations of enterprises. He captures the reality, in which once the range of the analysis extends beyond just one country, is usually followed by lesser accuracy on valuation [4].

- Young and Zeng research the role of having the same accounting regime on pricing multiples and notice how comparables that share the same set of accounting rules enhance the accuracy and performance of the valuation [6].

3.2.3 Culture

- Violet marks the idea that accounting is not culture-free, and that it ought to be viewed as a "socio-technological activity" that pins down the connectedness between anthropological science and comparative valuation [7].

- Finn finds support for his expectation that culture has an impact on the precision of selecting comparables used for multiples valuation [8].

3.3 Results

Hence, it occurs that the extent of similarity among comparables in terms of their ROE/ROA, Accounting Regime, and Culture shows significance, for enterprises that share the similarity in these factors constitute a relatively ideal selection for a peer group to conduct multiple valuations. This paper thereby chooses the Luzhou Laojiao Ltd., the Wuliangye Yibin Ltd., and the Shanxi Xinghuacun Fen Wine Factory Ltd. as the chosen comparables, for them naturally fitting with the criteria above, sharing the same geographic and cultural setting as all headliners of the Chinese Baijiu industry with similar ROE/ROA, as shown in Table 4.

Table 4. 2022 Profitability of Kweichow Moutai Ltd. and its Comparables

Subject	Kweichow Moutai Ltd.	Luzhou Laojiao Ltd	Wuliangye Yibin Ltd.	Shanxi Xinghuacun Fen Wine Factory Ltd.
ROE (%)	25.23	24.49	25.99	43.38
ROA (%)	31.28	34.02	20.59	25.25

To conduct the analysis of multiple valuations using P/E multiple, this paper first obtains the P/E ratios of its chosen comparables from Morningstar, the average of which serves as the benchmark value of the multiple. Then by multiplying the benchmark value by the value of the current diluted earnings per share of Kweichow Moutai Ltd. as of January 15, 2023, this paper obtains the valuation of Kweichow Moutai Ltd's fair stock price for each share being CNY547, which is significantly lower than its current share price of CNY1887, suggesting the current stock price is significantly overvalued, according to the multiple valuations using P/E multiple, as shown in Table 5.

Table 5. Multiple Valuation—P/E

Subject	Kweichow Moutai Ltd.	Luzhou Laojiao Ltd.	Wuliangye Ltd.	Shanxi Xinghuacun Fen Wine Factory Ltd.
Share Price (1/15/23)	1887			
P/E ratio	39.84	36.23	29.59	49.5
Average of Comparables' Target Multiple—P/E		38.44		
Diluted EPS	14.23			
Valuation (Price/Share)	CNY547			

For similar logistics, to conduct the analysis of multiple valuations using EV/EBITDA multiple, this paper first obtains the EV/EBITDA ratios of its chosen comparables, the average of which serves as the benchmark value of the multiple. Then by multiplying the benchmark value by the value of Kweichow Moutai Ltd.'s EBITDA for the last trailing twelve months as of January 15, 2023, this paper obtains the valuation of Kweichow Moutai Ltd.'s fair enterprise value being CNY2244.66 billion, which is slightly lower than its current enterprise value of CNY2312.72 billion, suggesting the enterprise value is relatively overvalued, according to the multiple valuations using EV/EBITDA multiple, as shown in Table 6.

Table 6. Multiple Valuation—EV/EBITDA

Subject	Kweichow Moutai Ltd.	Luzhou Laojiao Ltd.	Wuliangye Ltd.	Shanxi Xinghuacun Fen Wine Factory Ltd.
EV(Bil)	2312.72			
EV/EBITDA	27.67	25.90	19.06	35.6
Average of Comparables' Target Multiple—EV/EBITDA		26.85		
EBITDA(Bil)	83.60			
Valuation (Enterprise Value)	2244.66Bil			

4. SWOT Analysis

To further identify the favorable and unfavorable factors that could potentially alter the business prospect of the enterprise, this paper conducts a SWOT analysis in hope to generate meaningful information and showcase the comparative advantages and disadvantages of the enterprise relative to its competitors, regarding the four categories listed below as Strengths, Weaknesses, Opportunities, and Threats based on the model.

4.1 Strengths

The ultimate strength of the enterprise lies in its consumer demand. China has become the biggest consumer of alcoholic drinks in the world with a consumption of US\$311,827 million as of 2021. The quantity base of consumers sets up the room for the enterprise's profit to grow exponentially. In addition, the brand has gone through centuries of development and manages to leave an impression of reliability on the consumers who tend to have more confidence in products that come with a historic background. And the branding recognition coming from valued appraisers during the modern era also play a role in marking the stance of the brand in the heads of consumers. Over the years the enterprise receives countless awards and praises from different sides of the world, including the title of "National liquor" from the Chinese State Council and the "Top Regarded Companies" on Forbes. These accomplishments help consumers with growing attachments and loyalty to the brand [9].

The market strategies adopted by the enterprise are also well-designed. Years of accumulation of wealth enable it to expand further, tapping technology and product innovation. For example, the enterprise has recently launched its mobile app for e-commerce and communication purposes, and caught the attention of over 10 million users, while it made the unexpected move to touch upon the ice cream industry in partnership with the Chinese dairy giant Mengniu Dairy to explore a younger demographic, introducing the brand new Moutai ice-cream. In addition, the enterprise is increasingly expanding its number of outlets and distribution network, owning over 900 stores in China, making products available and easy to purchase for customers in need. And there are around 50 different products that are priced in the range of \$100 to \$20,000 with different bottle sizes and volumes, showing consideration of affordability while positioning its products.

And the fact that the enterprise thrives through arguably one of the worst health crises in mankind's history, in addition to a historic hike of interest rates across the globe in fear of surging inflation, tells a lot about the enterprise's profitability during unideal times. For one thing, the enterprise sees profit gains for consecutively three years since the covid starts in 2019, recording a 26.2% growth on its EBITDA for the three-year gap. For another, despite the number being down over 17% for the past 12 months as of May 2022, the company still manages to post substantial gains on its stock price compared to that before covid, recording a nearly 30% gain relative to the share price on December 1, 2019.

4.2 Weaknesses

The major weakness of the enterprise lies in a series of problems raised from the product-making process. It typically takes 4-5 years for a batch of moutai to finish its fermenting process, which serves as a reflection on the lack of supply that often takes place in the moutai market. In fact, the complex method requiring such a long time constitutes a below-industry-average efficiency on the cashflow used to produce income [10]. Even though the enterprise once tried finding other places to produce the alcohol in order to enlarge its supply, they failed doing so because accordingly the taste is different without the particular climate in Guiyang and the water source from the Chishui river, which has declined in volumes due to deforestation and the rise of polluting enterprises nearby [11].

Despite having around 50 different products, Kweichow Moutai Ltd. has liquors accounting for 99.9 percent of the revenue it generates, while 89.2 percent of those revenue comes from Moutai liquor, as opposed to a mere 10.98 percent of liquor revenue coming from other liquor series. And such concentrated composition of revenue may pose a disadvantage to further developing new

product lines that match the growing expectation of the enterprise regarding its product innovation [12].

It is hard to oversee regulation factors in the A-share market, where socialism-orientated values play a non-negligible role in affecting the enterprise. As Kate Lin from Morningstar says, “(T)her Chinese spirit is symbolized for social identity and is central to the country’s dining and hospitality”, so much so that once the beloved spirit was prohibited from the dining table of the government officials, for the act being considered to hinder ‘social harmony’ and fail to conform the thrifty lifestyle advocated by the central government in 2012. And the potential that there may be other policies blasting the enterprise’s products in the future, such as alcoholism control or environmental resources protection (that may lead to raw materials shortage), may one day shadow the enterprise’s prospect unexpectedly [13].

4.3 Opportunities

As a state-owned enterprise, Kweichow Moutai Ltd. is gifted with much governmental macro-policy and regional policy support. From the national “Opinions on Supporting Guizhou Grand Development in West China” issued by the state council in 2022 to the provincial “Opinions on Promoting the Transformation and Upgrading of the Baijiu industry in 2020” issued by the Guizhou province, the enterprise is given the well-rounded internal support to accelerate its growth. Though such support often comes at a cost, as Cai Xuefei, a liquor industry consultant and General Manager of Hefei Zhiqu puts it, “(i)t is quite common for liquor companies, such as Kweichow Moutai Group, Wuliangye Yibin, and Luzhou Lao Jiao, to support the local economies, and in turn, receive policy support from the local governments.” So, it is only a matter of evaluating the trade-off between the gives and takes for the enterprise, but either way, the intimate relationship between the enterprise and the government constitutes the most distinguished opportunity to drive the enterprise further.

4.4 Threats

Regardless of how the government could benefit the enterprise in terms of giving policy support in exchange for its investments, its role played in the growth of the enterprise is still two-sided. Mainly because there is no absolute certainty for the projects that the enterprise is asked to invest on can guarantee success, especially when they started poorly from the beginning—and these types of projects are usually the ones to ask. In 2021, the enterprise issued CNY15 billion of bonds to help pay off some debt of a state-owned highway project, which incurred a CNY1.9 billion net loss in the first half of 2020 due to the pandemic hit, in addition to a CNY260 billion of interest-bearing debt leading to a staggering 70 percent debt-to-equity ratio. And in “return” of the acquisition, Kweichow Moutai Ltd.’s debt-to-asset ratio raised by 5.3% to 19.5%, while the market reacted poorly to the decision, and the stock price dropped by 3.16% on September 17, 2021. As Iris Hong from Asia Finance puts it, “(a)s a provincial level state-owned company and the No. 1 brand in Guizhou Province, Kweichow Moutai Group has an inherent responsibility to support the harmonious development of the local economy”, and such burden may be viewed to the investors as a lack of control over its own financing decisions and a threat to destabilize the enterprise valuation [14].

5. Conclusion

Combining the results of the Financial Statements analysis, the Market Analysis, and the SWOT Analysis of Kweichow Moutai Ltd., this paper concludes that the enterprise is at the maturity stage of a business facing different levels of risk. The strengths of the enterprise clearly lie in its branding, profitability, and size as the biggest beverage company in the world, while, through the multiple valuations and the SWOT analysis, the enterprise may be perceived as overvalued by traditional quantitative analysis and an enterprise lacking comprehensive operational healthiness, resulted from its shareholders’ composition, undiversified product lines, governmental background, etc. Though the uniqueness and cultural heritage inherent to the enterprise’s branding may be significantly under-

appreciated, given the strong premium position of the stock currently and its hard-to-quantify nature of such value. So, the question of whether the enterprise's stock is truly trading beyond its intrinsic value, or it is only a fair price, for having taken thorough consideration into all multi-dimensional forces that are upholding the giant, is left for many other researches to follow and investigate.

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