Company In-Depth

14 August 2007 | 20 pages

Yantai Changyu Pioneer Wine (200869.SZ)

Initiate at Buy: A Behemoth in the Making

- 34% upside potential — Our target price of HK$62.30 is based on 35x 08E PE, equating to a 16% discount to our DCF-derived fair value. We think Changyu's long-term growth visibility and deep discount to the estimated fair value are sufficient protection against the low-liquidity risk of the B-share market.
- Targeting the rich and influential — Recognising that mass consumption is in its initial stages, the company focuses its marketing efforts on a niche group – China's rich and influential. Although volume declines in low-end sweet wine slowed overall growth in 2006, the premium series maintained growth of over 40% and constituted over 50% of total wine sales in that year.
- Competitive distribution model — While rivals depend on large dealers for market expansion, Changyu has established a three-tier distribution network that gives it better control over prices and marketing and enables it to take a more reactive approach. While the wine industry overall lacks pricing power, Changyu raised average product prices by 10% in 2005.
- Gaining market share in key markets — Changyu is quickly gaining market share in core markets, which contribute 80% of revenue, and will likely rank first by 2008 as rivals such as Great Wall are engaged in distribution network restructuring and Dynasty is troubled by the lack of marketing initiatives.
- A behemoth in the making — With domestic wine consumption rising steadily from a low base and its key rivals in weak positions, we believe Changyu is a behemoth in the making.

Buy/Low Risk	1L
Price (13 Aug 07)	HK$47.02
Target price	HK$62.30
Expected share price return	32.5%
Expected dividend yield	1.9%
Expected total return	**34.4%**
Market Cap	HK$33,063M
	US$4,228M

Price Performance (RIC: 200869.SZ, BB: 200869 CH)

See Appendix A-1 for Analyst Certification and important disclosures.

Statistical Abstract

Year to 31 Dec	Net Profit (RmbM)	Diluted EPS (Rmb)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	312	0.770	53.0	59.1	10.0	17.4	1.5
2006A	444	0.842	9.3	54.1	11.9	23.0	1.8
2007E	621	1.177	39.8	38.7	10.9	29.4	2.1
2008E	939	1.780	51.2	25.6	9.1	38.6	3.1
2009E	1,298	2.462	38.3	18.5	7.5	44.4	4.3

Source: Powered by dataCentral

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[1]Citigroup Global Markets Asia

Fiscal year end 31-Dec	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	59.1	54.1	38.7	25.6	18.5
EV/EBITDA adjusted (x)	51.0	35.8	26.1	18.2	13.0
P/BV (x)	10.0	11.9	10.9	9.1	7.5
Dividend yield (%)	1.5	1.8	2.1	3.1	4.3
Per Share Data (Rmb)					
EPS adjusted	0.770	0.842	1.177	1.780	2.462
EPS reported	0.770	0.842	1.177	1.780	2.462
BVPS	4.561	3.811	4.189	5.027	6.065
DPS	0.700	0.800	0.942	1.424	1.969
Profit & Loss (RmbM)					
Net sales	1,804	2,163	2,810	3,661	4,781
Operating expenses	-1,382	-1,549	-1,945	-2,423	-3,067
EBIT	**422**	**613**	**865**	**1,238**	**1,714**
Net interest expense	22	21	22	22	28
Non-operating/exceptionals	1	0	0	0	0
Pre-tax profit	**445**	**635**	**887**	**1,260**	**1,742**
Tax	-130	-187	-262	-315	-435
Extraord./Min.Int./Pref.div.	-2	-3	-4	-6	-8
Reported net income	**312**	**444**	**621**	**939**	**1,298**
Adjusted earnings	312	444	621	939	1,298
Adjusted EBITDA	460	652	896	1,275	1,756
Growth Rates (%)					
Sales	34.8	19.9	29.9	30.3	30.6
EBIT adjusted	37.1	45.2	41.0	43.1	38.5
EBITDA adjusted	32.3	41.9	37.4	42.3	37.6
EPS adjusted	53.0	9.3	39.8	51.2	38.3
Cash Flow (RmbM)					
Operating cash flow	**326**	**398**	**534**	**897**	**1,265**
Depreciation/amortization	37	39	31	38	41
Net working capital	-21	0	-100	-63	-55
Investing cash flow	**-21**	**-20**	**-152**	**-112**	**-113**
Capital expenditure	-44	-186	-152	-112	-113
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**-203**	**-284**	**-400**	**-475**	**-723**
Borrowings	0	0	0	0	0
Dividends paid	-203	-284	-422	-497	-751
Change in cash	**102**	**94**	**-18**	**310**	**429**
Balance Sheet (RmbM)					
Total assets	**2,348**	**2,729**	**3,097**	**3,743**	**4,552**
Cash & cash equivalent	1,161	1,192	1,175	1,485	1,914
Accounts receivable	124	145	188	245	320
Net fixed assets	473	590	710	783	853
Total liabilities	**460**	**666**	**830**	**1,028**	**1,282**
Accounts payable	348	558	691	846	1,044
Total Debt	0	0	0	0	0
Shareholders' funds	**1,887**	**2,063**	**2,266**	**2,715**	**3,270**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	25.5	30.2	31.9	34.8	36.7
ROE adjusted	17.4	23.0	29.4	38.6	44.4
ROIC adjusted	42.3	55.1	63.0	81.3	100.9
Net debt to equity	-61.5	-57.8	-51.8	-54.7	-58.5
Total debt to capital	0.0	0.0	0.0	0.0	0.0

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Powered by: dataCentral

Investment Thesis

With a low average consumption rate and driven by the consumption trend toward health-oriented products, China's wine market has the best growth visibility among alcoholic drinks, based on our analysis. Yet with a short history of brand building and limited marketing expertise, most brands do not have pricing power and their growth is volatile.

We believe Changyu has successfully dealt with the various challenges it faces. Realising that mass consumption is in its initial stages, the company has focused marketing efforts on a niche consumer group – China's rich and influential. The company has also leveraged its JV with global wineries in the promotion of its premium series. The company's wine revenue grew by CAGR of 34% for 2003-2006 and its premium series grew by over 40% and contributed to over 50% of total wine sales in 2006.

Changyu's three-tier distribution network is another key competitive edge over rivals. Unlike the regional dealer model, which helped market expansion, but also challenged producers' control abilities, Changyu's distribution model has enabled it to have better control of its price system and to take a more reactive approach to market conditions. The company was able to raise average product prices by 10% in 2005, while no competitors dared to follow.

Changyu currently ranks second in grape wine, with a 17% market share (next only to Great Wall) and first in the brandy market. In the seven cities that contribute over 80% of its revenue, Changyu is quickly gaining market share and will very likely rank first in most cities by 2008, with rivals Great Wall, engaged in distribution network restructuring, and Dynasty, troubled by lack of marketing initiatives. With its competitive edge and its rivals in a weak position, Changyu looks like a behemoth in the making.

We forecast EPS CAGR of 43% into 2009. We apply a 08E PE of 35x to value Changyu B, close to Hong Kong-listed peers. We thus derive a target price of HK$62.30, a 16% discount to our DCF-derived fair value of HK$74.09. We think the company's long-term growth visibility and current deep discount to fair value offer enough protection against the low liquidity risk of the B-share market.

Figure 1. Rival Comparison

	Changyu	China Foods (Great Wall) (Non-rated)	Dynasty (Non-rated)
Ticker	200869.SZ	0506.HK	0828.HK
Price	47	4.83	2.92
Market cap (US$ m)	4,228	1,752	470
Market position	No. 2 in grape wine with 17% market share, No.1 in brandy	No.1 in grape wine with 19% market share	No.3 in grape wine with 12% market share
Product mix	Grape wine and brandy contributed 75% and 18% of the company's revenue in 2006. Over 40% of grape wine revenue contributed by Chateau Wine (retail price over Rmb328) and Cabernet Wine (retail price Rmb56-198).	Mainly engaged in grape wine. 60% of revenue contributed by low-end products (priced below Rmb30/bottle).	Mainly engaged in grape wine. 46% of revenue contributed by "Dynasty Dry Red", a mass market product (retail price Rmb38/bottle)
Sales system	Extensive three-tier: over 37 branches and 500 sales offices, a professional marketing team with more than 1,700 sales people to assist over 3,300 dealers. High investment on channels at the beginning, but has now reached harvest time.	Is in the process of restructuring its regional dealer system.	Depends too heavily on regional dealers, as a result the company's growth has slowed in recent years

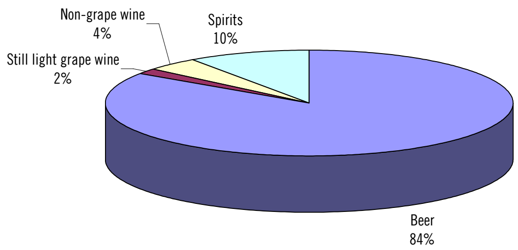
Source: Citigroup Investment Research estimates

Industry Overview

Consumption characteristics

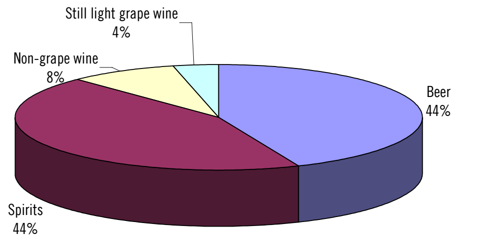
Grape wine consumption in China is still at an early developmental stage: per capita consumption is only 0.65 Litre; the percentage of the overall alcoholic drink market in China is only 2% by volume and 4% in value. This is reflected by the fact that over half of consumption is on-spot, in contrast to more mature market segments like beer and spirits, and also the fact that two-thirds of consumption is realized in more affluent and open regions in south and east China.

Figure 2. China Alcoholic Drinks Breakdown by Volume, 2006



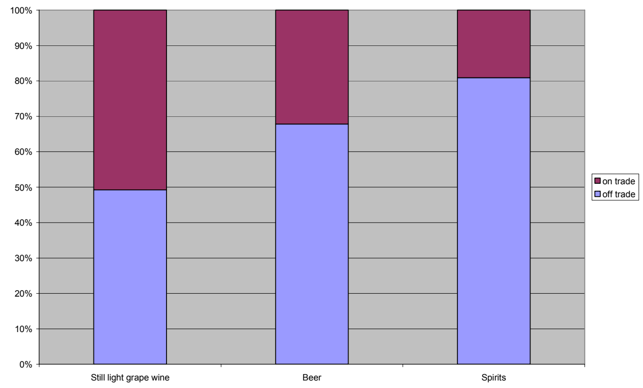
Source: Euromonitor

Figure 3. China Alcoholic Drinks Breakdown by Value, 2006



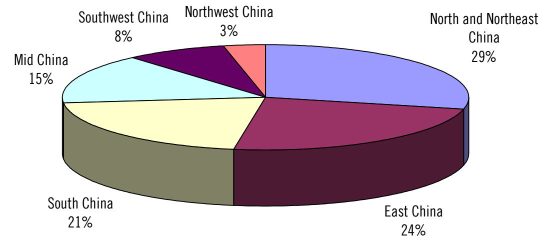
Source: Euromonitor

Figure 4. Grape Wine Consumption: On-trade vs. Off-trade in Volume, 2006



Source: Euromonitor

Figure 5. Grape Wine: Geographical Breakdown, 2006



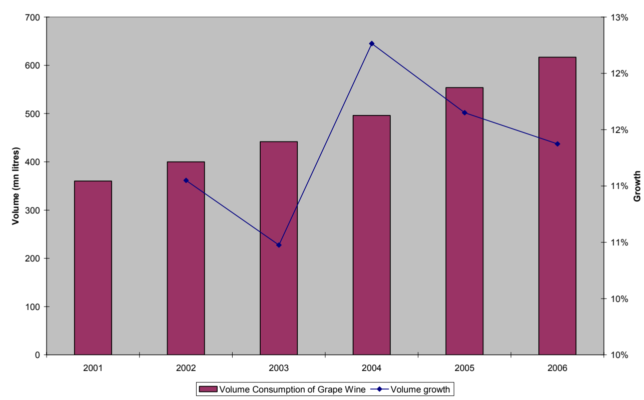
Source: Euromonitor

Growth and competition

For the past five years grape wine has maintained annual growth between 10-13%. ASP rose in 2006 as supply shortage and price rises for grapes caused wineries to cut down volume of low-end products. Market share by the top three wineries is 49% in terms of revenue and 27% in terms of volume.

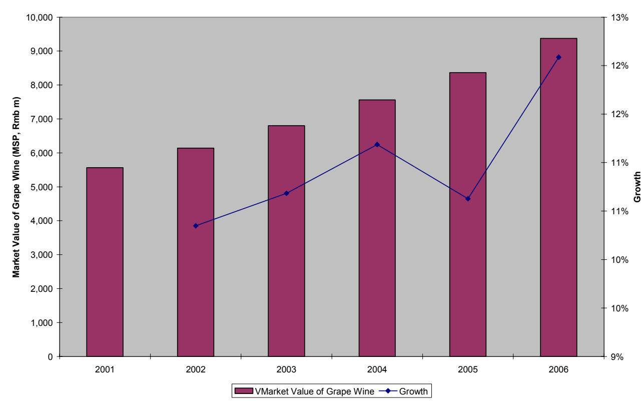
Growth of imported wine picked up in 2006, and accounts for around 19% of total wine production in China. Nearly 80% of the total takes the form of bulk wines, however, which are usually low-end products. We believe it would take time for global brands to pose tough challenge to leading domestic brands. Due to low official quality standard and lack of guidance, consumers in China are generally unable to compare the quality of domestic wine and imported wine. Domestic wineries' initiatives to educate consumers' palates are an effective way to build loyalty and taste preference.

Figure 6. Volume Consumption of Wine and Growth



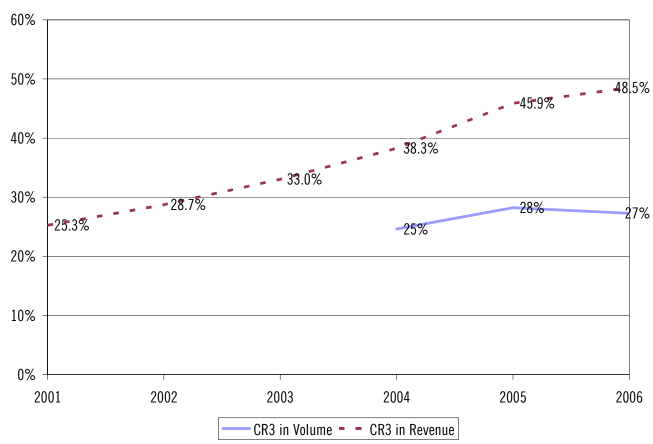
Source: Euromonitor

Figure 7. Market Value of Grape Wine and Growth



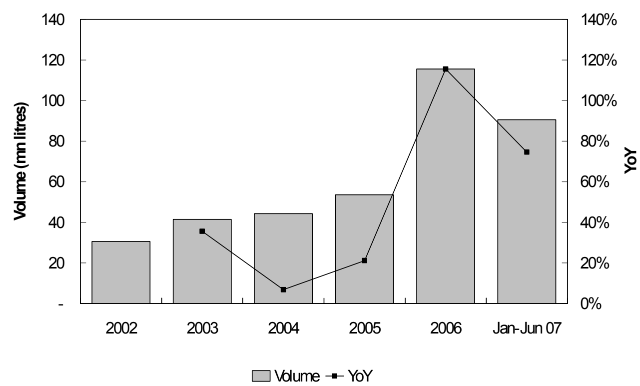
Source: Euromonitor

Figure 8. Total Market Share by Top Three Wineries



Source: Euromonitor

Figure 9. Imports of Grape Wines



Source: Euromonitor

Rival comparison

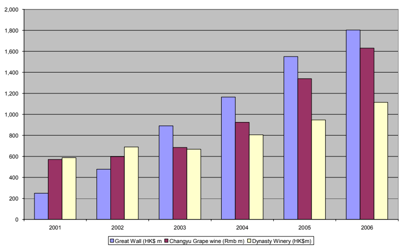
With a low average consumption rate and consumption trend toward health promoting products, China's wine market has the best growth visibility among alcoholic drinks, in our view. Competition is fierce in the mass market, and with a short history of brand building and limited marketing expertise, most brands lack pricing power, have volatile growth and low profitability.

Although Great Wall is the biggest player, with 60% of revenue contributed by low-end products (priced below Rmb30/bottle), it has the lowest ASP among the three leading players. Growth started to slow in 2006 as the company expedited consolidation of its wine business.

Dynasty faces tough competition from Changyu in its primary markets (Zhejiang, Jiang and Shanghai), due to a lack of marketing initiatives.

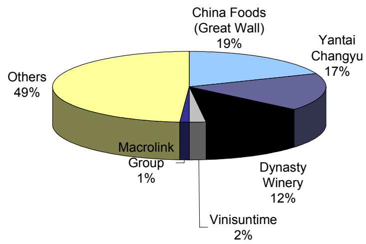
Changyu has grasped some of the challenges it faces. Understanding that mass consumption is at initial stages, the company has focused marketing efforts on a niche group – China's rich and influential, and its premium series contributes to over 50% of its wine sales. While rivals depend on large dealers for market expansion, Changyu has established a three-tier distribution network that ensures it has better control over prices and its market position and allows it to take a more reactive approach to market conditions. While the wine industry overall does not have pricing power, Changyu raised average product price by 10% in 2005.

Figure 10. Grape Wine Revenue Growth of Top Three Wineries



Source: Company data

Figure 12. Major Grape Wine Companies (by Revenue)



Source: Company data and Euromonitor

Figure 11. Financials of Leading Wineries

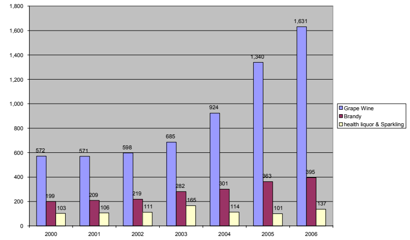
Revenue (Rmb m)	2004	2005	2006
China Foods (Great Wall)	1,164	1,550	1,803
Yantai Changyu (Grape wine only)	924	1,340	1,631
Dynasty Winery	805	947	1,114
Vinisuntime	287	212	198
Macrolink Group	-	66	109
Tonghua Grape Wine	40	70	70
Revenue growth			
China Foods (Great Wall)	31%	33%	16%
Yantai Changyu (Grape wine only)	35%	45%	22%
Dynasty Winery	20%	18%	18%
Vinisuntime	-15%	-26%	-7%
Macrolink Group	/	/	65%
Tonghua Grape Wine	-55%	75%	1%
Volumn (mn litres)			
China Foods (Great Wall)	57	78	86
Yantai Changyu (Grape wine only)	36	44	45
Dynasty Winery	29	34	37
ASP (Rmb/litre)			
China Foods (Great Wall)	20.4	20.0	20.9
Yantai Changyu (Grape wine only)	25.7	30.2	36.2
Dynasty Winery	27.6	27.8	30.0
Gross margin			
Yantai Changyu Group	65.8%	66.8%	68.8%
Dynasty Winery	53.0%	51.7%	50.9%
Vinisuntime International	-271.9%	29.5%	17.6%
Macrolink Group	-		39.3%
Tonghua Grape Wine	11.8%	37.8%	28.7%
EBIT margin			
China Foods	18.2%	19.0%	17.7%
Yantai Changyu Group	33.3%	31.5%	37.6%
Dynasty Winery	28.0%	24.1%	13.6%
Vinisuntime International	-14%	-66%	-252.9%
Macrolink Group	-	17.6%	16.2%
Tonghua Grape Wine	-246%	0.83%	3.4%
ROE			
Yantai Changyu Group	11.7%	16.9%	22.1%
Dynasty Winery	39.4%	13.5%	7.9%
Vinisuntime International	-	9%	11.3%
Tonghua Grape Wine	-23%	0.2%	0.3%

Source: Company data

Changyu Targeting the Rich and Influential

We estimate that over 50% wine sales of the company comes from high-end products like Chateau wine and Cabernet wine, which are usually consumed at business banquets or bought for gift purposes. It is worth noting that gift packaged products (excluding ordinary-packaged goods) alone make up over 10% of the company's total sales.

Figure 13. Revenue Growth by Product



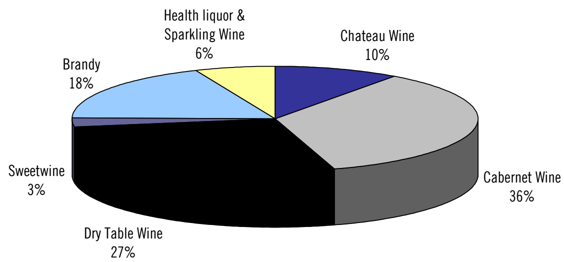
Source: Citigroup Investment Research

Figure 14. Prices of Major Products (Rmb/litre), 2006

	Grape Wine						
	Chateau	Cabernet	Dry Table Wine	Sweet Wine	Brandy	Health liquor	Sparkling Wine
ASP(Rmb/litre)	180.9	51.8	25.6	9.3	14.6	28.2	9.4
Typical Retail end price points (Rmb/750ml bottle)	328	56-198	30	/	/	/	/

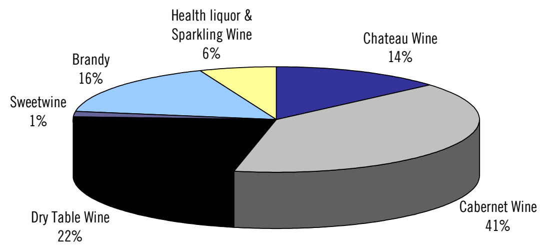
Source: Company data and Citigroup Investment Research

Figure 15. Revenue Breakdown, 2006



Source: Company data and Citigroup Investment Research

Figure 16. Gross Profit Breakdown, 2006



Source: Company data and Citigroup Investment Research

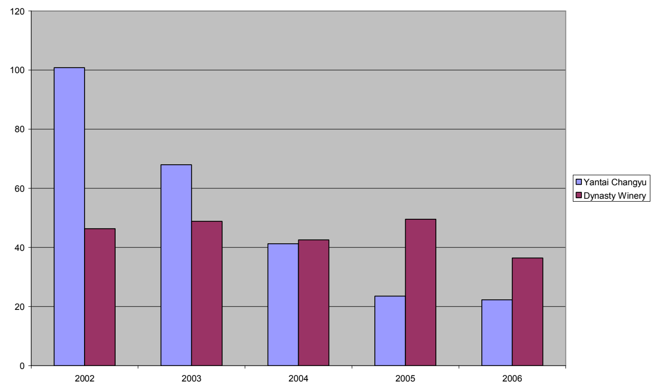
Competitive distribution model

The company started to restructure its distribution channels in 2000. By 2005 it had established an extensive nationwide three-tier distribution network made up by over 37 branches, 500 sales offices, and a professional marketing team with more than 1,700 sales people to assist its over 3,300 dealers. Compared with the regional-dealer model adopted by Great Wall and Dynasty, Changyu's three-tier distribution network gives the company stronger bargaining power with its sales channels, and gives it better control of its pricing. The company was able to raise prices in 2005 to pass on some of the rise in grape prices. Although this network cost time and cash to build, it has now reached harvest time and its selling expenses ratio started to fall in 2006 and we expect this will continue in 2007.

The establishment of 37 branches (which is a challenge on talent to peer companies) has also enabled the company to carry out performance reviews of branch managers based on profit and product mix, instead of purely sales and expenses as with most other companies. The benefit of this structure is a more efficient use of marketing expenses, in our view.

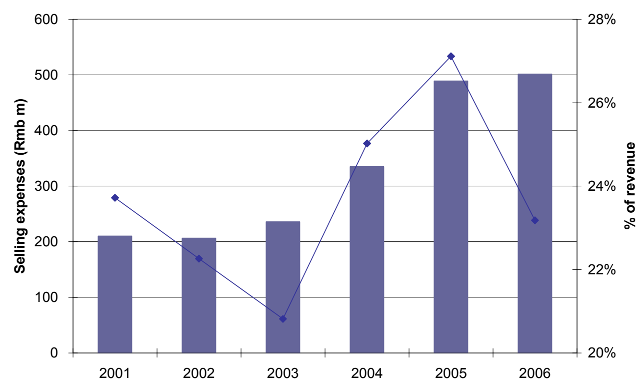
Given a better product mix, the ability to raise prices (although the company is focused more on volume growth than price rises), and a distribution network that brings economies of scale, the company's profit margins and profitability have been on a steady rise. By 2006 the company had demonstrated a rising margin unrivalled by competitors suffering from cost volatility.

Figure 17. Receivable Turnover Has Improved



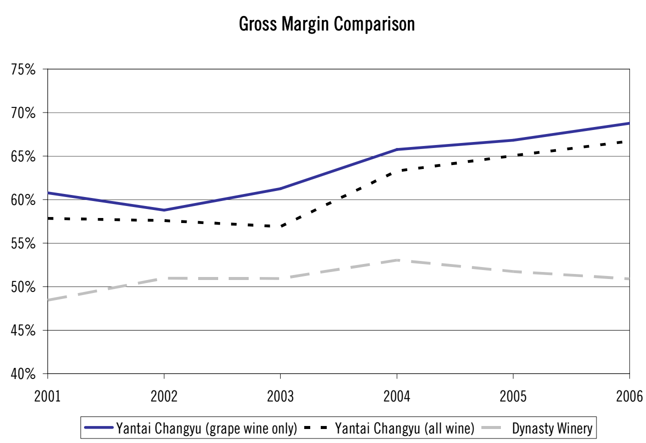
Source: Company data

Figure 18. Selling Expense Economies of Scale



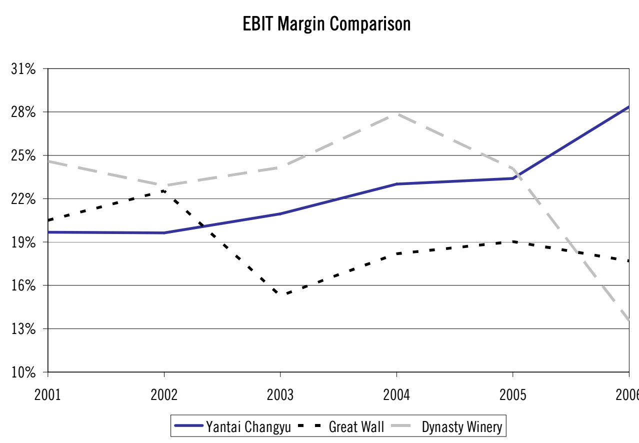
Source: Company data

Figure 19. Gross Margin Comparison: Changyu Able to Offset Cost Fluctuations



Source: Company data

Figure 20. EBIT Margin Comparison: Changyu on the Rise

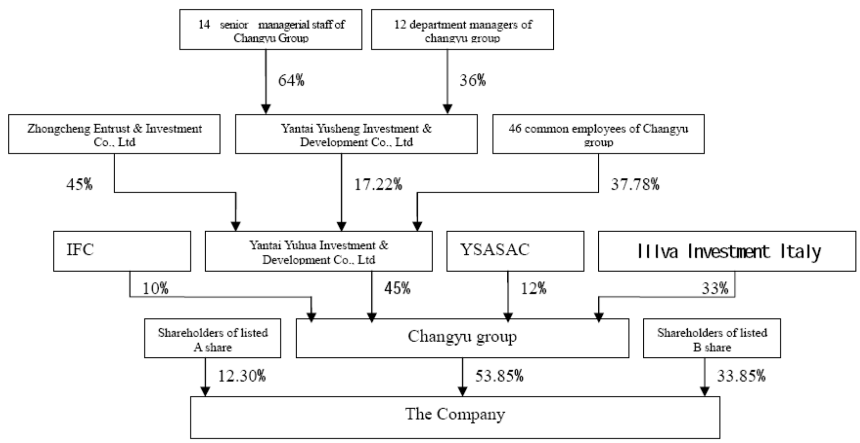


Source: Company data

Motivated management team

Changyu is majority-owned by its management and key employees. This gives its management and marketing teams a great incentive to do things even better.

Figure 21. Shareholding Structure of Changyu

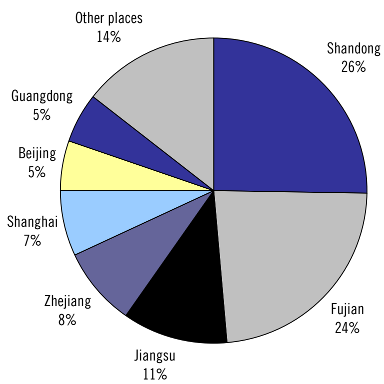


Source: Company report, Citigroup Investment Research

Gaining market share in major wine markets

In the seven cities that contribute over 80% of its revenue, Changyu is quickly gaining market share. The company ranks first in the wine markets of Shandong and Fujian with respective shares of over 70% and 40%. It aims to achieve top rankings in Jiangsu, Zhejiang, Shanghai, Guangdong and Beijing, and has made breakthroughs in 2007. We believe the company will very likely rank first in most cities by 2008 with rivals like Great Wall engaged in distribution network restructuring and Dynasty troubled by a lack of marketing initiatives.

Figure 22. Geographical Breakdown of Changyu's Wine Revenue



Source: Citigroup Investment Research estimates

Figure 23. Growth Forecast in Major Regions

	Growth		Comment
	05-06	06-09E	
Shandong	20%	28%	70% market share, growth rate is climbing as consumption rises
Fujian	20%	28%	Over 40% market share, growth rate is climbing as consumption rises
Jiangsu	40%	40%	Ranks top three, is expected to achieve top one by 2008
Zhejiang	45%	40%	Ranks top three, is expected to achieve top one by 2008
Shanghai	59%	40%	Ranks top three, is expected to achieve top one by 2008
Beijing	45%	30%	Ranks top three, is expected to achieve top one by 2008
Guangdong	-30%	28%	Ranks top three in grape wine, experienced slowdown in 2006 and the company has replaced local sales manager. Ranks first in brandy
Other regions	15%	44%	Growth is fast in regions like Heibei and Jilin from a low base

Source: Citigroup Investment Research estimates

Financial Forecasts and Valuation

Revenue growth

The company's wine business started to deliver above-average growth in 2004, mainly driven by Chateau and Cabernet wines. A slowdown in 2006 was mainly caused by the company's product mix adjustment away from low-end sweet wine while the high growth of Chateau and Cabernet continued. While educating mass market with its dry table line, the company's marketing focus remains on Chateau and Cabernet series. The company has recently started to promote its Ice wine series and its Chateau wine series will start to include its Beijing-based Chateau project which is priced higher than the present series. We forecast a CAGR of over 40% for the two high-end products into 2009 and then over 30% into 2012, with mild growth of dry table wine and negligible growth of sweet wine. We thus forecast overall wine revenue CAGR of 34% into 2009 and 27% into 2012.

Brandy contributes 18% of the company's revenue and health liquor and sparkling wine contribute 6%. The company's strategy with these products is to raise brand image and gradually improve product mix. Its brandy products are primarily sold in Guangdong and take over a 90% share of China's low-end brandy market. Since 2006 the company has allied with French based Cognac Frapin to improve its product quality. We forecast mild growth of these products.

Figure 24. Revenue Growth Forecast

	2002	2003	2004	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	CAGR 06-09E	CAGR 09-12E
Total revenue growth	**4.8%**	**22.0%**	**18.2%**	**34.8%**	**19.9%**	**29.9%**	**30.3%**	**30.6%**	**27.5%**	**25.3%**	**22.6%**	**30.3%**	**25.1%**
Grape wine	4.9%	14.5%	34.9%	45.0%	21.7%	34.0%	33.5%	34.7%	30.3%	27.3%	24.0%	34.1%	27.2%
Brandy	4.5%	29.1%	6.6%	20.8%	8.7%	17.3%	18.5%	13.3%	13.3%	13.3%	13.3%	16.3%	13.3%
Health liquor & Sparkling wine	4.9%	48.5%	-31.4%	-11.3%	35.5%	17.1%	21.0%	17.6%	17.7%	17.9%	18.0%	18.5%	17.9%
Growth breakdown of grape wines													
Chateau Wine	/	/	/	/	57%	40%	47%	42%	37%	31%	26%	42.9%	31.2%
Cabernet Wine	/	/	/	/	41%	40%	39%	42%	37%	31%	26%	40.3%	31.2%
Dry Table Wine	/	/	/	/	30%	30%	25%	25%	20%	20%	20%	26.6%	20.0%
Sweet wine	/	/	/	/	-61%	-7%	3%	3%	3%	3%	3%	-0.6%	3.0%

Source: Company and Citigroup Investment Research estimates

Margins and earnings growth

The company sourced around 70% of its grapes from contracted farmers and only 10% from imports in 2006. It will, however, increase the ratio of imports to offset domestic price fluctuations. Although grape prices have increased since 2004, the company was able to offset increases through both product mix upgrades and imposing its own price rises (in Dec 2005, the company raised prices of major products by around 10%).

The company is determined to raise the brand image and its other products (especially Brandy). We forecast gradually increasing gross margin for these products.

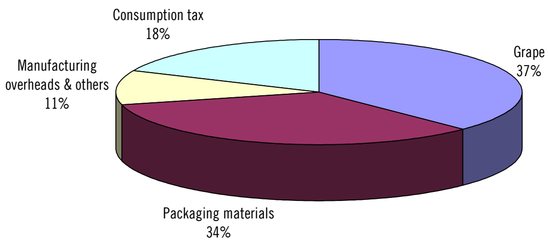
For the last three years, the company's EBIT margin grew by an average of 2.5ppts, mainly driven by product mix upgrade. We forecast another three years' average EBIT growth of 2.5ppts, driven by continuous 'premiumisation' and a distribution network that offers economies of scale. Taking into account the income tax rate unification in 2008, we forecast earnings CAGR of 42.6% into 2009 and then CAGR of 31% into 2012.

Figure 25. Margin and Earnings Forecasts

	2002	2003	2004	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	Average change 06-09	Average change 09-12
Total Gross margin	**50.2%**	**49.9%**	**55.7%**	**58.5%**	**59.3%**	**59.9%**	**53.5%**	**54.5%**	**55.5%**	**56.2%**	**56.6%**	**-1.6%**	**0.7%**
Grape Wines	51.4%	54.3%	58.2%	60.3%	61.3%	61.8%	62.8%	63.7%	64.6%	65.2%	65.5%	0.8%	0.6%
Brandy	52.9%	48.7%	52.1%	54.0%	52.7%	52.7%	52.9%	53.1%	53.3%	53.5%	53.7%	0.1%	0.2%
Health liquor	47.8%	53.5%	49.2%	56.1%	57.4%	57.4%	57.5%	57.6%	57.7%	57.8%	57.9%	0.1%	0.1%
Sparkling	27.2%	12.6%	19.4%	30.3%	29.5%	29.5%	29.6%	29.7%	29.8%	29.9%	30.0%	0.1%	0.1%
Marketing Expenses ratio	22.3%	20.8%	25.0%	27.1%	23.2%	21.7%	20.2%	19.2%	18.2%	17.2%	16.2%	-1.3%	-1.0%
G&A expenses ratio	8.5%	8.3%	7.8%	8.1%	7.8%	7.5%	7.0%	7.0%	6.5%	6.5%	6.5%	-0.3%	-0.2%
Effective income tax rate	38.0%	37.1%	35.5%	29.3%	29.5%	29.5%	25.0%	25.0%	25.0%	25.0%	25.0%	-1.5%	0.0%
EBIT margin	**19.6%**	**21.0%**	**23.0%**	**23.4%**	**28.4%**	**30.8%**	**33.8%**	**35.9%**	**38.3%**	**40.0%**	**41.4%**	**2.5%**	**1.8%**
Net Margin	**12.0%**	**13.4%**	**15.3%**	**17.3%**	**20.5%**	**22.1%**	**25.6%**	**27.1%**	**29.0%**	**30.3%**	**31.3%**	**2.2%**	**1.4%**
Earnings growth	**-35.2%**	**36.0%**	**35.0%**	**53.0%**	**42.1%**	**39.8%**	**51.2%**	**38.3%**	**36.0%**	**30.8%**	**27.0%**	**43.0%**	**31.2%**

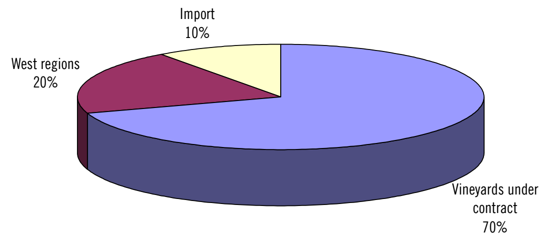
Source: Company and Citigroup Investment Research estimates

Figure 26. Cost Breakdown of Changyu, 2006



Source: Company data and Citigroup Investment Research

Figure 27. Sources of Changyu's Grape Purchase



Source: Company data and Citigroup Investment Research

Valuation

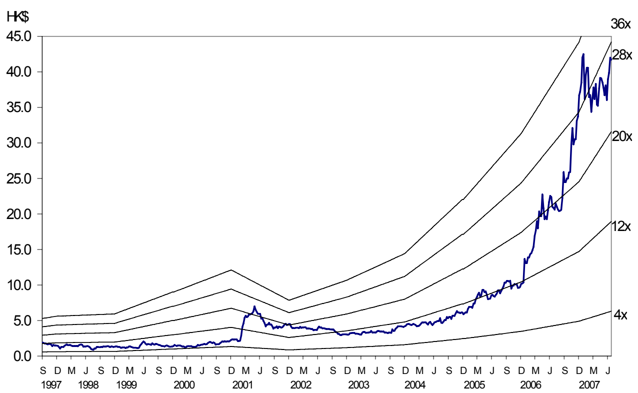
Changyu B has historically traded at discounts of 15-45% to Changyu A, basically in line the overall B-share discount, due to the liquidity issue with the B share market. We apply a 08E PE of 35x to value Changyu B, similar to the multiple at which its Hong Kong-listed peers are trading. We thus get a target price of HK$62.3, a 16% discount to our DCF-derived fair value estimate of HK$74.09. We think the company's earnings CAGR of 43% into 2009E, long-term growth visibility and current deep discount to fair value are enough protection against the low liquidity risk of the B share market.

Figure 28. Valuation Comparison with Peer Branded Consumer Names

	RIC	Rating	Price Cur	Target Price	Price on	Market Cap	PE (x)		EV/EBITDA (X)		Div Yield (%)		FCF Yield (%)		ROE (%)	
						(US$)	07E	08E	07E	08E	07E	08E	07E	08E	07E	08E
Changyu B	200869.SZ	1L	HKD	62.30	48.6	3,372	40.9	27.1	23.8	16.7	2.2%	3.3%	1.9%	3.5%	30%	39%
H Shares																
Tsingtao	0168.HK	1M	HKD	21.32	18.60	3,922	44.8	33.0	21.6	16.2	1.4%	1.9%	-0.3%	0.5%	10%	13%
Mengjiu	2319.HK	1L	HKD	27.00	27.00	4,918	41.7	32.2	23.5	17.2	0.5%	0.6%	2.1%	2.1%	27%	27%
Lining	2331.HK	1L	HKD	18.50	19.90	2,627	50.1	37.2	32.5	24.6	0.8%	1.3%	0.1%	1.9%	29%	32%
Weighted Average						11,467	44.7	33.6	24.9	18.6	0.9%	1.2%	0.8%	1.5%	21%	23%
A shares																
Luzhou Laojiao	000568.SZ	1M	CNY	48.94	61.20	7,038	85.2	46.5	58.9	38.2	0.6%	0.8%	1.1%	1.9%	27%	40%
Kweichow Moutai	600519.SS	1M	CNY	119.80	138.85	17,295	66.4	42.7	37.9	27.6	0.5%	0.7%	1.3%	2.4%	30%	37%
Wuliangye	000858.SZ	2M	CNY	26.14	34.00	17,034	73.8	54.0	41.1	34.5	0.1%	0.2%	1.5%	1.9%	19%	22%
Yanjing	000729.SZ	2M	CNY	18.19	14.44	2,097	43.8	34.5	16.0	13.1	0.9%	1.1%	-2.2%	0.3%	7%	8%
Shanxi Fenjiu	600809.SS	3H	CNY	32.95	38.00	2,171	44.4	30.8	22.0	18.0	1.2%	1.7%	2.5%	3.5%	31%	37%
Changyu A	000869.SZ	-		-	69.08	4,793	58.2	38.5	39.0	27.4	1.4%	2.1%	1.2%	2.2%	30%	39%
Weighted Average						50,428	68.8	45.8	40.4	30.4	0.5%	0.7%	1.2%	2.1%	25%	31%

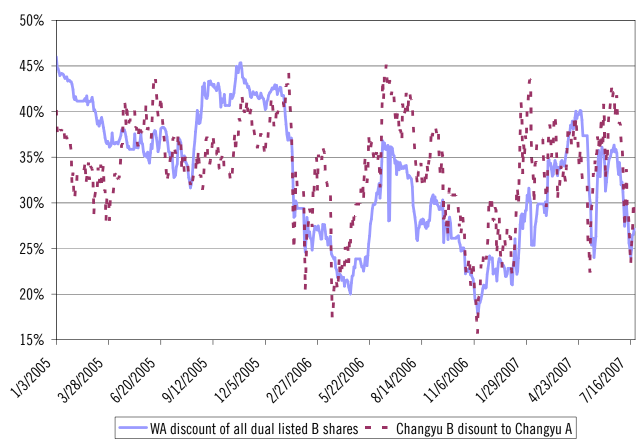
Source: Citigroup Investment Research estimates

Figure 29. Chang B 12-month Forward PE Bands



Source: Citigroup Investment Research

Figure 30. Changyu B and all B-share Historical Price Discount to A-share Counterparts



Source: Citigroup Investment Research

Figure 31. Changyu DCF Result

DCF Assumptions		DCF Result (Rmb)	
Beta	1.0	DCF value (mn)	39,436
Risk free rate	6.2%	Non-core assets	1,202
Equity risk premium	5.0%	Debt	-
Cost of Equity	11.2%	Minority	2.6%
Target debt ratio	0%	Ordinary shares (mn)	527
WACC	11.2%	Equity value per share	75.07
FCF growth			
2007-2010E	62.1%		
2010-2015E	21.0%		
Terminal	5%		

Source: Citigroup Investment Research estimates

Figure 32. Changyu DCF Sensitivity Analysis

DCF Sensitivity Analysis

		WACC				
		9.5%	10.5%	11.2%	12.0%	12.5%
g%	3.0%	79.62	67.60	60.99	54.76	51.42
	4.0%	90.16	74.78	66.63	59.12	55.18
	5.0%	105.38	84.58	**74.09**	64.74	59.94
	6.0%	129.29	98.73	84.42	72.22	66.16
	7.0%	172.34	120.97	99.66	82.70	74.65

Source: Citigroup Investment Research

Risks

We rate Changyu Low Risk according to our quantitative risk-rating system that tracks 260-day trading volatility of shares. Key downside risks include: 1) over the long run, the company faces tough competition from global brands if they have enough patience to educate China's consumers; 2) the company's premium series are primarily purchased for gift giving and business banquets, which may face cyclicality along with macro economy; 3) the stock is trading on China's low-liquidity B-share market and may be subject to an unreasonable discount. If any of these risk factors has a greater impact than we anticipate, Changyu's share price may have difficulty achieving our target price.

Company Description

Changyu Wine is a leading wine producer in China with around 17% share of the grape wine market (in value) and around 90% share of the low-end brandy market (in volume). Wine and brandy contributed 75% and 18% of the company's revenue in 2006, with the remaining 7% coming from sparkling wine and health liquor. It ranks second after Great Wall, which takes a 19% share of the grape wine market. Benefiting from its marketing strategy, Changyu has quickly gained market share since 2004 and we expect it to rank first by 2008.

Appendix A-1

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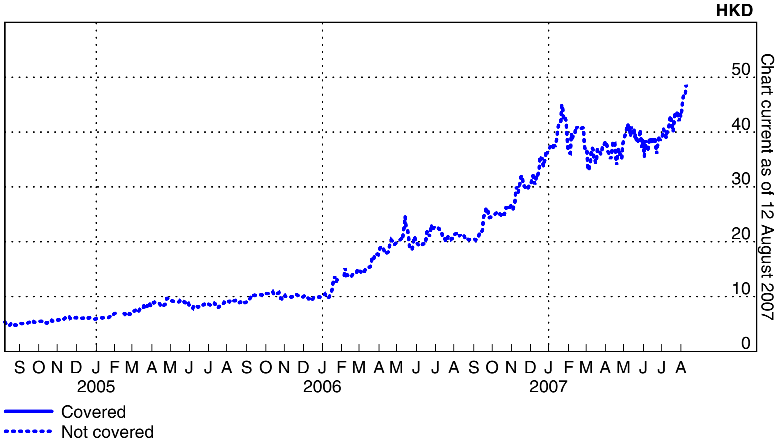
I, Joye Qiao, research analyst and the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

Yantai Changyu Pioneer Wine (200869.SZ)
Ratings and Target Price History - Fundamental Research



#	Date	Rating	Target Price	Closing Price

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