

Valuation Analysis of the Chinese Wine Sector Based on Indicators

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Abstract. As a unique type of wine, Chinese wine is one of the traditional beverages in China, with a long history and profound cultural deposits, and has a wide consumer base. Moreover, as the subject of heavy foreign investment, it is also one of the sectors with the highest share of institutional investors in A-shares, which is of great research value. Contemporarily, the Chinese wine industry has entered the stage of recovery and the production has started to show a gradual growth. Therefore, this paper attempts to value the 20 Chinese wine companies currently listed through the PE, PEG, PCF, and EV valuation method to help investors find suitable investment options. According to the valuation analysis, Luzhou Laojiao and Fen Wine are currently the most worthwhile companies to invest in. In fact, they have good operating conditions, i.e., no cash flow problems, PEG less than 1, indicating that they are undervalued companies and have high enterprise value. In addition, Gujing Distillery and King's Luck Brewery are also performing well, although their enterprise values are lower compared to the leading companies, they are still worth considering. These results shed light on guiding further exploration of stock valuation of Chinese wine industry.

Keywords: Chinese wine Industry, stock valuation, PE ratio, PEG ratio.

1. Introduction

Since entering the recovery phase in 2016, the production has started to show resilient growth. Moreover, Chinese wine, as the subject of heavy foreign investment, is also one of the sectors with the highest occupation ratio of institutional investors in A-share market making it more valuable for practical research. The share prices of many Chinese wine companies have doubled in a few years and the number of shareholders has been rising continually, with countless shareholders or fund managers profiting from the purchase of Chinese wine stocks. Therefore, a reasonable way to judge when to invest and the choice of investment objects in Chinese wine enterprises is something that investors are always looking for.

Li proposed that due to policy factors and adjustments in consumer demand and consumer groups, China's wine industry has entered a new stage of continuous and deep adjustment from full prosperity [1]. Wang studied the reasonableness of the valuation of Chinese wine enterprises, re-understood it by means of financial statements, and compared Chinese wine enterprises with foreign whisky listed companies to discover the development pattern of high-end wine. These studies provide a basis for understanding the valuation of Chinese wine companies [2]. Xu studied the value of listed companies in Chinese wine industry and found that it is susceptible to policy, with the government constantly issuing new documents to restrict it whenever it becomes too crazy or at a high point. This assessment questions the reasonableness of the valuation of the Chinese wine sector, and confirms the need to focus on the impact of the policy side when studying Chinese wine companies [3]. Xiao valued listed Chinese wine companies using dynamic PE and found that the stocks of the companies in the Chinese wine industry have experienced a market push in the last two years. And combined with the performance of those companies in their own reports, in fact, it still has a large valuation risk. He believes that investments in the Chinese wine industry need to be treated differently, while avoiding companies with overpriced shares and weak performance growth [4].

Since 1985, when the Chinese stock market was piloted, the number of people involved in investing in stocks had grown from zero to 212 million by the end of 2022 [5-8]. China's stock market is booming, as a result, people's professionalism in stock trading is also gradually increasing, and

more investors have changed from following others to looking for undervalued stocks to invest, which is clearly a more scientific approach. For investment in the Chinese wine industry, a reasonable valuation is also needed to avoid companies with rapid short-term growth but insufficient momentum in the later years [9-14]. This article therefore attempts to analyze the current situation of the Chinese wine industry as a whole, using different valuation techniques, to help investors analyze whether the industry is worth investing in and which companies are relatively more valuable. The article will first introduce the valuation methods used in this paper, then analyze the overall situation of the Chinese wine industry, followed by the valuation results of individual companies, and finally draw conclusions.

2. Valuation Methodology

2.1. PE Valuation method

The PE ratio is the ratio of the market price per share of a company's stock to its earnings per share. It is one of the most used indicators to assess whether a share price level is reasonable. It is generally accepted that if the PE ratio of a company's shares is too high, then the stock is priced in a bubble and is overvalued.

2.2. PEG Valuation method

The PEG indicator is calculated by dividing a company's PE ratio by the compound growth rate of the company's earnings per share over the next 3 or 5 years. While the PE ratio only reflects the current value of a stock, the PEG relates the current value of a stock to the future growth of that stock. The PEG indicator makes up for the lack of PE in estimating the dynamic growth of a company. Roughly speaking, the lower the PEG value, the more likely it is undervalued, which is similar to the PE ratio. It is important to note that both the numerator and denominator of the PEG value involve forecasts of future earnings growth, which are more likely to be wrong.

2.3. PCF Valuation Method

The PCF ratio is the ratio of stock price to cash flow per share and can be used to evaluate the price level and risk level of a stock. The smaller the price-to-cash ratio, the greater the increase in cash per share for a listed company and the lower the operating pressure. However, company's annual reports tend to show the cash flow from operating activities per share only, while cash flow from investing activities and financing activities are ignored, such data cannot reflect a company's ability to use cash. The estimation of cash flow of Chinese wine enterprises made in this paper is only a reference.

2.4. EV Valuation method

Enterprise value is the consideration to be paid to acquire a particular company. This enterprise value is organized by the formula: $EV = \text{market value of shares} + \text{company debt} - \text{cash}$; the expanded formula is: $EV = \text{market value of ordinary shares} + \text{market value of preference shares} + \text{market value of liabilities} + \text{minority interests} + \text{pension liabilities} - \text{cash and marketable securities}$. Enterprise value is considered more comprehensively, is less subject to leverage distortions and is not distorted by different accounting rules, allowing for a better representation of the investment value of the business.

3. Analysis of the Whole Industry

In February 2022, all 20 listed companies in the Chinese wine industry in the Shenzhen and Shanghai A-share markets have only published their third quarterly reports, so this is used as a reference. The report showed that in the first three quarters of 2022, the 20 listed companies in the Chinese wine industry achieved a total revenue of 268.454 billion yuan, up 16.04% year on year,

showing an overall growth trend. As shown in Table. 1, as many as 16 of the 20 listed Chinese wine companies had revenue of more than 1 billion yuan in the third quarter, and six of them reaching more than 10 billion yuan, while the revenue of these six Chinese wine companies also accounted for more than 80% of the total revenue of the 20 listed Chinese wine companies. From a net profit margin perspective, Kweichow Moutai, Luzhou Laojiao, Wuliangye, Yanghe and Fen Wine ranked in the top 5, operating in a better position. 20 companies only have 1 company, Golden Seed Winery Winery, operating at a loss. From this perspective, it is not recommended to invest in it.

Table 1. The general situation of 20 Chinese wine companies

Name of Securities	Total operating revenue (In billion)	Net profit after deduction (In billion)	Net profit margin (%)
Kweichow Moutai (600519)	897.86	443.93	53.14
Wuliangye (000858)	557.80	200.19	37.58
Yanghe Brewer (002304)	264.83	88.43	34.28
Fen Wine (600809)	221.44	71.02	32.3
Luzhou Laojiao (000568)	175.25	81.67	47.19
Gujing Distillery (000596)	127.65	25.78	21.22
Shunxin Agriculture (000860)	91.06	0.30	0.12
King's Luck Brewery (603369)	65.18	20.72	31.94
Shede Spirits (600702)	46.17	11.59	26.26
Yingjia Distillery (603198)	38.92	11.72	31.07
Sichuan Swell fun (600779)	37.71	10.25	27.98
Kouzi Distillery (603589)	37.62	11.81	31.94
Jiugui Chinese wine (000799)	34.86	9.7	27.88
Hengshui Laobaigan (600559)	34.55	3.16	15.44
Jinhui Chinese wine (603919)	15.61	2.16	13.68
Xin Jiang Yilite Industry (600197)	13.07	1.42	11.29
Golden Seed Winery (600199)	8.15	-1.54	-16.5
Tianyoude (002646)	7.90	0.88	12.45
Shanghaiguijiu (600696)	7.87	0.44	8
Gansu Huangtai (000995)	1.04	354.96	3.7

4. Valutiaon Results

4.1. PE Valuation

The PE ratios of the twenty Chinese wine companies were estimated as presented in Fig. 1. From the dynamic change in valuation of 20 Chinese wine companies, there is currently one company with a loss and a negative dynamic PE, while the other 19 companies are all positive. Golden Seed Winery Winery showed negative earnings in its third quarterly report last year, failing to bring profits to investors, and its comprehensive statements from previous years show mostly losses, so investment in it is not recommended. The current average dynamic PE of the Chinese wine industry is 42.75, which is a high PE ratio stock, which to some extent represents a long payback period for Chinese wine companies, in fact, it is basically impossible to profit through dividends, and generally only by means of high dumping. However, it may be feasible if one intends to make a stable long-term investment. If the PE is considered alone, Shunxin Agriculture, Yilite, Shanghaiguijiu and Huangtai are outside the normal range compared to their industry counterparts and are not recommended for investment. Overall, the performance of the Chinese wine industry last year still maintained a certain growth trend, which shows that the cycle of the boom of Chinese wine industry is still reflected, but in terms of competition and soaring stock prices, the report also suggests the high valuation risk of some varieties.

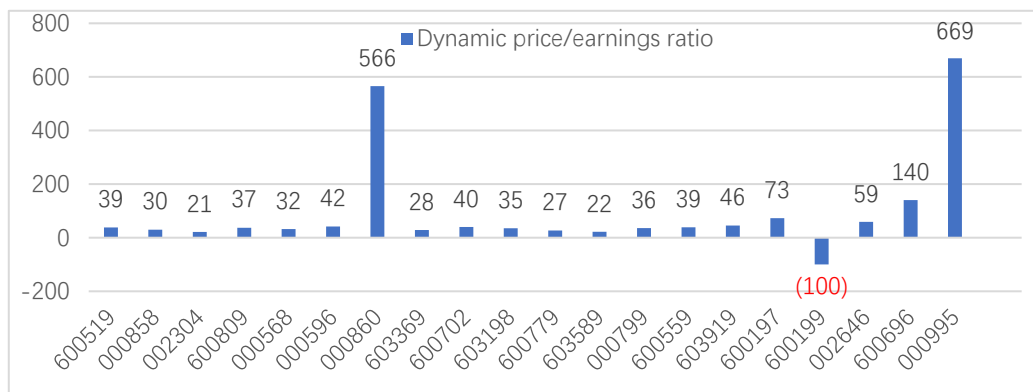


Figure 1. Dynamic PE valuation of 20 Chinese wine companies

4.2. PEG Valuation

The PEG ratios for the twenty Chinese wine companies are estimated as depicted in Fig. 2. After valuation, it can be found that Chinese wine companies belong to a high PE industry, in which case the use of PEG valuation may better reflect the value of the company. Seen from the results, most Chinese wine companies have a PEG higher than 1, which means that they are likely to be overvalued and should not be bought, and the Chinese wine industry does not belong to the growth industry which is developing rapidly recently. Excluding companies with negative estimated annual corporate earnings growth, Yanghe, Fen Wine, Luzhou Laojiao, Gujing Distillery, King's Luck Brewery, Jinhui, Laobaigan and Tianyoude are among the companies that are likely to be undervalued and worth buying. The Yanghe is the most undervalued in the period, and it may be a suitable point to buy Yanghe shares soon.

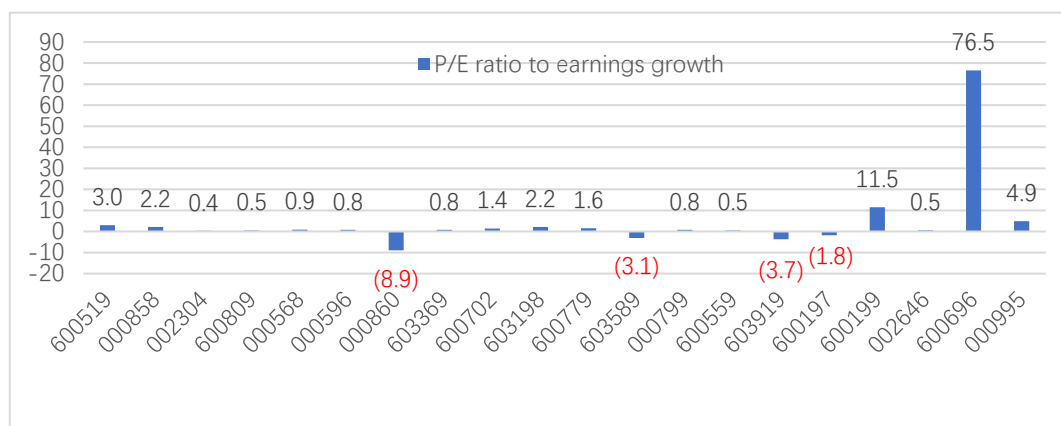


Figure 2. valuation of 20 white wine companies

4.3. PCF Valuation

The PCF ratios of twenty Chinese wine companies were estimated as illustrated in Fig. 3. In considering only cash flows from operating activities per share, Fen Wine, Gujing Distillery, King's Luck Brewery, Swellfun and Laobaigan are in a better operating position than the other companies when compared to the average PCF ratio of 33.48 in the Chinese wine industry, but this does not reflect their performance in dividend financing and investment capacity. Hence, the reference value is not very high. However, Yanghe, Shunxin Agriculture, Yilite, Golden Seed Winery and Huangtai all have negative PCF ratios and negative operating cash flow per share, and may be in questionable operating conditions.

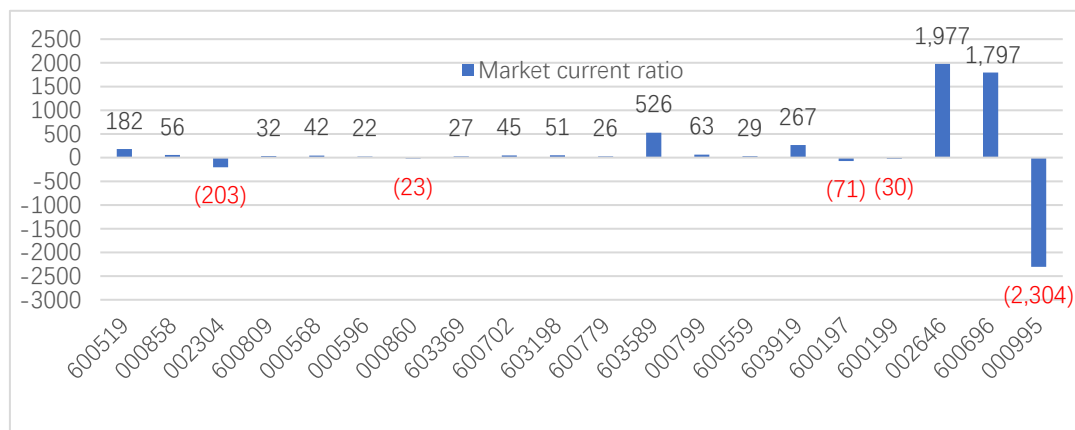


Figure 3. PCF valuation of 20 Chinese wine companies.

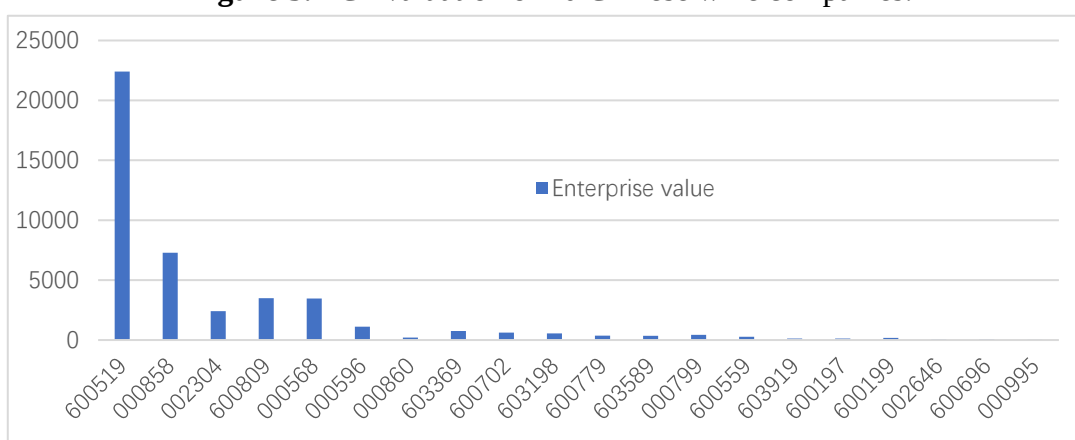


Figure 4. Enterprise value of 20 white wine companies

4.4. EV Valuation

The value of the twenty Chinese wine companies was estimated as demonstrated in Fig. 4. It is clear from the chart that regardless of other indicators, the enterprise value of the leading companies is far beyond that of other companies. If the value of investment is judged by enterprise value alone, then Kweichow Moutai, Wuliangye, Yanghe, Fen Wine and Luzhou Laojiao are the best choices, but a combination of factors is also need to be considered.

5. Limitations & Prospect

The relative valuation method is used in this paper because the absolute valuation, represented by the discounted cash flow model, has the advantage of a perfect logical framework and practical operation; however, it is complex to operate and the parameters in the model are based on assumptions and conjectures, so it is not used in this paper. In contrast, the relative valuation methods are simple to operate, but also have many limitations. The PE valuation method suffers from the problem that the net profit of listed companies is easily influenced by accounting methods and standards, which can make PE returns subject to artificial manipulation, and the PE ratio cannot distinguish between earnings created by operating assets and those created by non-operating assets. In addition to this, the PE method of calculating cash flows is based on net profit plus non-cash expenses such as depreciation and amortization, and does not consider other factors affecting operating cash flows. Free cash flow from equity is considered a better indicator, but is also more volatile than operating cash flows. In the future, if several absolute valuation models are added, the evaluation of these enterprises may be more accurate and the stock selection will be more appropriate.

6. Conclusion

In summary, combining the various indicators mentioned above, Luzhou Laojiao and Fen Wine are the most worthwhile Chinese wine companies to invest in now. They have good operating conditions, no cash flow problems, a PEG of less than 1, which are undervalued companies and have high enterprise value, making them the most valuable to invest in. In addition, Gujing Distillery and King's Luck Brewery are also performing well and although their enterprise values are lower compared to the leading companies. Therefore, they are also companies worth considering. As non-leading enterprises, their share prices are also relatively low for investors who do not intend to make large investments in this sector. Overall, stocks in the Chinese wine sector are generally overpriced and have a long payback period, making them suitable only for well-funded investors who intend to invest for the long term or for speculators who only make money through price fluctuation. Nevertheless, this undoubtedly carries a high degree of risk and needs to be considered carefully. These results offer a guideline for investors who want to invest in the Chinese wine industry.

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