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Financial Analysis of Maotai Company After the Police of "Three Public Consumptions" Was Introduced

NIE Zhiping[a],*

[a]Lecturer, Accounting Department, School of Business, Hohai University, Nanjing China.
*Corresponding author.

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Abstract

In the analysis of financial performance of Maotai Company, we find that its performance was influenced by the police of "three public consumptions" not as much as other liquor companies were. Its revenue and profit grew less than ever. Its advance receivables were almost exhausted. Its inventory turnover days became longer than before. Its net cash flow turned to be negative in recent years. However, Maotai Company still has surprising rate of return on net assets. Its monetary funds are abundant and rank 1st in the liquor industry. Its extremely high gross margin maintains as before. Therefore, Maotai Company has the possibility to bring its investors a high return in the long run.

Key words: Financial Analysis; Rate of return on net assets; Abundant cash flow; Advance receivables; Inventory turnover days

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INTRODUCTION

Maotai wine belongs to Maotai-flavor liquor. It is a fine product in the world of liquor and it occupies the leading high-end liquor. Maotai wine's uniqueness is mainly reflected in the 5 years of the aging process. Its unique geographical environment and microbial environment make its products scarce and hard to be copied.

Many people think Maotai wine is an important object of public consumption. Policies such as "three public consumptions", "eight rules of discipline" and "prohibition of liquor" introduced lead the liquor industry into deep adjustment (Zhou, 2014, p.70). However, according to financial data, we can not deny that the liquor industry has been lucrative for many years. This adjustment is perhaps a return to rational result. Although Maotai Company is in a controversy of public consumption, it still earns excellent performance which surprises investors very much.

1. HIGH RATE OF RETURN ON NET ASSETS

Maotai Company always has a high and admirable rate of return on net assets. Its average rate of return on net assets is 33.36% in recent 8 years. The stability and profitability are very amazing. After the listing, Maotai Company's net assets per share were 9.96 yuan in 2001. After 13 years of growth, the net assets per share value reached 241 yuan per share, rising 24.2 (241/9.96) times. Has the strong growth been reflected into its stock price? In December 31, 2001, the stock price of Maotai was 39.3 yuan per share. After the stock dividend, a share in December 31, 2011 is equivalent to 4.3 shares in the year of 2014. In October 21, 2014, the stock closed at 158 yuan per share, the share price rose 17.29 (equivalent to 158 × 4.3 ÷39.3) times. It also confirms the investment community rule: The performance of a company's growth will eventually be reflected in the stock price.

Table 1
Diluted Rate of Return on Net Assets of Maotai Company (unit: %)

Year	2014.6(annualized)	2013	2012	2011	2010	2009	2008
Diluted rate of return on net assets	31.94	35.51	38.97	35.06	27.45	29.81	33.79
Year	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**	**2001**
wDiluted rate of return on net assets	34.38	25.48	21.97	19.64	17.02	13.23	12.97

2. HIGH GROSS PROFIT

Because Maotai is the first high priced shares in the stock market, its super high gross profit naturally catches the attention of the public. Since 2008, Maotai Company’s average gross margin has always been above 90%. In fact, there are several other companies which have higher gross margin than Maotai. However, Maotai company’s years of the high speed growth and the market size make its super high gross profit a popular phenomenon.

Table 2
Years of Gross Margin of Maotai, Wuliangye and Yanghe (unit: %)

Year	2014.6	2013	2012	2011	2010	2009	2008
Gross margin of Maotai	93.10	92.90	92.27	91.57	90.95	90.17	90.30
Gross margin of Wuliangye	75.50	73.26	70.53	66.12	68.71	65.31	54.39
Gross margin of Yanghe	60.62	60.42	63.56	58.17	56.31	58.47	52.35

Compared with Wuliangye and Yanghe in the industry, Maotai has much stronger profitability (Chen, 2014, p.55). The reason for Maotai’s gross profit growth year after year is related to its price increase in recent years (Wang, 2014, p.18). In January 1, 2010, the average rate of price increase went to 13%. In January 1, 2011, the average rate of price increase went to 20%. In September 1, 2012, the average price ranges up to 20%-30%. In the liquor industry, Maotai is often the first to rise prices. After its rising, other liquor manufacturers will follow. For Maotai, high gross margin causes high profit margin. Generally, its net profit margin is above 50%. Therefore, its high gross profit plays a key role in the final performance.

3. PLENTY OF CASH FLOW

Liquor industry always has high profit margins. Companies with good performance often benefit a amount of cash flow. Their cash flow often accounts for a large proportion of assets. Maotai can be a model of these kinds of enterprises. From table three, we can find that Maotai’s cash flow has been very abundant. In previous years, the monetary funds maintained nearly half of the total assets. In recent two years, monetary funds declined. But it still accounted for 40% proportion of the total assets. Such high cash flow does not from investment return, not from the debt, but from profit accumulation of operating activities.

Table 3
Maotai’s Monetary Funds (unit: 10 million yuan)

Items	30 June 2014	31 December 20131	31 December 2012	31 December 2011	31 December 2010	31 December 2009
Monetary funds	211	252	221	183	129	97.4
Total assets	552	555	450	349	256	198
Proportion	38.22%	45.41%	49.11%	52.44%	50.39%	49.19%

Maotai’s mode mainly depends on its own development. Investment to expand its output capacity mainly comes from its own cash flow. The annual dividends also come from the cumulative surplus. These large amounts of funds all depend on the cash flow from business activities. Maotai’s inner and steady development has brought huge returns to long-term investors.

Renowned investment master Peter Linch once said, if current assets outside the monetary funds is enough to repay the debt, then the monetary funds will give your investment cost a discount. In the case of 2014.6.30, Maotai’s current assets mainly consist of monetary funds and inventory. The inventory is sufficient to repay the debt. Then the monetary capital is somewhat similar to the free cash flow, making the initial investment discounted. Down conversion, monetary fund per share 18.48 yuan (2110 million yuan / 114.2 million shares). The closing price of that day is 142 yuan. Considering the monetary funds bring cash per share, the stock price of Maotai is acturally 123.52 yuan.

4. THE LOW DEBT

Liquor companies with good performance often have plenty of cash flow and their debt levels are lower than other companies (Huang, 2014, p.86). Moreover, their debt often consists of short-term debt. Maotai's long-term debt was only 17.77 million yuan. It is seen from table four that Maotai's asset liability ratio is quite low, not exceeding 30%. With the accumulation of profit, Maotai is active to repay debts. Furthermore, reducing the debt did not prevent the monetary funds continue to rise. This is the characteristics of good investment objective: debt level drops, monetary funds increase.

Table 4
The Change of Asset Liability Ratio (unit: 10 million yuan)

Items	30 June 2014	31 December 20131	31 December 2012	31 December 2011	31 December 31 2010	31 December 2009
Monetary funds	211	252亿	221	183	129	97
Asset liability ratio	15.56%	20%	21%	27%	27%	26%
Current assets	4.51	3.71	3.80	2.94	2.89	3.06

5. ADVANCE RECEIVABLES

Advance receivable of Maotai's company is a report item questioned most by people. It showed a trend of increasing first and then decreasing. Seen from table five, Maotai's advance receivable had grown until 2011. Since the beginning of 2012, the item continued to decline. This trend is related to "three public consumptions". Usually, advance receivable is equivalent to "pre reservoir" of sales income. When the income grows slowly, advance receivable can be converted into income. The role of advance receivable is decided by the proportion of advance receivable. If advance receivable is 100%, annual conversion of 2 billion yuan advance receivables into revenue plays a little role for 30 billion annual sales. If advance receivable average proportion is 10%, annual conversion of 2 billion yuan advance receivable into revenue can bring about an income of 20 billion yuan, which will have a significant impact on the Maotai. Until June 30, 2014, Maotai's advance receivable was almost exhausted, leaving only 54.4 million yuan. That is to say, in the later period, income can no longer rely on advance receivable as a "reservoir" of income. Maotai's income can only depend on itself growth.

Table 5
The Change of Advance Receivable (unit: 10 million yuan)

Item	30 June 2014	31 December 20131	31 December 2012	31 December 2011	31 December 2010	31 December 2009
Advance receivabe	5.44	30.45	50.91	70.26	47.38	35.16

6. TURNOVER DAYS OF INVENTORY AND ACCOUNTS RECEIVABLE

Because of Maotai tight supply, little credit is given. Therefore, the accounts receivable's turnover days are very short, less than a day. Maotai stock mainly consists of semi-finished products. One of its characteristic is Maotai wine can be dispatched out of factory after 5 years of cellaring. Therefore, the inventory turnover days seemed long. If 5 years of cellaring are deducted, the inventory turnover days will be much shorter. However, the increasing trend of inventory turnover days needs attention. It may mean that Maotai meets sales bottleneck in 2013 and 2014. The reason for low inventory turnover may also be higher production and slower sales. Fortunately, the longer the liquor is deposited, the higher value it has. Therefore, the effect of long inventory turnover days for a liquor company is much smaller than on a company from other industries.

Table 6
The Turnover Days of Maotai's Inventory and Accounts Receivable (unit: 10 million yuan)

Items	30 June 2014	31 December 20131	31 December 2012	31 December 2011	31 December 2010	31 December 2009
Turnover days of inventory	2284	1764	1484	1481	1670	1384
Turnover days of accounts receivable	0.02	0.11	0.14	0.03	0.35	1.05

7. THREE PERIOD COST

Maotai has high gross margin and low operating cost. Three period costs play an important role. Due to Maotai's plenty of money, financial cost has been negative. Then what needs to study is whether sales costs and management fees change proportionately with the sales income. From table seven, the cost of sales in 2012 and

2013 is out of control, exceeding the growth of income. This may be explained that Maotai increases cost for sales expansion after the restriction of "three public consumptions". Management fees in 2013 and 2014 exceeded income change. Especially when the income in the first half of 2014 grows negatively, management fee is still on the rise. Management cost has certain hysteretic quality which needs to control.

Table 7
The Change of Three Period Cost (unit: 10 million yuan)

Items	30 June 2014	31 December 20131	31 December 2012	31 December 2011	31 December 2010	31 December 2009
Sales income	143	309	265	184	116	96.7
Sales income growth rate	-7.44%	16.60%	44.02%	58.62%	19.96%	-
Sales cost	6.47	18.6	12.2	7.2	6.77	6.21
Sales cost growth rate	-30.43%	52.46%	69.44%	6.35%	9.02%	-
Management cost	14.9	28.3	22	16.7	13.5	12.2
Management cost grow rate	5.30%	28.64	31.74%	23.70%	10.66%	-
Financial cost	-0.54	-4.29	-4.21	-3.51	-1.77	-1.34

Note: 2014.6.30 data is calculated and converted into annual data.

8. THE CASH FLOW STATEMENT

Maotai's cash flow statement is of simple structure: Its business operation creates cash flow, investment activities spend money on infrastructure to expand capacity and financial activities are mainly involved in paying dividends (Cai & Lin, 2014, p.31). Therefore, net cash flow generated from operating activities is positive while net cash flow from investment and financial activities is negative. This mode means that operating activities generate cash flow which is used in investment and financial activities.

Table 8
The Structure of Cash Flow Statement (unit: 10 million yuan)

Items	30 June 2014	31 December 20131	31 December 2012	31 December 2011	31 December 2010	31 December 2009
Net cash flow from operating activities	42.9	127	119	101	62.0	42.2
Net cash flow from investment activities	-30	-53.4	-42.0	-21.2	-17.6	-13.4
Net cash flow from financial activities	-51.1	-73.9	-39.1	-26.6	-12.9	-8.84

It can be seen from table eight that net cash flow was positive before 2013. It was nearly zero in 2013. In fact, as long as Maotai controls the scale of investment and dividends, positive net cash flow is easy to attain. Of course, the more dividends are paid (Qu, Feng, & Cai, 2014, p.49), the smaller net assets are and the easier the aimed rate of return on net assets is to achieve. Therefore, there is a trade-off.

CONCLUSION

Overall, Maotai still maintain a pioneer role in liquor industry. Its financial indicators are generally gratifying. Gross margin and rate of return on net assets maintained a high level. Its debt fell year by year and its monetary fund accumulated. Questions need to Concern include: Advance receivables become lower, sales become less and inventory turnover becomes slower. The growth of sales costs and management fees is beyond the income growth. These problems need to be considered combining with macro economic factors, policy guidance and micro-body needs.

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