

Golden Eagle Retail

Identifying the issue is the first step

Management seems to recognize key issue finally but cash-drain continues

2014 Golden Eagle (GE) gross sales proceeds (GSP) was down 6% YoY (SSS: -5.5%) while earnings was down 12% YoY. Management guided capex of RMB1.6b in 2015 and a low-single-digit SSS and slight increase to earnings. We are pleased that management team seems to finally recognize ineffective merchandising is the key issue behind the downtrend and will proactively adjust its portfolio in two ways. However, it is critical to deliver results quickly as cash-drain continues – as of end-2014, GE had a net debt position of Rmb127m, deteriorated sharply from net cash of Rmb1,448m at end-2013.

1. More private labels – Not the right fix to the merchandising issue

As of end-2014, GE owns 47 controllable merchandise brands. Management plans to expand to 200 brands in two years, covering 10-15% total floor areas. While we see the possibility of a few success cases to emerge and agree that the private labels could generate higher margin, we believe introduction/building of private labels without heavy investment on both marketing and production innovation does not fully address the merchandising issue.

2. More fast fashion brands – lower profitability

Several international fast fashion brands such as H&M and Uniqlo were introduced to its stores in 2014; Zara and Mango will join in 2015. We note that these shifts in brand portfolio will unlikely reverse deteriorating foot traffic, though a step in the right direction as GSP contribution from fast fashion brands will likely be steady. However, overall profitability from these fixed-rent tenants will be low.

Valuation: Maintain Sell; Very bullish guidance for Xinjiekou

Management anticipated Xinjiekou flagship store to generate GSP of Rmb4.8b-5.2b, a large 29-40% jump from Rmb3.7b in 2014. We remain cautious on the overall operating environment, and GE's higher financial burdens. We maintain our Sell rating and a DCF/VCAM-based PT of HK\$6.70 (WACC: 10.2%).

Equities

China
Retailers, Broadline

12-month rating **Sell**

12m price target **HK\$6.70**

Price **HK\$9.23**

RIC: 3308.HK BBG: 3308 HK

Trading data and key metrics

52-wk range	HK\$11.06-8.07
Market cap.	HK\$17.5bn/US\$2.26bn
Shares o/s	1,898m (ORD)
Free float	32%
Avg. daily volume ('000)	3,211
Avg. daily value (m)	HK\$29.0
Common s/h equity (12/15E)	Rmb6.19bn
P/BV (12/15E)	2.1x
Net debt / EBITDA (12/15E)	NM

EPS (UBS, diluted) (Rmb)

	From	To	% ch	Cons.
12/15E	0.64	0.62	-2.40	0.65
12/16E	0.69	0.68	-0.90	0.69
12/17E	0.76	0.76	-0.54	-

Spencer Leung

Analyst

spencer.leung@ubs.com

+852-2971 7459

Siguo Chen

Associate Analyst

siguo.chen@ubs.com

+852-2971 8506

Erica Poon Werkun, CFA

Analyst

erica-poon.werkun@ubs.com

+852-2971 8605

Highlights (Rmbm)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenues	3,623	3,660	3,625	4,300	4,937	5,682	6,221	6,910
EBIT (UBS)	1,557	1,515	1,323	1,434	1,663	1,863	1,982	2,163
Net earnings (UBS)	1,220	1,235	1,082	1,100	1,205	1,335	1,412	1,545
EPS (UBS, diluted) (Rmb)	0.63	0.65	0.56	0.62	0.68	0.76	0.80	0.84
DPS (Rmb)	0.19	0.19	0.27	0.19	0.21	0.23	0.24	0.26
Net (debt) / cash	1,982	1,435	(127)	306	31	(264)	(296)	(195)
Profitability/valuation	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
EBIT margin %	43.0	41.4	36.5	33.3	33.7	32.8	31.9	31.3
ROIC (EBIT) %	50.1	54.3	33.7	28.8	29.2	27.1	24.8	24.0
EV/EBITDA (core) x	14.6	9.9	9.0	7.0	6.0	5.4	5.1	4.6
P/E (UBS, diluted) x	22.6	15.6	14.1	11.9	10.9	9.8	9.3	8.8
Equity FCF (UBS) yield %	(0.7)	(0.5)	(0.3)	11.7	6.5	6.7	8.9	10.1
Net dividend yield %	1.3	1.8	3.4	2.5	2.8	3.1	3.3	3.6

Source: Company accounts, Thomson Reuters, UBS estimates. UBS adjusted EPS is stated before goodwill-related charges and other adjustments for abnormal and economic items at the analysts' judgement. Valuations: based on an average share price that year, (E): based on a share price of HK\$9.23 on 23 Mar 2015 22:41 HKT

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Investment Thesis

Golden Eagle Retail

Investment case

We believe the overcapacity situation in China's retail sector will worsen over the next few years as operators continue to expand in saturated regions. Golden Eagle and other department store operators may face difficulty in achieving sales growth while remaining profitable, as most brand operators have either recorded mild sales growth or a sales decline due to slow traffic and heavy discounting. We assume 2015E-17E top-line growth of 19%/15%/15%.

Upside scenario

Our upside scenario assumes the expansion is halted and retailers will offer smaller price discounts. Assuming top-line growth and operating expenses return to pre-2012 levels over 2015-17E, which implies a 20% top-line CAGR, we estimate a valuation of HK\$9.40 per share.

Downside scenario

Our downside scenario assumes the expansion accelerates and operators will offer deeper price discounts, severely impacting top-line growth and profitability. With top-line growth assumptions of 0%/5% and higher operating expense assumptions of 45%/45% for 2016E/2017E and onwards, we estimate a valuation of HK\$6.60 per share.

Upcoming catalysts

Sporadic news on Golden Eagle's new store operations and its cooperation with other department store operators such as Parkson, Lifestyle and Wangfujing Department Store could act as catalysts for the stock.

12-month rating

Sell

12m price target

HK\$6.70

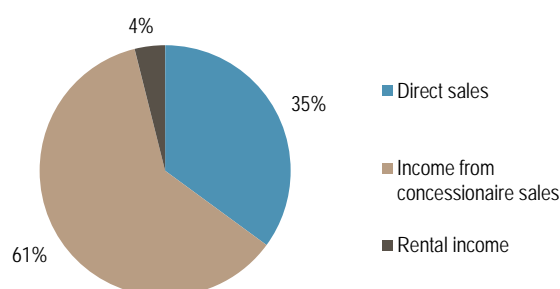
Business description

Golden Eagle Retail operates 26 self-owned stores, with a gross floor area of approximately 1,092,417 square metres as of 31 December 2013. It opened its first store, Nanjing Xijiekou, in Jiangsu Province in April 1996, and gradually spread to 16 cities in Jiangsu, Anhui, Yunnan and Shaanxi provinces. The company has a portfolio of more than 2,300 brands and offers a variety of mid-range to high-end products

Industry outlook

We think the current downturn in China's retail sector could continue, and earnings for the entire department store ecosystem could decline in 2014. Retail operators in China are expanding in an already saturated space, with diminishing returns from expansion. Mild sales growth at older stores has been supported by deeper price discounts. However, sales growth could turn negative if discounts are reduced. With or without discounting, brand operators face declining profitability, in our view.

Revenues by segment 2014 (%)



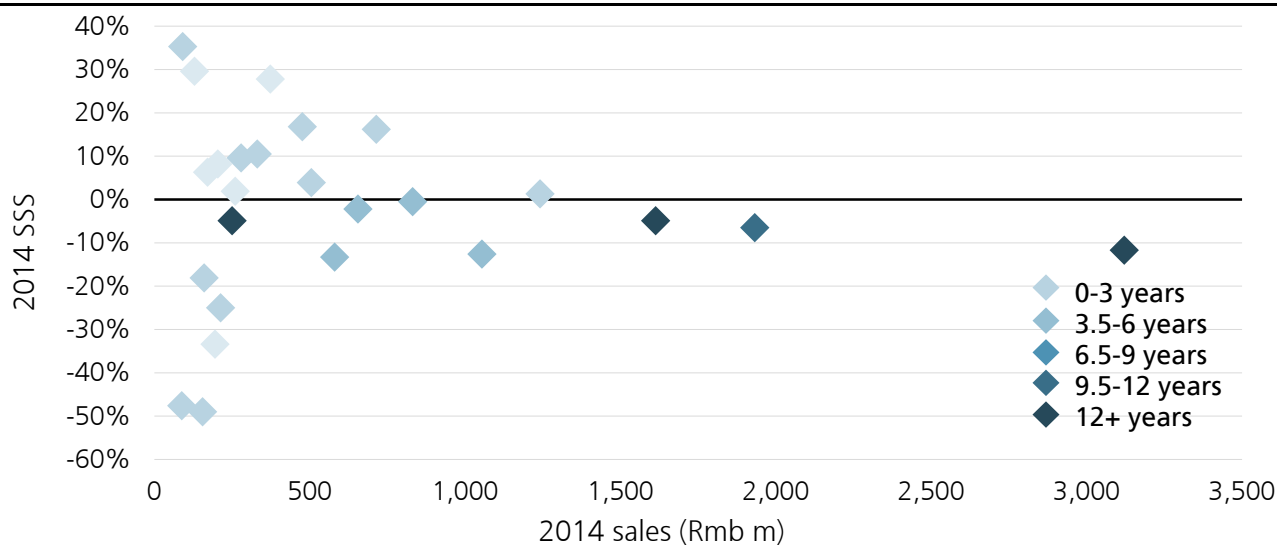
Source: Company Data

Gross Profit by product segment

(Rmb Mn)	2013	2014	2015E	2016E	2017E
Direct sales	228	226	249	309	373
Income from concessionaire sales	2,320	2,213	2,745	2,998	3196
Rental income	80	142	143	190	380
Management service fees	15	-	30	34	34

Source: Company data, UBS estimates

Figure 1: Store sales vs SSS with color coding indicating store age



2014 results summary and key briefing takeaways

- **2014 GSP/earnings down 6%/12% YoY** – 2014 GSP was down 6% YoY with an SSS of -5.5%. Management noted that the GSP decline was due to competition from new models of retailing and one-off effect of the expansion of the Group's flagship store Nanjing Xijiekou Phase II. Operating profit was Rmb1,323m, a decline of 12.7% YoY and earnings declined 12% YoY to Rmb1,082m.
- **2014 concessionary rate expanded to 18.2%** – 2014 concessionary rate expanded 40bps to 18.2%. The increase in concessionary rate was mainly due to: 1) reduced sales of certain product categories, such as gold and jewellery, which carry lower commission rates; 2) increase in younger stores' commission rates; and 3) more discount initiatives to provide good quality products at competitive prices.
- **2015 Jan-Feb SSS low-single digit** – Management noted that 2015 Jan-Feb SSS was at low-single digit and expected the trend to continue in 2015.
- **CAPEX budget of Rmb1.6 billion in 2015** – Management noted that 1) CAPEX budget of Rmb1.6b in 2015 and Rmb1.5b in the following years; 2) the transaction announced in Jan 2015 ("Orient Gate", consideration of Rmb1.29b) is still undergoing careful due diligence process. Management added that, if the "Orient Gate" deal goes through, there will be additional CAPEX for this year.

Golden Eagle Retail (3308.HK)

Income statement (Rmbm)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
Revenues	3,623	3,660	3,625	4,300	18.6	4,937	14.8	5,682	6,221	6,910
Gross profit	2,659	2,643	2,580	3,166	22.7	3,531	11.5	3,983	4,338	4,807
EBITDA (UBS)	1,738	1,710	1,557	1,919	23.2	2,227	16.1	2,498	2,706	2,998
Depreciation & amortization	(181)	(194)	(235)	(485)	107.0	(565)	16.3	(636)	(724)	(835)
EBIT (UBS)	1,557	1,515	1,323	1,434	8.4	1,663	16.0	1,863	1,982	2,163
Associates & investment income	25	113	115	30	-73.9	30	0.0	30	30	30
Other non-operating income	0	0	0	0	-	0	-	0	0	0
Net interest	68	80	100	63	-36.6	(19)	-	(38)	(50)	(47)
Exceptionals (incl goodwill)	(2)	0	0	0	-	0	-	0	0	0
Profit before tax	1,648	1,708	1,538	1,527	-0.7	1,674	9.6	1,855	1,961	2,146
Tax	(430)	(473)	(458)	(428)	6.5	(469)	-9.6	(519)	(549)	(601)
Profit after tax	1,217	1,235	1,080	1,100	1.8	1,205	9.6	1,335	1,412	1,545
Preference dividends and Minorities	0	0	2	0	-	0	-	0	0	0
Extraordinary items	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	1,218	1,235	1,082	1,100	1.6	1,205	9.6	1,335	1,412	1,545
Net earnings (UBS)	1,220	1,235	1,082	1,100	1.6	1,205	9.6	1,335	1,412	1,545
Tax rate (%)	26.1	27.7	29.8	28.0	-5.9	28.0	0.0	28.0	28.0	28.0
Per share (Rmb)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
EPS (UBS, diluted)	0.63	0.65	0.56	0.62	10.4	0.68	9.6	0.76	0.80	0.84
EPS (local GAAP, diluted)	0.62	0.65	0.56	0.62	10.4	0.68	9.6	0.76	0.80	0.84
EPS (UBS, basic)	0.63	0.66	0.57	0.63	11.0	0.69	9.6	0.76	0.81	0.85
Net DPS (Rmb)	0.19	0.19	0.27	0.19	-31.0	0.21	9.6	0.23	0.24	0.26
Book value per share	2.72	2.76	2.85	3.53	24.0	4.02	13.6	4.55	5.11	5.50
Average shares (diluted)	1,948.84	1,892.38	1,922.09	1,768.17	-8.0	1,768.17	0.0	1,768.17	1,768.17	1,841.97
Balance sheet (Rmbm)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
Cash and equivalents	5,193	5,930	5,409	5,842	8.0	5,567	-4.7	5,272	5,240	5,341
Other current assets	821	810	976	613	-37.2	739	20.6	876	963	1,069
Total current assets	6,013	6,740	6,385	6,455	1.1	6,306	-2.3	6,147	6,203	6,409
Net tangible fixed assets	4,025	4,034	5,933	7,600	28.1	9,172	20.7	10,790	12,478	14,243
Net intangible fixed assets	257	257	263	263	0.0	263	0.0	263	263	263
Investments / other assets	3,491	4,021	3,917	3,917	0.0	3,917	0.0	3,917	3,917	3,917
Total assets	13,787	15,051	16,497	18,234	10.5	19,658	7.8	21,118	22,861	24,832
Trade payables & other ST liabilities	5,128	5,180	5,388	6,356	17.9	6,936	9.1	7,461	8,216	9,105
Short term debt	1,079	0	3,116	3,116	0.00	3,116	0.00	3,116	3,116	3,116
Total current liabilities	6,207	5,180	8,505	9,472	11.4	10,052	6.1	10,577	11,332	12,222
Long term debt	2,132	4,494	2,420	2,420	0.0	2,420	0.0	2,420	2,420	2,420
Other long term liabilities	150	130	157	157	0.0	157	0.0	157	157	157
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	8,489	9,805	11,082	12,049	8.7	12,629	4.8	13,154	13,909	14,799
Common s/h equity	5,295	5,244	5,411	6,185	14.3	7,029	13.6	7,964	8,952	10,033
Minority interests	3	2	5	0	-	0	-	0	0	0
Total liabilities & equity	13,787	15,051	16,497	18,234	10.5	19,658	7.8	21,118	22,861	24,832
Cash flow (Rmbm)	12/12	12/13	12/14	12/15E	% ch	12/16E	% ch	12/17E	12/18E	12/19E
Net income (before pref divs)	1,218	1,235	1,082	1,100	1.6	1,205	9.6	1,335	1,412	1,545
Depreciation & amortization	181	194	235	485	107.0	565	16.3	636	724	835
Net change in working capital	(210)	28	(19)	1,330	-	454	-65.8	388	667	784
Other operating	(434)	93	(98)	(63)	35.0	19	-	38	50	47
Operating cash flow	755	1,550	1,201	2,852	137.5	2,243	-21.3	2,397	2,854	3,211
Tangible capital expenditure	(957)	(1,637)	(1,245)	(1,213)	2.6	(1,337)	-10.3	(1,454)	(1,612)	(1,799)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	(900)	(950)	(1,246)	(939)	24.6	(800)	14.8	(800)	(800)	(800)
Other investing	(422)	(1,806)	1,017	234	-	152	-	133	120	123
Investing cash flow	(2,279)	(4,393)	(1,474)	(1,918)	-30.1	(1,986)	-3.5	(2,121)	(2,292)	(2,476)
Equity dividends paid	(367)	(353)	(522)	(330)	36.8	(362)	-9.6	(401)	(424)	(463)
Share issues / (buybacks)	0	0	0	0	-	0	-	0	0	0
Other financing	(76)	2,245	(148)	(171)	-15.32	(171)	0.00	(171)	(171)	(171)
Change in debt & pref shares	1,726	(1,124)	1,030	0	-	0	-	0	0	0
Financing cash flow	1,284	768	360	(501)	-	(532)	-6.3	(571)	(594)	(634)
Cash flow inc/(dec) in cash	(240)	(2,076)	86	433	NM	(275)	-	(295)	(32)	101
FX / non cash items	3,479	2,813	(607)	0	100.0	0	-	0	0	0
Balance sheet inc/(dec) in cash	3,239	737	(521)	433	-	(275)	-	(295)	(32)	101

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Golden Eagle Retail (3308.HK)

Valuation (x)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
P/E (local GAAP, diluted)	22.6	15.6	14.1	11.9	10.9	9.8	9.3	8.8
P/E (UBS, diluted)	22.6	15.6	14.1	11.9	10.9	9.8	9.3	8.8
P/CEPS	19.5	13.4	11.5	8.2	7.3	6.6	6.1	5.7
Equity FCF (UBS) yield %	(0.7)	(0.5)	(0.3)	11.7	6.5	6.7	8.9	10.1
Net dividend yield (%)	1.3	1.8	3.4	2.5	2.8	3.1	3.3	3.6
P/BV x	5.2	3.7	2.8	2.1	1.8	1.6	1.4	1.3
EV/revenues (core)	7.0	4.6	3.8	3.1	2.7	2.4	2.2	2.0
EV/EBITDA (core)	14.6	9.9	9.0	7.0	6.0	5.4	5.1	4.6
EV/EBIT (core)	16.2	11.2	10.5	9.3	8.0	7.3	6.9	6.3
EV/OpFCF (core)	16.2	11.2	10.5	9.3	8.0	7.3	6.9	6.3
EV/op. invested capital	8.1	6.1	3.5	2.7	2.3	2.0	1.7	1.5
Enterprise value (Rmbm)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Market cap.	27,169	19,302	15,189	14,035	14,035	14,035	14,035	14,035
Net debt (cash)	(1,226)	(1,709)	(654)	(89)	(168)	117	280	280
Buy out of minorities	3	2	3	2	0	0	0	0
Pension provisions/other	137	140	144	157	157	157	157	157
Total enterprise value	26,084	17,736	14,683	14,106	14,024	14,309	14,473	14,473
Non core assets	(794)	(756)	(737)	(737)	(737)	(737)	(737)	(737)
Core enterprise value	25,289	16,980	13,945	13,369	13,287	13,572	13,735	13,735
Growth (%)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenue	12.6	1.0	-0.9	18.6	14.8	15.1	9.5	11.1
EBITDA (UBS)	3.9	-1.6	-8.9	23.2	16.1	12.2	8.3	10.8
EBIT (UBS)	1.5	-2.7	-12.7	8.4	16.0	12.0	6.4	9.2
EPS (UBS, diluted)	2.0	4.3	-13.7	10.4	9.6	10.8	5.7	5.0
Net DPS	26.9	-1.1	45.7	-31.0	9.6	10.8	5.7	9.4
Margins & Profitability (%)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Gross profit margin	73.4	72.2	71.2	73.6	71.5	70.1	69.7	69.6
EBITDA margin	48.0	46.7	43.0	44.6	45.1	44.0	43.5	43.4
EBIT margin	43.0	41.4	36.5	33.3	33.7	32.8	31.9	31.3
Net earnings (UBS) margin	33.7	33.7	29.9	25.6	24.4	23.5	22.7	22.4
ROIC (EBIT)	50.1	54.3	33.7	28.8	29.2	27.1	24.8	24.0
ROIC post tax	37.0	39.2	23.6	20.7	20.9	19.5	17.8	17.3
ROE (UBS)	24.7	23.4	20.3	19.0	18.2	17.8	16.7	16.3
Capital structure & Coverage (x)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Net debt / EBITDA	(1.1)	(0.8)	0.1	(0.2)	(.0)	0.1	0.1	0.1
Net debt / total equity %	(37.4)	(27.4)	2.4	(4.9)	(0.4)	3.3	3.3	1.9
Net debt / (net debt + total equity) %	(59.8)	(37.7)	2.3	(5.2)	(0.4)	3.2	3.2	1.9
Net debt/EV %	(7.8)	(8.5)	0.9	(2.3)	(0.2)	1.9	2.2	1.4
Capex / depreciation %	NM	NM	NM	NM	NM	NM	NM	NM
Capex / revenue %	26.4	NM	NM	28.2	27.1	25.6	25.9	26.0
EBIT / net interest	NM	NM	NM	NM	NM	49.2	39.3	45.6
Dividend cover (UBS)	3.3	3.5	2.1	3.3	3.3	3.3	3.3	3.2
Div. payout ratio (UBS) %	30.1	28.6	48.2	30.0	30.0	30.0	30.0	31.3
Revenues by division (Rmbm)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Others	3,623	3,660	3,625	4,300	4,937	5,682	6,221	6,910
Total	3,623	3,660	3,625	4,300	4,937	5,682	6,221	6,910
EBIT (UBS) by division (Rmbm)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Others	1,557	1,515	1,323	1,434	1,663	1,863	1,982	2,163
Total	1,557	1,515	1,323	1,434	1,663	1,863	1,982	2,163

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Forecast returns

Forecast price appreciation	-27.4%
Forecast dividend yield	2.5%
Forecast stock return	-24.9%
Market return assumption	9.3%
Forecast excess return	-34.2%

Statement of Risk

Department stores' growth has a high correlation to overall domestic economic performance. Consumers tend to spend more when the economy is on an upward trend and they have more disposable income. A recession or political turbulence could have a negative impact on consumer confidence and spending.

Required Disclosures

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UBS Investment Research: Global Equity Rating Definitions

12-Month Rating	Definition	Coverage ¹	IB Services ²
Buy	FSR is > 6% above the MRA.	47%	37%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	11%	21%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 31 December 2014.

1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category. 4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

KEY DEFINITIONS: **Forecast Stock Return (FSR)** is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months. **Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium). **Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation. **Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case. **Equity Price Targets** have an investment horizon of 12 months.

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UBS AG Hong Kong Branch: Spencer Leung; Siguo Chen; Erica Poon Werkun, CFA.

Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Golden Eagle Retail ²²	3308.HK	Sell	N/A	HK\$9.23	23 Mar 2015

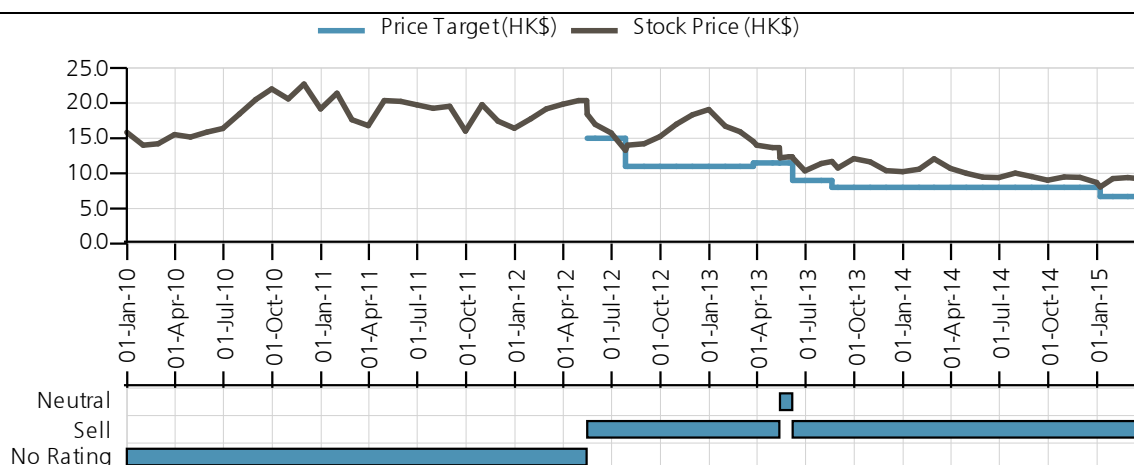
Source: UBS. All prices as of local market close.

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Golden Eagle Retail (HK\$)



Source: UBS, as of 23 Mar 2015

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