RATING ACTION COMMENTARY

Fitch Upgrades Golden Eagle to 'BB+'; Outlook Stable

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Fitch Ratings - Hong Kong - 17 May 2021: Fitch Ratings has upgraded China-based department store operator Golden Eagle Retail Group Limited's Long-Term Issuer Default Rating (IDR) and senior unsecured rating to 'BB+', from 'BB'. The Outlook is Stable.

The upgrade is driven by Golden Eagle's ability to maintain a strong financial profile amid the coronavirus pandemic, with higher revenue and EBITDA reported for 2020 despite significant disruption to business operations in 1H20. The company's sustained positive free cash flow (FCF) generation demonstrates its resilience against the challenging retail environment and provides sufficient rating headroom. We expect Golden Eagle to maintain its payable adjusted FFO net leverage at below 3x with a stable retail operating performance and controlled property development.

The ratings are constrained by the company's small scale and geographic concentration, with the bulk of revenue generated from the Yangtze River delta area.

KEY RATING DRIVERS

Recovery From Pandemic: Golden Eagle had a speedy recovery from the effects of the pandemic, with revenue rising by 15% yoy in 2H20; strong direct sales compensated for lower concessionaire sales. The robust performance was underpinned by continuous efforts to adjust merchandise, integrate online and offline operations and cut costs. We believe a broadening of its revenue streams, with an increased contribution from direct sales, will add to the resilience of the company's credit profile.

Strong Profitability: We expect a stable EBITDA margin of 42%-43% in 2021-2024, after increasing to 44% in 2020, from 43% in 2019, due to a flexible cost structure and a one-off reduction to the staff retirement benefits scheme. Some cost savings should be sustainable as the company further streamlines its operation. However, we expect increasing investment in talent recruitment, warehouse and logistics in the core retail operation.

Sustained Positive FCF: We expect positive FCF over the next few years, supported by a stable retail operation and limited retail capex, with higher capex being mainly for property development. Our base case assumes that property-related capex can be fully covered by inflow from property sales and that the company will not significantly increase its commercial property exposure. We forecast higher property cash inflow as the company's Yangzhou and Jilin projects start presales.

We believe the company's strategy to cooperate with business partners on some planned retail projects under an asset-light model will reduce capex and provide a recurring source of revenue, but the contribution will be limited at the initial stage.

Online to Supplement Offline: We expect Golden Eagle to utilise its online platform to offer a better shopping experience and services to its VIP customers and to acquire new customers. Its mobile app, Jingying.com, registered sales growth of 72% in 2020 and a large boost in daily traffic.

More resources will be put into the e-commerce platform to convert the higher traffic into sales to drive revenue growth; Golden Eagle plans to improve its online merchandise offerings with the launch of more than 100 flagship brands on its app in 2021 and to enhance the user experience. We expect a steady increase in the online contribution, but it is likely to account for a small proportion of total revenue in the near term.

Broadened Revenue Streams: Golden Eagle is continuing to invest in new store formats to increase lifestyle offerings and better meet customer demand. The lifestyle element increasingly contributes to total revenue, with direct sales and rental income accounting for 64% of total revenue in 2020, up from 47% in 2015. Gross sales proceeds from its supermarket and 7-Eleven convenience stores rose by 46% and 62% yoy, respectively, in 2020. A wider merchandise selection has helped the company stay relevant and maintain its market position within the competitive retail industry.

DERIVATION SUMMARY

Most non-food retailers under Fitch's coverage are based in the U.S.; Fitch downgraded the U.S. department stores following significant business interruption from the pandemic and the implications of a downturn in discretionary spending, which we expect to extend well into 2021. In comparison, China's retail environment has recovered faster and we expect it to generate more stable cash flow.

Golden Eagle has a weaker market position and significantly smaller scale than Macy's Inc. (BB/Negative), but benefits from more favourable consumer demand amid an early recovery from the pandemic. It has also been more resilient after adding more relevant retail formats over the last few years. Golden Eagle has a stronger financial profile than Macy's, with sustained positive FCF, lower leverage and more stable revenue and EBITDA.

Golden Eagle and Dillard's, Inc. (BB/Negative) are both regionally concentrated, with similar EBITDAR scale. Golden Eagle has stronger profitability and a more resilient performance over the past few years. Dillard historically had lower leverage, but leverage increased following a sharp drop in EBITDA amid the pandemic. The stronger financial profile and more favourable growth potential of Golden Eagle justify the one-notch rating difference between the two companies.

No Country Ceiling, parent/subsidiary or operating environment aspects affect the rating.

KEY ASSUMPTIONS

- Gross sales proceeds to increase by a high-single-digit in 2021, with an increase in both direct and concessionaire sales (2020: -7%, excluding property sales)

- EBITDA margin/operating revenue of 42% in 2021, excluding the contribution from property development (2020: 44%), remaining stable thereafter

- Capex of CNY1.3 billion, including capex for projects under development, in 2021, increasing to CNY2.6 billion in 2022-2024 due to higher property-related capex (2020: CNY380 million, not including capex for projects under development

- 55% annual dividend payout rate (2020: 50%)

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

-We do not expect positive rating action in the medium term until Golden Eagle achieves a substantially larger operating scale and improves its revenue diversification

Factors that could, individually or collectively, lead to negative rating action/downgrade:

-Payables adjusted FFO net leverage (adjusted for lease, payables and customer deposits) sustained above 3.0x (2020:2.6x)

-Sustained negative free cash flow

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity: Golden Eagle had reported cash and cash equivalents of CNY6.7 billion at end-2020, against short-term debt obligations of CNY3.8 billion. The company refinanced the whole amount of its syndicated loans in April 2021, which further strengthened its liquidity profile, with all its debt now long term in nature. In addition, Golden Eagle had unutilised banking facilities of CNY16 billion at end-2020.

SUMMARY OF FINANCIAL ADJUSTMENTS

- Leases: Fitch has adjusted debt by adding an 8x annual fixed operating lease expense (2020: fixed rental expense of CNY20 million)

- Payables-Adjusted Net Leverage: Fitch subtracts customer prepayments and 85% of trade payables from readily available cash. This metric applies mainly to Chinese department stores operating under the concessionaire model

- Operating EBITDA: Fitch treats the sale of properties and cost of properties sold as non-operating items and cash flow from the sale of properties as non-operating cash flow

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT		RATING		PRIOR
Golden Eagle Retail Group Limited	LT IDR	BB+	Upgrade	BB
senior unsecured	LT	BB+	Upgrade	BB

VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

- Corporate Rating Criteria (pub. 22 Dec 2020) (including rating assumption sensitivity)
- Country-Specific Treatment of Recovery Ratings Criteria (pub. 06 Jan 2021)
- Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

- [Sector Navigators - Addendum to the Corporate Rating Criteria (pub. 01 May 2021)]

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

- Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

- Dodd-Frank Rating Information Disclosure Form
- Solicitation Status
- Endorsement Policy

ENDORSEMENT STATUS

Golden Eagle Retail Group LimitedEU Endorsed, UK Endorsed

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