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# PANORAMA CHINA

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March 2015

By Coface Asia Pacific Economist



**C**oface conducts an annual survey of payment experience in China. With 80% of the survey respondents shared overdue experience and 56.7% of them saw an increase in overdue amount over the past year, the overall payment experience in China remained very challenging in 2014. This is in-line with the non-performing loan (NPL) figures released by the China Banking Regulatory Commission, which showed that NPL ratio has reached a multi-year high of 1.25% as of the end of 2014. The risk of rising non-payment cannot be neglected.

China's 7.4%YoY GDP growth in 2014 was the lowest growth rate in the last

24 years, and momentum is on a downtrend (Coface forecasts GDP to grow 7% in 2015). At the same time, the real economy in China is facing rising challenges in 3 major areas: **1) high leverage; 2) high cost of financing, 3) low profitability driven by overcapacities** in certain sectors. While monetary easing measures are introduced to smooth out the growth deceleration process, if the additional low-cost funding is not delivered to the parties that need and deserve it, the main purposes of such monetary easing measures are likely going to be defeated, and further concerns on credit pressure would be in sight.

With the economy slowing down, industry participants would need to adapt to slower demand growth in

general and dedicate to find new growth drivers. With the high debt level in China, there is an essential need for the cost of financing to come down. In the later part of this report, we examined 9 major sectors in the Chinese economy based on payment experience and financial performances to take stock on various sectors. With signs of deterioration in both payment experience and financial performance, risks in chemicals, construction, and paper-wood sectors are on the rise, while the metals sector remains as an origin of worries in China.

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FOR SAFER TRADE

MARCH 2015

# THE NOT-SO-CALM YEAR OF SHEEP



« Other than the high leverage level, high cost of financing, and low profitability driven by overcapacities, the weak payment experience in the country is also worth our attention. »

## BY OUR ECONOMIST

**ROCKY TUNG**

Economist, Asia Pacific  
rocky.tung@coface.com

## 1 PAYMENT SURVEY BACKGROUND

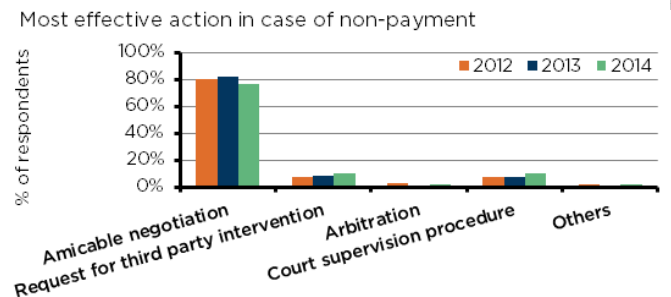
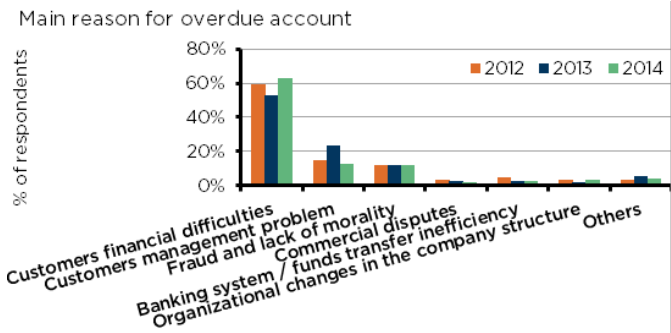
Starting from 2003, Coface has been conducting an annual survey of payment experience in China and this edition is the 12th one, with data prepared and provided by the Coface China's marketing team. Similar to the report Reality Check: Corporate Payment Trend and Sectorial Risk in China in February 2014, this edition of the report will talk about the corporate payment experience, macroeconomic development, as well as development in sectorial risk presented in the Chinese economy.

With a primary focus of credit environment and risk management in the business practice, the questionnaire was circulated to companies during the months of October and November 2014. We received valid responses from 882 China-based companies that are engaged in either manufacturing (73%) or trade (27%) businesses. These companies are involved in a range of industries, with the industrial machinery & electronics and chemicals industries - representing some 24.4% and 13.6% - being the most represented in the survey, respectively.

With most of the surveyed companies (89.6%) shared with us that they have adopted credit sales in their business practices, overdue or default payment is a key aspect of risk and it could potentially wash out their profits for the year. As indicated in our survey, the situation of overdue payment is primarily and increasingly driven by "customer financial difficulties" (63.2% in 2014) - mainly led by increasing competition (31.8%) and lack of financing resources (14.2%) - which is reflective of how the competitive environ-

ment and importance of rightly-priced sources of financing in business operation.

When it comes to remedy for non-payment, while the majority of the surveyed companies (76.1%) continue to believe that amicable negotiation continues to be the most effective tool, it is noteworthy that there is a trend of increasing credibility of other procedures that involve external parties and could relate to legal system (i.e. court supervision). Indeed, 45% of the respondents shared with us through their responses in the survey respondents believed that the legal environment in China has improved over the last year, signaling that the address on the rule of law by top policymakers could have seen positive results.



<sup>1</sup> Tung (February 2014) Reality Check: Corporate Payment Trend and Sectorial Risk in China, Coface Panorama

## 2 CORPORATE PAYMENT EXPERIENCE IN 2014

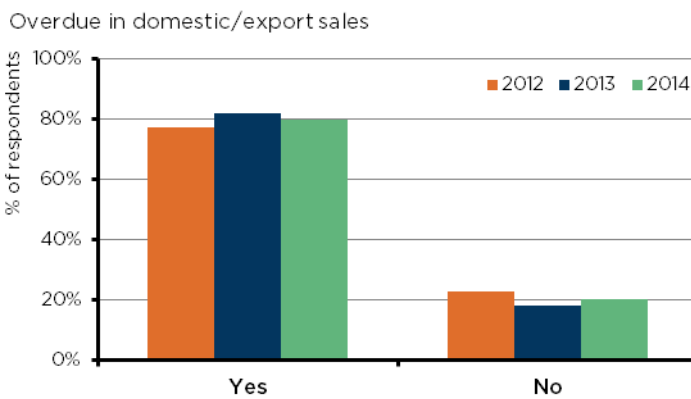
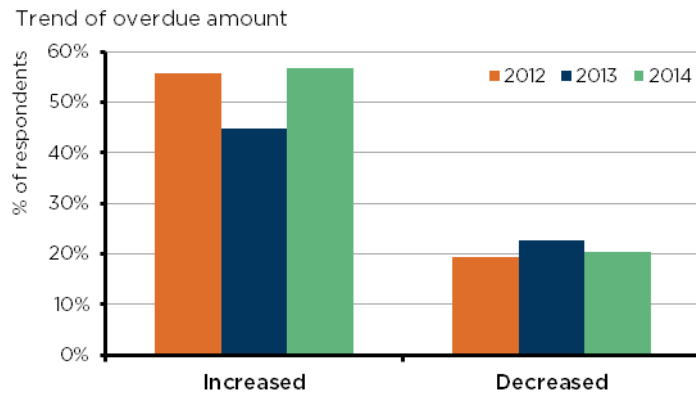
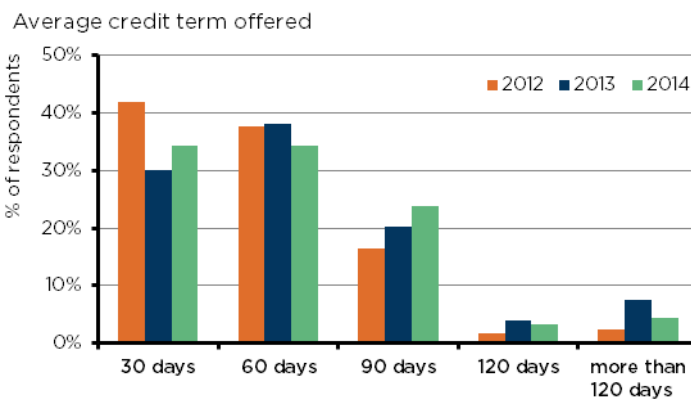
### Corporates became more prudent, but risks remained at high-level

From this year's survey result, China-based firms seem to have become more prudent in granting credit facilities to its customers, possibly as a result of the weak payment experience in 2013. Supporting such view is the decline in the length of credit terms and lower percentage of respondents who have experienced overdue payment in 2014 comparing to the previous year. Nevertheless, when overdue happened, the overdue amount has climbed as compared to a year ago, while the average overdue period has also shifted, albeit slightly, toward the long end.

From the length of credit terms extended to their counterparties, it appeared to us that businesses have become more prudent as both average credit term and maximum credit term have both shifted toward the short end. Comparing to 2013 where 49.1% of the respondents said the maximum credit term extended to their customers were 120-days or longer, only 37.3% of the respondents shared the same practice in 2014. At the same time, only 7.5% of the survey respondents told us that the average credit-term extended by their companies was 120-days or longer, compared to the 11.4% as reported in the 2013 survey. Such finding could be a result of the challenging environment and the much deteriorated payment experience in the previous year, as reported in the 2013 survey.

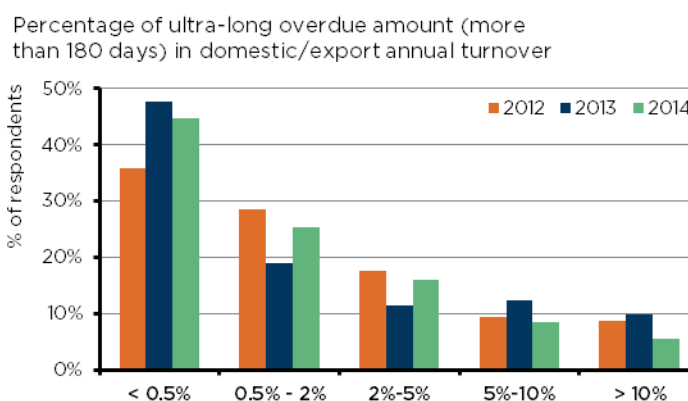
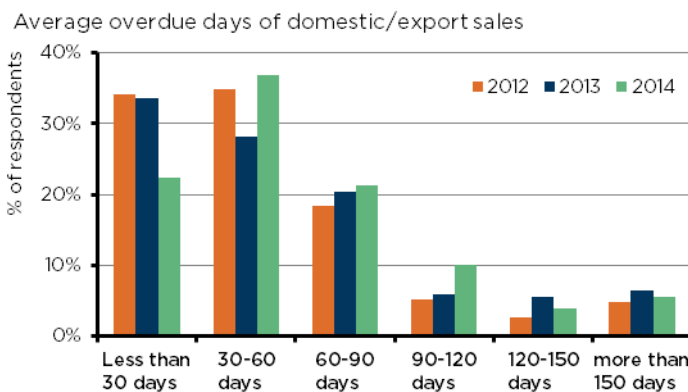
Looking at the trend of overdue occurrence, indeed, the payment experience in 2013 deteriorated notably from the period, but the situation has stabilized in 2014. Comparing to 2013 when 81.9% of survey respondents reported overdue experience in their business, 79.8% of the respondents said that they have seen overdue issues in their credit sales. The slight improvement in this category could be in-line with the more prudent credit control suggested in the previous paragraph. Indeed, in the follow-up process during the survey period some companies suggested that they have become more prudent as they granted credit-terms to their customers in 2014 comparing to a year ago.

When overdue happened in 2014, the amount tended to have increased and a higher percentage of respondents said the average overdue period have been longer than 90-days. 56.7% of the respondents suggested that the overdue amount owed to them have been relatively higher comparing to a year ago (45% in 2013), while 20.5% of them suggested the overdue amount have declined over the past year (22.6% in 2013). In terms of the overdue period, 19.6% of the respondents shared that the average overdue period exceeds 90-days in 2014, while only 17.8% shared the same experience in 2013.



Although a higher percentage of respondents shared that they have seen increased amount of overdue payment and lengthened average overdue period, pressure coming from ultra-long overdue payments (i.e. more than 180 days) has eased in 2014 comparing to a year ago. 29.8% of the respondents shared that ultra-long overdue payments weigh more than 2% of their annual sales; in 2013 and 2012, 33.4% and 35.6% of the respondents, respectively, shared similar experience. It is generally Coface's experience that the overdue amount has a high probability of becoming eventual no-payment if it is overdue for over 180 days. Given such circumstances, if such ultra-long payment weighs heavily as a percentage of the company's sales, it would logically lead to pressure on the company's financials. Such finding in this payment survey points to easing pressure on financials coming from long and massive overdue payments.

Despite the more prudent credit extension practice in 2014, payment experience remained weak, and corporates continued to face challenges. This is a result of the lack of financing resources and high cost of financing for smaller-and-medium enterprises (SMEs), and the weak profitability led by the oversupplied situation in certain industries. These are primarily the reasons of Coface's negative outlook on China issued in January 2015.<sup>2</sup>



### 3 CHINESE ECONOMIC OUTLOOK 2015

	2011	2012	2013	2014	2015F
<b>GDP growth (%)</b>	9.3	7.8	7.7	7.4	7
<b>CPI (%)</b>	5.4	2.6	2.6	2	2.2
<b>M2 (%)</b>	13.6	13.8	13.6	12.2	12.7
<b>Fixed Asset Investment (%)</b>	23.8	20.6	19.6	15.7	15.5
<b>Retail Sales (%)</b>	17.1	14.3	13.1	12.2	11.3
<b>RMB/USD (year-end)</b>	6.301	6.286	6.097	6.119	6.2

Source: Coface

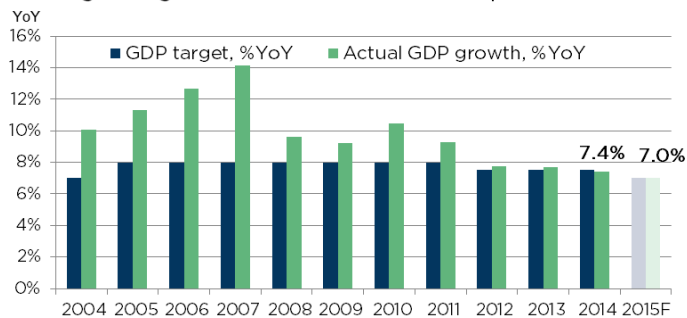
#### Normalized growth rate tolerated

While the actual targets of the economy should be announced in the National People's Congress in March, traces can be found that top policy-makers are likely going to tolerate a slower growth rate. Between December 9 and 11, top Chinese policy-makers got together for the Economic Working Conference and set the tone for the year of 2015. It is believed that the government has addressed the issues of carrying out reforms and stabilizing growth so the economy would not lose momentum drastically. From the post-conference communique and the external communications in the last couple of months, it has been shown that the government is dedicated to keep economic momen-

<sup>2</sup> Coface (January 2015) Laborious global recovery, subject to multiple risks

tum going, while moderation in the growth rate is inevitable. It is believed that the government would continue to pursue an accommodative monetary environment, while adopting a targeted-approach in their fiscal policy stance. With such rhetoric, it is believed that the GDP target for 2015 is set between 7-7.2% (Coface forecast: 7%YoY), on pace to see the slowest growth since 1990.

Slowing GDP growth and a mis-match of expectation



Bars in lighter colors reflect Coface estimates

Source: Coface, CEIC data

Indeed, since the second half of 2014, it seems that the economy has been moving toward the *right direction*. With regard to what the *right direction* may mean, it should consist of stable job growth and modest inflation, while it is also of the government's interest that the property market would not continue to deteriorate – as "land usage right transfers" is a major source of fund for the government (i.e. 28.2% in 2013).<sup>3</sup> As China is on pace to continue to add over 13 million new jobs, inflation is expected to stay low (Coface's expectation for 2015 is 2.2%YoY), and property market showing early signs of stabilization as the government removed purchase restrictions in all-but-5 of the cities together with the monetary easing measures (i.e. interest rate cut in November 2014, and required reserve ratio reduction in February), our 7% growth forecast is in-line with the government's rhetoric.

Stabilization of property market

A structurally important sector that weighs over 20% of portfolio of the regular banking system and contributed over 28% of government revenue in 2013, the property market has seen tremendous downward pressure since 2014 and none of the 70 cities traced

by the government saw any price increase between September and November in 2014. But as we have suggested in our previous publication, the sector is facing challenges as a result of lack of financing from "other resources" as well as overdevelopment particularly in third-tier cities (e.g. Wuqing). The widespread decline in prices and transaction volume was notable in 2014.

Comparing to the previous Hu-Wen (Hu Jintao and Wen Jiabao) administration, the Xi-Li regime has been relatively less vocal about the housing policy stance despite the topic being widely covered in major media both domestically and internationally. This is a sign showing that the central government is providing higher degree of autonomy to local governments in managing their local policies – as local property markets are major contributors to the revenue bases of their governments – which is in-line with the concept of streamlining administrative process as pointed out in the Third Plenary Session in 2013, the intention of the Xi-Li regime to make the economy more market-driven is seen in such process.<sup>4</sup>

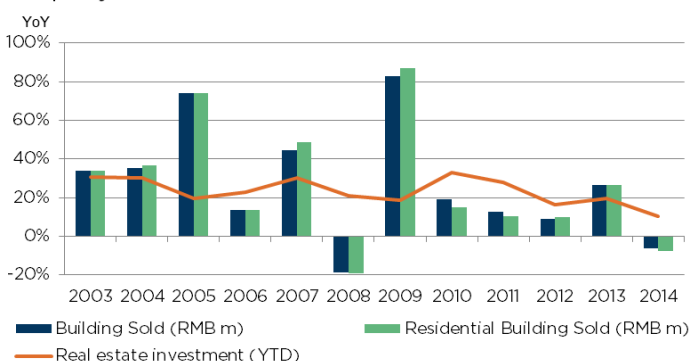
With the tamed hype of the property market since 2014, 2015 should be the year of stabilization for the property market and local governments should continue to feature an accommodative environment for the developers. Such development could include continuation of extending lending facilities via the regular banking system (e.g. through the revised loan-to-deposit ratio, etc.).

We continue to see a divergence of property market development between first (i.e. stabilized) and second/third tier cities (i.e. weak outlook), as overdevelopment in less developed areas (e.g. Wuqing) will spook the supply-demand equilibrium.



Source: Coface (November 18, 2014; Wuqing)

Property investment and sales declined in 2014



Source: Coface, CEIC data

Double-trouble: Leverage and cost of financing

Despite the normalization of growth being well-anticipated and the stabilization of property market being welcomed, risk factors in the Chinese economy are on the rise. Among the other matters and challenges, the 2 areas that are worth extra attention are: the increasingly higher leverage of the Chinese econ-

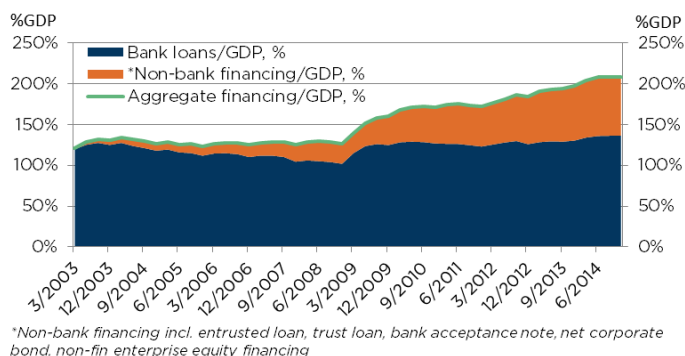
<sup>3</sup> Tung (September 2014) China: Carrot-and-stick, Coface Panorama  
<sup>4</sup> Tung (November 2013) China: Targets by 2020, p.3, Coface Panorama



omy and rising cost of financing as a result of normalization of risk premium.

The piling debt issue in China is nothing new to the Chinese economy, as it has been reliant on its banking sector for its growth. As illustrated in the chart below, bank loan as a percentage of GDP has “slightly” increased throughout the rapid expansionary phase of the economy in the past decade (from 120% in 2003 to 136% in 2014). Nevertheless, with the rapid development of the non-bank financing sector,<sup>5</sup> the aggregate debt (or aggregate financing) to GDP ratio has climbed to 209% at the end of 2014, comparing to the 121% in 1Q2003.

The piling debt issue in China



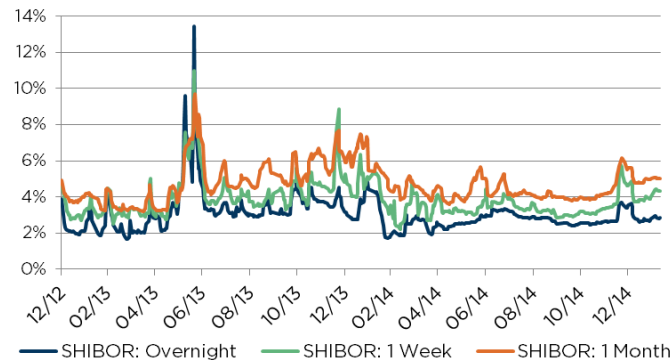
Source: Coface, CEIC data

Although high aggregate financing-to-GDP ratio does not necessarily translate into more frequent insolvencies, such ratio is indicative of mounting risks related to high debt servicing ratio, which could result in non-payment particularly when there is an uptick in interest rate.

It is believed that the policymakers in China are aware of the risks and tackling it proactively. The balance of aggregate financing activities has slowed to 16.9%YoY in 2014 comparing to the 27.3%YoY and 32.4% in 2013 and 2012, respectively. While activities through the regular banking system have been relatively stable (loan growth 10% in 2014 vs. 8.4% in 2013), non-bank financing activities have recorded -5.2%YoY decline in 2014. Such development is believed to be a result of stricter rules on the non-bank financing activities since the first quarter of 2014.

Particularly, financing activities from trust loan - a major worry during the first half when various wealth management products were said to be on the edge of default in local newspapers - have declined dramatically in 2014 (-71.9%YoY decline vs. 43.3%YoY increase in 2013). Such development would benefit the economy through reducing volatility in the banking system (as reflected by the less volatile interbank rates) and allowing the regulators to stay on top of the development of non-bank financing activities.

Stabilized interbank rates

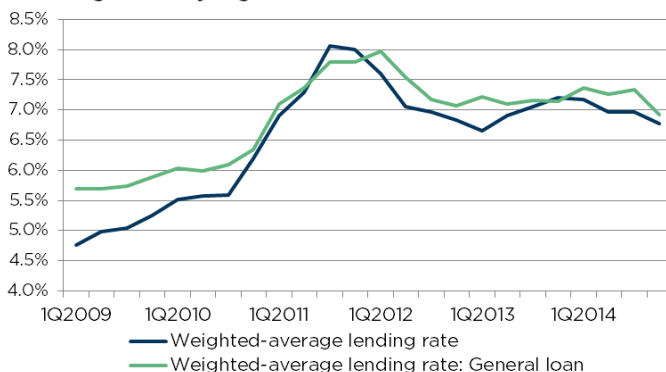


Source: Coface, CEIC data

Non-bank financing activities are a double-edged sword for businesses, particularly smaller and medium sized firms who have been relying on them for financing facilities.<sup>6</sup> On one hand, the north-of-20% cost of financing (e.g. as disclosed by Wenzhou Private Lending Registration Service Center) is extremely costly for businesses that are earning thin margins usually around 2-5%. On the other hand, without the credit facilities from non-bank financiers, small-and-medium size businesses may face cash flow issues. As non-bank financing activities wilt, smaller business could indeed face higher pressure to source funding. Indeed, from our channel checks and communication with bank officers mostly based in Guangdong province, borrowing costs have not come down even after the interest rate cut in late November. These may suggest eliminating non-bank financing activities, without replacing it with a more reliable alternative, can be damaging for smaller players.

Having acknowledged such unbalanced lending behavior among existing banks, China Banking Regulator Commission (CBRC) said in July that 3 privately-owned banks were approved to be set up (i.e. WeBank in Shenzhen, and 2 other banks would be in Wenzhou and Tianjin) and their key clientele would be targeted at smaller businesses. In September, 2 other banks were approved to be set up in Zhejiang and Shanghai. Although immediate impact is yet to be seen, if executed properly, such development would add strength to economy through reducing transaction cost of lending-borrowing activities, thus boosting profitability of the corporates who can presumably obtain credits at a much lower cost. On the other hand, even though high cost of financing

Lending rate stay high for SMEs



Source: Coface, CEIC data

<sup>5</sup> Non-bank financing activities include entrusted loan, trust loan, bank acceptance note, net corporate bond issuance, and equity financing activities by non-financial enterprises

<sup>6</sup> Tung (September 2014) China: Carrot-and-stick, Coface Panorama

may not be entirely justifiable, the hiking borrowing cost for certain corporates is reflective of the rising risk level. There are different indicators that we could refer to regarding the rising risk in China, and one of those would be the rising non-performing loans (NPL) in the regular banking system. There is quite a notable pickup in NPL ratio (from 1% in 2013 to 1.25% as of the end of 2014, the absolute amount of NPL is up 42.3%YoY, led by increased sub-standard loans<sup>7</sup> (58.8%YoY and weighed 47.8% of the whole NPL portfolio) exposure. Considering that banks' lending practice usually includes high quality due diligence, risk management and demands collaterals, such development is indeed worrying.

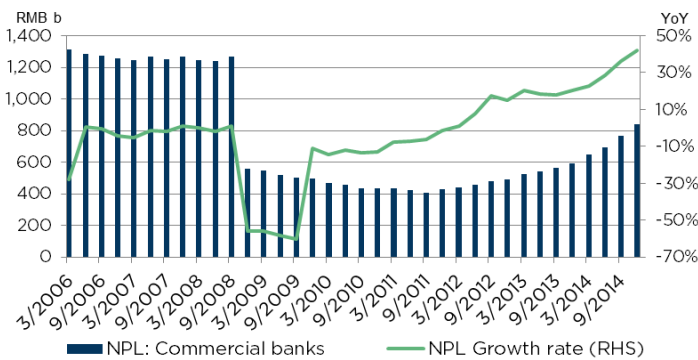
At the same time, we use the yield spread between Treasury bond and AA- bond as a proxy to show the risk premium paid by less-favored corporates.<sup>8</sup> We can see that the market is pricing in higher premium on risk since mid-2013. While this is may not be welcomed by corporates that tap the bond market for funding, it is healthy development as the lending to the Chinese government would be much safer than lending to a corporate - let alone the grading - and such trend is showing a more effective pricing of risk. With the government intends to transform China into a market-based economy, borrowing cost for corporates may sustain at high level.

### Risks of corporate insolvency to be closely monitored

With regard to the macroeconomic environment in China, while we believe the deceleration in growth from a high-base in the last decade is by no means disastrous and is now well-anticipated, the highly leveraged nature of the economy and the high cost of financing lead to mounting risks. Coface has put a negative outlook on China's A3 Country Risk Assessment (CRA)<sup>9</sup> in January, reflecting the awareness of weaker economic momentum, hiking leverage, high cost of financing, and weaker payment experience in the country.

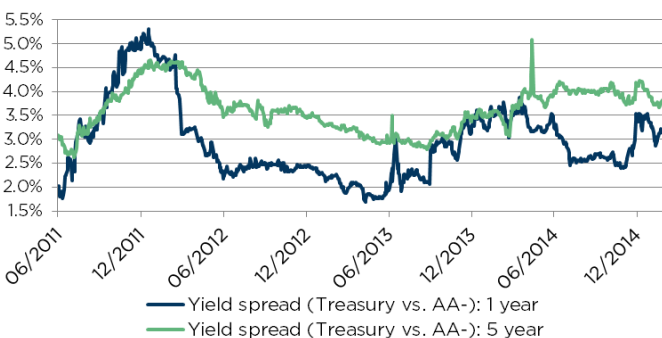
While it is not our baseline scenario to see the economy falling off a cliff in 2015, the following scenarios represent major downside risks to our assumptions i) a series of major defaults of non-bank financing facilitators, and ii) further erosion in property demand that would hurt upstream suppliers, both in terms of revenue and their repayment abilities. Such development would be closely monitored and will be reported accordingly.

Non-performing loans rising furiously



Source: Coface, CEIC data

Yield spread between AA- bonds and Chinese Treasury bonds



Source: Coface, CEIC data

<sup>7</sup> Sub-standard loan: repayment on a loan is overdue by 91 to 180 days and no full-repayment can be made by the borrower

<sup>8</sup> The most common ranking of local government financing vehicles is AA

<sup>9</sup> CRA assesses the average risk of payment defaults by companies in a given country. This evaluation combines economic and political prospects of the country, Coface payment experience and business climate assessment. This evaluation has 7 grades: A1, A2, A3, A4, B, C, D and can be watch-listed

## 4

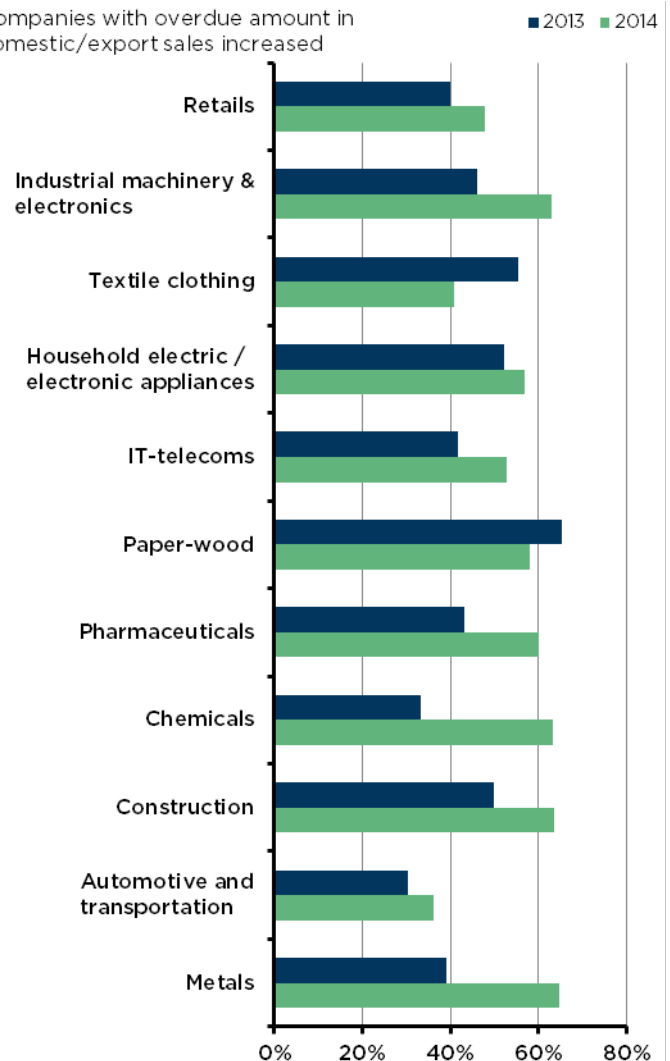
## SECTOR ANALYSIS

The moderation of growth in China is driven both by the slowdown in investment and consumption activities, which combine for some 84% of the country's aggregate output in nominal term. As overcapacity issues are expected to continue in 2015 and will underwhelm the specific industries (e.g. steel, aluminum, shipbuilding, etc.) – and the government is expected to act on it more forcefully – near-term outlook for most of these sectors will be challenging. Such development should pose challenges to industries' payment experience as well.

As discussed in Part 2 of this report, 56.7% of firms stating that they are facing an increased overdue amount in 2014 comparing to a year earlier; only 45% of the firms reported such situation in 2013. Indeed, when we look at the chart below, with the exception of paper-wood and textile-clothing industries, all other industries are facing pressure with regard to such aspect. The most significant increase, in terms of percentage point, are **Chemicals (+30%), Metals (+26%), Industrial machinery & electronics (+17%),** and Pharmaceuticals (+17%). In the last edition of the payment survey, we have warned that these industries are facing pressure including but not limited to margin squeeze (e.g. Metals, Industrial machinery & electronics) and saturated market demand (e.g. Chemicals); in this edition, we remain conservative in these industries due to the aforementioned reasons.

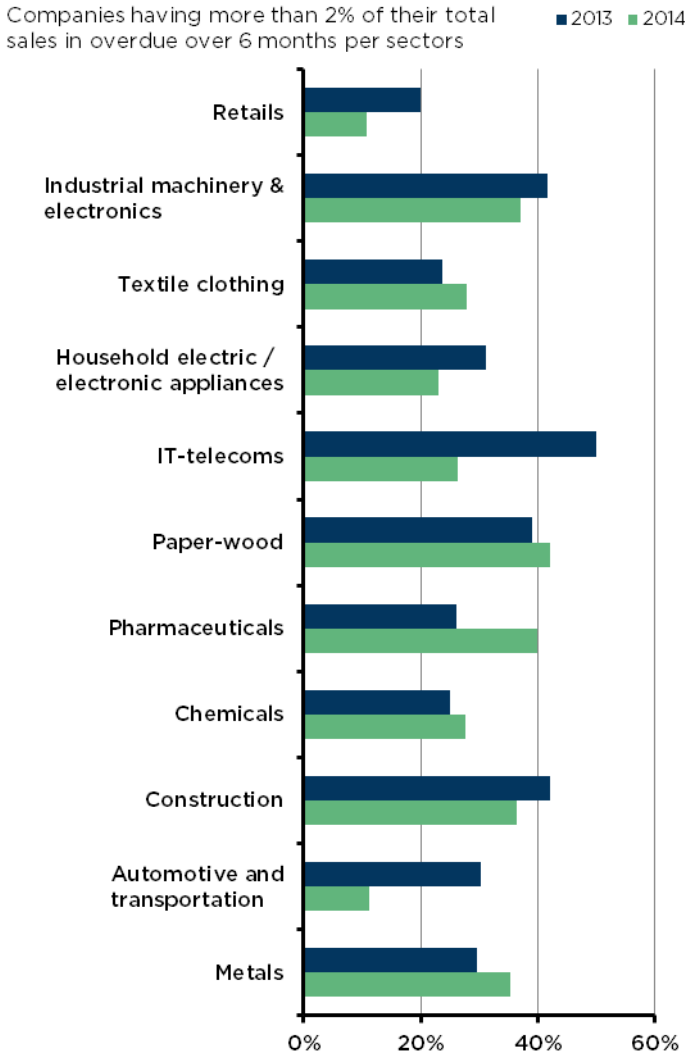
We consider collection of overdue that is “6-month and beyond” *doubtful*. It is our experience that roughly 80% of these overdue are not repaid at all if they were not paid for after being overdue for 6 months. In the case of such lengthy overdue amount exceeding 2% of the total annual turnover, liquidity of such companies could be an issue and thus their ability to repay the suppliers could be questioned.

Companies with overdue amount in domestic/export sales increased





From the chart below, we can see that **Pharmaceuticals (+14%), Metals (+5%), Textile-clothing and Paper-wood (+3%)** are the only industries to see an increased percentage of respondents reporting that they are facing such situation. While such industries face increasing challenges in collecting debts, they could potentially be seeing increasing liquidity pressure.

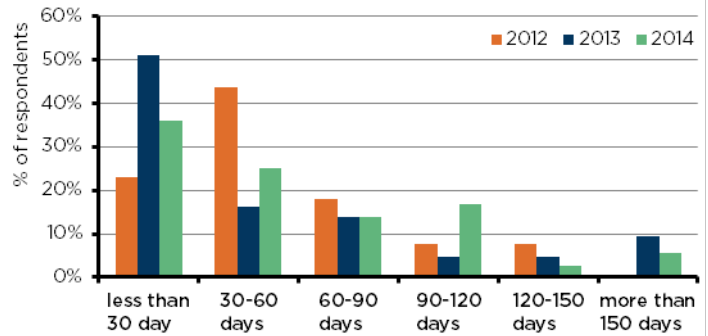


In the following section, we will look into the payment experience of different sectors. Besides looking into industry-results from payment survey, we also take a look at financial ratios (i.e. net profit margin and debt-to-equity ratio) to come up with a brief idea about the trends of the respective industries.

### Automotive and transportation - The ride goes on

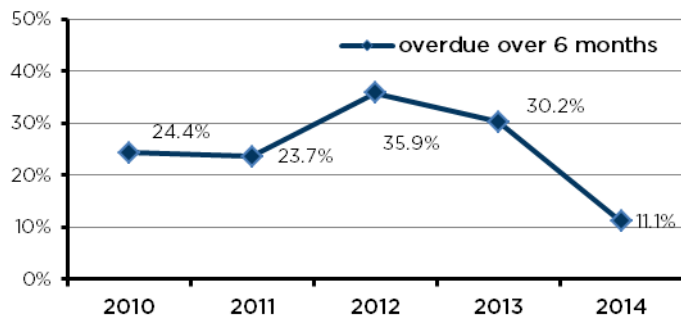
In 2014, credit cycle has become longer for the automotive and transportation sector. Credit term extended by the participants in the sector has generally lengthened, with 32.6% of the survey respondents suggesting that their average credit term was longer than 60-day; only 27.1% of the respondents reported the same behavior in 2013. At the same time, when overdue occurred, they tend to have increased in terms of length, too. 25.1% of the respondents from the industry suggested that average overdue period were longer than 90-days in 2014, while only 18.7% suggested they faced similar results. The combination of such trends suggests that industry participants had to wait longer before they could get their cash back from the customers.

Average overdue days in automotive and transportation sector in the past 3 years

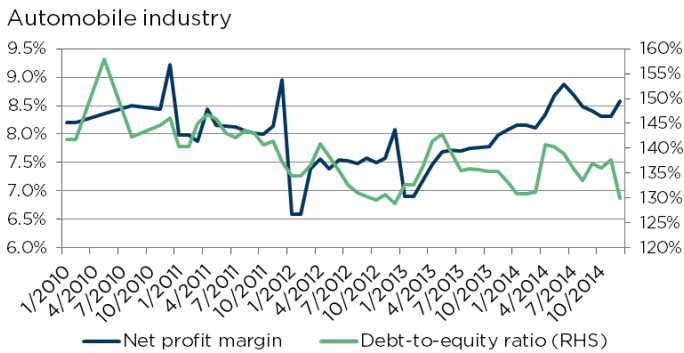


Only 11.1% of the respondents in the automotive and transportation sector experienced 6-month-or-beyond overdue payments in their respective companies accounted for the more than 2% of total sales; comparatively, 30.2% respondents in 2013's survey faced similar situation. This is a positive development suggesting that businesses in the industry were less likely to face ultra-long overdue weighing on their balance sheets.

% of companies in automotive and transportation sector having more than 2% of their domestic/export sales in overdue



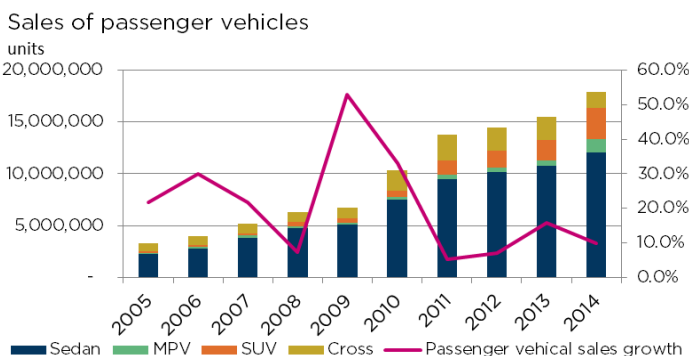
Taking a look at financial indicators, the automotive industry faced positive development in trends of profits comparing to a year ago. As of December 2014, total profit for the automobile industry went up by 17.3% YoY, and total profit as a percentage of total sales slightly went up to 8.57% from 8.08% in 2013. At the same time, debt-to-equity ratio has dipped slightly from 133% to 130% in 2014.



Source: Coface, CEIC data

Similar to what was suggested in our last year's report, sales of automobiles continued to pick up at a slower rate comparing to 2013 as a result of slower (i.e. 7%YoY). Such trends should continue to play out in 2015, as a result of slower sales growth in sight as a result of income growth and potential purchase restriction in other first-tier cities.

Among the different types of passenger vehicles (PVs), sales growth of sports utility vehicles (SUVs) and multi-purpose vehicles (MPVs) significantly outperformed the other segments; SUV and MPV sales grew 36.4%YoY and 46.7%YoY in 2014 as compared to the 9.9%YoY of general PV sales. This development was, according to our discussion with various industry analysts, led by the preference of larger passenger vehicles. Such trend should remain intact as the preference should not change in the near-term.



Source: Coface, CEIC data

Similarly, Chinese preference of foreign branded cars should continue to last, despite potential downside drag from lower income growth. In a recent visit to

Guangzhou in Guangdong province, we spoke to a group of middle-class consisting of medical doctors and business owners. 9 of them have recently bought or were thinking about purchasing a new vehicle - 8 of them already owned at least one vehicle. All of these 9 people said that they lean toward purchases of European brands to Japanese brands; and they said they have not considered Chinese brands thus far.

In addition, car sales could be indirectly stimulated by Chinese government's investigation in August 2014, which would drive prices lower going forward.<sup>10</sup> The investigation was primarily on imported cars of foreign brands in the luxury segment, which were suspected to be pricing cars and its components more aggressively in the country comparing to their domestic markets. With the investigation in place, it is believed that prices for this segment (i.e. imported luxury cars) should head south in 2015 comparing to a year ago, leading to increasing affordability in the country. While the investigation would have little to no impact on vehicles produced locally by domestic-foreign joint-ventures, with the depreciation of Euro and Japanese Yen against the RMB, it is believed that foreign-branded cars would continue to see strong demand in China.

Key downside risks to the sector remain similar to those in 2014, and any vehicle purchase restrictions in major cities (e.g. introduced in Shenzhen in late-2014) would put limit the upside of auto demand. With utilization rate running at an estimated 60-70%, underutilization of production capacity is also a concern for some observers.<sup>11</sup> Moreover, Japanese brands have seen weaker demand growth in 2014, perhaps a result of tension between the two largest Asian economies as suggested in *China - What to expect in 2014*.<sup>12</sup> In 2014, accumulated auto sales of Guangqi Honda Automobile Co. and FAW Toyota Sales Co. went down to 2.8%YoY and 7.9%YoY, respectively, and lag behind the industry average. Such trend should be improved in 2015 as a result of low base-effect and the less intense tension between the two largest Asian countries.

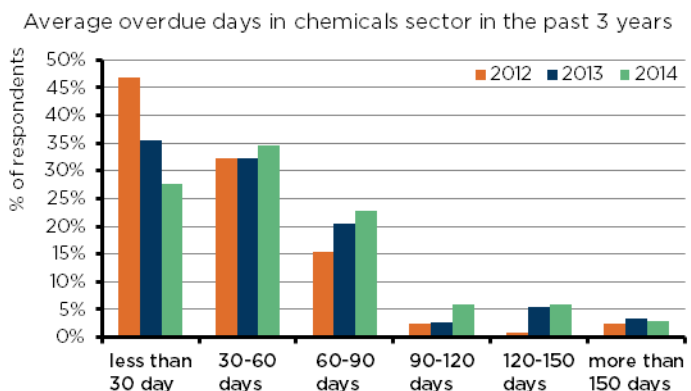
### Chemicals - Problems arising

For the chemical sector, credit conditions slightly tightened in 2014 comparing to 2013 as a result of relatively longer credit term and slightly extended average overdue period. 30.6% of the respondents shared with us that their average credit term extended to the customers was 90-days or longer, comparing to the 23.1% and 17.6% in 2013 and 2012, respectively. At the same time, average overdue period was lengthened. 37.6% of the respondents shared that average overdue period were longer than 60-days, having lengthened compared to 32.2% and 20.9% in 2013 and 2012, respectively. Such situation suggests that credit cycle likely lengthened in 2014 comparing to previous years.

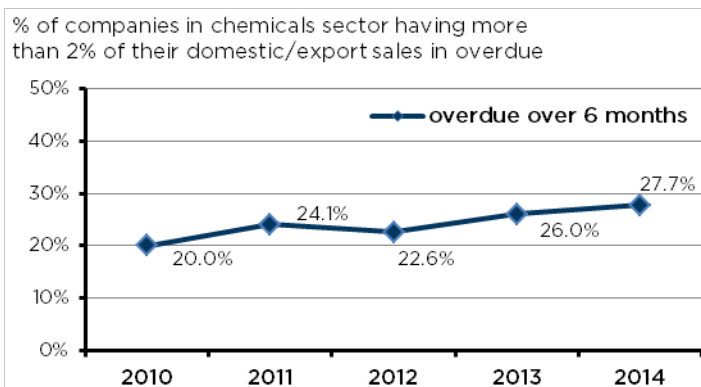
<sup>10</sup> China Daily (August 2014) More than 1,000 auto companies are probed

<sup>11</sup> Mohr, et al. (August 2013) What's driving the global automotive industry? McKinsey & Company

<sup>12</sup> Tung (January 2014) China - What to expect in 2014, Coface Panorama

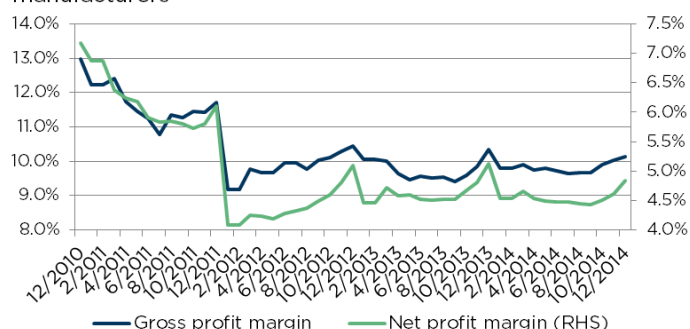


Similar finding can be found on the ultra-long overdue, when an increased in percentage of respondents sharing that they faced such issues. For the second year in a row, there was a pickup in responses stating that ultra-long overdue weighed more than 2% of the companies' balance sheet. Such trend is showing that industry participants are seeing increasing pressure of bigger amount of ultra-long overdue payment, and it is a trend that is worth our attention.



With the broad spectrum nature of the chemical industry, we could only focus on the fundamental of synthetic resin as an example. Nonetheless, the slightly worsened payment situation cannot be explained by the market dynamics - at least for the synthetic resin market alone - as apparent consumption of synthetic resin picked up by 11.8% in 2014 comparing to 2013, to 33.2million tons. With the positive demand growth, the industry profitability has remained largely stable, with estimated net profit margin at around 4.8% for the year, slightly lower than the 5.1% in 2013.

Primary form plastic product & synthetic resin manufacturers



Source: Coface, CEIC data

Instead, for chemical sector in general, crude prices would be one of the determining factors that would lead to changes in profitability and payment experience, among the other aspects for the sector. While the drop of crude prices may be beneficial to the future development of participants in the chemical sector, high volatility would lead to uncertainty and unpredictability for businesses and is generally regarded as a risk factor.

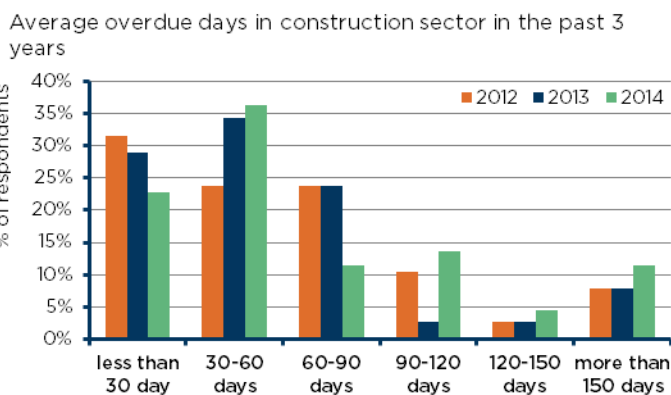
The fall in crude prices came as a result of expanded supply glut, while demand growth has slowed notably (e.g. China slowdown, rise of alternative energy). While we are not experts in crude price forecasting, the low crude price at current level, if sustained, is expected to drive out high-cost producers.

Generally speaking, lowered oil prices would hurt the margin of petrochemical producers. As oil prices are usually used as a reference of the price floor of crude-derivative products, therefore, any fluctuation in oil prices - particularly abrupt changes - should be exerting strong downward pressure on prices of petrochemical products. Besides, the sharp fall in oil prices could also lead to write-offs in the value of inventories, and thus should be posting negative impacts on relevant companies in the near-term.

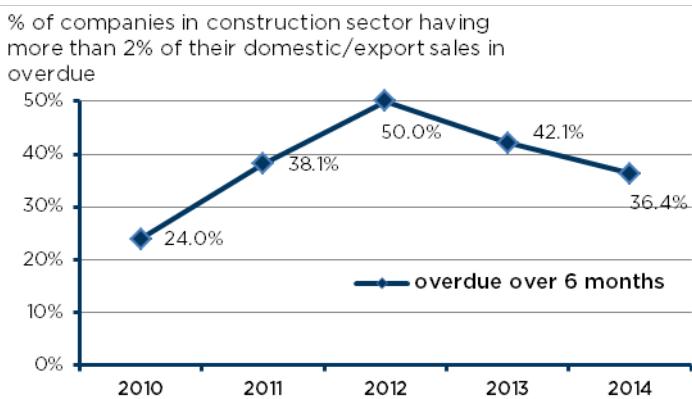
Moreover, the drastic fluctuation in oil prices could lead to worsened payment experience. To put it into practical experience, if a customer has ordered some crude-based chemical product when crude prices were high, the customer would tend to ask for discount on the product after the crude price has fallen. Such practice would hurt the supplier tremendously in terms of business operation and in extreme cases where the relationship between the customer and the supplier is not too strong, default payment could also occur as a result of the latest episode of sharp fall in oil prices.

### Construction - Underwhelmed by overdevelopment and reduced funding

2014 was a challenging year for the construction sector, with credit cycle becoming longer for the sector in general. Average credit term extended by the sector participants has been lengthened, with 37.5% of the survey respondents indicated that their average credit term was longer than 60-day comparing to the 31.1% a year ago. Average overdue period has expanded in terms of length as well, with 29.5% of the respondents from the construction industry reporting average overdue period beyond 90-days in 2014 comparing to the 13.2% in 2013.



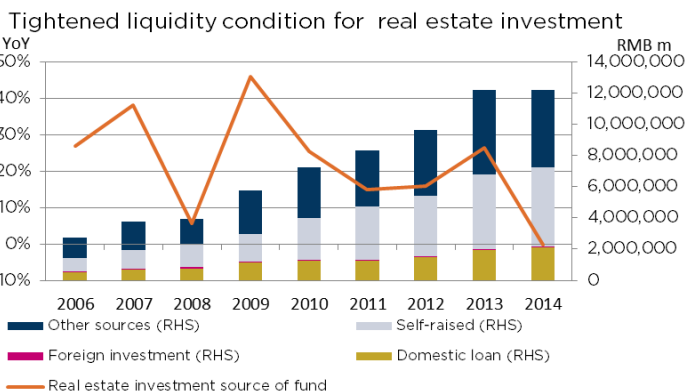
While respondents from the construction industry shared that they credit cycle has generally been extended in 2014, ultra-long overdue payment was an issue for lower percentage of industry participants. For the second year in a row, there was a decline, in percentage, of responses sharing that ultra-long overdue weighed more than 2% of the companies' balance sheet, despite the hurdles that we have seen from industry and macro data (42.1% vs. 36.4%).



The property market has faced headwinds in 2014, headlined by the slowdown in demand and investment appetite, as well as the lack of financing resources.<sup>13</sup> Nevertheless, with its importance to the banking sector and as a source of government revenue, it was suggested in the last report that the Chi-

nese government would continue to support the property sector. Hence, 2015 should be a year of stabilization for the Chinese property sector, especially for first-tier cities like Beijing and Shanghai.

In our conversations with some property analysts in the Chinese market, it is clear now that the golden years of broad-base expansion of the property market is behind us. Indeed, 2014 is marked as the turning point for the Chinese property market. With reduced funding facilities from non-bank financing activities as a result of the clampdown of non-bank financing activities and the less dynamic sales market, property developers should have had a difficult year, with weaker cash flow both from financing and operational activities.



Source: Coface, CEIC data

With the more supportive government policy stance - including the relaxation of purchase restrictions and lowered interest rate - the challenging environment for the property sector may turn the corner in 2015. However, while the *modest* (i.e. simple average of -4.3%YoY decline as reflected in the 70 cities traced by the government) but *broad-based* (i.e. decline in property prices reached 69 out of 70 cities as of November 2014) slowdown may be over, a V-shape recovery is not likely in front of us as a result of the oversupply situation in many third-tier cities.

For 2015, although it is not our baseline scenario that the Chinese property market would see high double-digit sales growth, annual property sales should stabilize at around 1.15-1.25 billion square meter for the year. The contribution to growth will likely come from first-tier cities, where demand will be driven by scarcity. First-tier cities (i.e. Beijing, Shanghai, Guangzhou and Shenzhen) will continue to attract talents both domestically from other regions in China and internationally; such development would continue to drive demand higher - and with the contraction in housing starts in 2014 - prices in these cities should have higher probability of recovery. Again, such recovery in first-tier cities would not be drastic, but rather moderate, which could bring prices back to 2013 level during the course of 2015. For third tier-cities, the

<sup>13</sup> Tung (September 2014) China: Carrot-and-stick, Coface Panorama

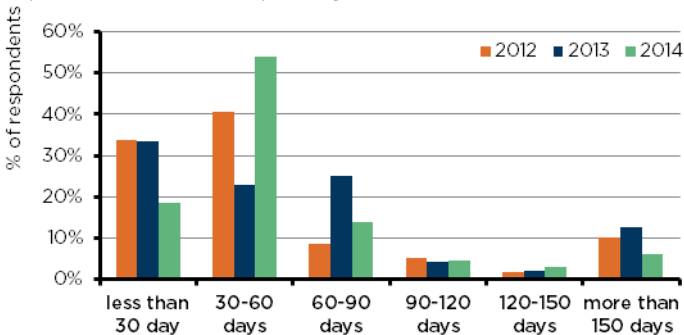
legacies of overdevelopment will still haunt them in the near-term.

For the medium-term development of property sector in China, the decline in housing starts in 2014 shows a self-adjusted dynamic in the market. Inventory level has begun to moderate, which would ease the pressure on pricing in the medium-term. At the same time, affordability of properties - as disposable income still grows at around 7% level while property prices remain flat - is improving, which should lead to less restrictive policy environment. These factors should also support a stabilization of the property market in the medium-term.

**Household electric/ electronic appliances<sup>14</sup> - Computer manufacturers at risk**

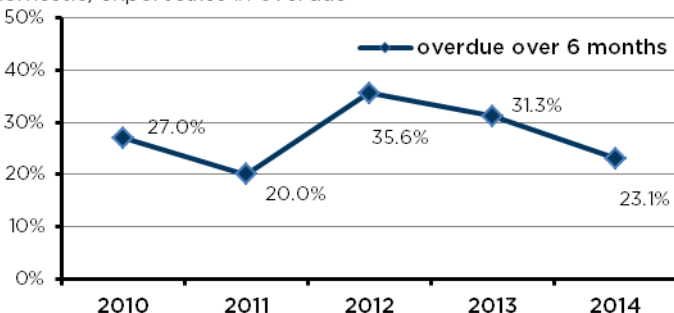
The household electric/electronic appliances (HEEA) industry went through some ups-and-downs in recent years, but there are traces of recovery in 2014. Credit managers of the HEEA industry seemed to have become more prudent when they extended their credit facilities to their customers. From the survey response, credit cycle seemed to have shortened in 2014 comparing to 2013, with average credit-term offered was 13.8% of the respondents in the HEEA sector shared that average overdue period for their companies were longer than 90 days, comparing to 18.8% in 2013 and 10.2% in 2012.

Average overdue days in household electric/electronic appliances sector in the past 3 years



In-line with the trends suggested above, ultra-long overdue is an issue less frequently for companies in the sector. Percentage of company reported ultra-long overdue weighing more than 2% of the company's annual sales fell from 35.6% in 2012 and 31.3% in

% of companies in household electric/electronic appliances sector having more than 2% of their domestic/export sales in overdue

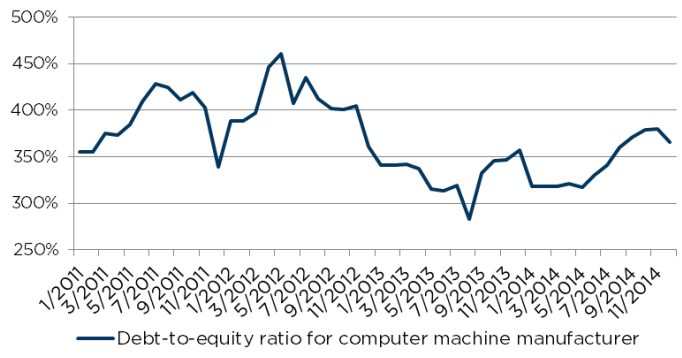


2013 to 23.1% in 2014, suggesting that overall payment experience for the broad HEEA industry has improved during the year.

With a broad spectrum of products and specializations, the fundamentals of the HEEA sector are difficult to be generalized. In this section we are going focus on the computer manufacturing sector, which we identified in last year's report as it was facing very high leverage level.

The high-leverage nature of the computer manufacturing sector continued to exist in 2014, while profitability has seen moderate deterioration. Debt-to-equity ratio of the computer manufacturing industry rose slightly from 358% in 2013 to 366% in 2014, while net profit margin of the industry slipped from 2.4% in 2013 to 2.2% in 2014. With the low profitability and high leverage nature of the industry, together with the ambiguous outlook of the sector due to increasing competition from smartphones and tablets, we believe the risk of overdue and default payment remains at a high level for the industry.

Computer machine manufacturer



Source: Coface, CEIC data

**Industrial machinery & electronics<sup>15</sup> - Divergence of fundamentals of sub-sectors**

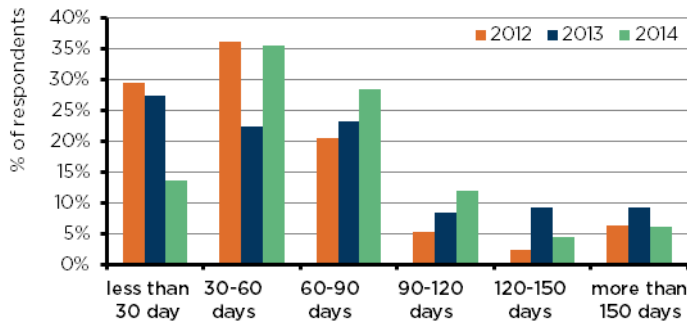
The industrial machinery and electronics (IME) industry saw significantly deteriorated payment experience in 2013, likely as a result of challenges faced by sub-sectors like computer-parts manufacturers. In 2014, the intensity of challenges in terms of payment experience has been smoothed, even though it is still relatively high comparing to 2012. 37.9% of the respondents of the IME industry shared that their average credit term were 90-days-or-longer, comparing to 43.2% in 2013 and 26.3% in 2012. 22.4% of the respondents faced average overdue period of 90-days-or-longer, while 27% and 13.8% of the respondents shared such experience in 2013 and 2012, respectively. Such results are likely results of stricter and more conservative extension of credits to the customers.

<sup>14</sup> We define household electric/electronic appliances as the products that are readily available to be used domestically

<sup>15</sup> We define industrial electronics as the products that are for industrial use or semi-finished products

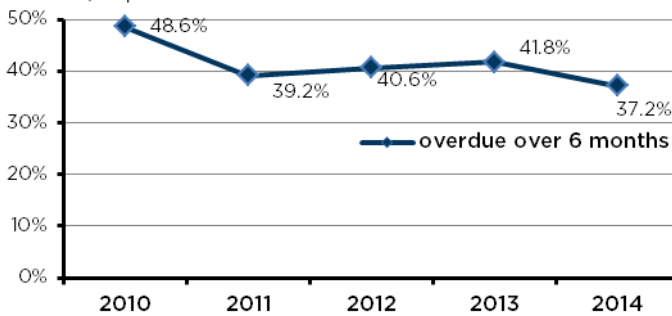


Average overdue days in industrial machinery & electronics sector in the past 3 years



Another sign of improved payment experience for the IME industry from the survey comes from the impact of ultra-long overdue payment on its participants. While it is still at a quite high level, “only” 37.2% of the respondents reported that 180-days-or-longer overdue weighted more than 2% of their annual turnover. Such reporting figure is the lowest in 5 years, this should be considered as a positive sign, despite the fact that such number is the second highest among all sectors (i.e. behind paper-wood).

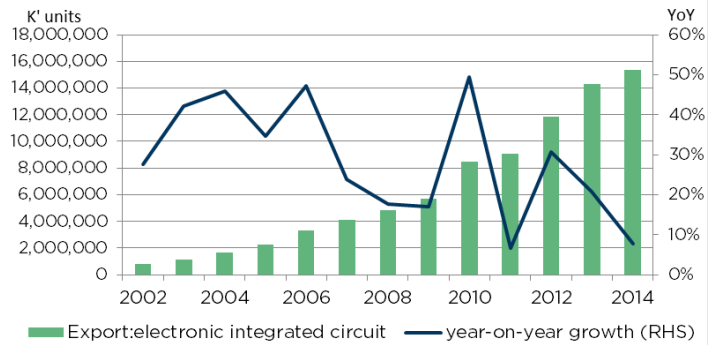
% of companies in industrial machinery & electronics sector having more than 2% of their domestic/export sales in overdue



As the IME industry is the sector that is the most represented sector in our sample (24.4%), and it has a broad spectrum of products, we are going to talk about 2 sub-sectors in the industry, namely semiconductor and heavy mining machinery sectors.

After some stable years of development in 2012 and 2013, 2014 was a good year for the semi-conductor industry. Net profit margin expanded from 5.1% as of the end of 2013 to 6.9% in 2014, largely because of the continued strength in demand from external economies. Take export of electronic integrated circuit as an example, while the growth rate of exports of electronic integrated circuit slowed to 7.6% in 2014, from 20.7% and 30.7% in 2013 and 2012, respectively, pricing of these products generally increased moderately – according to an analyst we spoke with. Combine these factors with the low leverage nature of the industry (77.5% debt-to-equity ratio); financial health of the sector remained sound.

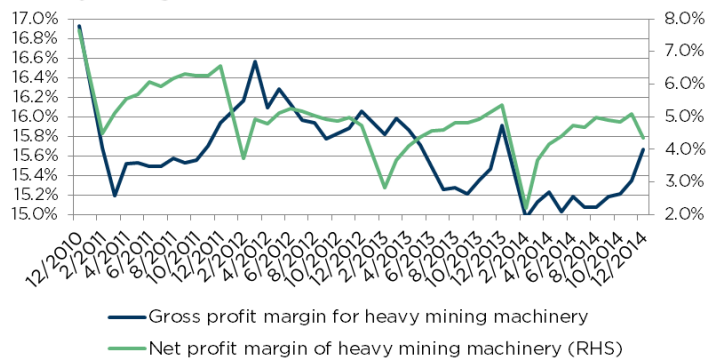
Electronic integrated circuit exports



Source: Coface, CEIC data

For the heavy mining machinery sector, sector performance was mixed in 2014. While leverage of the industry participants remained generally stable compared to 2013 (i.e. 153% in 2013 vs. 144% in 2014), net profit margin is estimated to have declined to 4.3% for 2014, compared to 5.3% in 2013. The lowered profitability is led by various factors, headlined by the lower demand of these products as a result of weaker commodity demand driven by lower investment growth in China. While upside to the demand of these machineries may be limited, the sector may see stabilization of profitability around current level, as investment growth is expected to stabilize in 2015 after the continuous slowdown in recent years (e.g. 23.8%YoY in 2011 vs. 15.7%YoY in 2014).

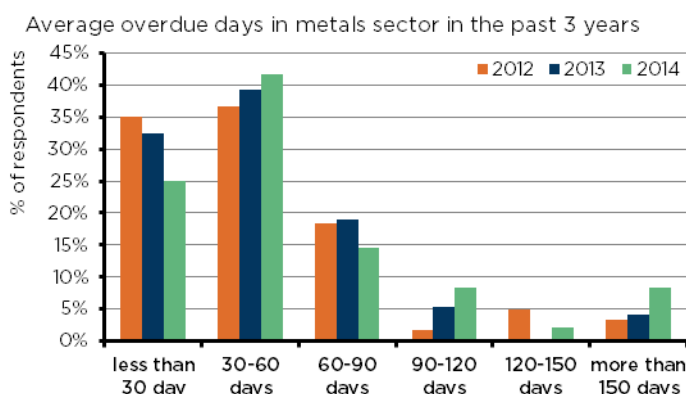
Heavy mining machine manufacturer



Source: Coface, CEIC data

### Metals - Clouded by overcapacity issues, as always

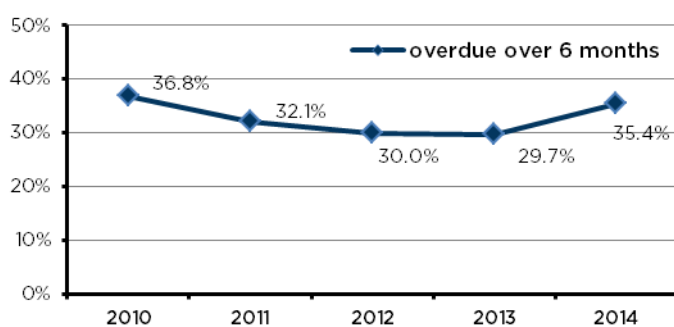
For the metals sector in China, business environment remained challenging in 2014. On average, 24.6% of the respondents shared that the credit term extended to customers was over 60 days; 17.7% and 10.3% of the respondents shared the same experience in 2013 and 2012, respectively. Overall overdue period also extended to the long end in 2014 comparing to previous years. 1.8.8% of the respondents said that the average overdue period was longer than 90 days, while 9.5% and 10% of the respondents experienced such experience in 2013 and 2012, respectively.



After a slight drop in reports of ultra-long overdue weighing on companies' balance sheet in 2013 for the metals industry, there is an obvious pickup in the report of such issues in 2014. 35.4% of the respondents experienced that ultra-long overdue (i.e. 180-days or longer) weighed more than 2% of their annual turnover. Such issue is by no means to be neglected, as that could potentially lead to rising write-offs of the companies' assets.

The metals sector saw "very high risk" as shown in our last report.<sup>16</sup> The fundamentals of the metals industry remain unpromising in the near-future, but there may be slight improvement to come.

% of companies in metals sector having more than 2% of their domestic/export sales in overdue



Take the steel industry as an example. Supply side is set to benefit from some improved conditions, with the State Council poised to impose stronger effort to eliminate the overcapacity situation through accelerating the elimination of outdated production capacity. Coface expects a target of 40 million ton production capacity removal in 2015, compared to the 26 million ton capacity ousting announced in early-2014. The Xi-Li regime appears to be quite effective in the implementation of policy, and the continuation of the effort would help the rebalance of the overcapacity situation. With the less dynamic investment sentiment in the sector in the last 2 years, the most severe phase of production capacity expansion should be behind us and should lead to healthier supply outlook in the medium-term.

While some may argue that the government to export its overcapacity to other countries through the development of the "Belt and Road Initiative"<sup>17</sup> (BRI), it may be slightly too early to see the materialization of such intension. The assumption that many of China's neighbors - particularly those in Asia - would need to invest heavily on infrastructure as they would need to further develop their competitiveness in the manufacturing sector is valid, as suggested by the logistics performance index (LPI) developed by the World Bank.<sup>18</sup> However, the production capacity of China's steel mills are way beyond what the other countries can absorb.

	LPI	World Rank
Thailand	3.31	31
India	3.07	39
Indonesia	3.01	43
Vietnam	2.89	53
Pakistan	2.62	68
Bangladesh	2.47	87
Laos	2.25	117
Kazakhstan	2.12	133
Mongolia	2.08	136
Myanmar	1.86	147

Source: World Bank

Take what Hebei Steel suggested in September 2014 as an example: by forming a joint venture with South Africa's Industrial Development Corp. (IDC), the JV aims at producing 5million metric tons of steel per annum by 2019. While a steel mill with 5million ton annual production capacity is quite common in China, the intended production capacity of the new JV alone already represents over 60% of the existing annual production of the country. Although the steel demand in the country could escalate during the next few years, such explosion of production capacity could not be absorbed easily. As such, the BRI remains a "possible" solution to the overcapacity situation in China at best.

Crude steel production 2014	
European Union (28)	169,243
South America	45,201
South Africa	7,210
China	822,700
India	83,208
<b>Total 65 countries</b>	<b>1,636,960</b>

Source: World Steel Association

<sup>16</sup> Tung (September 2014) China: Carrot-and-stick, Coface Panorama

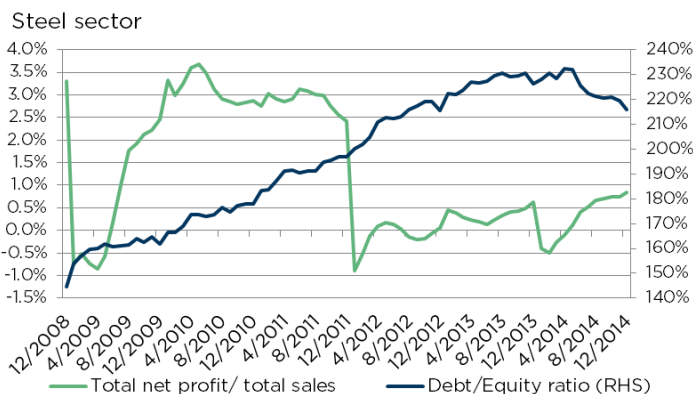
<sup>17</sup> Xinhua: China's Initiative on Building Silk Road Economic Belt and 21<sup>st</sup>-century Maritime Silk Road

<sup>18</sup> According to World Bank's definition: "The LPI is based on a worldwide survey of operators on the ground (global freight forwarders and express carriers), providing feedback on the logistics "friendliness" of the countries in which they operate and those with which they trade"

On the demand side, as discussed earlier in the report, the construction sector – headlined by the property sector – could be stabilizing in 2015 after seeing major downward pressure in 2014. While the materialization of such assumption remains unknown and that could mean ambiguity of outlook for the steel sector, the improvement in construction industry would certainly be positive news; after all, property and infrastructure represents over 50% of steel demand in China, and the demand outlook is set to improve should these sectors see better support.

While the rapid demand growth from the property market may be behind us, the acceleration of infrastructure investment plan may boost demand of steel products (e.g. long steel) in early 2015. Bloomberg and the other local media reported in early-January that the government is ready to speed up the progress of RMB7trillion-worth of investment on infrastructure.<sup>19</sup> These projects are already planned – thus it should not be seen as added stimulus. The accelerated implementation should provide more confidence in investment for the private sector, including property developers.

With the demand of other key downstream components (e.g. machineries, appliances, automobiles, and shipbuilding) also expected to be stabilizing, supply-demand equilibrium should improve slightly in 2015. Such development would likely be beneficial to the profitability of the industry, if input prices stabilize as well.

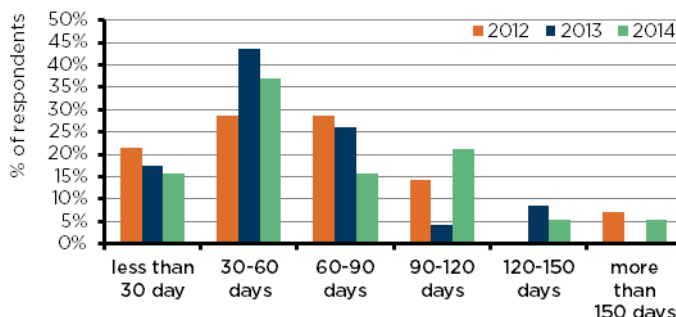


Source: Coface, CEIC data

### Paper-wood - Not getting paid

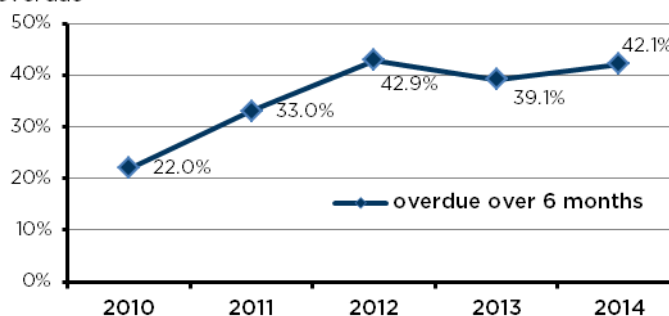
Payment experience in the paper-wood industry has deteriorated in 2014 comparing to a year ago, particularly dragged by extended overdue experience. Average credit term offered in the paper-wood industry has been stable, with 40% of the companies sharing that it averaged 90-days or above (40% in 2013). Yet, there is rising pressure on the length of overdue, where 31.6% of the respondents shared that average overdue was longer than 90-days, comparing to the 13% in 2013 and 21.4% in 2012.

Average overdue days in paper-wood sector in the past 3 years



Ultra-long overdue continued to be a factor underwhelming the paper-wood sector, with 42.1% of the respondents in the sector shared that 180-days-or-longer overdue weighs more than 2% of the annual turnover of the company. While Coface’s experience shows that 80% of these ultra-long overdue would not be paid at all, such trend adds worries to the sector, on top of the other fundamental weaknesses.

% of companies in paper-wood sector having more than 2% of their domestic/export sales in overdue



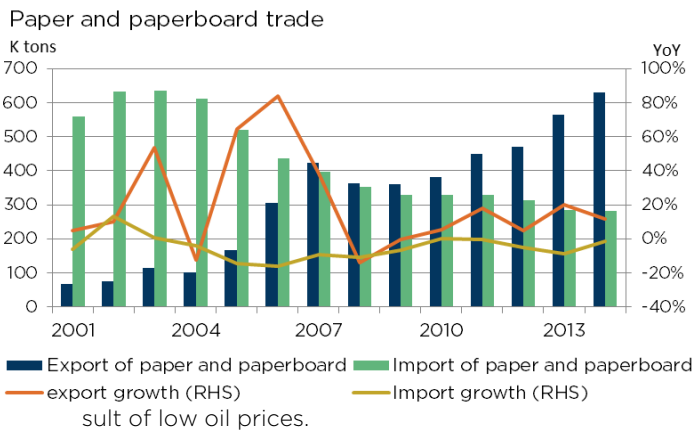
Net profit margin of the Chinese paper-making industry has deteriorated from 5% in 2013 to 4.5% in 2014, while leverage has remained largely stable (e.g. debt-to-equity ratio of 131% and 132% in 2013 and 2014, respectively). The margin squeeze was driven by the usual suspects of rising costs and slower demand growth in the country, which were felt by many industries across the board.

Demand of different subsectors would vary, but for the containerboard, it is largely driven by export demand. With evidence coming from recent export figures (i.e. -3.3%YoY in January 2015), demand may be dragged. Similar trend is expected to continue, as buyers would continue the trend of sourcing from the other lower cost countries for manufacturing products.

Notwithstanding the recent trend of containerboard manufacturers, the overall paper demand should still continue to grow modestly in the near future, as a result of the export demand. As demonstrated in the

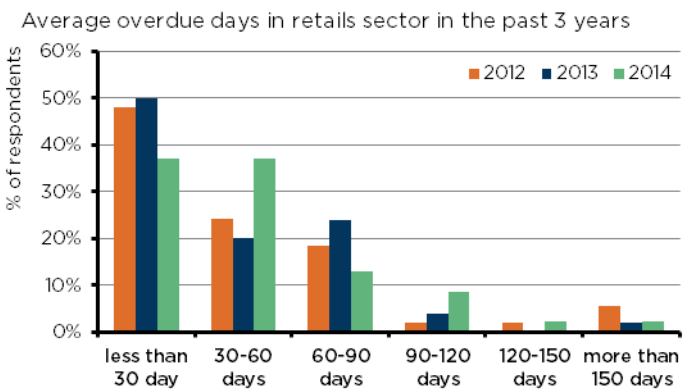
<sup>19</sup> Bloomberg (January 2015) China Said to Accelerate \$1 Trillion in Projects to Spur GDP

chart below, while import growth of “paper and paperboard” continued to be in negative territory in 2014 (i.e. -1.2%YoY decline), export growth remained strong (i.e. 11.6%YoY). It is illustrative of an emerging trend that Chinese paper products – and its oversupplied nature – may begin to overwhelm producers in neighboring economies (e.g. Japan, Korea) especially when cost of transportation is relatively low as a re-



**Retail - Weakened consumption demand growth**

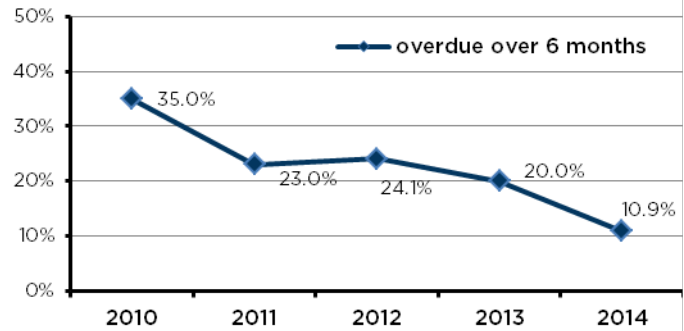
Average credit term offered by companies in the sector are stable over the last few years; 89.5% of the respondents shared that average credit term was 60-day or below, compared to the 87.9% and 90.0% in 2013 and 2012, respectively. But the average overdue situation has seen some sign of deterioration. 13% of the respondents said that their average overdue period was 90 days or above, notably higher than the 6% and 9.3% in 2013 and 2012, respectively.



While average overdue period has lengthened as suggested above, the overall impact by ultra-long overdue is still manageable for the participants in the retails sector. Only 10.9% of the respondents shared that 180-day-or-longer overdue weighs over 2% of their annual turnover, indicating that such ultra-long

overdue is generally not a big issue for the industry for the time being.

% of companies in retails sector having more than 2% of their domestic/export sales in overdue

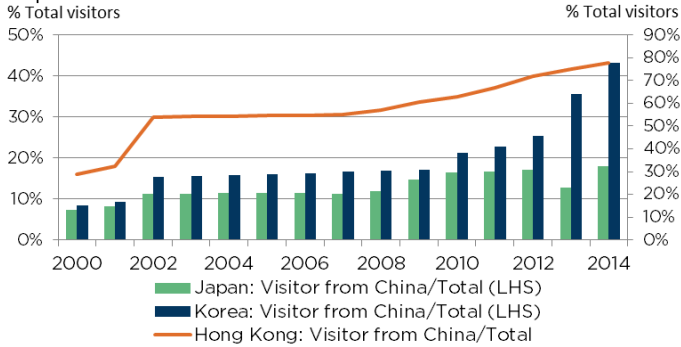


Despite the high hopes on consumption taking over the driver-seat of the Chinese economy, such scenario may not be materializing in the near-future. With nominal income growth in urban household slowing to the lowest level in over a decade to 7%YoY in 2014 – after breaking the double-digit mark for the first time in 2013 (i.e. 9.7%) – it is unlikely that consumption would see robust upward momentum in the near-term. In addition, the positive and hiking positive real interest rate (i.e. nominal deposit rate minus inflation) lowers the incentive to invest and consume. According to the “Bankcard Consumer Confidence Index” provided by China UnionPay, consumer confidence is at the lowest level (82.56) as of December 2014 since the data was introduced in 2010. These trends are the obstacles of a significant breakthrough in the consumption story in China.

In our casual and regular, but non-scientific, contact with consumers in China, the general sentiment on consumption – particularly high-end luxury items in China – is rather conservative. We believe that consumption of luxury items will be constrained. Many of the people we have contacted shared the view that they are becoming less-likely to increase their spending on luxury items (with the exception of automobiles) in the country, partly because of the increasing affordability (e.g. strength of RMB against Japanese Yen, Euro), accessibility (e.g. easier visa application process, increase in visa-free countries for Chinese passport holders<sup>20</sup>), and tax incentives (e.g. VAT-free in Hong Kong, tax rebate for purchases in Eurozone and Japan) to travel and go on a shopping spree in other economies. Indeed, Chinese visitors now represent a major portion of total visitors in Korea, Japan, and some European countries, which could help boost retails sectors in those markets. On the flip side, continuation of such development would be negative to domestic high-end retails sector in China.

<sup>20</sup> China Daily (October 2014)

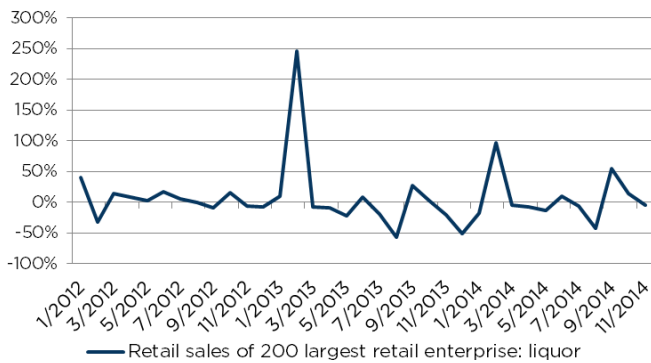
Impact of Chinese visitors felt in other economies



Source: Coface, CEIC data

Moreover, the continuous effort of the anticorruption scheme is also a driver of the less-luxurious spending culture. The impactful effort to fight against corruption in the country began as the President Xi Jinping and Premier Li Keqiang took office in March 2013, and has impacts on different industries, including restaurants and alcohol makers. For the latter, the impact on alcohol consumption is felt deeply as the government tackles extravagant spending, with 13 out of 19 months between March 2013 and September 2014 seeing year-on-year decline of retails of liquor. Such declining trend may see an end in 2015 - in year-on-year term - with the sales of alcohol having decreased by 19% comparing the 3-months ending November 2014 and the 3-months ending November 2012.

Sales of alcohol impacted by anti-corruption scheme

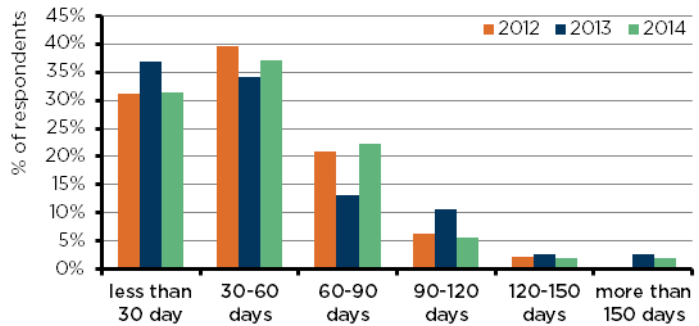


Source: Coface, CEIC data

**Textile-clothing - Bitten by rejuvenated competition and climbing costs**

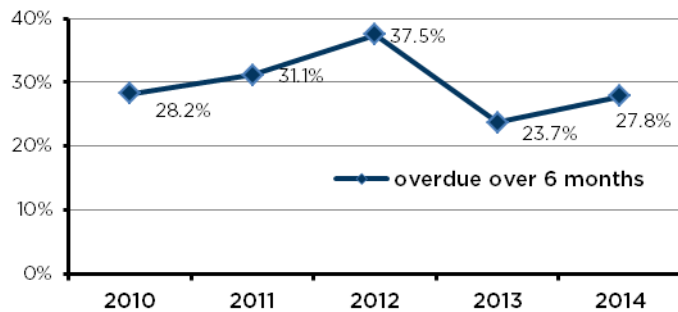
The credit cycle, as reported by participants, of the textile-clothing industry is largely stable. While 5% of respondents shared that average credit term was longer than 90-days (none in 2012 and 2013), the average overdue period has been largely stable comparing to earlier years. 9.3% of the respondents shared that the average overdue period was 90-days-or longer, comparing to the 15.8% in 2013 and 8.3% in 2012.

Average overdue days in textile clothing sector in the past 3 years



Yet, issues related to ultra-long overdue payment has picked up somewhat in 2014, comparing to 2013. 27.8% of the respondents shared that ultra-long overdue weighs more than 2% of the companies' annual turnover; only 23.7% of the companies shared the same issue in 2013. While the pickup is not dramatic, the situation could become worse if competition rises for the industry.

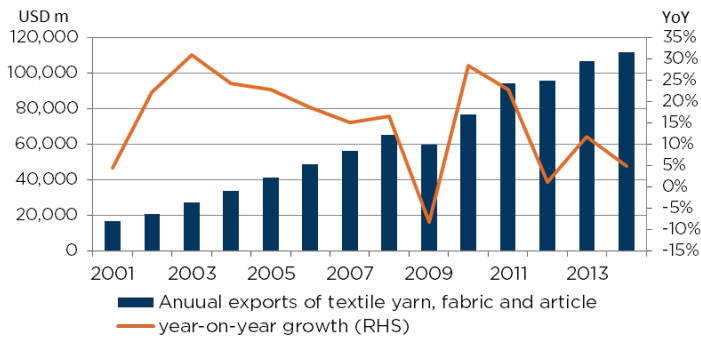
% of companies in textile clothing sector having more than 2% of their domestic/export sales in overdue



Leverage of the textile industry was rather stable during 2014, while profitability slightly declined. With debt-to-equity ratio continued its downtrend throughout the year and recorded 117% as of November 2014 comparing to 126% in 2013, the net profit margin is estimated to have declined to 4.8% in 2014 from 5.2% in 2013. The lower profitability is likely related to the less dynamic export market for the Chinese textile industry. While it still registered positive growth in 2014, export demand only grew 4.8%YoY, while costs were also on the rise. Such trends were likely contributors to the margin pressure.



Lower export growth of textiles in 2014



Source: Coface, CEIC data

In terms of industry outlook, while near-term outlook is challenging, like the others, as a result of the lower-but-still-high pressure on rising cost, medium-term development would rely on the return on investment in innovation, research and development, which is designed to back up the cost factors (e.g. environmental, labor, rental) in China. In our discussion with industry participants, it was mentioned in different conversations that the industry has been investing in machineries with better technology that focus on improving the quality, durability and functionality of the products. For instance, in a recent conversation with a Guangdong-based manufacturer, who was introduced to “water-free dyeing”, we were told that such technology would allow the traditionally polluting process to be more environmentally friendly (e.g. lower water usage and contamination). Together with the other disruptive technology and logistical services that target at capturing the “soft-3-dollars”, medium-term development should be on the bright side.<sup>21</sup>

<sup>21</sup> Fung, Fung, and Wind (2009) *Competing in a Flat World: Building Enterprise for a Borderless World*. Wharton School Publishing.

## CONCLUSION

China's 7.4%YoY GDP growth in 2014 was the lowest growth rate in the last 24 years, while Coface's expectation of 7% in 2015 would be yet another record. At the same time, the real economy in China is facing rising challenges in 3 major areas: 1) high leverage; 2) high cost of financing, 3) low profitability driven by overcapacities in certain sectors. Policymakers are addressing these issues proactively, and they are actively preventing the economy from falling off a cliff. The interest rate cut in November and RRR cut in February - as well as the targeted stimuli introduced throughout the year of 2014 - are designed to provide a buffer for the challenging economic environment and tight liquidity situation expected in 2015. Nevertheless, if the additional low-cost funding is not delivered to the parties that need and deserve it, the main purposes of such monetary easing measures are likely going to be defeated, and further concerns on credit pressure would be in sight.

With 80% of the respondents shared overdue experience (i.e. stabilized in 2014) and 56.7% of them saw an increase in overdue amount over the past year (i.e. deteriorated in 2014), the overall payment experience in China remained very challenging in 2014, after absorbing some strong headwinds in 2013. Although risk and credit managers seemed to have become more prudent in 2014, more respondents shared that the overdue amount they were owed tended to have increased. Moreover, a higher percentage of respondents said the average overdue period have been longer than 90-days. This is in-line with the non-performing loan figures released by the China Banking Regulatory Commission, which showed that NPL ratio has reached a multi-year high of 1.25% as of the end of 2014. The risk of rising non-payment cannot be neglected.

We examined 9 major sectors in the Chinese economy based on payment experience, using indicators including average credit terms, average overdue days and large-sized long-overdue payments' weighting on their aggregate sales to take a snapshot on the sectors. Besides payment experience from the payment survey, we use net profit margin as a broad-based indicator to examine the ability to generate operating

cash flow by different sectors; we also use changes in debt-to-equity ratio to monitor owners' stake in the companies so to see potentials of runaway payments. Key findings are as below:

Sector	Payment experience vs. 2013	Financial performance vs. 2013 (subsector)
Automotive and transportation	Improved	Improved
Chemicals	Deteriorated	Deteriorated
Construction	Deteriorated	Deteriorated
Household electronics	Improved	Slightly deteriorated (Computer machine)
Industrial electronics	Stabilized	Improved (Semi-conductor) Deteriorated (Heavy mining machinery)
Metals	Deteriorated	Stabilized
Paper-wood	Deteriorated	Deteriorated
Retail	Deteriorated	N/A
Textile-clothing	Similar	Slightly deteriorated

Source: Coface

With the economy slowing down, industry participants would need to adapt to slower demand growth in general and dedicate to find new growth drivers. With the high debt level in China, there is an essential need for the cost of financing to come down. In practical term, when net margins of the manufacturing industries average some 3-5%, the >15% cost of financing (as shown by Wenzhou Private Lending Registration Service Center) might severely hurt the corporate sector. With signs of deterioration in both payment experience and financial performance, risks in chemicals, construction, and paper-wood sectors are on the rise, while the metals sector remains as an origin of worries in China.

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#### RESERVATION

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29/F, @Convoy  
169 Electric Road, North Point  
Hong Kong

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