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FOR SAFER TRADE

REALITY CHECK: CORPORATE PAYMENT TREND AND SECTORIAL RISK IN CHINA

February 2014

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By Rocky Tung
Economist, Asia Pacific

REALITY CHECK: CORPORATE PAYMENT TREND AND SECTORIAL RISK IN CHINA

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The overall payment experience in China has deteriorated in 2013 comparing to 2012. Key messages from the China Payment Survey are:

- Average credit terms extended in China has become longer comparing to 2012
- Maximum credit terms has generally been lengthened in 2013 comparing to 2012
- Overdue situation has also become more common in 2013 comparing to 2012, with a rising concern of management
- A higher percentage of respondents told us that the average overdue-period has been lengthened
- 45% of the respondents told us that they have seen an increase in overdue amount in 2013, comparing to the 56% in 2012

Besides payment experience as reflected in the China payment survey, we also use debt-to-equity ratio and profitability of industries to take a quick look at the healthiness of various industries in the Chinese economy. Key takeaways from our study of various industries are as below:

Sector (subsector)	Payment experience (vs. 2012)	Financial performance ¹ (vs. 2012)
Automobile	Slightly improved	Similar
Building and construction	Slightly improved	Improved
Chemicals	Deteriorated	Similar
Household electronics - computer machine	Deteriorated	Slightly deteriorated
Household electronics - health and beauty		Similar
Industrial electronics - electronics part	Slightly deteriorated	Slightly improved
Industrial electronics - heavy mining machinery		Slightly improved
Industrial electronics - computer parts		Deteriorated
Paper and printing	Similar	Similar
Steel	Similar	Similar
Textile	Similar	Similar

Source: Coface

Deteriorated payment experience reminds us of the credit risk in China. Traditionally speaking, smaller companies in China do not necessarily get enough credit facilities from the regular banking system and such issues are the main driver of the shadow banking system² development in China. While we are expecting cost of fund to point higher in 2014, interest rate in the shadow-banking system is already high. An increasing trend of overdue payment adds weights to liquidity management of different stakeholders in the supply chain, and the vicious cycle could lead to significant ripple effect.

While hiking labor cost and RMB appreciation could be the headlined stories in the news, they are by far not the most concerning factor for business practitioners in China. When asked about what the most affecting factors are for 2014, the potentials of economic slowdown in China and credit tightening are namely the top two worries, according to our survey respondents.

(1) Leverage and profitability

(2) Non-bank financing system includes, but is not limited to, trust loans, banker's acceptance note, bond financing, non-financial firms' equity financing

1 / SURVEY BACKGROUND AND CREDIT MANAGEMENT PRACTICE IN CHINA

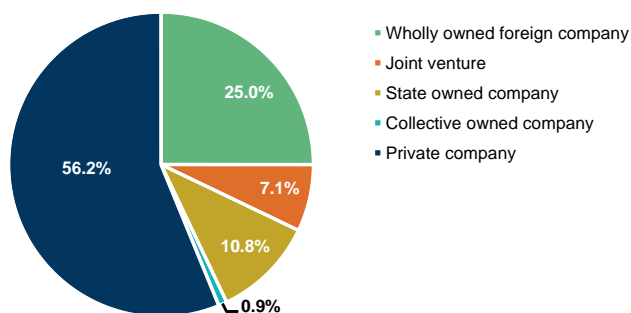
As a leading credit insurer in the Asia-Pacific region, Coface conducts a wide-range of economic and industry studies to provide our clients with the most up-to-date information with on-the-ground insights. Among the others, payment survey has traditionally been a key point of reference for us to we utilize different macroeconomic and microeconomic indicators to analyze the business environment.

The payment survey gives us insights on what happened to the credit experience in various companies in the Chinese economy. Particularly, the payment survey allows us to understand the general status of corporate credit management practice and experience in Mainland China. Reflected in the responses of the survey, we can have a better understanding of China based companies' payment experience and the trend of domestic trade in Mainland China.

Coface has been conducting the China Payment Survey in China since 2003, and the 2013 survey is the 11th edition. Survey data is collected and cleaned up by Coface's marketing team based in Shanghai. Data collection period was between October and December 2013. During the period, the survey questionnaire was sent out to numerous companies. By mid-December, we have received valid responses from 956 companies.

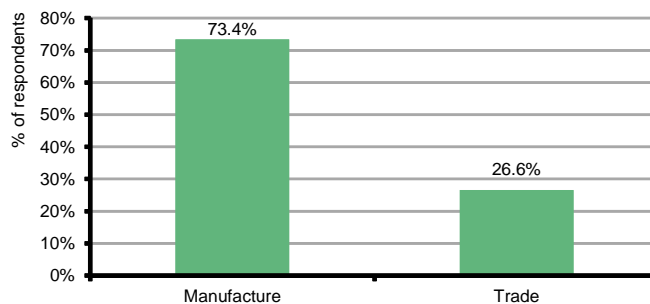
Among the 956 surveyed companies, private companies and wholly-foreign-owned companies were the major respondents, representing 56.2% and 25% of the surveyed companies, respectively. State-owned enterprises (SOE) represent 10.8% of the sample size, with the remaining 0.9% of respondents being joint-ventures.

Nature of companies interviewed



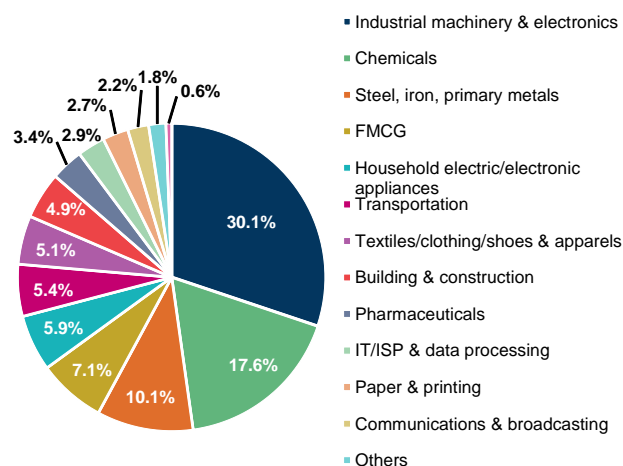
Among the 956 valid respondents, 702 (or 73.4%) of the companies are manufacturers and 26.6% of them are engaged in merchandise/commodity trading businesses.

Main business activity of company interviewed



These survey respondents are engaged in a diverse group of industries, while the largest groups are industrial machinery & electronics (30.1%), chemicals (17.6%) and steel, iron & other primary metals (10.1%).

Sectors of interviewed companies



Credit management practices

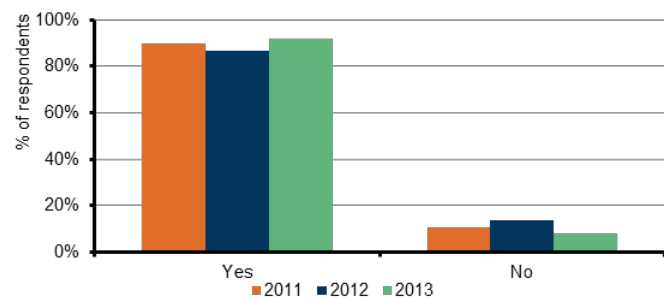
As represented in the survey, credit sales have gained popularity in 2013, after taking a dip in 2012. 91.8% of the surveyed companies responded that they have offered credit sales during the year, comparing to 86.5% in 2012.

Payment default risk is an aspect we have to watch out for in credit sales and the respondents have indicated what the most effective actions are in case of non-payment. “Amicable negotiation on repayment schedule”, according to the 82% of the respondents, is the most effective action in such cases. We assume that the importance of guanxi (relationship) in Chinese business culture could be a major reason of such findings, as Chinese business practitioners tend to believe that “all problems can be solved with good relationships”.

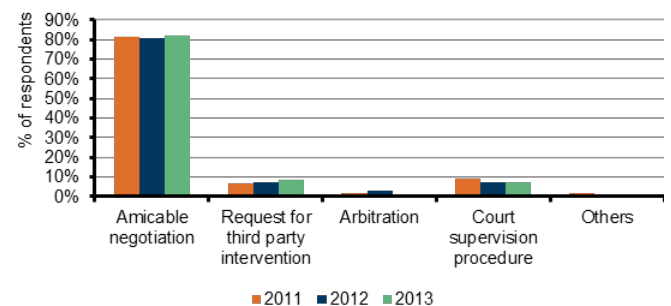
While more people believe amicable negotiation has become the most effective action in case of non-payment, arbitration was only considered by 0.6% of survey respondents as the most effective action.

A higher percentage of respondents told us that they are using credit management tools in light of potential issues arising from credit sales. 60.8% of the respondents told us that they have use some forms of credit management tools, increasing from 58.4%. Chinese companies have indicated their preference of credit management tools used in the business operations. The most common tool used are credit reports and recommendations provided by credit agencies, as 38.7% of the respondents told us that they have been using such products. Moreover, credit insurance, debt collection and factoring have also gained popularity in China comparing to 2012.

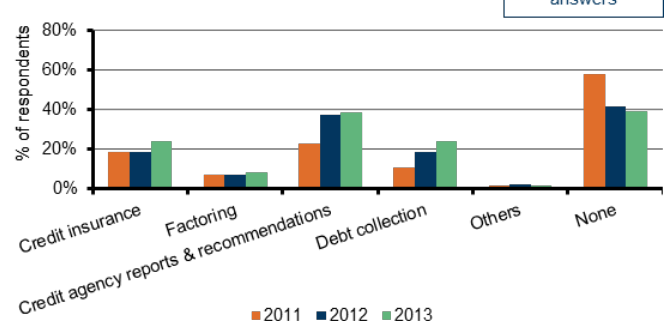
Whether the interviewed companies offered credit sales in their domestic sales



Most effective action in case of non-payment



Popularity of credit management tools used



2/ CREDIT SITUATION SUGGESTED BY THE SURVEY

Looking in to Coface China Payment Survey 2013, the overall payment experience in China has deteriorated in 2013 comparing to 2012. Key messages:

- Average credit terms extended in China has become longer comparing to 2012
- Maximum credit terms has generally been lengthened in 2013 comparing to 2012
- Overdue situation has also become more common in 2013 comparing to 2012
- A higher percentage of respondents told us that the average overdue-period has been lengthened
- 45% of the respondents told us that they have seen an increase in overdue amount in 2013, comparing to the 56% in 2012

Lengthened average credit terms

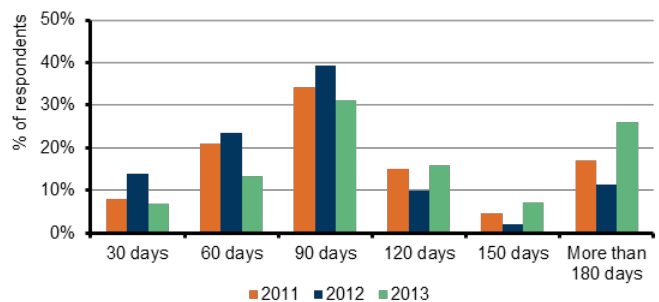
Suggested by the payment survey, in general, credit situation has worsened slightly comparing to the year before. Among the companies that did offer credit sales, most of them (about 68.3%) responded that the average credit terms offered was no more than 60 days, which is around what is expected in an ideal business situation. Such figure, however, has declined significantly from the 79.7% as we have seen in 2012; in other words, more companies have seen the average credit terms expanded during 2013. Particularly noteworthy, among companies that offer credit sales, 11.4% of the companies saw average credit terms of 120 days or longer, comparing to 5% only in 2012.

Albeit not extremely alarming, the increase in the length of credit terms could be an indication of higher potentials of seeing liquidity pressure.

Longer maximum credit terms seen

In-line with the situation suggested by in the average credit terms, maximum credit terms offered has slightly deteriorated during the year. Almost 50% of the respondents told us that they have seen credit terms that was at least 120-days long. According to the survey, 15.9%, 7.1%, and 26.1% of the companies reported that the maximum credit terms offered to their clients was 120-days, 150-days, and 180-days or above, respectively. These figures have jumped quite significantly from the 10%, 2% and 11.3% in 2012.

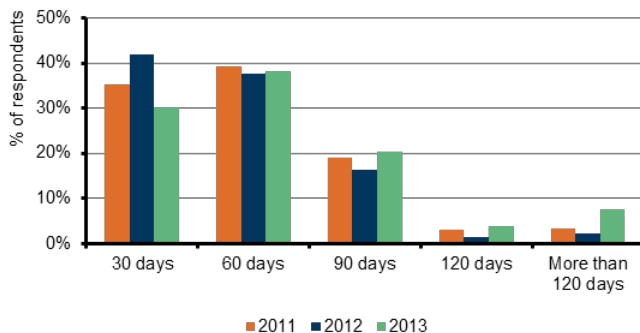
Maximum credit term offered to customers during last 12 months



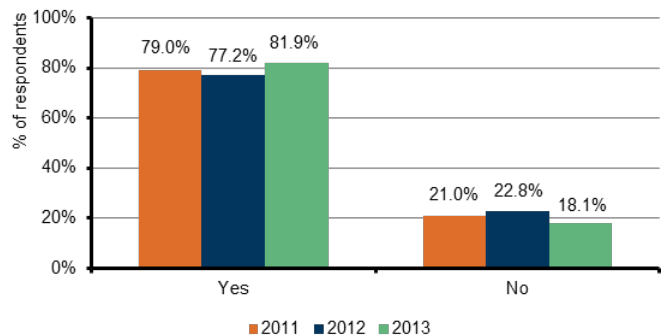
Overdue became even more common than before

Indeed, payment overdue has happened to more companies in 2013 as compared to previous years according to the survey. 81.9% of the companies that have used credit sales experienced overdue payment in 2013, as compared to the 77.2% in 2012. Key reasons are customers' financial difficulties (52.5%) and customers' management problems (23.5%). The 5 point increase is a red flag that the payment experience in China has deteriorated during the course of 2013.

Average credit term offered in domestic sales



Overdue in domestic sales



Average overdue-period has also grown

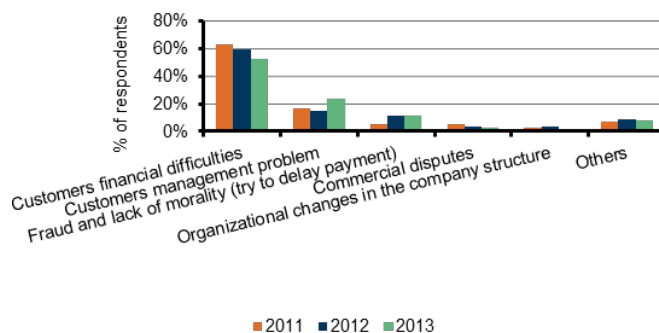
Similar to what we have observed over the last few years, the majority overdue in 2013 was within in 90 days, which has shown a fairly steady trend since 2011. However, as we can see from the chart below, the length of overdue periods the companies faced have also established an increasing trend. In 2013, 17.8% of the companies who experienced overdue payments have seen average overdue days beyond 90 days; such figure was 12.6% in 2012 and 11.2% in 2011, respectively. The differentials between 2013 and 2012 would be widened if we consider overdue payments that exceed 60 days (i.e. 38.2% in 2013 and 31% in 2012).

As a general rule of thumb, the longer the overdue period, the riskier the receivable would become. What the average overdue days is revealing is that, generally speaking, companies had to wait longer for them to receive payments from their customers, provided that the customers had not paid on time in the first place.

Corporate management remains as a concern

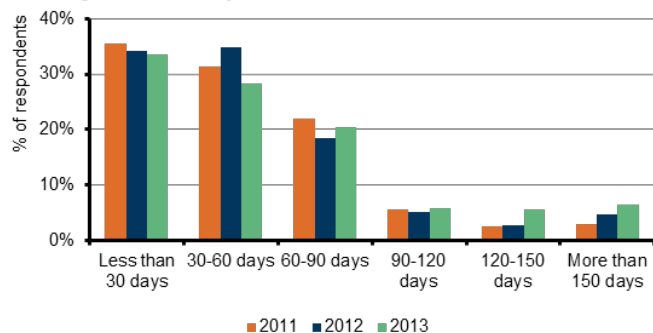
While it remains as a key reason, only 52.5% of the survey respondents told us that overdue payments were mainly caused by customers' financial difficulties, comparing to 52.2% in 2012, while an increasing share of respondents (23.5% in 2013 vs. 14.6% in 2012) shared with us that customers' management problem was a main reason driving overdue payments. While such finding is not alarming, it does remind us that corporate management - and perhaps, governance - remains as a key concern for business operations in China.

The main reason of overdue account



From the survey, it is observed that corporate payment experience has deteriorated in 2013 comparing to 2012. It is, however, believed that experience has diverged among, or even within, industries. Such trends will be discussed in the next section.

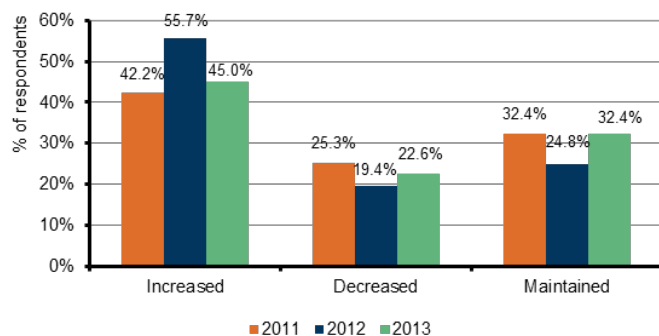
Average overdue days of domestic sales



Close to half of the respondents saw an increase in overdue amount

With slight improvement - in terms of growth rate - comparing to our 2012 survey result, "only" 45% have reported that overdue amount they have experienced during 2013 has increased on a year-on-year basis, with an increasing share of respondents telling us that the overdue amount has largely remained the same.

Trend of overdue amount



3 / INDUSTRY ANALYSIS AND PAYMENT EXPERIENCE

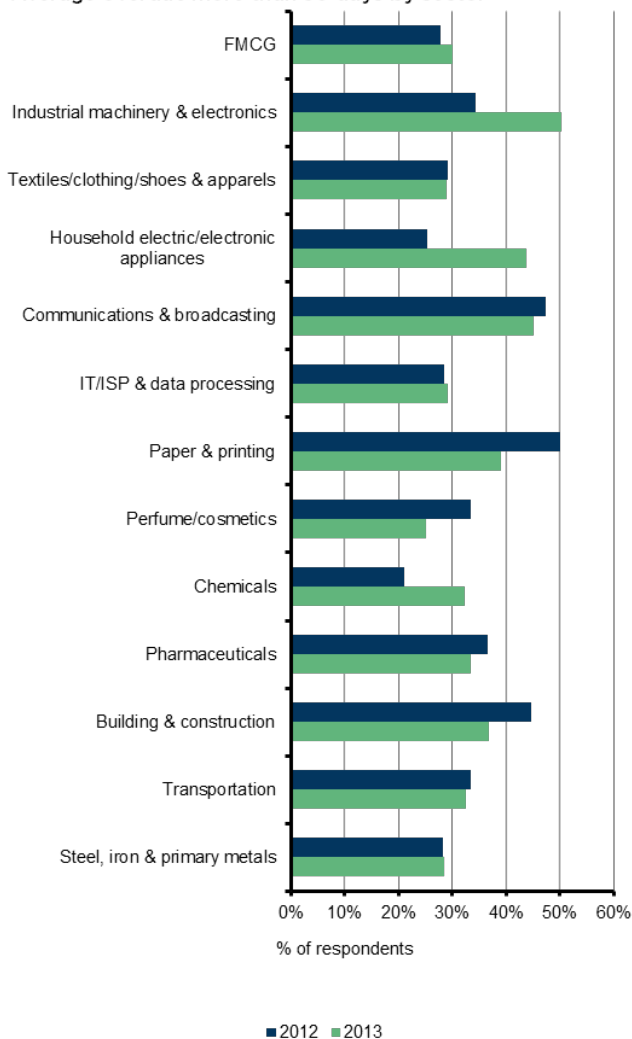
As defined in our latest Panorama China, 2014 is a Year of Divergence for the Chinese economy.³ On one hand, headline economic growth will remain relatively stable (see section 4), while certainly industries would see hiking pressure. In this section, we utilize our survey result to see if it had been the case of 2013 and what we could expect for 2014.

As we can see from the following charts, besides 2 sectors - paper and printing, and building and construction - that have reported obvious improvement, most of the industries in the Chinese economy have seen deteriorating in their payment experience in 2013. As reflected in chart below, there are an increasing percentage of industry participants reporting their average overdue-period extended in 2013, showing signs of deteriorating comparing to 2011. This is especially attention-worthy for 3 particular sectors: industrial machinery & electronics, household electric/electronic appliances and chemicals, which have seen increases of such situation by 16%, 19%, and 11% of respondents, respectively.

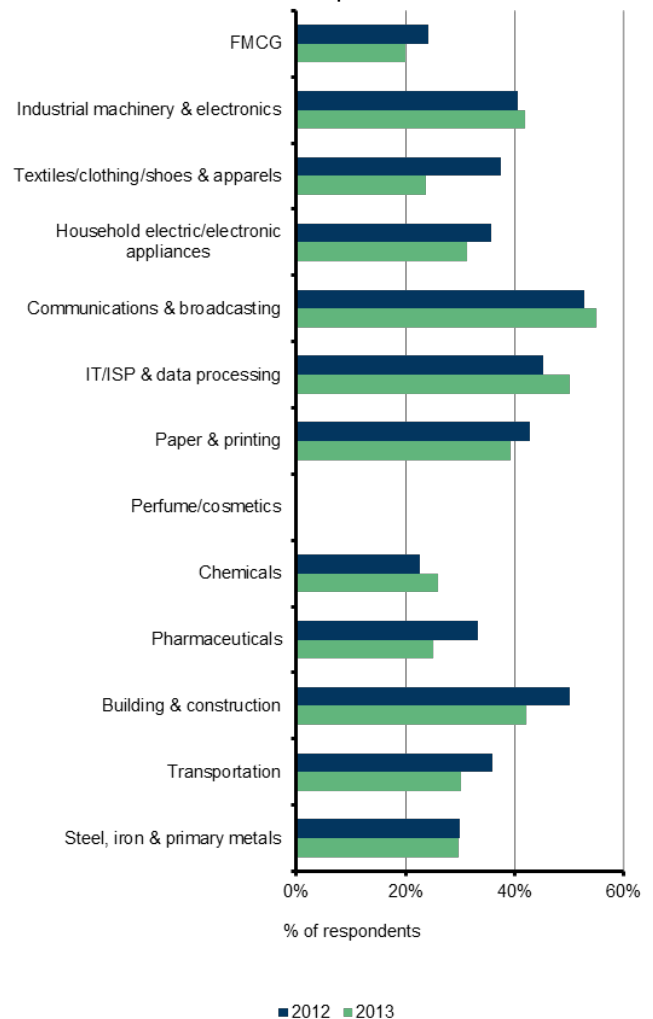
We usually consider payments that are 6-month overdue as highly risky. From our experience, there is an 80% chance for these overdue not to be repaid at all if they were not paid within 6-months. Moreover, if the amount of such overdue payment exceeds 2% of the total sales, it is believed that large-amount overdue payments are weighing on the liquidity of the companies. As such, we generalize that such industries are seeing increasing pressure in their debt collection practice, which could potentially lead to liquidity issues.

In this regard, we have seen at least some improvements in most of the industries tracked in our payment survey, except for industrial machinery & electronics, communications & broadcasting, and IT/ISP & data processing industries.

Average overdue more than 60 days by sector



Companies having more than 2% of their total sales in overdue over 6 months per sectors



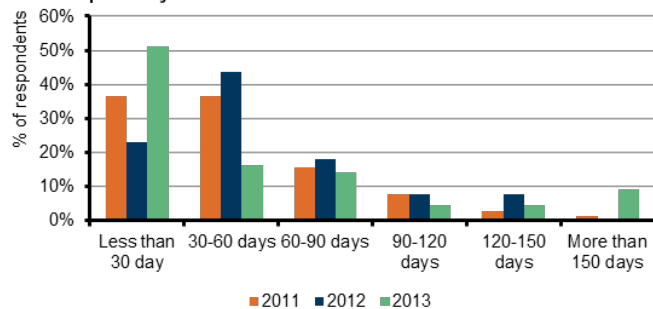
(3) Coface (January 2013)

In the following section, we will take a look at the survey results regarding the key sectors. These sectors are chosen due to their significance to the Chinese economy as well as to our business.

AUTOMOBILE - Slight Improvement in Payment Experience, But Weaker Demand Growth in Sight

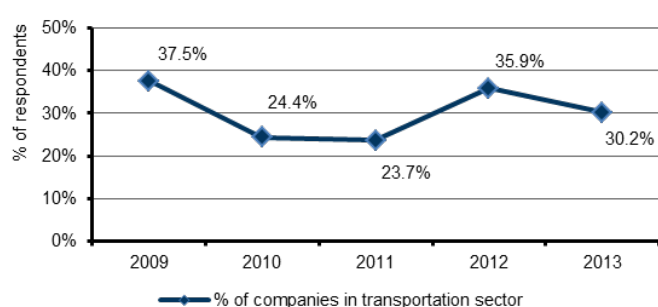
From the surveyed data, it is believed that credit payment experience has improved slightly during 2013 comparing to a year ago. Similar to 2012, about 72% of the respondents told us that average credit terms was less than 60 days (72.9% in 2013 vs. 72.6% in 2012). What triggered us to believe that credit situation has improved was that 51.2% (23.1% in 2012) of the respondents told us average overdue days in the sector was only less than 30-day-old. Nevertheless, we also noticed that 9.3% of the respondents did show us that they have seen average overdue days of over 150 days in transportation sector, which indicates that such companies could be facing problems in collecting their debts.

Average overdue days in transportation sector in the past 3 years



Only 30.2% of the respondents said that the 6-month-or-beyond overdue payments in their respective companies accounted for the more than 2% of total sales. It has shown improvement against 2012, but it is still about 6 percentage point above the 2010 and 2011 when the government has launched various supportive policies to boost consumption amid global economic slowdown.

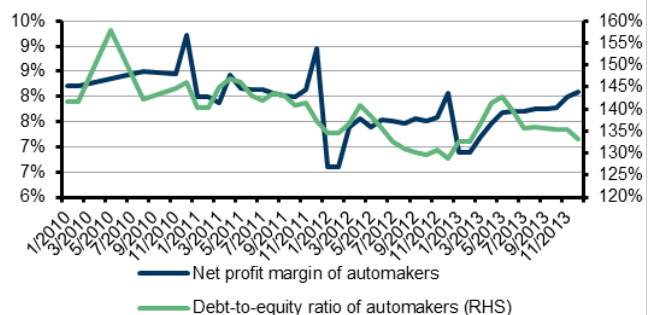
6-month overdue payment weighed more than 2% of domestic turnover



Combination of indicators from the payment survey showed us that there are slight improvements in terms of credit experience for auto companies.

Financial data shows that the automobile industry has remained largely the same comparing to 2012. Net profit margin has remained at 8.1% for 2013, exactly the same as 2012. Industry participants have not been leveraging extensively as well. While debt-to-equity ratio has temporarily been rising beyond 140% in May, the ratio has eventual come down to 133% for 2013, slightly above the 129% for 2012.

Profitability and debt-to-equity ratio of auto companies

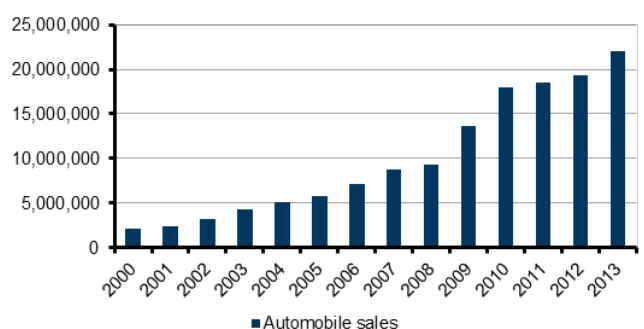


Source: CEIC, Coface estimates

Looking ahead in 2014, the automobile sector in China is expected to see stable development. On the demand side, while income and wage growth will remain as the key growth driver of demand of automobiles. Together with the government's intention to improve air quality, replacement demand of "greener" vehicles should lead to higher automobile demand in the medium term.

Nonetheless, downside risk to the sector persists. Vehicle purchase or registration restrictions in major cities would put a cap on auto demand. Moreover, while income is still expected to grow 9% in 2014, such growth rate is the lowest in more than a decade, and it could lead to slower growth rate in auto demand in the medium term. Last but not least, as we have flagged in the latest Panorama China, potential negative shocks would hit Japanese automakers in China should the Sino-Japan relationship intensifies.

Annual automobile sales

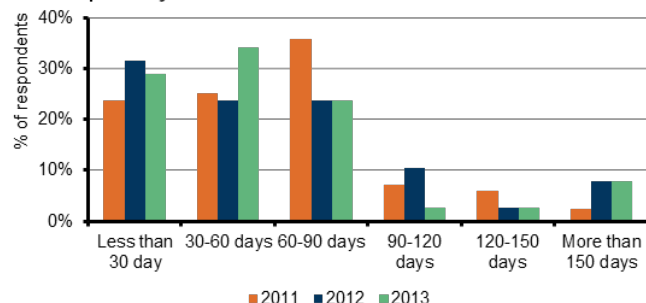


Source: CEIC, Coface estimates

BUILDING AND CONSTRUCTION - A Basket of Mixed Signals

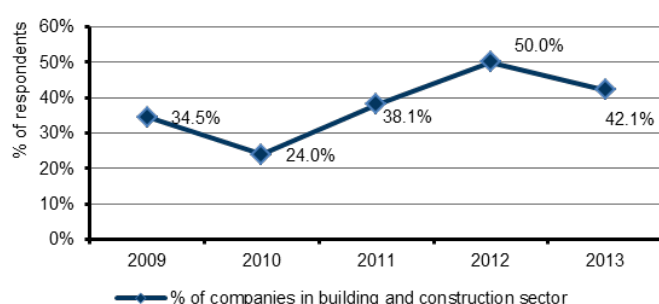
Reflected in the surveyed data, credit payment experience has shown an interesting development in 2013 comparing to a year ago. Comparing to 2012, more respondents told us that they have extended lengthier credit terms in 2013, with 31.1% of the respondents saying that average credit terms was 90-days and beyond, comparing to the 14% seen in 2012. On the other hand, average overdue days has somewhat declined comparing to a year ago, with only 13.1% of the respondents showing that their average overdue period was 90-days and beyond, comparing to the 21.1% in 2012.

Average overdue days in building & construction sector in the past 3 years



42.1% of the respondents said that the 6-month-or-beyond overdue payments in their respective companies accounted for the more than 2% of total sales. Whilst it has shown improvement against 2012, it is still staying at relatively high level, implying that construction quite a large percentage of construction companies are underwhelmed by large amount and long-overdue payments that would weight on the liquidity of these companies.

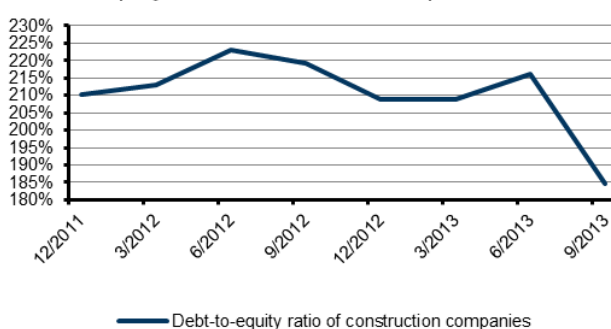
6-month overdue payment weighed more than 2% of domestic turnover



As of September 2013, profit margins for the construction sector remained largely the same as that seen in 2012, with gross and net profit margins maintained at 10.8% and 3.1%, respectively. An area

where we saw improvement in the construction sector was the development in debt-to-equity ratio, which has dropped from 220% in September 2012 to 185% in September 2013.

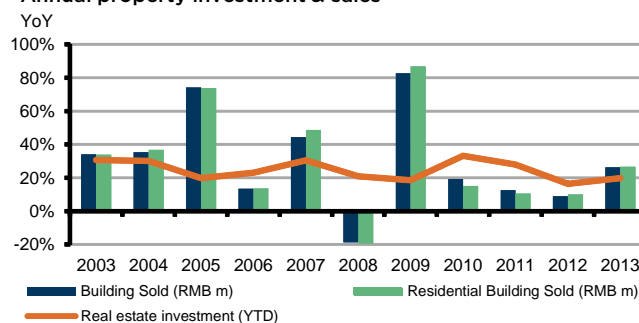
Debt-to-equity ratio of construction companies



Source: CEIC, Coface estimates

While the construction sector also includes various subsectors,⁴ the favorable development in the sector was likely a result of the development in the property development. In 2013, property sales reached RMB8.1 trillion, a historical high level and grew 26.3% YoY. As companies received payments from buyers, they have consequentially re-invested it in other projects, leading to record high real estate investment of RMB8.6 trillion in 2013, growing 19.8% YoY. At the same time, even though property prices have been increasing in most of the regions tracked by the government, the Xi-Li government has appeared to be more tolerating against such development comparing to its precedent.

Annual property investment & sales



Source: CEIC, Coface estimates

In our discussions with clients, we are often asked whether such production-driven growth would continue to add fuel to the asset bubbles and potentially leading to waste of resources. Particularly for our customers based outside of China, the reports of “ghost towns” definitely brought attention.

Nevertheless, the Chinese government uses

(4) Construction sector includes companies with functions of civil engineering, building construction, installation, fitting and decoration, etc.

urbanization as a means to achieve the goal of improving the standard of living of its people. Although it isn't an apple-to-apple comparison, income and quality of life should be correlated, and one of the parameters that the government watches closely is the big income differentiation between urban and rural households. While cash income in rural households grew relatively quicker than that in urban area in 9M2013 (12.5% vs. 9.3%), the difference in nominal income between rural and urban households have widened in the first 9 months comparing to 2012 (RMB14,441 per capita in 2013 vs. RMB13,412 in 2012) due to base effects. As such, it is sometimes argued that standard of living between urban and rural area has continued to polarize.

As a result of the government's aforementioned intention to bring higher quality of life to its people, urbanization will continue to take place. Although urbanization ratio of 52.5% has already surpassed the 51.5% target for the 12th Five-Year Plan by 2012, such ratio remains low comparing to the other countries (e.g. North Korea's urbanization rate reached 60.3% in 2011)⁵. The Xi-Li regime has named urbanization as one of the 2 key foci in economic development; construction sectors should continue to see stable demand growth in 2014, particularly from the less-developed regions in China.

Nonetheless, policy risk remains as the key ambient factor to construction sectors in 2014, especially in the more advanced regions in the country. Albeit the higher tolerance level of moderate price inflation, the current regime has indicated that asset inflation shall be prevented. Such rhetoric is indicative of the potentials of restrictive policy measures against property price inflation, more likely in developed regions like Shanghai and Beijing, where property prices have increased around 20% in 2013, far beyond the 9.6% income growth during the same period.

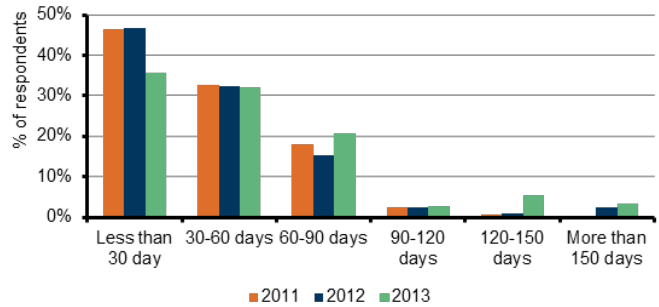
CHEMICALS - With Pick-up in Long-overdue, the Saturated Market Conditions May Not Help

In the chemicals sector, the overall payment experience has seen slight pick-up in longer term overdue payments. In general, consistent with previous years, over 90% of the respondents told us that average credit terms offered remained under 90-days (95% in 2013 vs. 98.6% in 2012). In 2013, however, 5% of the respondents shared with us that the average credit terms offered in the chemicals sector were either 120 days or beyond; such figures were only 1.4%

in 2012.

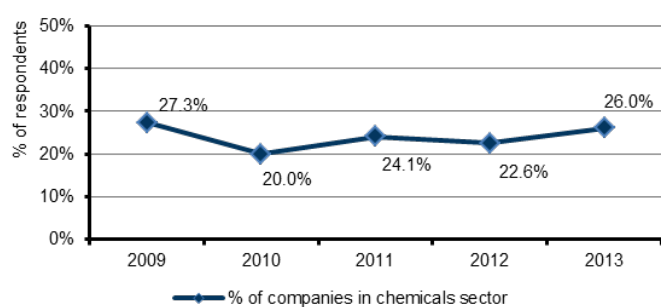
Consistent with average credit terms, there are also signs that average overdue days have slightly worsened in 2013. 11.6% of the respondents in the chemicals industry shared with us that average overdue days exceeded 90 days in 2013; only 5.6% of the survey respondents had faced such situation in 2012 and 3% in 2011.

Average overdue days in chemicals sector in the past 3 years



In-line with the trend as indicated above, we saw an increasing percentage of respondents telling us that the relatively long-overdue payments are weighting on their businesses. 26% of the respondents said that the 6-month-or-beyond overdue payments in their respective companies accounted for the more than 2% of total sales, picking up from 22.6% in 2012.

6-month overdue payment weighed more than 2% of domestic turnover



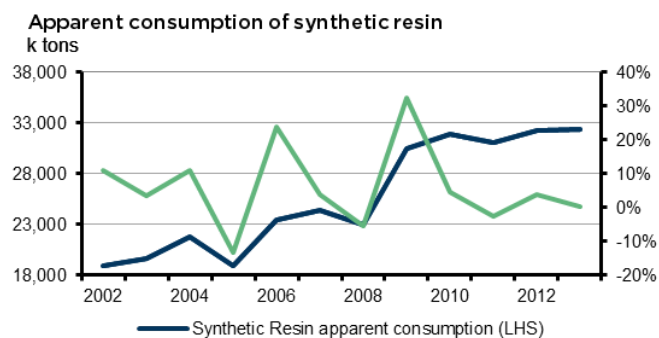
These indicators, combined, are suggesting that payment experience for industry participants in the chemicals industry in China. That could be related to the industry performances.

As there is a broad spectrum of products in the industry, it is difficult to generalize what is happening to the chemicals sector in general. In our following analysis, we pick up synthetic resin as an example.

One of the reasons leading to deteriorated payment

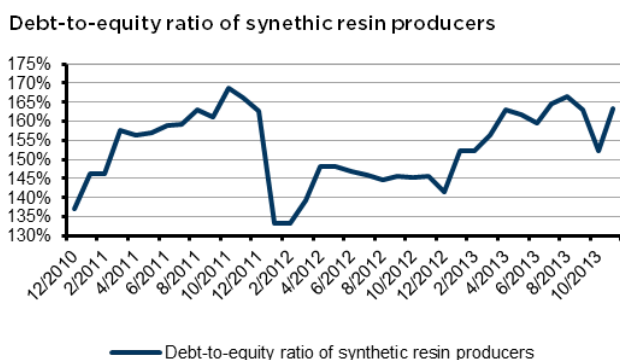
(5) World Urbanization Prospects: The 2011 Revision

situation could be the saturated market condition. Although apparent consumption of synthetic resin has picked up slightly in 2013 comparing to 2012, the growth rate is marginally positive at 0.3%, while we estimated that the apparent consumption has stayed at around 32 million tons for 4 consecutive years.⁶ With limited demand growth for the product, industry profitability has remained largely stable, with estimated net profit margin at around 4-5% throughout the course of 2012 and 2013.



Source: CEIC, Coface estimates

With saturated demand, sector outlook for 2014 will remain largely in-line with what we saw in 2013. Nevertheless, the synthetic resin industry has been re-leveraging in 2013 after going through a deleveraging phase in late 2011. Debt-to-equity ratio of the industry has climbed close to 165% toward the end of 2013. While such ratio is not particularly different if we compare with the 151% average since 2006, we shall keep monitoring the development in such area as further leveraging to imply increasing risk amid the saturated demand of the industry.

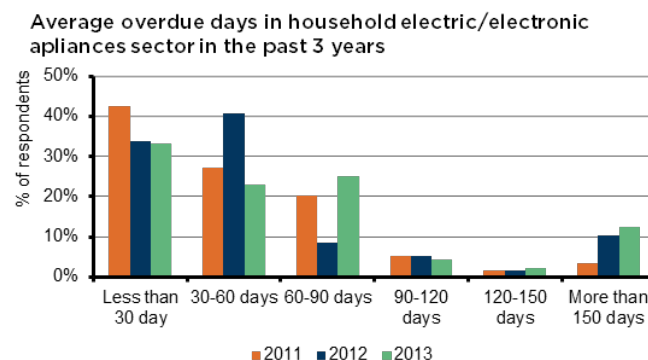


Source: CEIC, Coface estimates

HOUSEHOLD ELECTRONICS⁷ - Clouded by Highly-leveraged Segments with Low-profitability

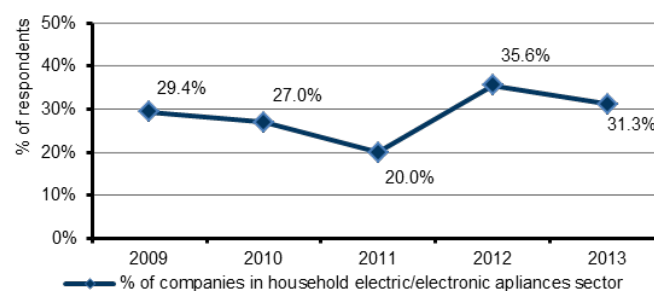
Survey respondents coming from the household electronics sectors showed us that the overall

payment experience has deteriorated slightly in 2013. Consistent with previous years, over 90% (i.e. 90.7%) of the respondents expressed that average credit terms offered remained below 90-days, with an increase in respondents showing us that they are now offering more 90-day terms than before (i.e. 22.2% in 2013 vs. 13.6% in 2012). What could potentially become an issue is the increase in lengthy overdue payments. Survey respondents have experienced lengthened average overdue periods in 2013 comparing to 2012. Specifically, 12.5% of the respondents from the industry told us that their average overdue days exceeded 150 days in 2013, while only 10.2% and 3.4% of the survey respondents had faced such situation in 2012 and 2011, respectively.



Moreover, only 31.3% of the industry participants shared with us that overdue payment that lasted for 6-months or beyond exceeded 2% of their overall sales, declining from 35.6% in 2012.

6-month overdue payment weighed more than 2% of domestic turnover



With a broad spectrum of products ranging from smartphone to shavers, it is difficult for us to come up with any single trend for the household electronics industries. Due to the wide-ranged product categories, we will focus on home beauty and health electrical appliance and computer machine manufacturers.

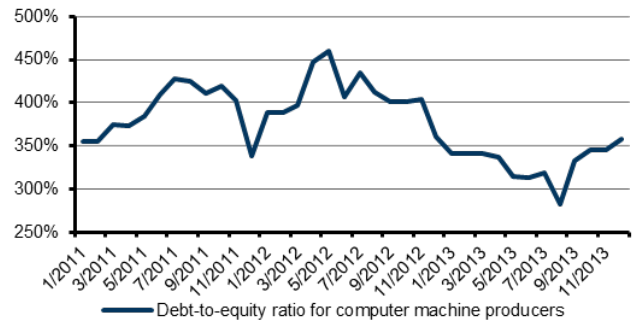
For home beauty and health electrical appliances

(6) Apparent consumption = production + imports – exports

(7) We define household electronics as the products that are readily available to be used domestically

manufacturers, financial performances have been very steady since 2012. Both gross and net profit margins in 2013 remain similar to those in 2012. Gross margin and net margin were 13.5% and 4.2%, respectively, comparing to the 13% and 4.3% in 2012. Debt-to-equity ratio has also been largely range-bounded throughout the year, and closed the year of 2013 at 106%, comparing to the 105% in 2012.

Debt-to-equity ratio of computer machine producers

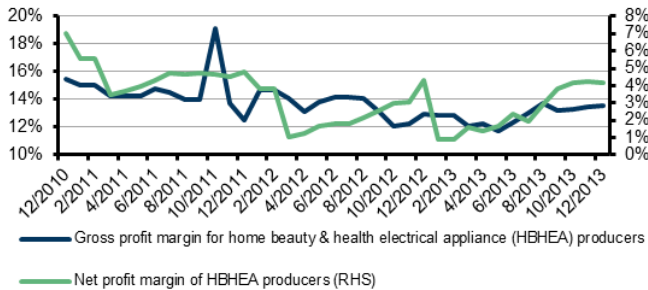


Source: CEIC, Coface estimates

INDUSTRIAL MACHINERY AND ELECTRONICS⁸ - A Big Sector with Different Trends

Like the results from household electronics segment, survey respondents coming from the industrial machinery and electronics sectors showed us that the overall payment experience has deteriorated in 2013.

Profitability of home beauty & health electrical appliance producers

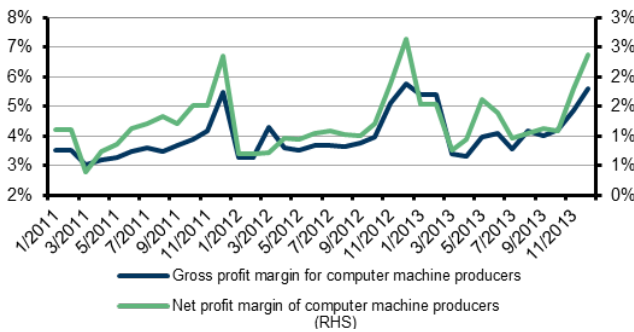


Source: CEIC, Coface estimates

As for computer machine manufacturers, they are also facing tremendous pressure on their margins. Both gross and net profit margins are estimated at razor-thin levels, with gross margin recorded 5.6% and net margin recorded 2.4% in 2013, even lower than the gross and net margins of 5.8% and 2.6%, respectively. Although the magnitude of these declines is not very significant in absolute term, such declines are deeply felt by the manufacturers as such changes in already-thin margins are extremely detrimental to the survival of such companies.

Unlike results from previous years, 21% (including 14.7% saw average credit terms of more than 120-days) of the respondents expressed that average credit terms offered was above 90-days, comparing to the 8.1% in 2012 (including 4.7% of respondent having extended credit terms of more than 120-days). What adds to our worries regarding the sector is that the increase in relatively-long overdue payments exceeding 90-days. To put that in context, 27% of the respondents from the industry told us that their average overdue days exceeded 90 days in 2013, while only 13.9% of the survey respondents had faced such situation in 2012.

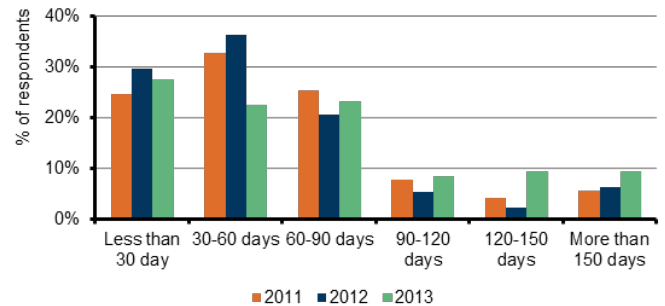
Profitability of computer machine producers



Source: CEIC, Coface estimates

Moreover, despite the slight decline in debt-to-equity ratio (from 360% in 2012 to 357% in 2013) the computer manufacturers continue to be highly leveraged. Such financial performance continues to stand as an alert regarding the industry.

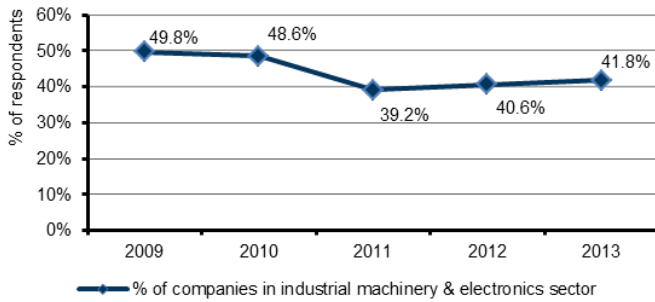
Average overdue days in industrial machinery & electronics sector in the past 3 years



In-line with the trend as indicated above, but at a less serious rate of acceleration, we saw an increased percentage of respondents telling us that the relatively long-overdue payments are weighting on their businesses. 41.8% of the respondents said that the 6-month-or-beyond overdue payments in their respective companies accounted for the more than 2% of total sales, picking up from 40.6% in 2012. These results coming out of the payment survey are definitely alerts.

(8) We define industrial electronics as the products that are for industrial use or semi-finished products

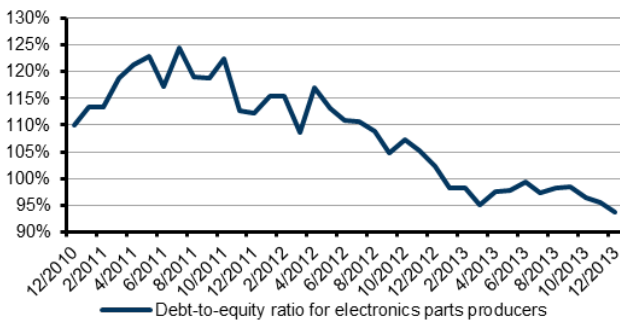
6-month overdue payment weighed more than 2% of domestic turnover



Similar to the household electronics sector, there are different trends among the subsectors of the industrial machinery and electronics sector. To better demonstrate a variety of the subsectors, we will focus on electronics part manufacturers, heavy mining machinery, and computer parts manufacturers.

The electronics part manufacturers did not see high pressure on their profitability. Gross and net profit margins held up strongly comparing to 2012. Comparing to 2012, net profit improved by 0.1% to 4.5% in 2013, while gross profit margin dropped 0.2% to 12.3% during the same period. At the same time, debt-to-equity ratio has declined quite obviously during the year, closing at 94% for 2013 comparing to the 102% as of the end of 2012. These indicators suggest that electronics part manufacturers have enjoyed a relatively good year, and, barring unforeseen circumstances, should continue to experience stable performances.

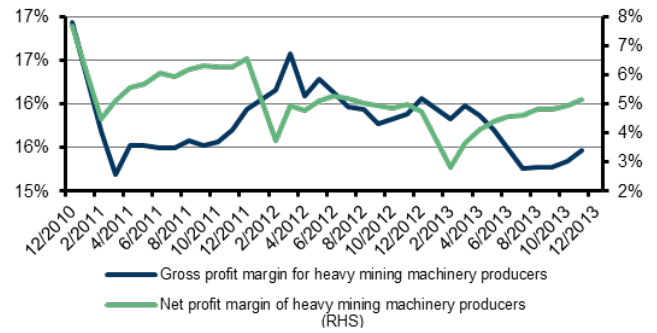
Debt-to-equity ratio of electronics parts producers



Source: CEIC, Coface estimates

As of November 2013, heavy mining machinery companies have maintained their leverage at similar level comparing to 2012. Debt-to-equity ratio as of November was 157%, comparing to the 155% as of the end of 2012. Comparing to year-to-date data as of November 2012, these companies have seen slight improvement in net profit margin from 5% to 5.2%, while gross profit margin slid slightly from 15.9% to 15.5% in November 2013. It is believed that the relatively niche market has allowed companies in the sector to enjoy relatively high margins.

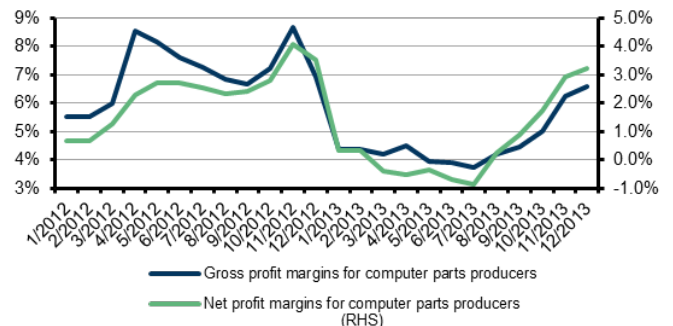
Profitability of heavy mining machinery producers



Source: CEIC, Coface estimates

Computer parts manufacturers probably felt like riding rollercoaster in 2013. Profitability drove to crisis-level during the middle of 2013, with net profit margin turning negative between March and July. Although strong momentum recovery in the second half did help drive the overall the net profit margin up to positive territory, the 3.2% net margin is still lower than the 3.5% seen in 2012. Similar trend is seen in the gross profit margin, which ended at 6.6% for 2013 and was lower than the 7% seen in 2012. Moreover, although computer parts manufacturers have slightly improved their balance sheets, they are still highly leveraged, with debt-to-equity ratio dropping slightly from 205% to 195% in 2013. These trends show that risks remain high in these manufacturers.

Profitability of computer parts producers



Source: CEIC, Coface estimates

All in all, after taking into account the industry financial performances together with our payment experience, we can conclude that not all the companies and subsectors are at the same level of risk. Among the others, computer parts manufacturers would be a key area to watch out for.

PAPER AND PRINTING - Stable Outlook Despite Lower Margins

As shown in our latest survey, the paper and printing sector has seen a reportedly lengthened credit terms in 2013 comparing to 2012. 40% of the respondents told us that they have extended credit terms for 90 days and above; only 18.8% of the respondents shared

the same view in our survey conducted in late-2012. Such trend is indicating that that payment terms has been lengthened in 2013, potentially because of tighter liquidity situation for the industry. Good news for the industry is that long overdue-payments have not been increasing furiously. Only 13% of the respondents in the paper and printing industries told us that average overdue period was higher than 90 days, comparing to 21.4% from our 2012 survey.

At the same time, the industry has reduced the leverage in 2013, especially during the fourth quarter, reaching the lowest level last seen in late-2010. These top-line industry indicators risks for the industry remain manageable for 2014.

Debt-to-equity ratio of paper making companies

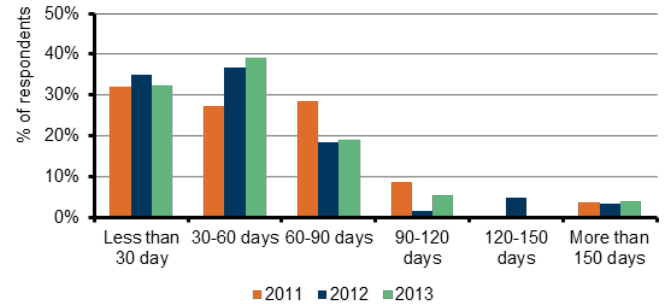


Source: CEIC, Coface estimates

STEEL - Similar Payment Experience With Lingering Stories

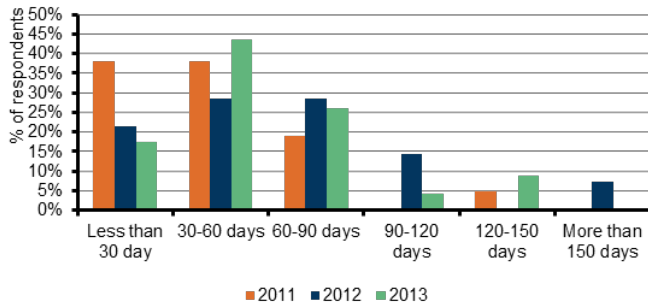
Payment experience of the steel sector has largely remained the same comparing to 2012. Most of the companies under this industry continued to offer credit terms at 30 and 60 days. Notably, comparing to 2012, there is an increasing number of companies (14.1% in 2013 vs. 7.4% in 2012) reported that the average credit terms they have extend was 90 days. Average overdue period in the industry has largely remained the same, with most of the overdue payments (i.e. 90.5% in 2013 and 90% in 2012) being repaid within 90 days.

Average overdue days in steel, iron & other primary metals sector in the past 3 years



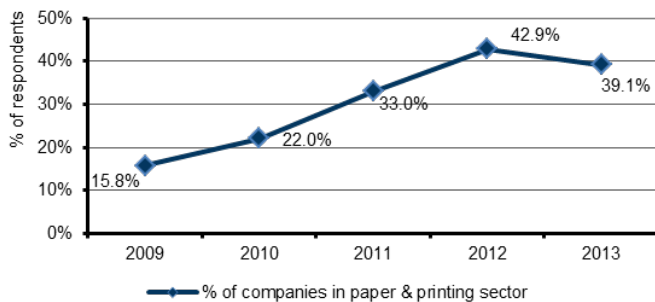
Moreover, only 29.7% of the industry participants told us that overdue payment that lasted for 6-months or beyond exceeded 2% of their overall sales. While such number merely lowered by 0.3% comparing to 2012, it is indeed the lowest level since at least 2009, reflecting that industry participants could be seeing less disruption from massive and long-overdue payments.

Average overdue days in paper & printing sector in the past 3 years



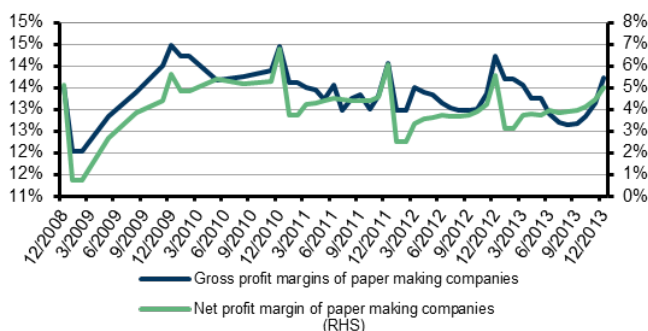
39.1% of the industry participants told us that overdue payment that lasted for 6-months or beyond exceeded 2% of their overall sales, comparing to the 42.9% in 2012, indicating that about 40% of the industry participants are still bugged by large-amount long-overdue payments.

6-month overdue payment weighed more than 2% of domestic turnover



Survey results related to the paper industry leads us to believe that payment experience of the industry participants have largely remained the same, and industry data is supporting such view. Despite some slight deterioration in 2013, profit margins have largely remained the same in the last 2 years. Gross and net profit margins for 2013 were 13.7% and 5%, respectively, while those figures were 14.2% and 5.6% for 2012.

Profitability of paper making companies



Source: CEIC, Coface estimates

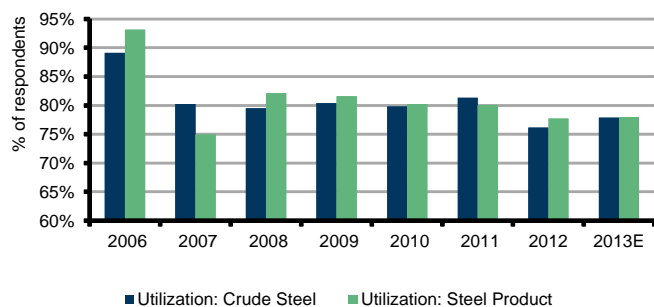
6-month overdue payment weighed more than 2% of domestic turnover



The combination of these findings lead us to believe that the overall payment experience among the industry participants have been stabilizing - or, at least not worsening - in 2013.

The Chinese steel sector is expected to see underwhelming pressure led by the overcapacity issue. We estimate that utilization of crude steel production and rolling capacity of steel products was at 77.9% and 78% in 2013, respectively. While it is expected to be improving due to the strong government measures on dismantling outdated capacities, utilization will continue to stay below the 80% minimal-threshold for 2014, and it is hard to see strong recovery in the profit margins in the near-term.

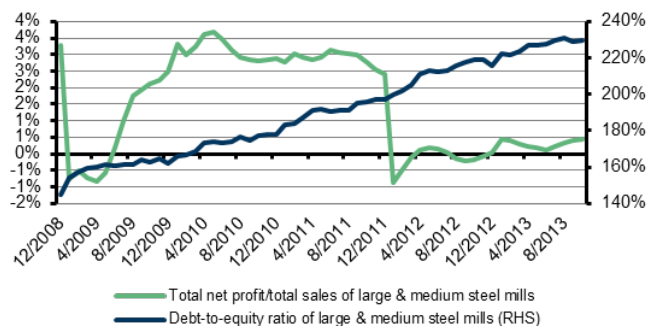
Capacity utilization rate of steel & steel products



Source: CEIC, Coface estimates

The overcapacity situation is the main driver of the low profitability. Net profit margins were estimated at 0.6% for large and medium steel mills as of December 2013.⁹ At the same time, steel industry players have been leveraging extensively as shown in the upward trend of the industry's debt-to-equity ratio. Comparing to late 2008 when the debt-to-equity ratio was lower than 150%, it has climbed to over 230% as of November 2013. Together with the strong rhetoric by the government to tackle the overcapacity situation, there will be increasing pressure for industry participants, particularly the smaller and less efficient industry players.

Profitability & debt-to-equity ratio of steel makers



Source: CEIC, Coface estimates

In 2014, as the government continues to step up its effort to dismantle outdated production capacity and not approving new production capacity to come into place, utilization rate could see slight improvement from the 77.9% we saw in 2013. Nevertheless, take into account our estimated production of steel would only increase modestly to 800mt in 2014, representing a 2.7% YoY increase, together with a 1% increase in production capacity, utilization will continue to stay below the 80%-threshold at 78.4%.

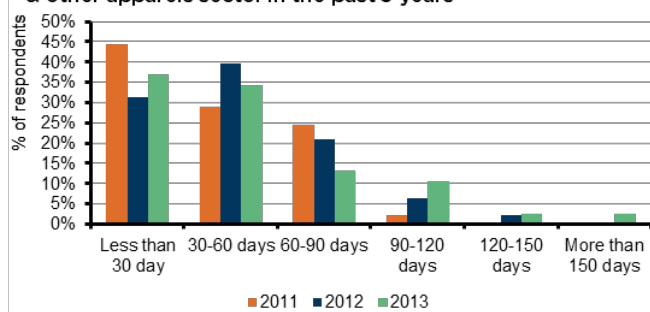
While the reform in the sector will take longer than one year to materialize, the sector would continue to see profit recovery during the course. However, as indicated in our latest Panorama China, smaller and inefficient steel mills will see increasing pressure, both from rising administrative costs and policy uncertainties.

TEXTILE - More Frequent Overdue Situation

Survey respondents coming from the textile-related industries told us that the overall payment experience has been largely stable, with slight deterioration among certain respondents. In general, average credit terms offered by the industry remained strictly below 90-days for 2 consecutive years, while there are signs that industry participants tend to offer more 90-day and 60-day credit terms in 2013 comparing to last year. In 2013, 23.3% and 37.2% of the respondents said that their average credit terms were 90-day and 60-day, respectively; those numbers are compared to 15.4% and 25.8% in 2012.

At the same time, according to the survey respondents, they have also experienced lengthened average overdue periods in 2013 comparing to 2012. Particularly, 15.7% of the respondents told us that their average overdue days exceeded 90 days in 2013; only 8.4% of the survey respondents had faced such situation in 2012.

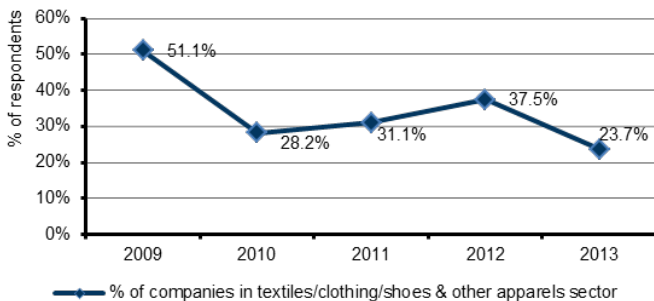
Average overdue days in textiles/clothing/shoes & other apparels sector in the past 3 years



(9) Total Net Profit/ Total Sales Revenue

Nonetheless, only 23.7% of the respondents said that the 6-month-or-beyond overdue payments in their respective companies accounted for the more than 2% of total sales. Such reported figure has shown drastic improvement against results from 2012, and it is also the lowest percentage we have seen in the last 5 years.

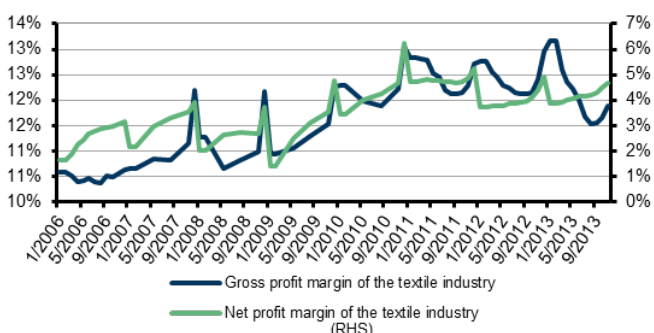
6-month overdue payment weighed more than 2% of domestic turnover



Results coming from the payment survey suggest that albeit the existence of overdue payment, textile industry participants generally enjoyed better payment experience comparing to a year ago.

Looking ahead, the textile industry will continue to see pressure on rising costs, but the industry will continue to surf through the winds. Despite concerns on rising costs of non-tradable assets in the country (e.g. labor, land) as well as appreciation of the currency, the textile industry has in fact experienced margin expansion comparing to 2006, before the outburst of global financial crisis. We estimate that net profit margin and gross profit margin are currently 4.7% and 11.9%, respectively, comparing to 3.2% and 10.6% as of December 2006. Reasons behind such development could be linked to i) higher factor (i.e. labor, capital) productivity, ii) improving image of Chinese-made products relative to products made in other economies, among the other reasons.

Profitability of textile companies



Source: CEIC, Coface estimates

The industry has also been going through a deleveraging phase. As shown in the trend below, the industry is seeing debt-to-equity ratio lingering around the lowest level since 2002, when industry data began to be available. Such trend leads us to believe that the textile industry in China is not overleveraging.

Debt-to-equity ratio of textile companies

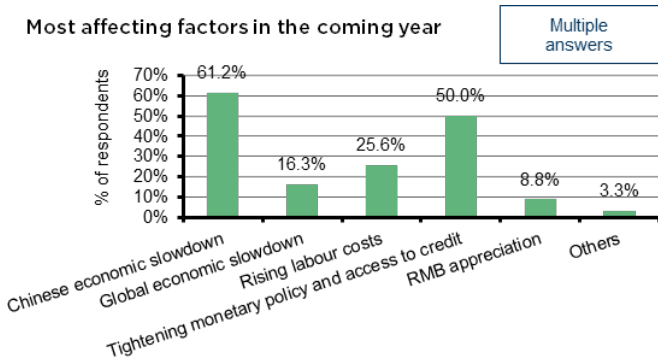


Source: CEIC, Coface estimates

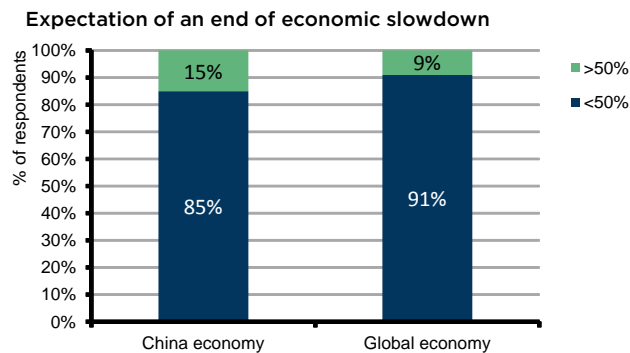
Rising labor cost will continue to be a concern for the textile sector, as well as the others, in 2014, but pressure is on a downtrend. In the first nine months of 2013, average wage growth of the manufacturing sector grew 11.9% YoY, comparing to the 13.6% in 2012 and 18.6% in 2011. With lower inflationary pressure comparing to previous years, businesses owners would see easing pressure to bring up nominal wages aggressively and will still be able to improve the standard of living of the workers.

4/ MACRO ENVIRONMENT ANALYSIS

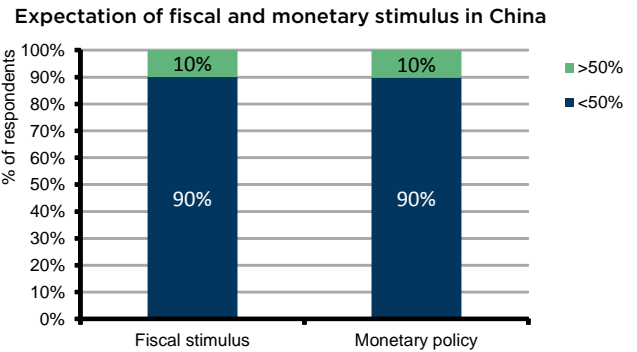
While hiking labor cost and RMB appreciation could be the headlined stories in the news, they are by far not the most concerning factor for business practitioners in China; only 25.6% and 8.8% of the respondents told us they considered those as the most affecting factors, respectively. When asked about what the most affecting factors are for 2014, 61.2% of the respondents shared with us that they are worried about the potentials of economic slowdown in China. Exactly 50% of the respondents told us that they worried about credit tightening, which would potentially reduce their accessibility to credits.



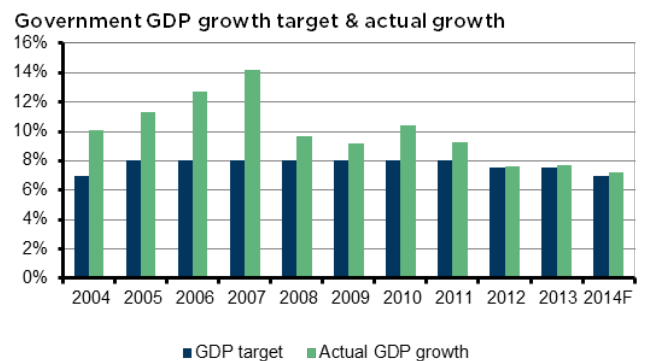
The majority of survey respondents were relatively pessimistic on both China and global economies. When asked about their expectation on seeing an end in economic slowdown, 85% and 91% respondents told us that they saw less than 50% chance of seeing an end of the slowdown in the Chinese and global economies, respectively, implying that businesses could remain conservative in the near-term.



Additional to their worries related to the extension of economic slowdown, the survey respondents are neither expecting the Chinese government to stimulate the economy through injection of fiscal nor monetary stimulus. In terms of their expectation of getting fiscal or monetary stimulus to be introduced by the government, coincidentally, 90% of the participants – who are business practitioners in China – told us that chances are lower than 50%.



Such finding from the survey is in-line with our view. For 2014, the overall macroeconomic environment in China will remain healthy, albeit top-line economic growth is expected to slow during the ongoing normalization process. Reflected in the government's slowing growth target in the last few years, topline economic growth has also dropped slightly over the period. The 7.7% real GDP growth in 2013 was the lowest growth rate achieved by the world's second largest economy in 14 years. This is in-line with the government's address on focusing on the quality – instead of quantity – of growth going forward.



Source: CEIC, Coface estimates

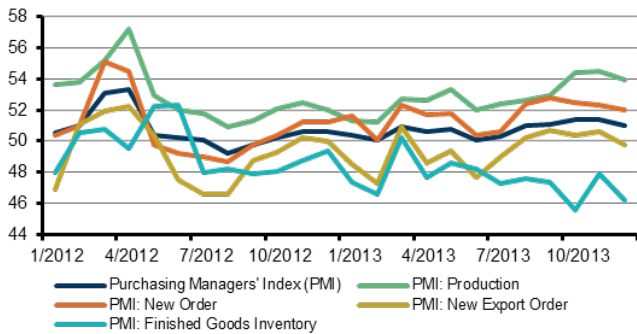
Nonetheless, while growth rate could continue to slow comparing to previous years, growth will remain healthy. Coface's estimate of 7.2% YoY GDP growth in 2014 will continue to make China as one of the fastest growing economies in the world.

Conducted by the National Bureau of Statistics (NBS), the purchasing managers' index (PMI) is recognized as a representative leading indicator of the economy.¹⁰

(10) Total Net Profit/ Total Sales Revenue

As we can see from the chart below, except for the outlook on finished goods inventory, most of the sub-indices under the manufacturing PMI umbrella has seen moderate pickups since early 2013. Albeit the slower numbers we have seen in February 2014, such trend should be extended to 2014 as a result of stable domestic demand and recovery external demand, supportive of a stable economic environment.

Manufacturing PMIs



Source: CEIC, Coface estimates

Despite the high hope of seeing consumption-led economic growth, investment will remain as the growth engine in the medium term as we expect income growth in Chinese family will carry on the slowing trend from the last few years. Growth rate of average income and consumption expenditure declined from 12.4% and 10% in 2012 to 9.6% and 8.1% in 2013.

Wage increase is the third major concern of the survey respondents. In fact, wage growth - together with income and consumption expenditure growth - has slowed down from the hike in 2011 as a result of higher comparable base. In addition, automation of manufacturing lines domestically and the shift of manufacturing base to external economies have led to reduced demand of low-skilled labor, taming wage increase pressure. While wage policy in China varies across provinces, with minimum wage set in place but at different levels. For instance, Shenzhen's minimum wage growth has slowed tremendously after jumping 20% in 2011.

Moreover, the government has launched different measures to stabilize prices - including property prices - in the economy. One way to do it is to subsidize the consumption. For instance, through our on-the-ground conversation with various drivers, the rent per day for taxi drivers in Shanghai has been lowered from RMB370/day to RMB310 or 320; the same has happened to a second-to-third city in Jiangmen, Guangdong Province where the rental per day dropped from around RMB250 to RMB 200. The lower rental cost compensates the taxi drivers for not raising the charges on meters. Such measures lead to stable real wage growth is still decent, estimated at 8.2%.¹¹ The slowing inflationary environment in the Chinese economy keeps improving standard of living, despite a low nominal wage increase.

Minimum wages in Shenzhen



Source: CEIC, Coface estimates

Please refer to our latest China-focus publication "Panorama China - What to expect for 2014" for more detailed analysis of the macroeconomic environment in China.

(11) Estimated using year-to-date average wage increase minus year-to-date average CPI

CONCLUSION

The overall payment experience in China has deteriorated in 2013 comparing to 2012. Average credit terms extended in China has become longer comparing to 2012, while maximum credit terms has generally been lengthened during the same period. Overdue situation has also become more common in 2013 comparing to 2012, with a higher percentage of respondents told us that the average overdue-period has been lengthened. Moreover, 45% of the respondents told us that they have seen an increase in overdue amount in 2013, comparing to the 56% in 2012.

We examined 8 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 coming out of the payment survey, we use gross and net profit margins 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 (subsector)	Payment experience (vs. 2012)	Financial performance ¹² (vs. 2012)
Automobile	Slightly improved	Similar
Building and construction	Slightly improved	Improved
Chemicals	Deteriorated	Similar
Household electronics - computer machine	Deteriorated	Slightly deteriorated
Household electronics - health and beauty		Similar
Industrial electronics - electronics part	Slightly deteriorated	Slightly improved
Industrial electronics - heavy mining machinery		Slightly improved
Industrial electronics - computer parts		Deteriorated
Paper and printing	Similar	Similar
Steel	Similar	Similar
Textile	Similar	Similar

Source: Coface

As mentioned in our latest Panorama China, rising cost of fund will be a major concern for businesses in 2014, and highly-leveraged companies shall bear the brunt shall this materialized. Certain electronics sector, particularly computer machine and computer parts manufacturing are examples of industries at risk.

(12) Leverage and profitability

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The logo for Coface, featuring the word "coface" in a lowercase, sans-serif font. The "co" is in a dark blue color, and the "face" is in a lighter blue color. The "o" in "co" is stylized with a white dot.