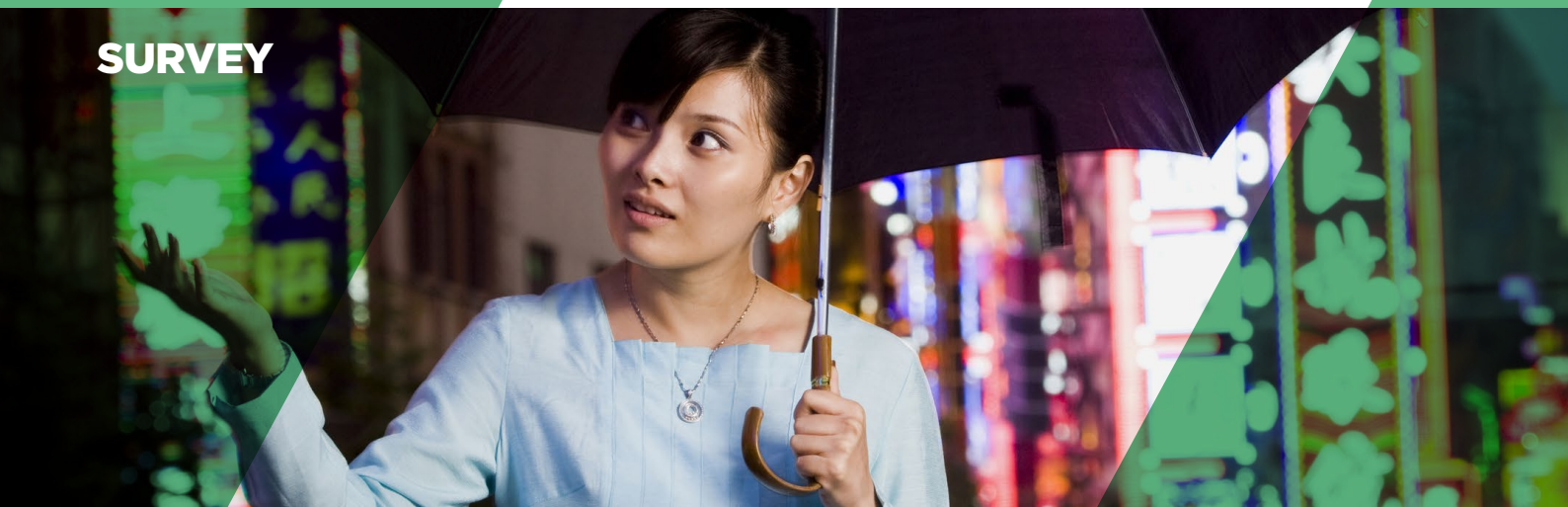


SURVEY



China corporate payment survey: the devil is in the detail

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CHINA corporate payment survey results

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APPENDIX: payment survey background

1/ The higher the percentage of respondents with ultra-long overdue amounts that exceed 2% of annual turnover, the higher the rank - and thus the greater the vulnerability. The percentage of respondents in 2016 with ultra-long overdues was compared to 2015, to give a 3 level assessment: Deteriorated, Stabilised or Improved.

In 2016, credit extension practices in China differed from those seen in previous years. Fewer Chinese companies offered credit sales - but those that did, offered better average credit terms. This trend indicates a selective relaxation of credit controls in China.

Overdue payment risks appear to be markedly improved, with only 68% of the respondent companies experiencing overdue payments in 2016 (compared to the previous 5-year average of 80%) and fewer respondents reporting an increase in overdue amounts. Nevertheless, the situation surrounding ultra-long overdues gives cause for alarm, as 35.7% of those companies concerned had ultra-long overdue amounts (over 180 days) which exceeded 2% of their annual turnover.

Against the backdrop of the deterioration in ultra-long overdue issues and ever-evolving market conditions, only around 4 out of 10 respondent companies used credit management tools to mitigate their non-payment risks. This indicates that greater risk management efforts need to be made in China.

Among the 11 sectors analysed in the survey, ultra-long overdue issues deteriorated¹ in the six sectors of chemicals, industrial machinery & electronics, IT-telecoms, metals, pharmaceuticals and retail. Among these, the situation of the chemicals and industrial machinery & electronics sectors (the former champions of the Chinese economy) give the greatest causes for concern. Metals, a very high risk sector over the past few years, showed some signs of improvement, as it was boosted by restructuring and a rebound in metal prices. Many of the companies in this sector are continuing to

struggle with ultra-long overdue issues - although fewer were faced with ultra-long overdues that accounted for over 10% of their turnover.

Although the long term outlook for the pharmaceutical sector is positive and supported by structural growth drivers (such as the country's ageing population and improving per-capita income), the survey results clearly demonstrate a puzzling deterioration in overdue issues during 2016 compared to 2015. This is partially due to the rapidly evolving regulatory and policy framework, which has included the implementation of a two-invoice system, which has been tested in 11 provinces.

Risks of non-payment remained steady in the household electric & electronic appliances sector, while the four sectors of automotives & transportation, construction, paper-wood and textile-clothing, saw improvements in ultra-long overdue issues.

Despite some amelioration, construction remained China's most at-risk sector in 2016, with 45.9% of companies (the highest percentage of respondents across all sectors) reporting 2% or more of their turnover in ultra-long overdues. 2017 will be another challenging year for highly indebted construction corporates, against a backdrop of tighter monetary and credit conditions. The improvements in the automotive & transportation sector that were seen last year, thanks to the government's tax incentives to boost car sales, are probably temporary. There is likely to be a bumpy road ahead, stemming from keener market competition, lower demand for cars and the rising costs of raw materials.



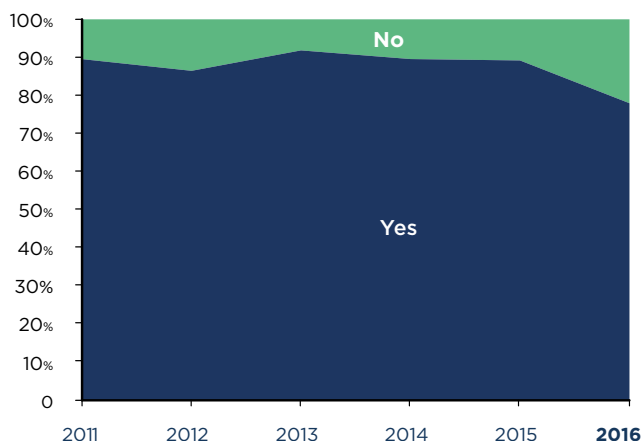
Jackit Wong
Economist, Asia Pacific,
based in Hong Kong

With the deterioration in ultra-long overdue issues, sound credit management practices and non-payment protection measures need to be implemented in China, especially in the light of ever-changing market conditions. The survey results highlighted the fact that greater attention to risk management needs to be paid in China.

1 CHINA CORPORATE PAYMENT SURVEY RESULTS

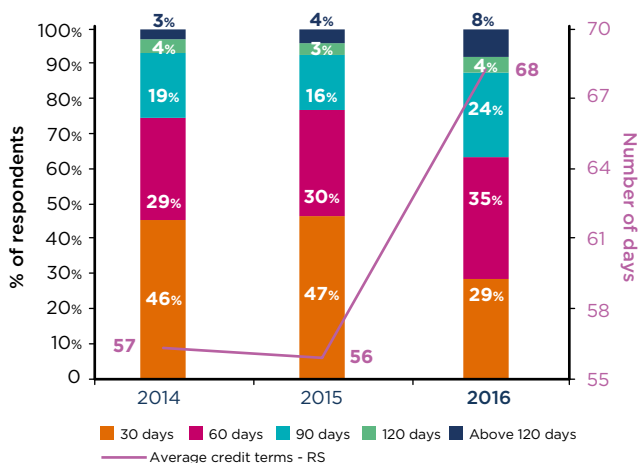
China's credit extension practices in 2016 differed from those seen in previous years and signalled a selective relaxation of credit controls.

Graph 1
Did respondents offer credit sales to their customers during the past 12 months?



Source: Coface Survey 2016

Graph 2
Average credit terms (from date of invoice) offered to customers during the last 12 months



Source: Coface Survey 2016

Only 78% of the surveyed Chinese companies offered sales on credit terms to their customers in 2016. This is a fall from the five-year average of 89% (*graph 1*). Market competition, although less important, remained the primary motivation for credit extension practices (38.2% vs. 50.0% in 2015). Slightly fewer respondents (18.9% vs. 21.2% in 2015) offered credit sales due to requests from customers who were suffering from tight liquidity. However, there were more respondents (28.5%, vs. 19.2% in 2015) that extended credit sales as they had confidence in their customers' ability to pay.

Overall average credit terms offered increased significantly in 2016, to 68 days (compared to 56 days in 2015, 57 days in 2014 and the five-year average of 57 days), as fewer respondent companies (63.6% vs. 77.1% in 2015) granted average credit terms of 60 days or below. There was also a notable increase in respondents (8.1% vs. 3.7% in 2015) that offered average credit periods of 120 days or more (*graph 2*).

Fewer Chinese companies offered sales on credit, but those that did offered better average credit terms. This signals a selective relaxation of credit controls in China.

OVERDUE PAYMENT RISKS APPEAR TO HAVE DECREASED, BUT SURVEY DETAILS REVEAL THAT FAT-TAILED RISKS REMAIN.

In 2016, only 68% of the respondent companies experienced overdue payments. This is a marked improvement compared to the previous 5-year average of 80%. The main reason for overdue payments continued to be "customer financial difficulties" (57.3%, vs. 62.4% in 2015). These customer financial difficulties were primarily, and increasingly, driven by "fierce competition impacting margins" (50.0% vs. 47.1% in 2015), but also due to lower domestic and international demand (21.5% vs. 25.7% in 2015), as well as "lack of financing resources" (11.6% vs. 18.2% in 2015).

As concerns overdue amounts, some improvements were observed in 2016. More respondents (23.6% vs. 18.2% in 2015) reported a reduction in overdue amounts and there was a distinct decline in companies (45.6% vs. 58.1% in 2015) that reported an increase in overdue amounts (*graph 3*).

Despite some corrections, with fewer respondents experiencing overdue payments, or reporting an increase in overdue amounts, ultra-long overdue situations are cause for serious concern.

There was a rise in the number of companies that reported average overdue times of 90 days or more in 2016 (26.3%, vs. 21.0% in 2015). Moreover, there was a particularly sharp increase in respondents (15.9%, vs. 9.9% in 2015) with average overdue times of above 150 days (*graph 4*).

Coface's experience has shown that approximately 80% of ultra-long overdue amounts (180 days or more) are not paid back at all. When over 2% of a company's total annual turnover is involved in ultra-long overdues, the company's liquidity can become an issue and its ability to repay suppliers is questionable.

A higher percentage of respondents (35.7% vs. 33.4% in 2015) indicated that ultra-long overdue amounts accounted for over 2% of their total annual turnover. Moreover, there was an increase in companies (10.9%, vs. 8.7% in 2015) with ultra-long overdue amounts accounting for more than 10% of their total annual turnover (*graph 5*). This significantly reduces cash flow, the lifeblood of a business.

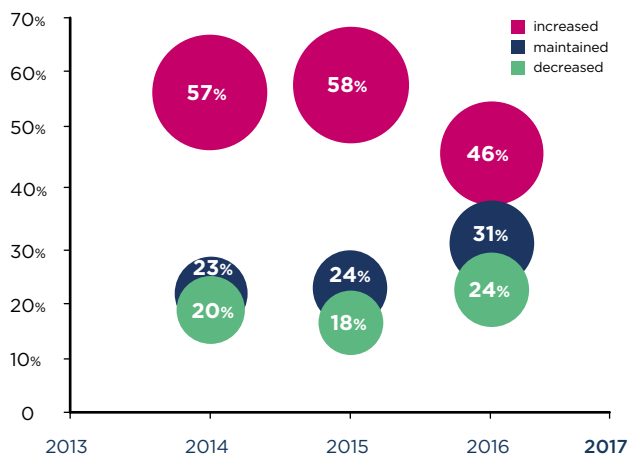
Chinese companies that have suffered from non-payment of these ultra-long overdue amounts have been facing significant financial stress. This is compounded by tighter monetary and credit conditions in 2017² and the squeeze on profit margins owing to industrial overcapacity, subdued demand and keener business competition in recent years.



2/ For more details, please refer to Coface Economic Publication "Focus: RMB depreciation, capital flow measures and new monetary stance - What are the implications for Chinese corporates?", March 2017

Graph 3

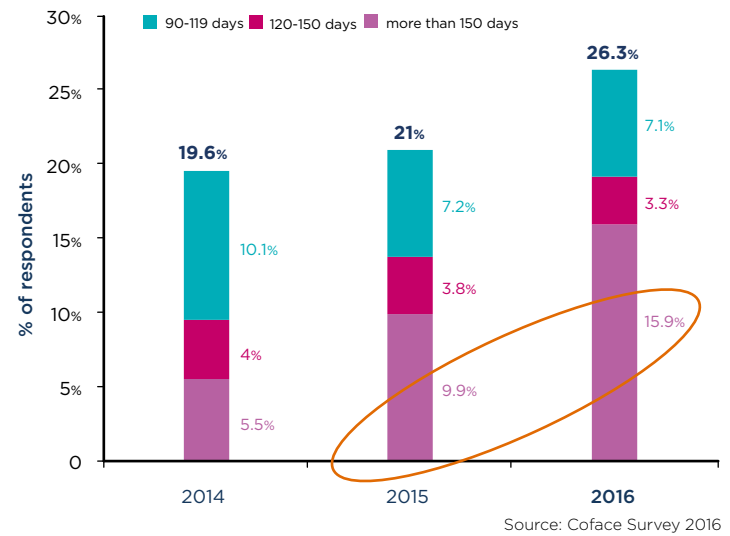
Compared with the previous year, the overdue amount (in dollars) has:



Source: Coface Survey 2016
* The higher the percentage of respondents, the larger the circle size.

Graph 4

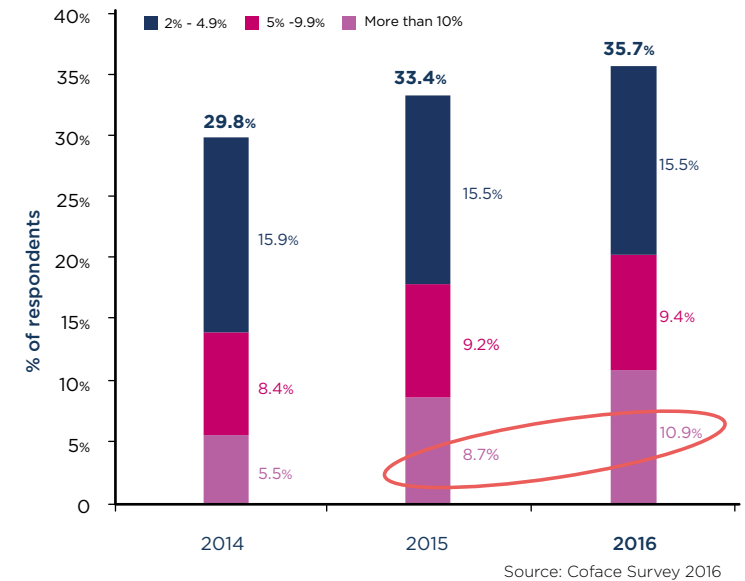
Average overdue days of credit sales



Source: Coface Survey 2016

Graph 5

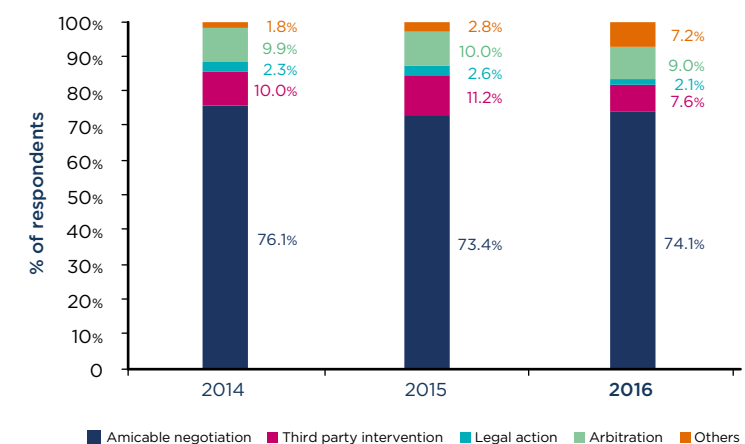
Percentage of ultra-long overdue amounts (more than 180 days) in annual turnover



Source: Coface Survey 2016

Graph 6

The most effective actions in case of non-payment



Source: Coface Survey 2016

LESS THAN HALF OF THE SURVEYED COMPANIES USED CREDIT MANAGEMENT TOOLS TO MITIGATE THEIR NON-PAYMENT RISKS. AMICABLE NEGOTIATIONS REMAIN THE MOST EFFECTIVE SOLUTION

With the deterioration in ultra-long overdue issues, sound credit management practices and non-payment protection measures need to be implemented in China, especially in the light of ever-changing market conditions. The survey results highlighted the fact that **greater attention to risk management needs to be paid in China.**

In 2016, less than half of the companies surveyed (43.0% vs. 60.3% in 2015) used credit management tools to reduce their risks of non-payment. Credit agency reports and recommendations (25.8%) continued to be the most popular tool, followed by trade credit insurance (17.6%), debt collection (11.0%) and factoring (5.9%).

In addition, there were fewer respondents that requested secure forms of payment (43% vs. 51% in 2015), monitored buyers' track records (26% vs. 32% in 2015) or made reserves against bad debts

(16% vs. 23% in 2015). On a positive note, however, 56% of companies checked and monitored buyer credit worthiness (a similar level to in previous years).

In terms of solutions for non-payments, the majority of respondent companies (74.1%) continue to favour amicable negotiations (i.e. repayment schedules) as the most effective tool, while a lower percent resort to third party intervention and legal action (*Graph 6*). Around 44% of those surveyed (similar to in previous years) have observed an improvement in China's legal environment.

ONLY AROUND ONE-THIRD EXPECT CHINA'S ECONOMY TO PICK UP IN 2017

Looking ahead, 64.2% of respondents believe that China's economy is unlikely to pick up in 2017. This is in line with the government's growth target and with Coface's projection of 6.5% (vs. actual growth of 6.7% in 2017). Premier Li Keqiang's work report to the National People's Congress 2017 also indicated more cautious macroeconomic targets and tighter credit and monetary conditions. The targeted growth for real GDP, urban fixed assets, retail sales, M2 money supply and total social financing were cut for 2017 (*in comparison to 2016, see Table 1*).

Table 1
Key official targets and 2016 actual figures

	TARGET		ACTUAL
	2017	2016	2016
Real GDP growth	6.5%	6.5% to 7%	6.7%
Urban fixed asset investment growth	9%	10.5%	8.1%
Retail sales growth	10%	11%	10.4%
Consumer price inflation	3%	3%	2%
M2 growth	12%	13%	11.3%
Total social financing growth	12%	13%	12.8%
Urban unemployment rate	4.5%	4.5%	4%
Fiscal deficit (as of GDP)	3%	3%	N/A

Source: Report on the work of the government, NBS

Against the backdrop of ongoing economic rebalancing, most Chinese corporates are expected to have a challenging year ahead, with higher borrowing costs (tighter credit and monetary conditions), slightly weaker domestic demand (amid growth moderation) and keener market competition (more industries opening up to foreign companies to attract capital inflows). Some companies may face higher import costs, due to the RMB depreciation and an increase in commodity prices. All of these factors are likely to weigh on the profitability of Chinese corporates, although a recovery in external demand

could provide a buffer if this is not interrupted by global trade protectionism (contrary to the pessimism expressed by the majority of respondent companies). Approximately 7 out of 10 Chinese companies believe that global economic growth is unlikely to pick up in 2017. On a positive note, Coface forecasts slightly improved world growth of 2.8% this year (compared to 2.5% in 2016)³.

^{3/} For more details, please refer to Coface Economic Publication "Country Risk and Sector Barometer", March 2017.

2 SECTORIAL ANALYSIS⁴

OFFERING SALES ON CREDIT TERMS CONTINUED TO BE A COMMON BUSINESS PRACTICE ACROSS SECTORS, WHILE VARIATIONS IN AVERAGE CREDIT TERMS SOMEWHAT REFLECTED SECTOR-SPECIFIC CHANGES IN CREDIT CONTROL AND LIQUIDITY CONDITIONS.

Among the 11 sectors analysed in the survey, chemicals showed the highest percentage of respondents offering sales on credit terms (88%) in 2016 – although 4% fewer respondents operated this practice than in 2015 (Table 2). This was followed by metals (83%) and retail (82%), while the lowest percentage was found in the construction sector, where 64% of respondents provide sales on credit terms.

Average credit terms offered across sectors did, however, vary - from 53 days in the retail sector, up to 78 days in construction. The overall average credit term in 2016 was 68 days. When comparing the average credit terms offered in 2016 to 2015, the pharmaceutical and textile-clothing sectors provided significantly longer average credit terms. At the other end of the scale, the paper-wood sector offered significantly shorter terms (with a 16-day reduction in 2016), followed by the construction and household electric /electronic appliances sectors. This is, in part, a reflection of the changes in credit control and liquidity conditions within these sectors.



Table 2
% of respondents offering sales on credit terms over the past 12 months, and average credit terms (in number of days) by sector

SECTOR	% OF RESPONDENTS OFFERING SALES ON CREDIT TERMS		AVERAGE CREDIT TERMS	
	2016	Variation*	2016	Variation*
Chemicals	88%	-4%	70	9
Metals**	83%	-7%	68	2
Paper-wood**	83%	-17%	58	-16
Retail	82%	1%	53	1
Automotives and transportation	81%	-9%	70	-2
Industrial machinery & electronics	80%	-8%	76	5
Pharmaceuticals**	79%	-6%	74	12
Household electrics / electronic appliances	77%	-13%	57	-4
IT-telecoms	75%	-23%	71	5
Textile clothing**	70%	-16%	67	11
Construction**	64%	-23%	78	-5
Total	78%	-11%	68	12

* Variation refers to the difference of % of respondents offering sales on credit terms and average credit terms between 2016 and 2015.

Source: Coface Survey 2016

** The sample size is below 68 (with the margin error of 10% and the confidence level of 90%), so caution should be used in interpreting these findings.

4/ For the margin error of 10% and the confidence level of 90%, an estimated sample size of 68 per sector is required. In the 2016 survey, the five sectors were construction, pharmaceuticals, paper-wood and textile clothing, with fewer than 68 samples – please refer to Appendix for survey details. Caution is therefore required when interpreting these results.

ULTRA-LONG OVERDUE ISSUES DETERIORATED IN 6 SECTORS, BUT IMPROVED OR STABILISED IN OTHERS⁵

In 2016, ultra-long overdue issues deteriorated in the six sectors of chemicals, industrial machinery & electronics, IT-telecoms, metals, pharmaceuticals and retail. Of these, the chemicals and industrial machinery & electronics sectors gave the biggest causes for concern, as considerably more respondents in these sectors had over 10% of their turnover involved in ultra-long overdue issues (*Graph 7*) and reported average overdue times of more than 150 days (*Graph 8*). Going forward, **the chemicals and industrial machinery & electronics sectors – the**

former champions of the Chinese economy – are likely to continue facing challenges, mainly due to overcapacity and lower support from the government, which is shifting away from energy-intensive, highly-polluting, heavy industries. With approximately 9 out of 10 companies experiencing overdue issues and being one of the most highly energy intensive sectors, chemical companies are likely to be faced with multiple challenges. One of these could be the expected increase in crude oil prices, as well as price volatility. Oil prices have fallen over the past two weeks, amid the possible recovery in oil supply from US shale drillers, which undermines the reductions in production by the Organization of the Petroleum Exporting Countries (OPEC).

SECTOR	OVERDUE ISSUES IN 2016 VS. 2015 (% OF RESPONDENTS)						COFACE barometer ***
	Overdue issues over the past 12 months		Increase in overdue amounts over the last year		More than 2% of their total annual turnover in ultra-long overdue issue**		
	2016	2015	2016	2015	2016	2015	
Automotives and transportation	71.8%	75%	33.9%	59.5%	26.8%	31%	
Chemicals	90.2%	83.9%	51.4%	65.7%	33.8%	29.3%	
Construction	66.1%	82.1%	54.1%	71.7%	45.9%	56.5%	
Household electrics/electronic appliances*	61.5%	80.9%	40.3%	56.2%	33.3%	32.6%	
Industrial machinery & electronics*	73.4%	82.1%	51.5%	59.4%	43.9%	36.2%	
IT-telecoms*	55.7%	84.6%	40.9%	48.5%	40.9%	36.4%	
Metals	64.6%	85.2%	58.1%	67.4%	38.7%	30.4%	
Paper-Wood	77.8%	100%	42.9%	69.2%	14.3%	30.8%	
Pharmaceuticals	78.6%	75%	36.4%	26.7%	45.5%	20%	
Retail	63%	73.4%	43.5%	46.8%	28.3%	19.1%	
Textile-Clothing	63%	76.3%	41.4%	53.5%	13.8%	29.6%	
Total	67.9%	80.6%	45.6%	58.1%	35.7%	33.4%	

Low risk Medium risk High risk Very high risk The risk has improved The risk has deteriorated

Source: Coface Survey 2016,
Coface sector barometer
(Last update: March 2017)

*For Coface barometer, these three sectors are categorised as Information and Communication Technologies (ICT).

**Ultra-long overdue issues refer to those last 180 days or more.

***Coface's assessments are based on the financial data published by listed companies. Our statistical credit risk indicator simultaneously summarises changes in 4 financial indicators: turnover, profitability, net indebtedness and cash flow, completed by the claims recorded through our network.
(Last update: March 2017).

5/ The higher the percentage of respondents suffering from ultra-long overdue amounts exceeding 2% of annual turnover, the higher the rank and thus the more vulnerable the sector. This percentage of respondents with ultra-long overdues in 2016 was compared to 2015, to give a 3 level assessment: Deteriorated, Stabilised and Improved.



Non-payment risks in the IT-telecoms sector appear to be high, but manageable, with fewer respondents (6.8%, vs. 9.1% in 2015) with more than 10% of their turnover involved in ultra-long overdue issues. Going forward, **strong support from the government** (such as the “Made in China 2025” initiatives, which include the segments of communications, computers and other electronic equipment manufacturing), preferential import taxes on display panel component parts and raw materials (announced by the Ministry of Finance on 23 December, 2016) **and the recovery in global demand, are all likely to help the sector, despite keener regional market competition, shorter business cycles and market saturation.**

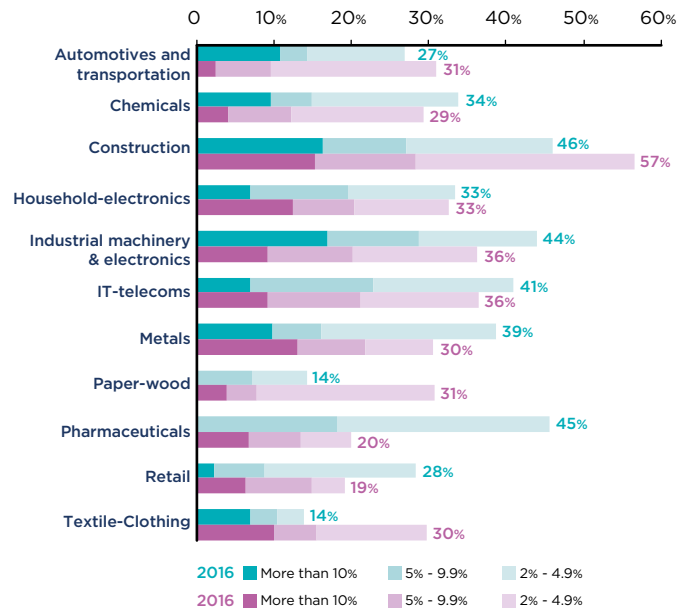
In the retail sector, there were more respondents (17.4% vs. 8.5% in 2015) that reported average overdue times of more than 150 days. Nevertheless, this impact did not appear to weigh too heavily on corporates’ financial conditions, as there was a clear decrease in the percentage of respondents (2.2% vs. 6.4% in 2015) with more than 10% of their turnover involved in ultra-long overdue issues. Looking forward, **the outlook for the retail sector remains cautiously optimistic**, mainly supported by the growing middle-income class and stronger government emphasis on consumption. Despite this, the government’s retail sales target growth for 2017 is slightly revised down, to 10.0%, compared to the 11.0% target set for 2016.

The four sectors of automotives & transportation, construction, paper-wood, and textile-clothing, saw improvements in ultra-long overdue issues last year, while non-payment risks in household electric & electronic appliances remained steady. As concerns the paper-wood sector, China is by far the world’s largest producer and consumer of wood-based panels and paper, and the largest importer of industrial round wood, sawn wood and fibre furnish (pulp and recovered paper)⁶. China’s textile-clothing sector is also heavily reliant on imported products for manufacturing. The depreciation of the renminbi is likely to result in higher costs for imports, which will weigh on the profitability of Chinese corporates in both sectors. Structurally, digitalisation and fast fashion will probably weigh on the paper-wood and textile-clothing sectors. Meanwhile, in the somewhat saturated household electric & electronic appliances sector, increases in production costs (relating to raw materials, packaging and shipping), are only likely to be gradually passed on to customers, due to keen market competition. This is likely to mean a challenging path ahead. Despite these difficulties, the three above-mentioned sectors should benefit from the recovery in external demand (if it is sustainable) and the resilience of domestic demand.

In the light of some of the government’s latest policies, as well as corporate payment data, the outlook for the construction, pharmaceutical, automotive & transportation and metal sectors will now be examined in more detail.

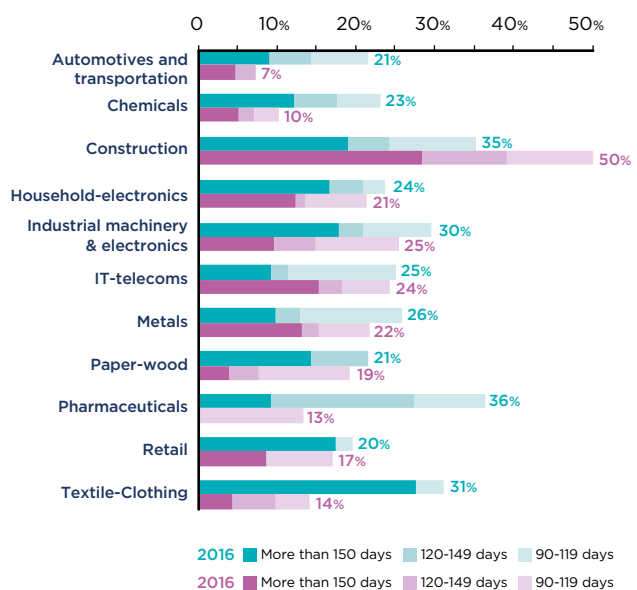


Graph 7
Total annual turnover in ultra-long overdue (% of respondents), by sector



Source: Coface Survey 2016

Graph 8
Average overdue times of more than 90 days (% of respondents), by sector



Source: Coface Survey 2016

6/ Source: 2015 Global Forest Products Facts and Figures, Food and Agriculture Organisation of the United Nations.

**CONSTRUCTION: IMPROVING,
BUT STILL VERY RISKY**

Construction was China's highest risk sector in 2016, despite overall improvements compared to 2015.

- (i) Among all of the sectors, it was construction that had the highest percentage of respondents (although lower than in 2015) facing more than 2% of their turnover in ultra-long overdues⁷ (45.9% vs. 56.5% in 2015). Of these, just over one-third had over 10% of their turnover involved in ultra-long overdue issues. Despite overall improvements, construction remained the most vulnerable sector in 2016 (in terms of the percentage of respondents with more than 2% of total annual turnover involved in ultra-long overdue issues).
- (ii) Although improving (35.1% vs. 50% in 2015), construction still recorded the second highest percentage of respondents with average overdue periods of more than 90 days. Of these companies, slightly more than half (18.9% vs. 28.3% in 2015) faced even longer average overdue periods, of over 150 days (Graph 8).
- (iii) The cross-sector also had the second highest percentage of respondents with a rise in overdue amounts in 2016, even though this percentage was lower than for 2015 (54.1% vs. 71.7% in 2015).

The official aggregate financials of Chinese construction corporates are in line with our survey findings. For Chinese construction corporates, **the debt-equity ratio (known as the leverage ratio – a key indicator for assessing the ability of companies to meet their financial obligations) remained at consistently high levels of over 200%. The latest available figure, as of Q3 2016, was 220.2%**⁸. In addition, growth of contract values and total profits (on a year-on-year, year-to-date basis) for Chinese construction corporates hit their lowest level during the second half of 2015, before gradually recovering, respectively, to 10.4% and 6.7% as of Q3 2016 (Graph 9). Nevertheless, they remain below the corresponding 5-year averages of 14.5% and 14.0%.

Looking ahead, **the construction sector is likely to continue facing challenges**. The anticipated tighter monetary and credit conditions are expected to cloud the outlook for highly leveraged Chinese construction corporates. This limits the scope for private investments and will probably result in higher home loan interest rates – which will reduce home purchasing intentions.

The property market in first and second-tier cities is expected to cool down, mainly due to governmental policies. In addition to the implementation of selective restrictions on home-purchases, the Asset Management Association of China (a government-affiliated industry group) has suspended fund companies from registering for five types of asset management plans that provide funding to commercial housing projects in 16 cities. This suspension came into effect on February 13, 2017.

On a positive note, public infrastructure projects (such as RMB 800 billion invested in railway construction and RMB 1.8 trillion in highway and waterway projects), public-private-partnership (PPP) funded infrastructure projects and policy-boosted home sales in tier 3 and 4 cities are all factors that will probably be able to provide a cushion to the construction sector.

**PHARMACEUTICALS: A PUZZLING
DETERIORATION IN RISKS - BUT
BRIGHTER IN THE LONGER-TERM**

The pharmaceutical sector showed a puzzling deterioration in overdue issues during 2016. More companies reported an increase in overdue amounts (36.4% vs. 26.7% in 2015) and the percentage increase in respondents from this sector with ultra-long overdue issues more than doubled (45.5% vs. 20.0% in 2015). Visibly more respondents (9.1% vs. 0.0% in 2015) suffered from average overdue periods of over 150 days. On a more positive note, none of the respondents reported that ultra-long overdues accounted for more than 10% of their annual turnover (vs. 6.7% in 2015).

The official aggregate financials of Chinese pharmaceutical manufacturers revealed a healthier picture. The leverage ratio of Chinese pharmaceutical manufacturers declined to 67.1% in 2016,

Graph 9
Construction corporates: Value of contract and total profit (YTD, YoY, %)



Source: NBS, Coface

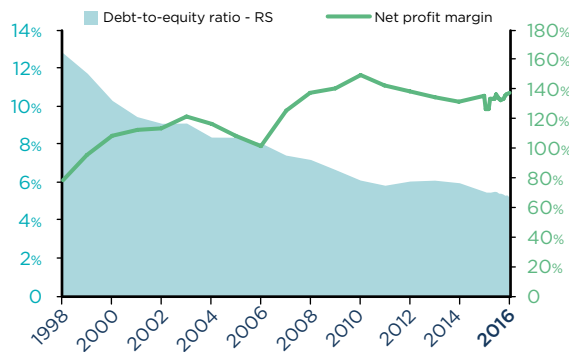
* Total profit for 2016Q2 was missing which we estimated with the use of average

7/ According to Coface's experience, approximately 80% of ultra-long overdues (180 days or more) are not paid at all. When a company has more than 2% of its total annual turnover involved in ultra-long overdue issues, its liquidity can be an issue and its ability to repay suppliers could be questioned.

8/ Source: NBS (Last update: March 13, 2017)



Graph 10
Pharmaceutical manufacturers: Net profit margin and leverage ratio (%)



Source: CEIC, NBS, Coface

the lowest since 1998 (when data on the subject first became available) and down from 70.9% in 2015. This indicates that their ability to meet financial obligations has strengthened. Their net profit margin remained steady, at 10.7% in 2016 (vs. 10.6% in 2015).

Looking ahead, the rapidly changing regulatory and policy environment, along with ongoing healthcare reforms, are likely to bring both challenges and opportunities to the pharmaceutical sector in the near future.

The two-invoice system (两票制 in Chinese) refers to the mechanism whereby a maximum of two invoices are issued in the drug procurement process - one by the drug manufacturer and the second by the distributor, to the medical services provider. This system is already being tested in 11 provinces. Fujian, in the east, has reported a halving of distributors since its adoption in 2012 and nation-wide implementation is expected by 2018. **It would therefore not be surprising to see some of the smaller drug distributors shut down, while those with better-established networks with medical services providers (including hospitals) and those that have been employing vertical integration, will probably benefit.**

According to the **National Drug Reimbursement List (NDRL)** released by the Ministry of Human Resources and Social Security (MHRSS) on 23 February, 2017, 2,535 drugs are eligible for government insurance programs (up from 2,196 in the previous version, published in 2009). The latest list includes new drugs produced by at least 44 listed Chinese companies (and by some global pharmaceutical giants). The MHRSS has also set up a drug reimbursement negotiation list, which includes 45 relatively highly-priced drugs (mainly expensive cancer medicines). As a consequence, **local drug manufacturers that are on the new list are likely to enjoy higher earnings. Nevertheless, the negotiation list does indicate the authorities' commitment to**

lobbying for more affordable medicines and this will weigh on the profit margins of domestic drug manufacturers in this segment.

Against this backdrop, restructuring in the sector is likely to take place, with a rise in merger and acquisition activities and the closure of some smaller, less diversified companies.

In the long term, China's ageing population (with approximately 1 in 4 people expected to be 60 or older by 2030⁹), **rising life expectancy** (to increase from 76.3 in 2015 to 79.0 by 2030¹⁰) and **improving per-capita income** (the government's goal, announced in late 2015, is to double per-capita income in the decade through to 2020) should **structurally support strong growth of the country's pharmaceutical sector.**

AUTOMOTIVES AND TRANSPORTATION: A BUMPY ROAD AHEAD

In 2016, China's car sales surged by 14.9%, to reach a total of 24.38 million vehicles (compared to a growth of 7.3% and 21.15 million vehicles in 2015). This is thanks to the government's tax incentives for buyers of cars with engines of up to 1.6 litres, for which the tax rate was halved to 5% between October 2015 and the end of 2016. It would not be surprising to see some broad-based improvements in the automotive and transportation sector last year, given that the automotive segment represented around 80% of the sector in terms of total assets, as of 2016 (vs. 73% in 2015).

Fewer respondents from this sector suffered from ultra-long overdue issues (26.8%, vs. 31.0% in 2015), or reported increases in overdue amounts (33.9% vs. 59.5% in 2015). Nevertheless, **non-payment risks appear to be growing:** (I) There was a worrying deterioration, with a notably higher percentage of respondents with 10% or more of their turnover involved in ultra-long overdue issues (10.7% vs. 2.4% in 2015). (II) Considerably more respondents (21.4% vs. 7.1% in 2015) suffered from average overdue periods of more than 90 days. Among these companies, slightly more than one-third (8.9% vs. 4.8% in 2015) faced even longer average overdue periods - of over 150 days. (III) The leverage ratio of Chinese automakers surged to 139% in 2016, the highest in six years, up from 136% in 2015. On a positive note, the leverage ratio of Chinese manufacturers of rail, ship, aircraft, spacecraft and other transport equipment declined to 149% in 2016, the lowest since 2012 (when data first became available) and up from 175% in 2015.



9/ According to the population development plan released by the State Council on January 25, 2017 (i.e., 国务院关于印发国家人口发展规划 (2016—2030年) 的通知, in Chinese), about a quarter of China's population (vs. 13.3% in 2010) is expected to be 60 or older by 2030.

10/ According to the "Healthy China 2030" blueprint released by the Communist Party of China Central Committee and the State Council on October 25, 2016 (i.e., "健康中国2030"规划纲要 in Chinese), average life expectancy is projected to increase to 77.3 by 2020 and 79.0 by 2030 - up from 76.3 in 2015.

■ ■ ■

With keener market competition, the automotive and transportation sector will probably have a bumpy road ahead, particularly with the:

(i) **Moderation in demand for cars.** The tax rate for buyers of cars with engines of up to 1.6 litres will be increased to 7.5% in 2017 and back up to the normal level of 10% in 2018. The frontloaded auto demand seen in 2016 will probably lead to a moderation in the growth of car sales, to around 3-5% in 2017. The world's largest automobile market has showed some signs of market saturation, with only single-digit growth recorded in four of the last six years.

(ii) **Rising cost of raw materials** (such as steel, rubber and chemical products). China's producer prices of ferrous metals saw a surge, with mining and dressing up by 27.6%, smelting and pressing of ferrous metals up by 40.1% and chemical products up by 11.8% in February (compared to a year earlier). This is likely to weigh on the profitability of manufacturers in the sector.

METALS: CHALLENGING BUT IMPROVING. OVERCAPACITY REDUCTIONS CONTINUING

Metals - a very high risk sector over recent years - finally saw some improvements in 2016. Not only were fewer respondents (64.6% vs. 85.2% in 2015) from the metal sector faced with overdue issues, but there was a notable decline in those suffering from an increase in overdue amounts (58.1%, vs. 67.4% in 2015). At the same time, many metal companies continued to struggle with ultra-long overdue issues, although fewer respondents (9.7% vs. 13.0% in 2015) reported average overdue periods of more than 150 days and fewer (9.7% vs. 13.0% in 2015) struggled with ultra-long overdues accounting for more than 10% of their turnover.

Looking ahead, **there is a slightly positive outlook for the metal sector**, as indicated in the latest Coface sector barometer of March 2017. The sector has been upgraded to "high risk" from "very high risk". Although Coface remains **cautious on the sector's risk, amid restructuring, there are two key reasons for the improved risk ranking:**

(i) **Lower operating costs:** China's metal producers and traders have been expanding their distribution and sales channels, improving their supply chains and cutting their operating costs by leveraging online-trading platforms (boosted by the "Internet Plus" initiative introduced by the State Council in July 2015).

(ii) **Rising metal prices:** Due to continuous overcapacity reduction and steady demand (amid public and PPP infrastructure projects and a possible recovery in manufacturing activity), metal prices should, on average, be higher this year. At the same time, the pick-up in metal production prices (since the final quarter of last year) is likely to improve the bargaining power of China's steel and metal corporates. This will somewhat alleviate pressures from higher production costs, amid tougher environmental legislation.

The closing of older, highly-polluting manufacturing facilities, along with relatively lower production output (in the light of the government's overcapacity reduction targets - Table 4) have already occurred, although they could be on a smaller scale than that shown in the official figures. Some independent studies suggest that a large portion of this capacity reduction concerned plants that had already stopped production for some time. Moreover, the official figures on capacity reduction do not take into account capacity "creations" resulting from new projects that began last year (even though the 2016 plan officially banned all of them). Restructuring in the sector is therefore expected to continue, with closures of more steel and metal "zombie" companies¹², along with merger and acquisition activities. Higher production costs, combined with tougher environmental regulations, are likely to pose challenges in the near-term.

Companies with stronger financials are expected to gradually upgrade their existing capacity to higher quality, more cost-effective and environmentally friendly facilities. This will lead to economies of scale in terms of production and should boost the sector's competitiveness in the longer term.

Table 4
Government's overcapacity reduction targets for steel and coal production

	Target		Actual
	2017	2016	2016
Steel production capacity	To reduce 50 million tons	To reduce 45 million tons	Reduced more than 65 million tons
Coal production capacity	(1) To shut down at least 150 million tons (2) To suspend or postpone construction on or eliminate no less than 50 million kilowatts of coal fired power generation capacity	To cut 250 million tons	Shed more than 290 million tons

Source: Report on the work of the government, National Energy Administration

11/ Source: Statement related to tax rate for buyers of cars with engines up to 1.6 liters jointly issued by the Ministry of Finance and the State Administration of Taxation on December 15, 2016 (i.e., 两部门发文减征1.6升及以下排量乘用车购置税 in Chinese).

12/ "Zombie companies" refer to non-profitable, inefficient and non-performing SOEs, which rely on aid from the government and state-banks for survival.

3 APPENDIX: PAYMENT SURVEY BACKGROUND

Coface began conducting annual surveys on business payment experience in China in 2003, with the aim of understanding corporate credit management practices and payment experiences.

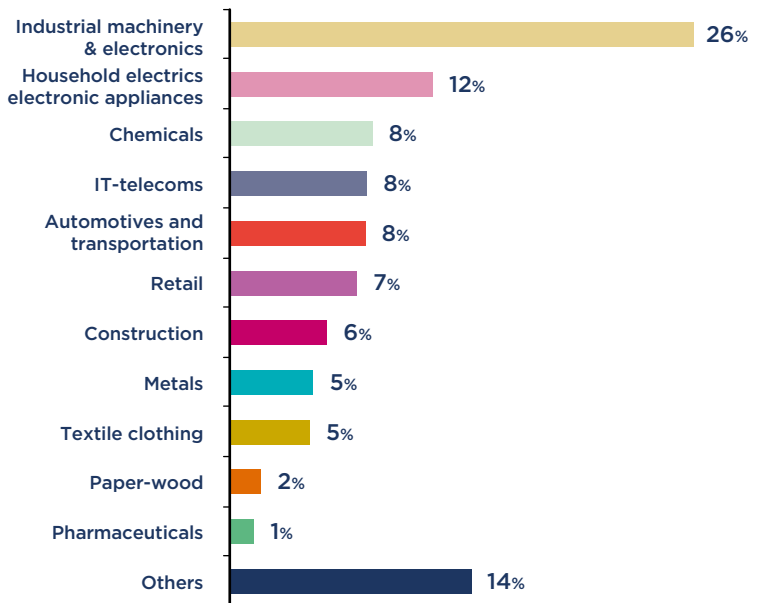
In our 2016 survey, data collection was conducted during the final quarter last year, and valid responses were received from 1,017 China-based companies. The majority of the companies surveyed are private companies (70%), with the rest of the sample being wholly owned foreign companies, state-owned companies, joint ventures and collectively owned companies (Graph 12).

The companies surveyed are from a variety of industries (Graph 13), with the five most represented sectors being industrial machinery & electronics (26%), household electronics (12%), chemicals (8%), IT-telecoms (8%) and automotives & transportation (8%).

The majority of the respondent companies are engaged in manufacturing activities (69%), while those engaged in trading activities account for 26% and other business activities, 5%. 74% of companies focus on the domestic market, while the remaining 26% target foreign markets.

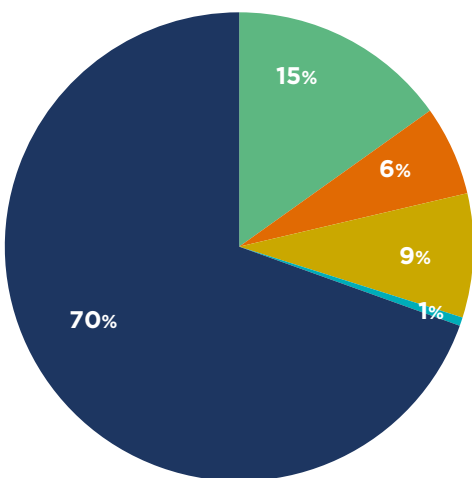
The companies surveyed cover a wide range of business sizes (Graph 14), with 48% having estimated sales revenues of less than RMB 50 million and 13% with revenues of over RMB 1,000 million.

Graph 13
Percentage of respondents by sector



Source: Coface Survey 2016

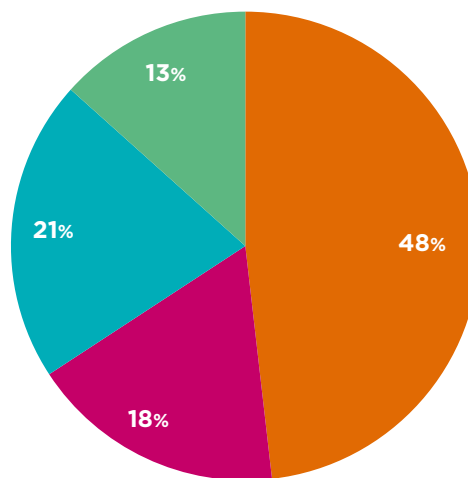
Graph 12
Percentage of respondents by company ownership structure



Wholly owned foreign company Joint venture
State owned company Collectively owned company
Private company

Source: Coface Survey 2016

Graph 14
Percentage of respondents by estimated sales revenues in 2016



Less than RMB 50 M RMB 50M to 100 M
RMB 100M to 1000 M More than RMB 1000 M

Source: Coface Survey 2016

RESERVATION

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