

PAYMENT SURVEY

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China Payment Survey 2020: Payment delays will increase further because of COVID-19

- 2 PAYMENT TERMS
- 4 PAYMENT DELAYS
- 5 ECONOMIC EXPECTATIONS
- 7 APPENDIX

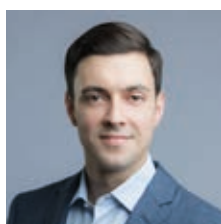
Coface's 2020 China Corporate Payment Survey looks at the payment behaviour of over 1,000 companies in China in late 2019. The data was compiled in the fourth quarter, which means that the figures do not take into account the impact of the COVID-19 pandemic on the Chinese economy. Notwithstanding this caveat, our survey shows a deterioration in payment behaviour in 2019, which ultimately does not bode well for Chinese companies in the context of weaker activity in 2020. Coface expects growth to fall to 1.0%, the lowest level in 30 years, so given the historic correlation between economic activity and payment delays, we anticipate a sharp deterioration in 2020.

Average payment terms remained stable at 86 days in 2019. However, the percentage of respondents offering average credit terms exceeding 120 days increased to 23% in 2019, up from 20% in 2018 and 12% in 2017. In practice, 50% of respondents offered maximum payment terms exceeding 120 days. Payment delays also deteriorated, with the proportion of companies experiencing payment delays that exceed 120 days increasing to 37% in 2019 from 31% in 2018. More ominously, the proportion of respondents experiencing

ultra-long payment delays (ULPDs, over 180 days) that exceed 10% of their annual turnover increased to 27% in 2019, up from 21% in 2018. When these constitute a large proportion of total annual turnover, a company's cash flow may be at risk, which is worrisome in case of exogenous shocks like COVID-19.

Coface expects an increase in bond defaults and insolvencies amongst sectors that experienced a build-up in cash flow risks in 2019. The sectors with the highest proportion of ULPDs accounting for more than 10% of annual turnover are construction (30%), transport (30%), energy (29%) and automotive (28%). ICT recorded the highest increase in payment delays on the back of US-China trade war disruptions, deteriorating by 12 days to reach 102 days. While all sectors are exposed to these risks, sectors that entered the crisis from a position of strength have better chances than those who did not.

In fact, companies may be in a weaker position to withstand the impact of the COVID-19 shock relative to last year, with 40% of respondents admitting that they did not use any form of credit management tool to mitigate cash flow risks in 2019, while only 17% of respondents declared using credit insurance.



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1 PAYMENT TERMS: AVERAGE PAYMENT TERMS REMAIN STABLE, BUT THE DEVIL IS IN THE DETAIL

• Coface’s 2020 China Corporate Payment Survey looks at the payment behaviour of over 1,000 companies in 2019. While the results of the survey do not reflect the impact of COVID-19, which affected the Chinese economy from end-January 2020 onwards, these can help to better understand what to expect in 2020 (see Box).

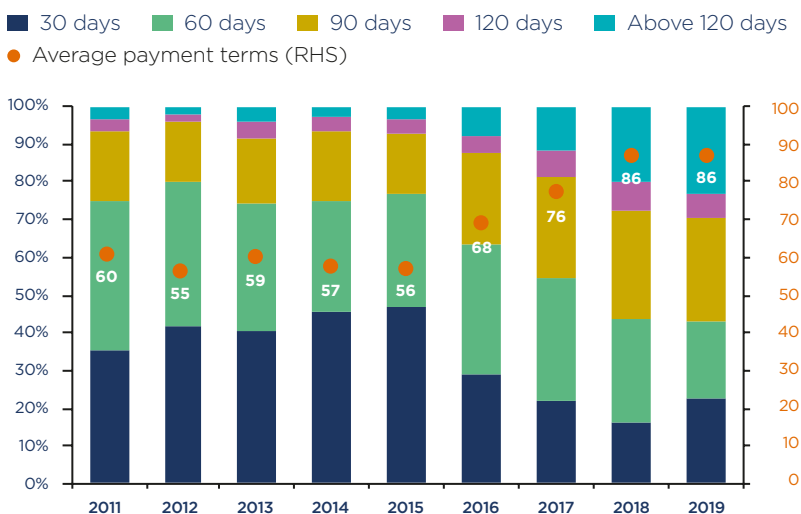
• Approximately two-thirds of respondents continued to offer credit terms in 2019 (66% vs. 67% in 2018). The main reason for this was confidence in their customer’s ability to pay (40%), followed by market competition (37%) and tighter liquidity (18%). Even with pressure on Chinese corporates to offer longer payment terms in order to secure business, average payment terms remained stable, at around 86 days in 2019. This resistance to increase payment terms reflects simultaneously a very large increase in 2018, as well a weaker domestic sentiment surrounding the US-China trade war, which may have been enough to offset customer demands for longer payment terms.

• The distribution skewed strongly towards longer maturities. The percentage of respondents who offer average credit terms exceeding 120 days increased to 23% in 2019 from 20% in 2018 and 12% in 2017. In practice, payment terms can be higher than these averages. For instance, 50% of respondents offered maximum payment terms exceeding 120 days, in line with figures for 2018.

• Differences were also apparent across sectors. Average payment terms were longest for the energy and construction sectors. Payment terms lengthened by 15 days for the energy sector. ICT came in third, following ongoing uncertainties related to the US-China trade war. Chemicals also saw a 15-day increase in average payment terms, which reached 88 days. While not amongst the sectors with the longest payment terms, the retail sector also experienced a sharp increase of 9 days in 2019.

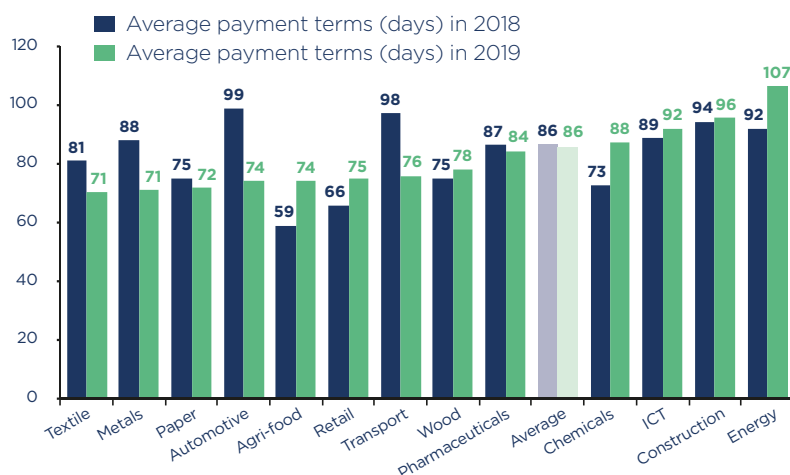
• At the other end of the spectrum, the metals, textile and paper sectors featured the lowest payment terms in 2019, which fell compared to the previous year. The agri-food sector remains amongst the sectors with the lowest payment terms, albeit average payment terms increased by 15 days to 74 days in 2019, one of the largest increases, on the back of disruptions generated by African Swine Fever. Automotive and transport featured the highest payment terms in 2018, but are now below average due to a decline of 25 days and 23 days respectively.

Chart 1:
Average payment terms (days)



Source: Coface Payment Survey

Chart 2:
Average payment terms (days) by sector



Source: Coface Payment Survey

BOX:

COVID-19 will lead to longer payment delays in 2020

Coface's China Corporate Payment Survey looks at the payment behavior of over 1,000 companies in China. Data compilation took place during the fourth quarter of 2019, meaning the impact of the COVID-19 pandemic is not reflected in the data yet. Nevertheless, payment trends can help to understand credit risks, especially given the sharp contraction in activity expected in 2020.

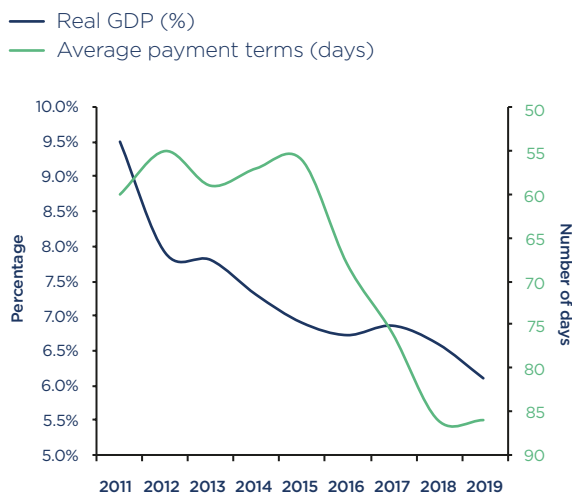
China's GDP contracted to -6.8% year-on-year in Q1 2020, the weakest reading since 1976. Moreover, activity indicators for April are pointing towards continued weakness in Q2, as most of the world remains under lockdown to control the spread of COVID-19. This exerts pressure on China's growth outlook and Coface now expects the economy to decelerate to 1.0% in 2020, the faintest expansion on record. There is an inverse correlation between GDP and payment delays, so this contraction should also translate into a sharp deterioration of payment delays in 2020. For instance, sectors that have been hit the most by lockdown measures will have to delay payments in order to survive and some businesses may even go bankrupt. Moreover, sectors like construction, energy, transport, automotive and ICT, which accumulated cash flow risks over the past years, will be more vulnerable to exogenous shocks such as a contraction in demand caused by the COVID-19 pandemic.

There is also a clear link between cash flow risks - defined as Ultra Long Payment Delays (ULPDs) exceeding 10% of total annual turnover - and corporate bond defaults. China registered its first corporate bond default in 2014, but these have increased rapidly, peaking at USD 16 billion in 2018 according to figures compiled by Bloomberg. The trend stabilized in 2019, reaching approximately USD 13 billion, but these were concentrated in a few sectors. According to BICS sector classifications, metals and mining featured the highest amount of corporate bond defaults in 2020,

followed by chemicals, other industrial and manufactured goods. However, the patterns differ significantly upon closer inspection. Most of the defaults in metals and mining are linked to CITIC Guoan Group, which defaulted on a payment related to real estate development. The same is true for other industrial manufacturing, where the largest bond default was Shandong Construction, a company involved in real estate development. In both cases, the defaults were linked to weaker activity in the construction sector. In the case of chemicals, the biggest default was Qinhai Salt, a large state owned enterprise that produces potash fertilizer. However, the company had diversified into producing magnesium alloys for the automotive and ICT industries in 2010 and had struggled with falling demand in the past years. In fact, after accounting for these nuances, it is observed that the highest concentration of bond defaults in 2019 were in the construction, ICT and automotive sectors. Not coincidentally, our 2019 China Corporate Payment Survey suggested that these sectors also had high cash flow risks, with the largest proportion of respondents stating that they had more than 10% of annual turnover tied up in ULPDs (28% in construction, 27% in automotive and 25% in ICT).

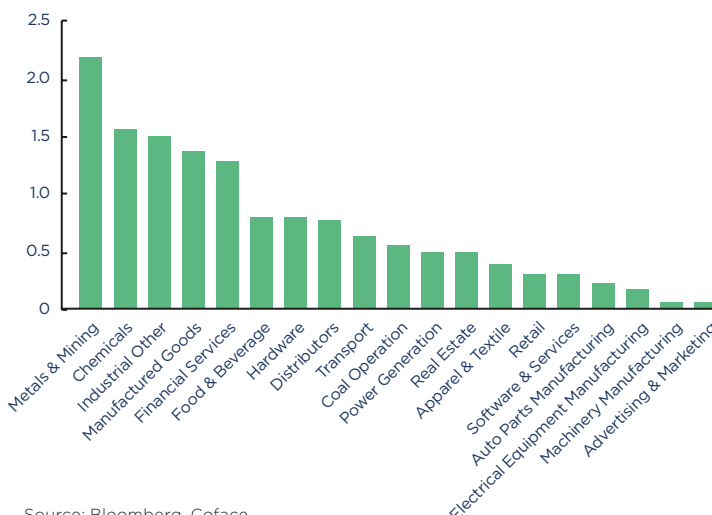
Looking forward, Coface expects to see an increase in bond defaults and insolvencies amongst sectors that experienced a build-up in cash flow risks in 2019. According to our 2020 China Corporate Payment Survey, the sectors with the highest proportion of ULPDs accounting for more than 10% of annual turnover are construction (30%), transport (30%), energy (29%) and automotive (28%). This increase would have happened naturally, but the trend will likely be amplified by the massive demand shock resulting from the global COVID-19 crisis. While all sectors are exposed to these risks, sectors that enter the crisis from a position of strength have better chances than those who do not.

Chart 3:
Average payment terms and GDP



Source: Coface China Payment Survey and IMF World Economic Outlook

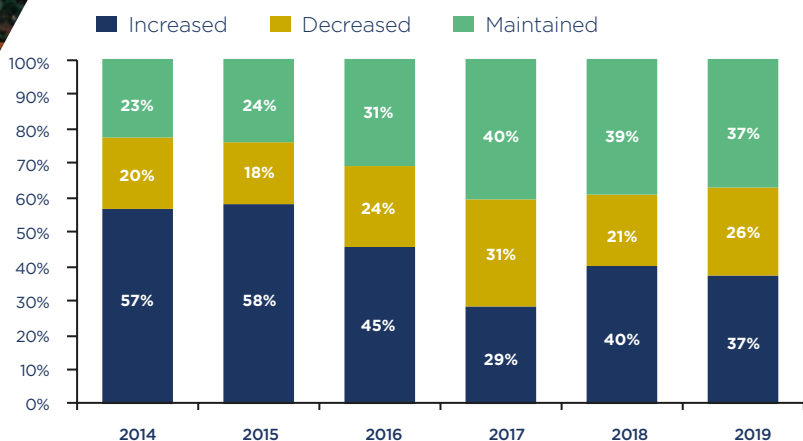
Chart 4:
Corporate bond defaults by sector (2019)
Amount outstanding in USD Bn



Source: Bloomberg, Coface

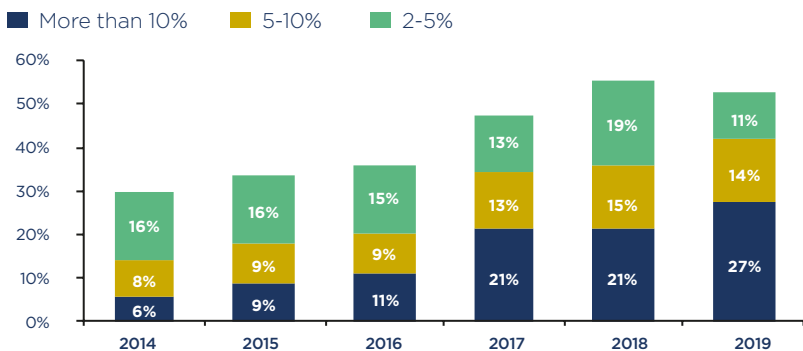
2 PAYMENT DELAYS: CHINESE COMPANIES BRACE FOR A MUCH TOUGHER 2020, AS CASH FLOW RISKS PILE UP FOR SOME SECTORS

Chart 5:
Evolution of payment delays



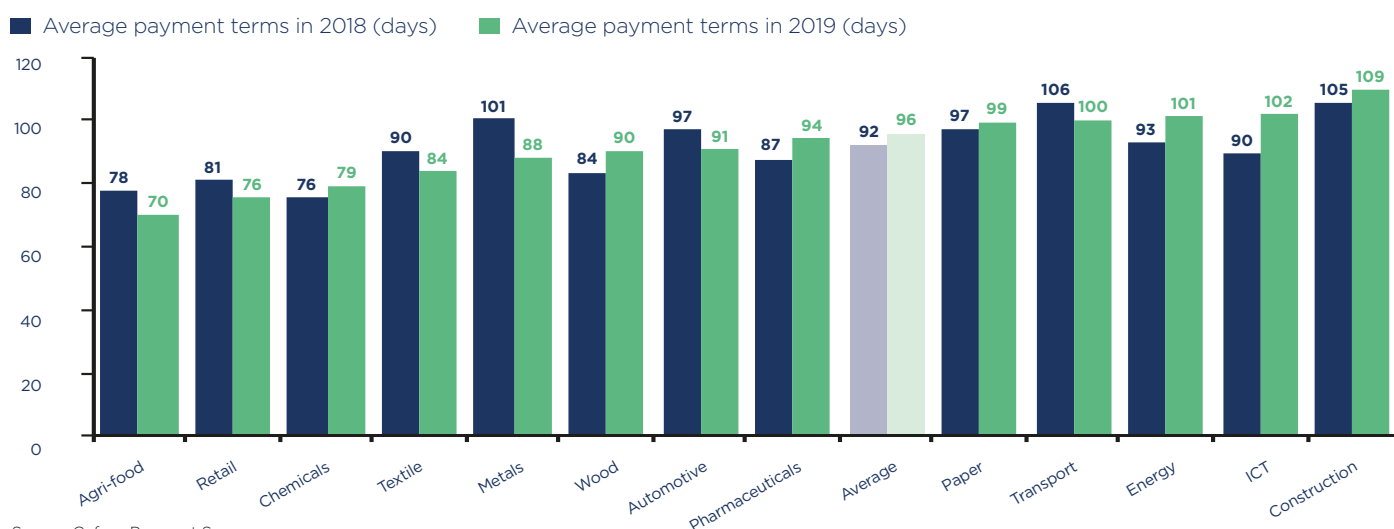
Source: Coface Payment Survey

Chart 6:
Ratio of ultra-long payment delays as a percentage of turnover



Source: Coface Payment Survey

Chart 7:
Average payment delays (days) by sector

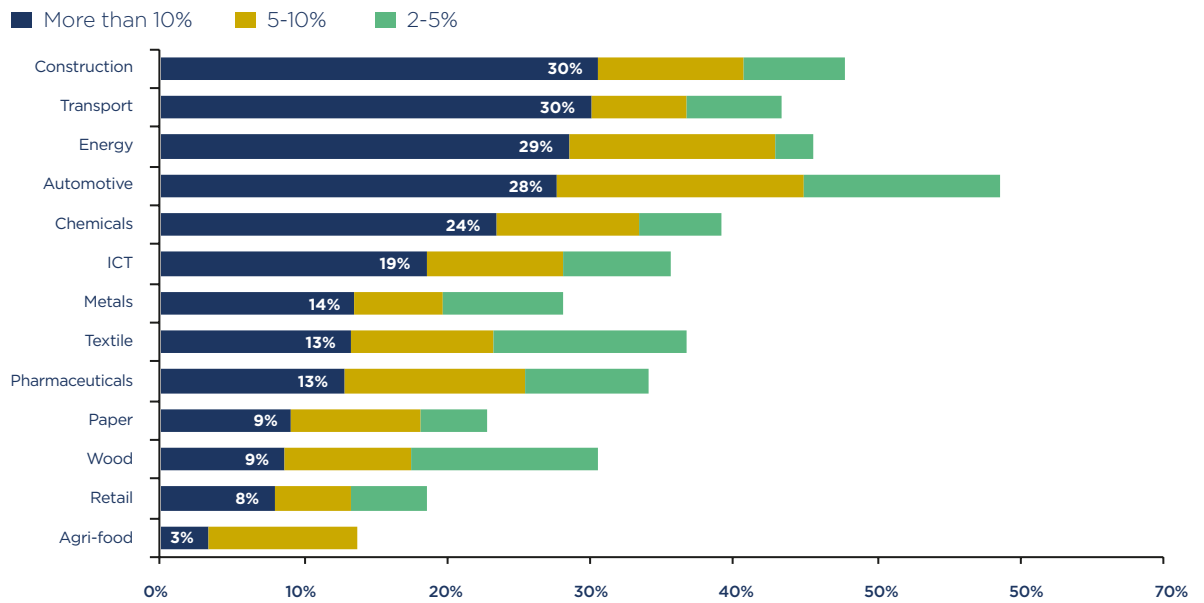


Source: Coface Payment Survey

- According to our survey, 66% of respondents experienced payment delays in 2019, up from 62% in 2018. Of these, 37% reported that they recorded an increase in payment delays, slightly lower than the 40% registered in 2018. Despite this apparent improvement, the proportion of those experiencing payment delays exceeding 120 days increased to 37% in 2019 from 31% in 2018.
- In order to gauge whether this deterioration is affecting cash flows, we look at the ratio of Ultra-Long Payment Delays (ULPDs, over 180 days) as a percentage of total annual turnover. According to our experience, 80% of ultra-long payment delays do not get paid at all. When these constitute more than 2% of annual turnover, a company's cash flow may be at risk - the higher the ratio, the higher the risk.
- The proportion of respondents experiencing ULPDs exceeding 2% of their annual turnover decreased to 52% in 2019 from 55% in 2018. Once again, this improvement is misleading, as signs of deterioration can be observed in the underlying data. While the number of respondents reporting ULPDs that account for 2-10% of their annual turnover decreased, the proportion of those reporting more than 10% of their annual turnover tied up in ULPDs increased to 27% in 2019, up from 21% in 2018 and in line with a trend observed since 2014. This is a telling sign that pockets of stress continue to be present in the Chinese economy, calling for even more insolvencies in 2020. In other words, tail risks were on the rise even before the COVID-19 shock.

- The sectors most at risk vis-à-vis the difficult situation that everybody is facing in 2020 are construction, transport, energy, ICT and automotive. Excluding automotive, all of these sectors reported payment delays above average in 2019. A large number of respondents in the auto sector reported ULPDs exceeding 10% of annual turnover (28%), which points to cash flow risks following a second consecutive year of falling auto sales in China. ICT recorded the highest increase in payment delays, deteriorating by 12 days to 102 days. However, the sector recorded a fewer proportion of respondents with ULPDs exceeding 10% of annual turnover relative to the other sectors (19%).
- The transport and construction sectors had recorded the highest payment delays in 2018 and continued to experience cash flow risks in 2019. Respondents in the construction sector recorded an increase in average payment delays of 4% to 109 days in 2019, while 30% of them experienced ULPDs exceeding 10% of their annual turnover, up from 28% in 2018 and the highest figure in 2019. Transport registered a moderate decline in average payment delays of 6%, but these remain high at 100 days. Moreover, it trailed closely behind construction in terms of ULPDs (30%). Respondents in the energy sector reported a 9% increase in payment delays, while 29% reported ULPDs exceeding 10% of annual turnover, making it third in terms of cash flow risks.

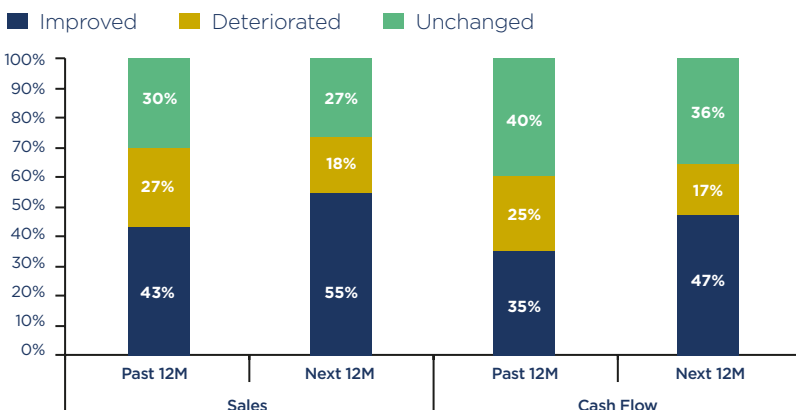
Chart 8:
More than 2% of total annual turnover in ultra-long payment delays



Source: Coface Payment Survey

3 ECONOMIC EXPECTATIONS: IMPROVEMENT IN 2019 WILL BE SHORT LIVED

Chart 9:
Economic expectations (% respondents)



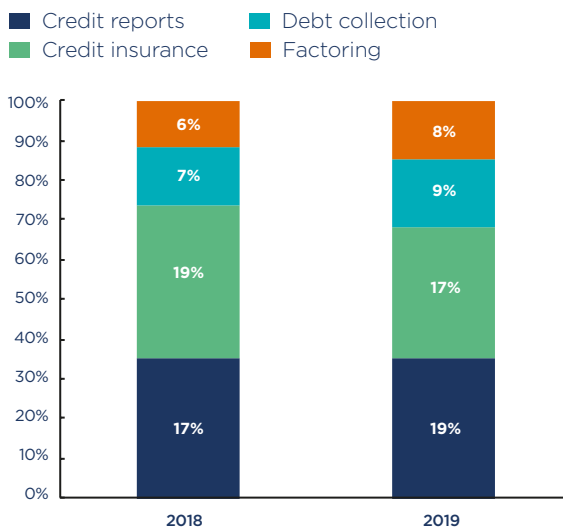
Source: Coface Payment Survey

- China's structural slowdown had an impact on payment delays in previous years, leading a majority of respondents to state that growth was unlikely to improve in 2019 - the first time since Coface started conducting payment surveys for China in 2003. This prediction proved to be correct, with the Chinese economy slowing to 6.1% in 2019. The outlook for 2020 is even grimmer, following shocks to global demand and supply by the COVID-19 pandemic. Despite the government's assertive response (see Focus), Coface expects economic growth to slow to 1.0% in 2020, marking the toughest macroeconomic environment for Chinese companies yet witnessed, worse than the global financial crisis of 2009.



- One can only hope that companies have made the adequate provisions, but buoyant expectations on the sales and cash flow fronts seem to suggest otherwise. 43% of respondents reported that their sales increased in 2019 relative to 2018, down from 46% the previous year. Meanwhile, 55% expect sales to improve further in 2020, up from 54% in 2019. The results were slightly more subdued for cash flows: 35% of respondents reported an improvement relative to 2018, while 47% expected cash flows to improve in 2020.

Chart 10:
Most popular types of credit management tools



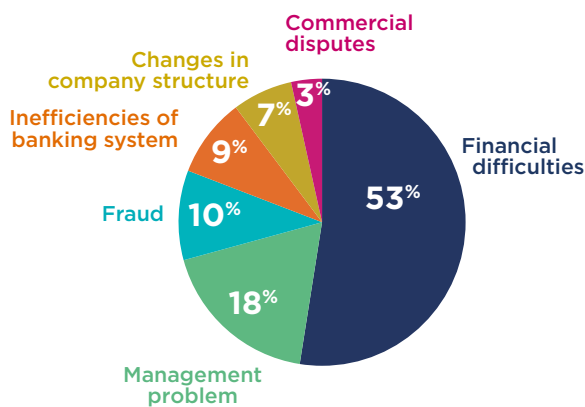
Source: Coface Payment Survey

- Companies may be in a weaker position to withstand the impact of the COVID-19 shock relative to last year. 40% of respondents admitted not using credit management tools to mitigate cash flow risks in 2019. There was also a smaller proportion of respondents using credit insurance, 17% compared to 19% the previous year. A larger proportion of respondents stated that they used credit reports, 19% compared to 17% in 2018. Factoring and debt collection remain marginal.

- Not surprisingly, 53% of respondents stated that the main reason behind payment delays was customers' financial difficulties. These were brought about by fierce competition impacting profit margins, slower growth in China and lack of financial resources. These answers do not factor in the impact of COVID-19 on the economy. Given the historic correlation between payment delays and economic activity, we expect that these will spike in 2020. A contraction in domestic liquidity could make matters worse, particularly for sectors in which cash flow risks have accumulated over time.

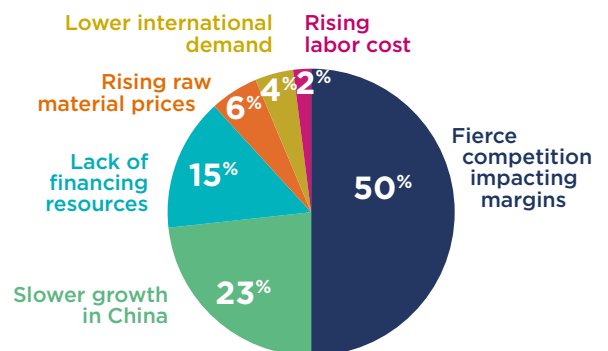
- Lastly, 54% of respondents admitted using Banker Acceptance Drafts (BAD), Commercial Acceptance Drafts (CAD) or both in place of cash for payments. While these delays do not appear on corporate balance sheets, they represent hidden cash flow risks. This is something that will require close monitoring as the economy comes to a standstill in 2020, potentially resulting in an even higher rate of defaults for some sectors.

Chart 11:
Main reason for payment delays



Source: Coface Payment Survey

Chart 12:
Main reason for financial difficulties

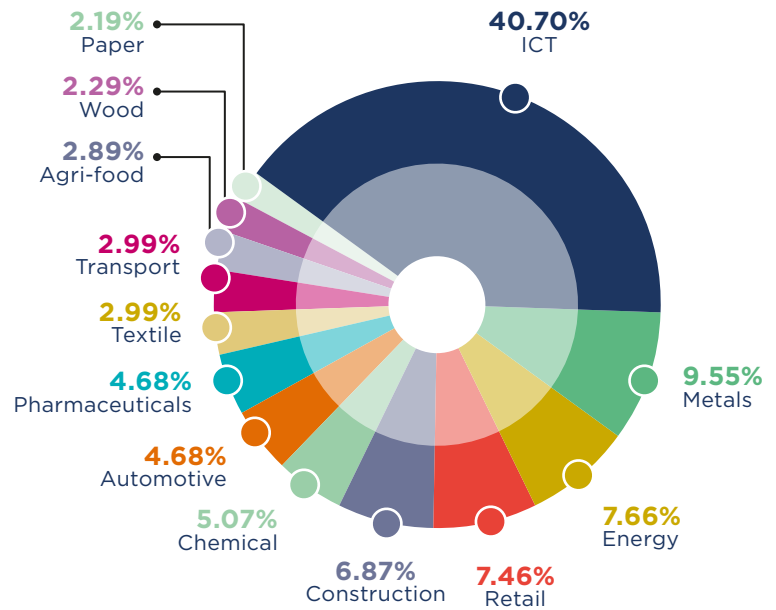


Source: Coface Payment Survey

APPENDIX

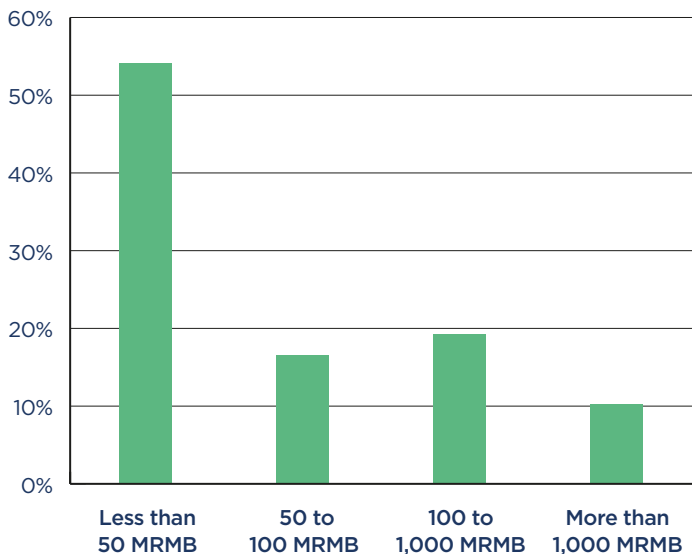


Which of the following best describes your company's industry?



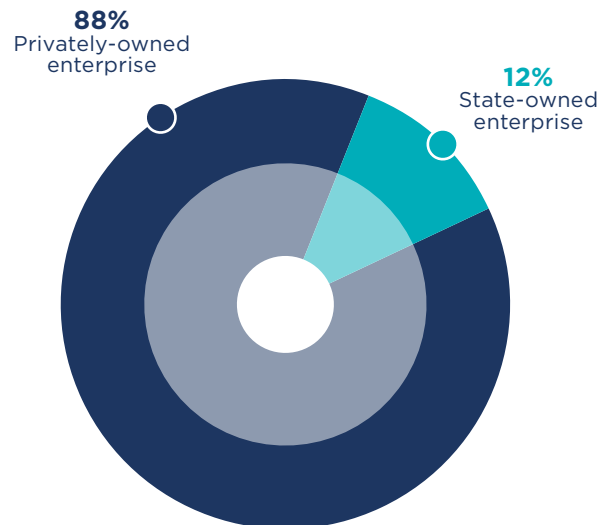
Source: Coface Payment Survey

The total estimated sales revenue of your company will be:



Source: Coface Payment Survey

Please state the nature of your company:



Source: Coface Payment Survey

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