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China Inc. Will Struggle To Stay On The Deleveraging Path

October 14, 2018

Key Takeaways

- China Inc. will find it hard to maintain the current two-year deleveraging trend.
- The median debt-to-EBITDA ratio improved to 3.3x in 2017, from 3.6x in 2016 and 3.8x in 2015.
- State-owned upstream sectors deleveraged the most last year, due to supply-side reforms and continued price reflation.
- In this year's survey of China's top companies, real estate surpassed oil and gas to be the third largest sector by total debt.
- As per previous surveys, private-sector companies demonstrated more capital efficiency and stronger financials.
- China's top 254 corporates have an overall business risk profile that we classify as fair and a financial risk profile of intermediate.
- Our assessments map the portfolio to an anchor of 'bb+', compared with 'bbb' to 'bbb-' last year.
- The weakening profiles reflect our forward-looking views, as well as our wider coverage of companies in this year's sample. This year we added 34 companies and two new sectors.
- Our expectation of a pause in deleveraging is based on tougher credit conditions amid "shadow banking" reform, and slower earnings growth off a heightened base.

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China's top companies will likely veer from the deleveraging path this year. S&P Global Ratings believes the slippage will come from slowing earnings growth rather than excessive outlays or borrowing. Overall we expect capital spending to remain more disciplined, setting the stage for China Inc. to eventually resume the major undertaking of reducing its debt burden.

After two years of improving debt to income, corporate balance sheets are in better shape to face potential economic headwinds brought by subsiding reflation and trade rifts. State-owned enterprises (SOEs) in upstream sectors have led improvements in capital discipline, under the close watch of state reformers. Property companies, on the other hand, have only recently begun to hem in debt-fueled expansions, partly in response to tougher financing conditions.

We expanded our survey this year, which brought some smaller and riskier companies into the mix. Overall, our portfolio of 254 companies represent the biggest players in their respective sectors.

In 2017, financial metrics improved for the second consecutive year, but business and financial risk profiles weakened. This is because our assessments are forward-looking. The deterioration also reflects our wider portfolio.

Who's Who In The Top Corporates?

Our 2018 study of China's top corporates includes 254 entities from 21 industry sectors. We added two new sectors. To improve coverage, we add chemicals with seven companies. We added package express to capture the rising importance of this sector in the consumer economy and online consumption over the past few years.

There is a net increase of 34 companies compared with last year, focusing mainly in capital goods (eight new companies), chemicals (seven), technology hardware (five), and consumer (five). The changes reflect China's positioning in the global supply chain, as well as the domestic economy's continuous shift to a consumption-led economy.

The portfolio for this study extends beyond our rated China universe. The number of rated entities make up one-third of the composition, similar to last year.

SOEs still dominate China Inc.

The constituents selected are leading or the largest borrowers in their industry. SOEs comprised 63% of the sample, slightly lower than last year. The declining trend in SOE composition should reflect the wider participation of private enterprises in the economy and rising services sectors.

We believe our sample has meaningful representation to gauge the financial health of "China Inc." As a group, the top 254 corporates (including infrastructure) account for 17.8% of the total borrowings of nonfinancial companies in China.

The SOEs dominate sectors that are strategic to China's national interests. These include energy (oil and gas, utilities, mining), infrastructure (telecommunications, transport, railway and metro), and engineering and construction. Companies in strategic sectors have a dual role: to support the state's policies in economic and social development, and maintain a reasonably healthy financial profile to execute these roles.

The areas in which SOEs are financially stronger than private enterprises usually have high barriers to entry due to policy or legacy reasons, a highly concentrated market, or special operating rights. These sectors include telecommunications, oil and gas, and electricity grid operators.

A good representation across sectors

For this year's survey, most represented sectors have at least five companies. The exceptions include telecommunications, which has only four operators. Both oil and gas and media entertainment also have only four companies. S.F. Holding Co. Ltd. and four delivery companies, were reclassified from transportation to the package express sector.

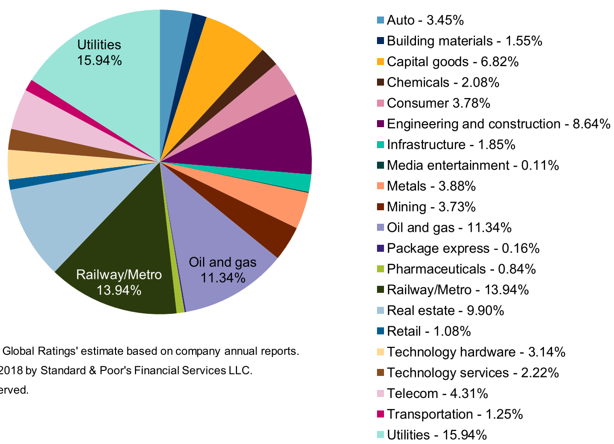
In terms of sheer number of companies, consumers (retail and goods) continue to be the largest sector in our survey, followed by capital goods and utilities. Each of these three sectors account for at least 10% of the total sample size.

In terms of assets size, the capital-intensive industries of utilities, railway and metro, and oil and gas dominate (see chart 1). On the debt front, utilities and railway and metro together account for about 40% of the sample's total borrowings (see chart 2).

China Railway Corp. (CRC), the commercial arm of the former Ministry of Railways, is the largest borrower in our sample and accounts for 19% of the total debt of sample corporates.

Chart 1

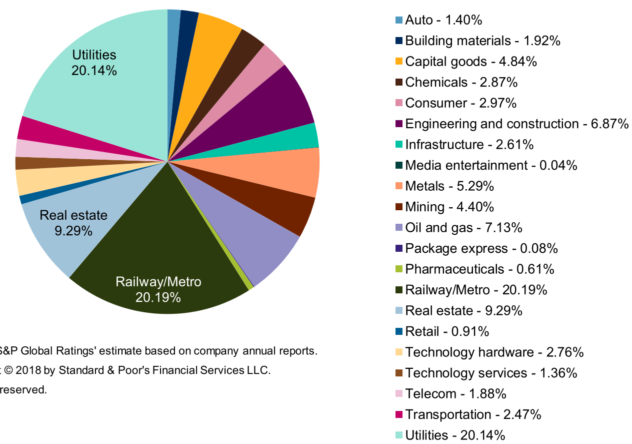
China's Top Corporates' Sector Breakdown By Assets



Source: S&P Global Ratings' estimate based on company annual reports.

Chart 2

China's Top Corporates' Sector Breakdown By Gross Debt



Source: S&P Global Ratings' estimate based on company annual reports.

In this year's survey, real estate surpassed oil and gas to be the third largest sector by total debt, reflecting the aggressive expansions by property developers. In contrast, major state-owned oil operators followed the government's deleveraging initiative. As such, they demonstrated more disciplined control over debt growth.

In our analysis, we have used median rather than averages to gauge the credit metrics for each sector and for the sample. This removes the impact of the size of a company and outliers.

Rankings Shifted Moderately

The credit rankings of the top corporates shifted moderately compared with last year's survey. One-fifth of sectors saw their business and financial risk profiles modified compared with last year. The composition of the top- and bottom-five sectors changed, due to the inclusion of two new sectors. The package express sector ranks fourth and chemicals nineteenth. The media entertainment sector dropped the most, from tenth in 2017 to fourteenth in 2018 (see table 1).

Table 1

Sector Rankings: 2018 Anchor Versus 2017 Anchor

2018 ranking				2017 ranking			
	Sector*	**Business risk profile**	**Financial risk profile**		**Sector***	**Business risk profile**	**Financial risk profile**
1	Telecom (4)	Strong	Modest	1	Telecom (4)	Strong	Modest
2	Infrastructure (15)	Satisfactory	Intermediate	2	Consumer (25)	Satisfactory	Modest
3	Oil and gas (4)	Strong	Significant	3	Infrastructure (15)	Satisfactory	Intermediate
4	Package express (5)	Fair	Minimal	4	Technology services (6)	Fair	Modest
5	Consumer (30)	Fair	Modest	5	Oil and gas (4)	Strong	Significant
6	Technology services (6)	Fair	Modest	6	Pharmaceuticals (10)	Fair	Modest
7	Pharmaceuticals (11)	Fair	Modest	7	Engineering and construction (10)	Satisfactory	Significant
8	Auto (15)	Fair	Modest	8	Utilities (23)	Satisfactory	Significant
9	Utilities (25)	Satisfactory	Significant	9	Auto (16)	Fair	Modest
10	Engineering and construction (11)	Satisfactory	Significant	10	Media entertainment (4)	Fair	Modest
11	Capital goods (29)	Fair	Intermediate	11	Technology hardware (14)	Fair	Intermediate
12	Technology hardware (20)	Fair	Intermediate	12	Capital goods (20)	Fair	Significant
13	Retail (13)	Fair	Significant	13	Real estate (14)	Satisfactory	Aggressive
14	Media entertainment (4)	Weak	Intermediate	14	Railway/Metro (8)	Satisfactory	Aggressive
15	Railway/Metro (8)	Satisfactory	Aggressive	15	Mining (8)	Satisfactory	Aggressive
16	Real estate (14)	Satisfactory	Aggressive	16	Retail (13)	Fair	Significant
17	Mining (8)	Fair	Significant	17	Transportation (9)	Fair	Significant
18	Building materials (8)	Fair	Aggressive	18	Building materials (8)	Fair	Aggressive
19	Chemicals (7)	Fair	Aggressive	19	Metals (9)	Fair	Aggressive
20	Transportation (5)	Weak	Aggressive				
21	Metals (12)	Fair	Highly leveraged				

*Numbers in brackets represent numbers of companies. Source: S&P Global Ratings' estimate based on company annual reports.

Credit quality between the top and bottom sectors are widely divergent. The telecom, oil and gas, and infrastructure sectors benefit from high barriers of entry, concentrated market structures, and government policies favoring strong companies playing a key role in strategic industries. Against this, the weakest sectors in terms of credit quality tend to operate in volatile, competitive, and capital-intensive industries, such as commodities.

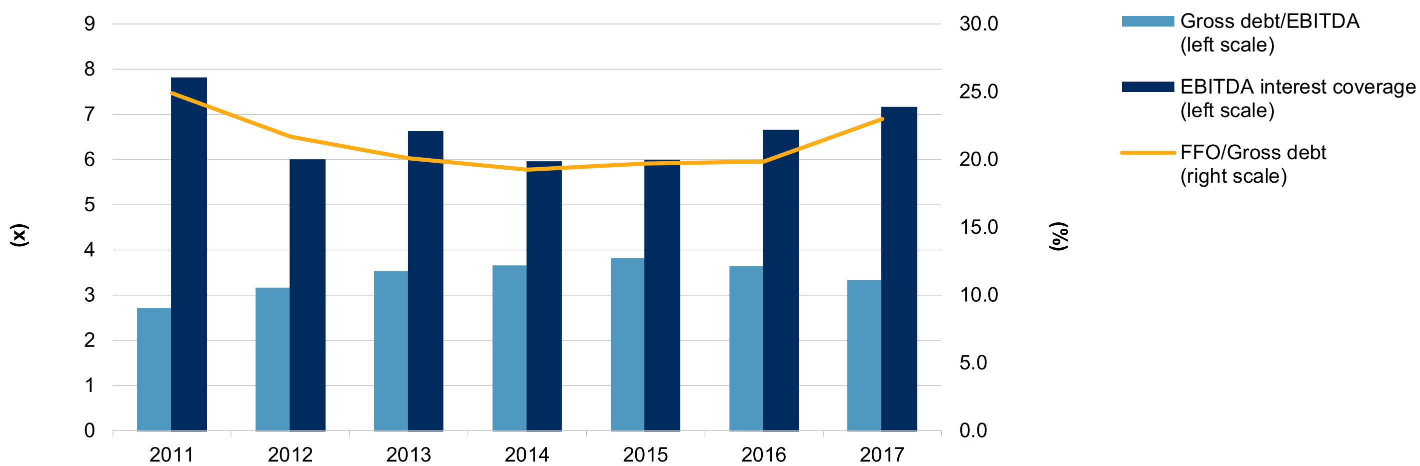
Notably, the newly included package express sector is in the top-five club, reflecting its healthy financial position. Most of the main players in moving packages started their businesses in the 1990s, maintain good cost controls, and benefit from continuous market concentration. While express delivery in China remains relatively fragmented compared with the U.S. market, the companies we include in this sector account for nearly 60% of China's total package volume in 2017.

Two Consecutive Years Of Deleveraging

The pace of deleveraging picked up for China's top corporates in 2017. The median debt-to-EBITDA ratio further improved to 3.3x in 2017 from 3.6x in 2016, and 3.8x in 2015. Moreover, the deleveraging progress was highest for the 25% of companies with the highest leverage. Other metrics including interest coverage and cash flow debt coverage also built on the improving trend that began in 2016.

Chart 3

China's Top Corporates' Credit Metrics



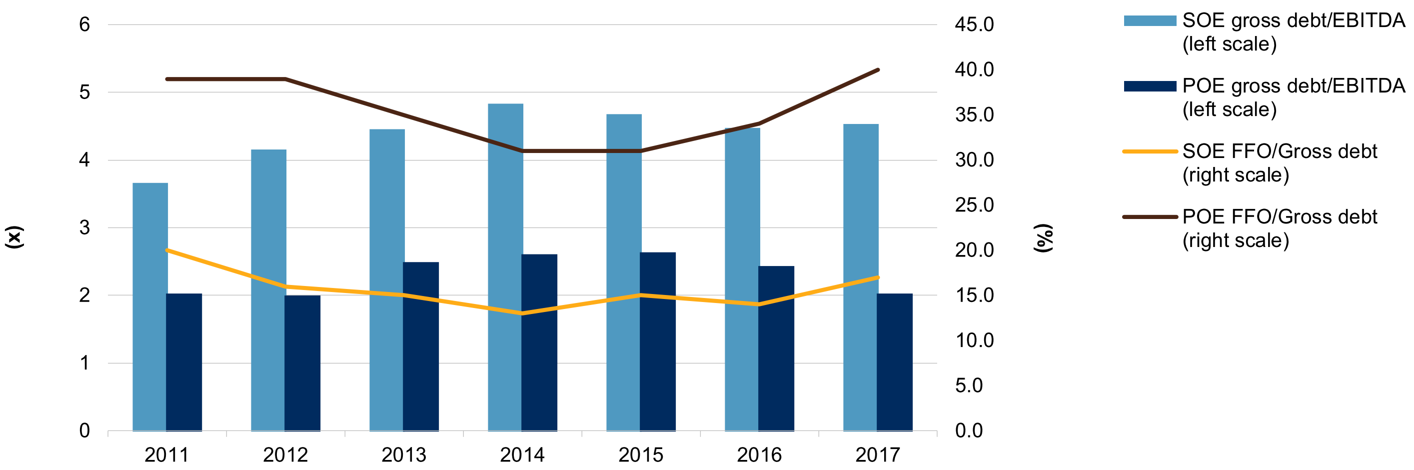
FFO--Funds from operations. Source: S&P Global Ratings' estimate based on company annual reports.

SOEs as a group showed flat credit metrics from 2016 to 2017. However, this is because the newly added SOEs concentrate more in capital goods and commodities, which have weaker financial profiles.

Private companies continue to demonstrate more capital efficiency. They have consistently presented stronger ratios than SOEs in the past seven years.

Chart 4

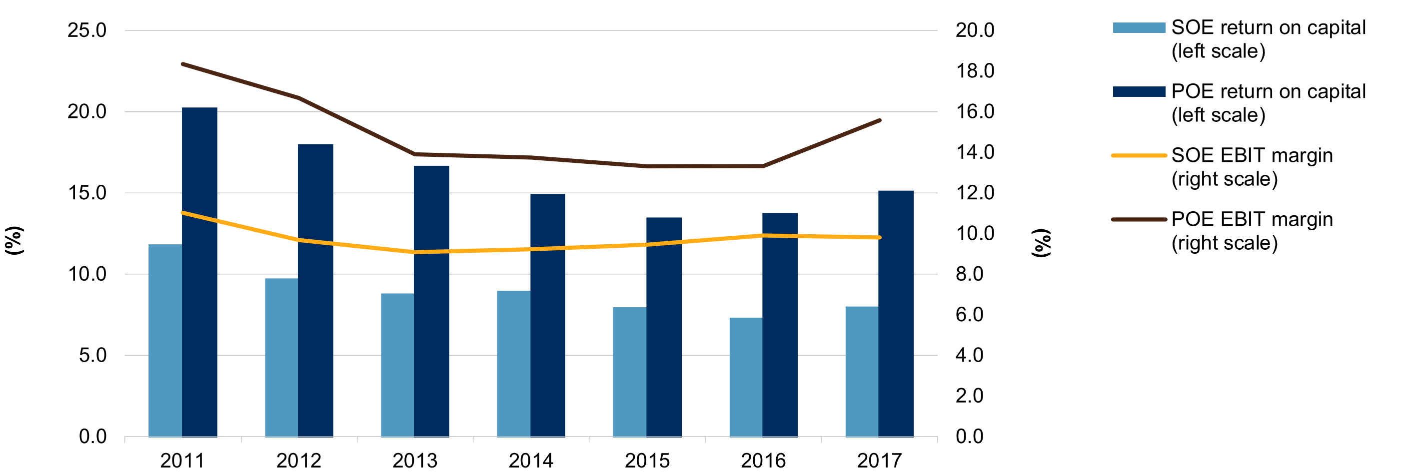
Leverage Of State-Owned Enterprises And Privately Owned Enterprises



SOE--State-owned enterprises. POE--Privately owned enterprises. FFO--Funds from operations. Source: S&P Global Ratings' estimate based on company annual reports.

Chart 5

State-Owned Enterprises And Privately Owned Enterprises Profitability



SOE--State-owned enterprises. POE--Privately owned enterprises. Source: S&P Global Ratings' estimate based on company annual reports.

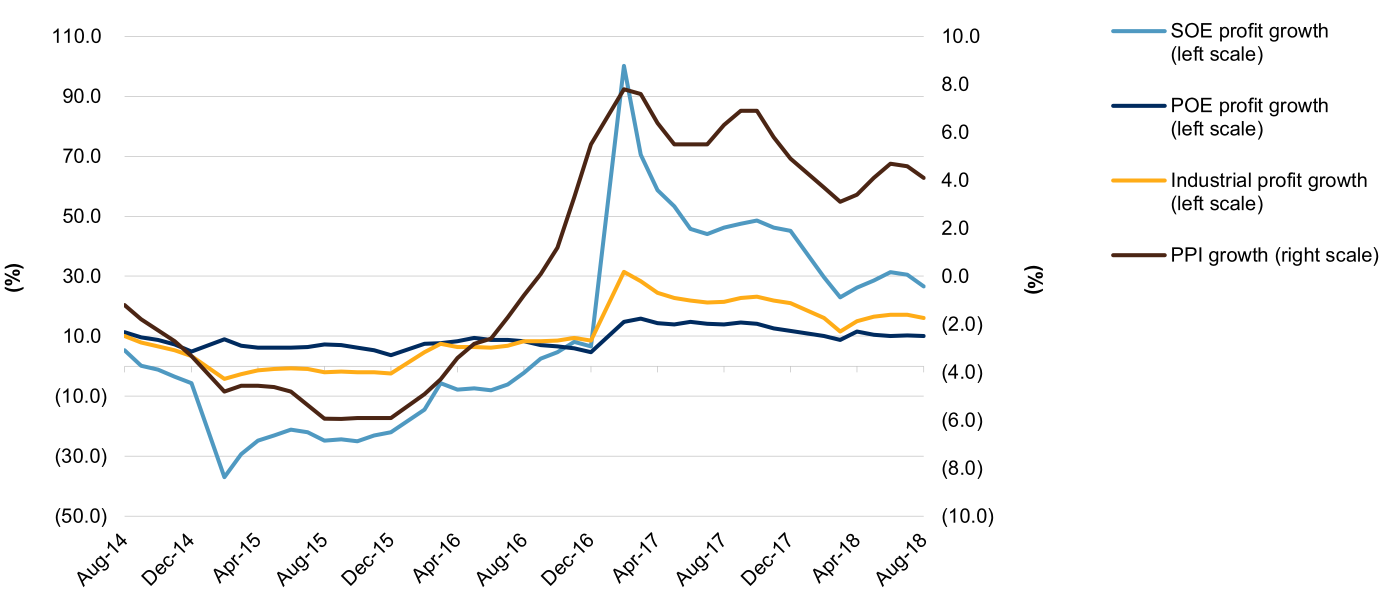
Financial risk profiles for companies in the commodities sectors generally improved in this year's survey. We have seen strong price gains from the supply-side reforms and closures of polluting industrial producers in 2017. Though price gains have moderated, price should be resilient at high levels going forward in 2018.

Upstream SOE industrial firms continued to deleverage in 2017. More disciplined capital expenditure and limited overseas acquisitions last year have also shored up financial positions.

Private-enterprises, in general, faced some margin pressure than SOEs amid higher raw material prices. Still, their profits grew, if at a slower pace than SOEs, amid China's broader reflationary trends in 2017.

Chart 6

Moderate Producer Price Index Growth Led State-Owned Enterprises And Privately Owned Enterprises Converge



PPI--Producer price index. SOE--State-owned enterprises. POE--Privately owned enterprises. Source: National Bureau of Statistics, S&P Global Ratings.

Private companies have been hit harder by China's crackdown on shadow banking activities. Their banking relationships are not as deep, and as such they have faced refinancing difficulties and higher funding costs this year.

Mixed Showing In Business And Financial Risk Profiles

The top 254 corporates have an overall business risk profile that we classify as fair and a financial risk profile of intermediate. Compared with last year, the business risk profile deteriorated by one category due to a wider coverage of smaller companies. Our assessments map the portfolio to an anchor of 'bb+', compared with 'bbb' to 'bbb-' last year.

Our business and financial risk profiles are forward-looking, which also explains some of the deterioration, given tougher credit conditions and rising economic uncertainty.

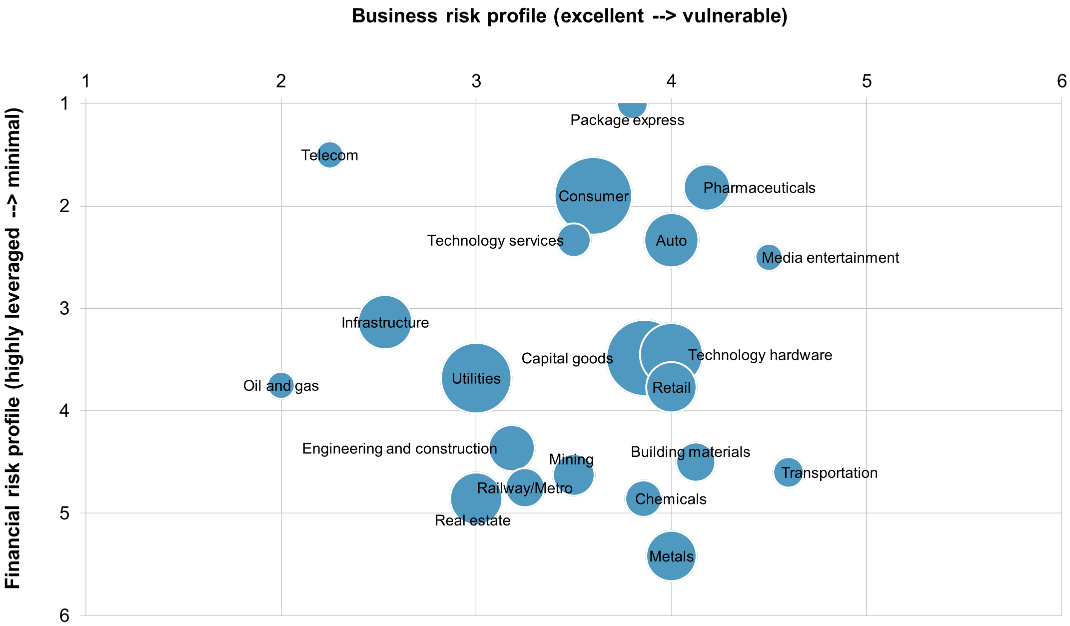
Looking only at companies that were in last year's sample, we revised our business or financial risk assessments for a quarter (26%) of the portfolio. Business risk profiles weakened for four sectors. Financial risk profiles deteriorated for three sectors and improved for two. However, keep in mind that one of the improved sectors was capital goods, a major one with 29 companies, while one of the weakened sectors, media and entertainment, has only four companies.

Our transportation sector now captures more risks from airline operators and logistics companies, since we moved package express companies into a separate category. As a result, we lowered our financial and business risk profiles for transportation, even though the credit metrics of individual companies did not deteriorate.

Newly added miners present weaker financial metrics, dragging down the sector's financial risk profile by one category as well.

Chart 7

China Top Corporates: Average Business And Financial Risk Profile Of Sample Companies In Industry Sectors



Size of bubble denotes number of entities in sample. Business Risk Profile: 1-Excellent, 2-Strong, 3-Satisfactory, 4-Fair, 5-Weak, 6-Vulnerable. Financial Risk Profile: 1-Minimal, 2-Modest, 3-Intermediate, 4-Significant, 5-Aggressive, 6-Highly leveraged. Source: S&P Global Ratings.

Table 2

China's Top Corporates' Business Risk And Financial Risk Profiles

No.	Entity	Business risk profile	Financial risk profile	No.	Entity	Business risk profile	Financial risk profile
1	AAC Technologies Holdings Inc.	4	2	128	Harbin Electric Co. Ltd.	5	4
2	Air China Ltd.	4	5	129	He Steel Group Co. Ltd.	4	6
3	Alibaba Group Holding Ltd.	2	1	130	Heilan Home Co. Ltd.	4	1
4	Aluminum Corp. of China Ltd.	3	6	131	Hengan International Group Co. Ltd.	3	1
5	Anhui Conch Cement Co. Ltd.	3	1	132	Hengyi Petrochemical Co. Ltd.	5	6
6	Anhui Transportation Holding Group Co. Ltd.	2	5	133	Hisense Electric Co. Ltd.	4	1
7	Ansteel Group Corp.	3	6	134	Hisense Kelon Electrical Holdings Co. Ltd.	5	1
8	Asia Cement (China) Holdings Corp.	5	5	135	Hua Hong Semiconductor Ltd.	4	2
9	Aviation Industry Corp. of China Ltd.	3	5	136	Huabao International Holdings Ltd.	4	1
10	Bailian Group Co. Ltd.	3	1	137	Huadong Medicine Co. Ltd.	5	1
11	BBMG Corp.	4	6	138	Huawei Investment & Holding Co. Ltd.	3	1
12	Beijing Automotive Group Co. Ltd.	4	4	139	HUAYU Automotive Systems Co. Ltd.	3	1
13	Beijing Enterprises Water Group Ltd.	4	6	140	Inner Mongolia Baotou Steel Union Co. Ltd.	5	6
14	Beijing Gas Group Co. Ltd.	3	1	141	Inner Mongolia Yili Industrial Group Co. Ltd.	3	1
15	Beijing Gehua CATV Network Co. Ltd.	5	3	142	JA Solar Holdings Co. Ltd.	5	5
16	Beijing Infrastructure Investment Co. Ltd.	3	6	143	JD.com Inc.	4	1
17	Beijing Originwater Technology Co. Ltd.	4	3	144	Jiangsu Expressway Co. Ltd.	2	2
18	Beijing Wangfujing Department Store (Group) Co. Ltd.	4	3	145	Jiangsu Guoxin Investment Group Ltd.	4	4
19	Beijing Yanjing Brewery Co. Ltd.	4	1	146	Jiangsu Hengrui Medicine Co. Ltd.	4	1
20	BOE Technology Group Co. Ltd.	4	4	147	Jiangsu Shagang Co. Ltd.	4	2
21	Bosideng International Holdings Ltd.	5	3	148	Jiangsu Yanghe Brewery	4	1
22	Bright Food (Group) Co. Ltd.	3	5	149	Jin Jiang International (Holdings) Co. Ltd.	3	6
23	Brilliance China Automotive Holdings Ltd.	4	3	150	Jinke Property Group Co. Ltd.	4	6
24	BYD Co. Ltd.	4	4	151	Jizhong Energy Group Co. Ltd.	4	6
25	Capital Airports Holding Co.	2	3	152	Joy City Property Ltd.	4	6
26	Chengdu Xingrong Environment Co. Ltd.	4	2	153	Kangmei Pharmaceutical Co. Ltd.	4	2

Table 2

China's Top Corporates' Business Risk And Financial Risk Profiles (cont.)

No.	Entity	Business risk profile	Financial risk profile	No.	Entity	Business risk profile	Financial risk profile
27	China Aerospace Science and Industry Co. Ltd.	3	1	154	Kingsoft Corp. Ltd.	5	3
28	China Aerospace Science and Technology Corp.	2	1	155	Kunlun Energy Co. Ltd.	3	3
29	China Baowu steel Group Corp. Ltd.	3	5	156	Kweichow Moutai Co. Ltd.	3	1
30	China Coal Energy Co. Ltd.	4	6	157	Lenovo Group Ltd.	4	4
31	China Communications Construction Co. Ltd.	3	5	158	Lens Technology Co. Ltd.	4	3
32	China Communications Services Corp. Ltd.	3	1	159	Lianhua Supermarket Holdings Co. Ltd.	5	6
33	China Co-op Group Co. Ltd.	4	6	160	Longfor Properties Co. Ltd.	3	4
34	China Cosco Holdings Co. Ltd.	5	6	161	Lonking Holdings Ltd.	4	3
35	China CSSC Holdings Ltd.	5	6	162	Luxshare Precision Industry Co. Ltd.	4	2
36	China Datang Corp.	4	6	163	Maoye International Holdings Ltd.	4	6
37	China Eastern Airlines Corp. Ltd.	5	5	164	Midea Group Co. Ltd.	3	1
38	China Electronics Corp.	4	6	165	Minth Group Ltd.	5	2
39	China Energy Engineering Corp. Ltd.	3	4	166	NetEase Inc.	4	1
40	China Everbright International Ltd.	3	4	167	New Oriental Education & Technology Group Inc.	4	1
41	China Evergrande Group	3	6	168	Ningbo Port Co. Ltd.	2	2
42	China Film Co. Ltd.	4	1	169	OCT Enterprises Co.	4	5
43	China Gas Holdings Ltd.	3	4	170	Parkson Retail Group Ltd.	5	6
44	China General Nuclear Power Corp.	2	6	171	Poly Real Estate Group Co. Ltd.	2	5
45	China General Technology (Group) Holding Co. Ltd.	4	5	172	Power Construction Corporation of China Ltd.	3	5
46	China Guodian Corp.	3	5	173	Qingdao Haier Co. Ltd.	3	1
47	China Huadian Corp.	3	5	174	Qingling Motors Co. Ltd.	5	2
48	China Huaneng Group Co. Ltd.	3	5	175	Rongsheng Petrochemical Co. Ltd.	5	6
49	China International Marine Containers Group Co. Ltd.	4	6	176	S.F. Holding Co. Ltd.	3	1
50	China Lodging Group Ltd.	3	5	177	SAIC Motor Corp. Ltd.	3	2
51	China Longyuan Power Group Corp. Ltd.	2	5	178	Sanan Optoelectronics Co. Ltd.	4	2
52	China Machinery Engineering Corp.	4	2	179	Sany Heavy Industry Co. Ltd.	4	5
53	China Mengniu Dairy Co. Ltd.	3	2	180	Semiconductor Manufacturing International Corp.	4	3

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No.	Entity	Business risk profile	Financial risk profile	No.	Entity	Business risk profile	Financial risk profile
54	China Merchants Shekou Industrial Zone Holdings Co. Ltd.	3	4	181	Shandong Chenming Paper Holdings Ltd.	4	6
55	China Metallurgical Group Corp.	3	5	182	Shandong Gold Group Co. Ltd.	4	5
56	China Minmetals Corp.	3	5	183	Shandong Iron and Steel Co. Ltd.	5	6
57	China Mobile Ltd.	2	1	184	Shandong Linglong Tyre Co. Ltd.	4	4
58	China Molybdenum Co. Ltd.	4	4	185	Shanghai Construction Group Co. Ltd.	4	4
59	China National Building Materials Co. Ltd.	4	6	186	Shanghai Electric Group Co. Ltd.	3	1
60	China National Chemical Corp. Ltd.	3	6	187	Shanghai FOSUN Pharmaceutical (Group) Co. Ltd.	4	4
61	China National Machinery Industry Corp.	4	3	188	Shanghai Huayi (Group) Co.	4	5
62	China National Nuclear Power Co. Ltd.	2	6	189	Shanghai Industrial Holdings Ltd.	4	5
63	China National Offshore Oil Corp.	2	3	190	Shanghai International Airport Co. Ltd.	2	1
64	China National Petroleum Corp.	1	3	191	Shanghai International Port (Group) Co. Ltd.	2	2
65	China North Industries Group Corp.	3	2	192	Shanghai Municipal Investment (Group) Corp.	4	6
66	China Nuclear Engineering Corp.	3	5	193	Shanghai Oriental Pearl Media Co. Ltd.	4	3
67	China Overseas Land & Investment Ltd.	2	4	194	Shanghai Pharmaceuticals Holding Co. Ltd.	4	2
68	China Petrochemical Corp.	2	3	195	Shanghai Shentong Metro Group Co. Ltd.	3	6
69	China Railway Construction Corp. Ltd.	3	4	196	Shanxi Coal Transportation and Sales Group Co. Ltd.	5	6
70	China Railway Corp.	2	6	197	Shanxi Coking Coal Group Co. Ltd.	4	6
71	China Railway Group Ltd.	3	5	198	Shaanxi Yanchang Petroleum (Group) Co. Ltd.	3	6
72	China Railway Signal & Communication Corp. Ltd.	4	1	199	Shenergy (Group) Co. Ltd.	3	2
73	China Resources Beer (Holdings) Co. Ltd.	3	1	200	Shenzhen Airport Co. Ltd.	3	1
74	China Resources Cement Holdings Ltd.	4	4	201	Shenzhen Expressway Co. Ltd.	3	3
75	China Resources Land Ltd.	2	4	202	Shenzhen Metro Group Co. Ltd.	3	6
76	China Resources Pharmaceutical Group Ltd.	3	3	203	Shenzhen O-film Tech. Co. Ltd.	4	4
77	China Resources Power Holdings Co. Ltd.	3	4	204	Shenzhou International Group Holdings Ltd.	3	1

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No.	Entity	Business risk profile	Financial risk profile	No.	Entity	Business risk profile	Financial risk profile
78	China Shenhua Energy Co. Ltd.	2	2	205	Sichuan Expressway Co. Ltd.	3	3
79	China Shipbuilding Industry Corp.	3	4	206	Sino Biopharmaceutical Ltd.	5	1
80	China Shougang Group Co. Ltd.	4	6	207	Sinochem Group Co. Ltd.	3	5
81	China South Industries Group Corp.	3	2	208	Sinopharm Group Co. Ltd.	3	3
82	China Southern Airlines Co. Ltd.	5	5	209	Sinotrans Ltd.	4	2
83	China Southern Power Grid Co. Ltd.	2	3	210	Sinotruk (Hong Kong) Ltd.	5	3
84	China State Construction Engineering Corp. Ltd.	2	4	211	Skyworth Digital Holdings Ltd.	5	6
85	China State Shipbuilding Corp.	4	5	212	State Grid Corp. of China	2	2
86	China Telecom Corp. Ltd.	2	2	213	STO Express Co. Ltd.	4	1
87	China Three Gorges Corp.	2	4	214	Sun Art Retail Group Ltd.	3	1
88	China United Network Communications Ltd.	2	2	215	Suning Commerce Group Co. Ltd.	4	4
89	China Vanke Co. Ltd.	2	3	216	Sunny Optical Technology (Group) Co. Ltd.	4	2
90	China Water Affairs Group Ltd.	3	4	217	TAL Education Group	4	1
91	China Yongda Automobiles Services Holdings Ltd.	4	6	218	Tangshan Jidong Cement Co. Ltd.	4	6
92	China Yuchai International Ltd.	3	2	219	Tencent Holdings Ltd.	2	1
93	Chongqing Changan Automobile Co. Ltd.	4	2	220	Tianjin Port Development Holdings Ltd.	3	4
94	Chongqing Water Group Co. Ltd.	4	1	221	Tingyi (Cayman Islands) Holding Corp.	3	2
95	COFCO Corp.	2	6	222	Tongkun Group Co. Ltd.	4	3
96	COSCO Shipping Ports Ltd.	2	4	223	Travelsky Technology Ltd.	4	2
97	CRRC Corp. Ltd.	3	1	224	Triangle Tyre Co. Ltd.	4	2
98	CSG Holding Co. Ltd.	4	4	225	Tsinghua Holdings Co. Ltd.	3	6
99	CSPC Pharmaceutical Group Ltd.	5	1	226	Tsingtao Brewery Co. Ltd.	4	1
100	Ctrip.com International Ltd.	4	6	227	Uni-President China Holdings Ltd.	4	2
101	Dalian Port (PDA) Co. Ltd.	4	4	228	Vinda International Holdings Ltd.	4	3
102	Dalian Wanda Commercial Management Group Co. Ltd.	3	5	229	Vipshop Holdings Ltd.	4	1
103	Daqin Railway Co. Ltd.	4	1	230	Wanda Cinema Line Co. Ltd.	5	3
104	Dashang Group Co. Ltd.	4	3	231	Wanhua Chemical Group Co. Ltd.	3	3
105	Dongfang Electric Corp. Ltd.	4	1	232	Want Want China Holdings Ltd.	4	1
106	Dongfeng Motor Group Co. Ltd.	4	2	233	Weichai Power Co. Ltd.	3	2

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No.	Entity	Business risk profile	Financial risk profile	No.	Entity	Business risk profile	Financial risk profile
107	Dongxu Optoelectronic Technology Co. Ltd.	4	6	234	Weiqiao Textile Co. Ltd.	4	2
108	ENN Energy Holdings Ltd.	3	3	235	WH Group Ltd.	3	2
109	First Tractor Co. Ltd.	5	5	236	Wuliangye Yibin Co. Ltd.	3	1
110	Fuyao Glass Industry Group Co. Ltd.	4	2	237	XCMG Construction Machinery Co. Ltd.	4	5
111	GCL-Poly Energy Holdings Ltd.	4	5	238	Xingfa Aluminum Holdings Ltd.	4	5
112	Geely Automobile Holdings Ltd.	4	2	239	Xinxing Cathay International Group Co. Ltd.	4	5
113	GoerTek Inc.	4	3	240	Xinyi Glass Holdings Ltd.	5	4
114	Golden Eagle Retail Group Ltd.	4	4	241	Yanfeng Global Automotive Interior Systems Co. Ltd.	4	2
115	Great Wall Motor Co. Ltd.	4	2	242	Yanzhou Coal Mining Co. Ltd	4	5
116	Gree Electric Appliances, Inc. of Zhuhai	4	1	243	Yonghui Superstores Co. Ltd.	4	4
117	Guangdong Communication Group Co. Ltd.	3	6	244	YTO Express Group Co. Ltd.	4	1
118	Guangdong Investment Ltd.	3	1	245	Yunda Holding Co. Ltd.	4	1
119	Guangshen Railway Co. Ltd.	4	1	246	Yunnan Aluminum Co. Ltd	4	6
120	Guangxi Liugong Machinery Co. Ltd.	5	6	247	Yunnan Baiyao Group Co. Ltd.	4	1
121	Guangzhou Automobile Industry Group Co. Ltd.	4	2	248	Zhejiang Dahua Technology Co. Ltd.	4	2
122	Guangzhou Baiyun International Co. Ltd.	2	1	249	Zhejiang Provincial Energy Group Co. Ltd.	3	3
123	Guangzhou Baiyunshan Pharmaceutical Holdings Co. Ltd.	5	1	250	Zhongsheng Group Holdings Ltd.	4	4
124	Guangzhou Communications Investment Group Co. Ltd.	3	6	251	Zijin Mining Group Co. Ltd.	3	3
125	Guangzhou Metro Corp.	3	6	252	Zoomlion Heavy Industry Science and Technology Co. Ltd.	4	6
126	Guizhou Tyre Co. Ltd.	6	6	253	ZTE Corp.	4	4
127	Hangzhou Hikvision Digital Technology Co. Ltd.	4	2	254	ZTO Express (Cayman) Inc.	4	1

Business Risk Profile: 1-Excellent, 2-Strong, 3-Satisfactory, 4-Fair, 5-Weak, 6-Vulnerable. Financial Risk Profile: 1-Minimal, 2-Modest, 3-Intermediate, 4-Significant, 5-Aggressive, 6-Highly leveraged. Source: S&P Global Ratings.

Table 3

Business And Financial Risk Profile Matrix

	Financial risk profile					
Business risk profile	1 (minimal)	2 (modest)	3 (intermediate)	4 (significant)	5 (aggressive)	6 (highly leveraged)
1 (excellent)	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
2 (strong)	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
3 (satisfactory)	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
4 (fair)	bbb/bbb-	bbb-	bb+	bb	bb-	b
5 (weak)	bb+	bb+	bb	bb-	b+	b/b-
6 (vulnerable)	bb-	bb-	bb-/b+	b+	b	b-

Source: S&P Global Ratings

Conditions Are Getting More Difficult

After two years of progress, the deleveraging trend is set to pause. In our view, this is due mainly to decelerating earnings growth rather than profligate spending or borrowing. We think capital spending is still restrained. In particular, SOEs have a mandate to control debt growth and reduce asset leverage target (total liabilities to total assets). Capacity reduction for industries with excess capacity such as metals and mining, building materials and coal-fired power generation, is likely to continue under the supply side reform policy. Forced reduction of capacity has also shrunk capital spending in these industries. However, slowing growth in fixed asset investment (FAI), consumption and exports could lead to contracting industrial earnings growth.

We expect financial risks to continue to rise amid tighter credit conditions. By making banks bring "shadow financing" onto their balance sheets, regulators have clamped down on the alternative financing instruments heavily patronized by private-sector borrowers. These enterprises have faced difficulty in refinancing their debt obligations this year, causing defaults in some cases. Private-sector firms are also more likely to have shares pledged as collateral for loans. This has made them vulnerable to falling equity markets, which could lead to unwinding risk or covenant-breaching changes in control.

Going forward, defaults, especially in private companies, will likely to continue to increase.

Escalating trade tensions add more complications

The trade rift between the U.S. and China will likely lead to slowing demand for industrial goods and a higher cost of goods for corporates. Indirect effects on investor confidence could be larger, deferring investment activities and knocking consumption. In a worst-case scenario of losses and job cuts, nearly all sectors will be affected to some degree, even those that mainly focus on the domestic market. For example, property developers could face lower housing purchasing power or willingness to buy. Local government financing vehicles (LGFVs) may find it difficult to deleverage due to the higher infrastructure investment demand to counteract the trade war impact, increasing the debt growth of LGFVs and local governments.

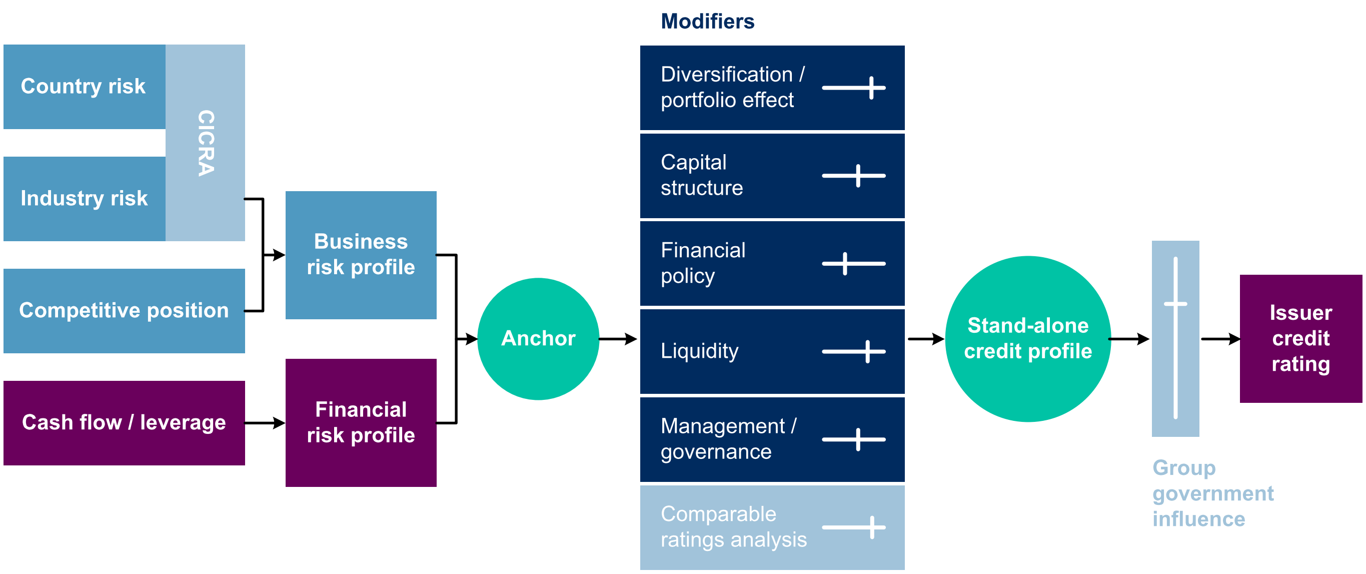
Appendix: How We Assess Business And Financial Risk Profiles

We analyze the credit profiles of China's top corporates by assessing their business risk and financial risk profiles.

These factors are two key components in determining the anchor rating (see chart 8). In our analysis, we do not consider the rating modifiers (including liquidity, capital structure, among other factors) and group or government support. For some companies, extraordinary support from government or the parent group often provides a meaningful uplift to the rating.

Chart 8

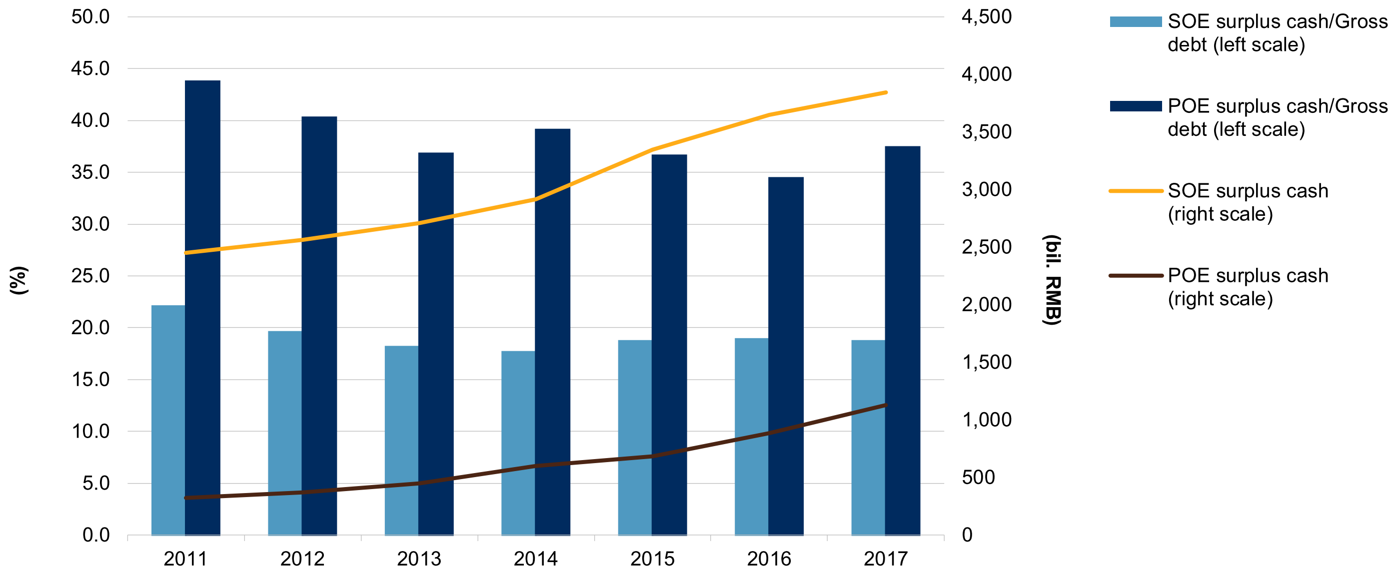
Corporate Criteria Framework



In calculating the total debt for the sample, we typically have assumed a standard "haircut" of 25% for surplus cash unless there is specific information to use a different amount. The residual cash is used to offset gross debt. This treatment can have a meaningful impact on the financial risks assessment as our portfolio's surplus cash is nearly 16.3% of total reported gross debt in 2017.

Chart 9

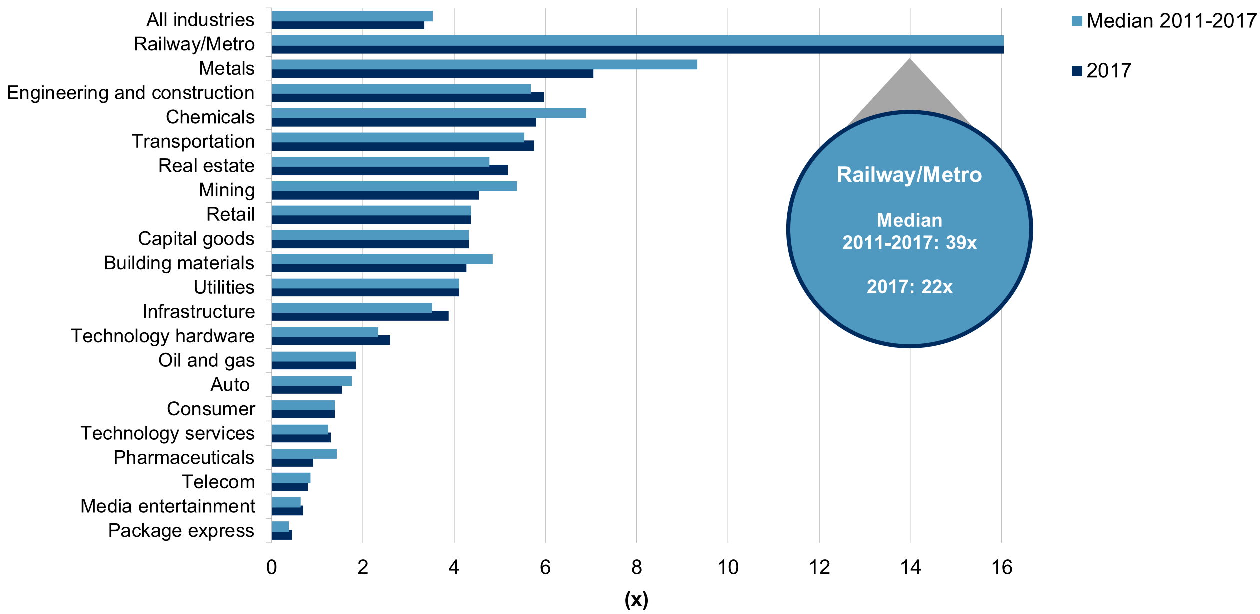
China's Top Corporates' Material Cash Balances Somewhat Offset High Corporate Leverage



RMB--Renminbi. SOE--State owned enterprises. POE--Privately owned enterprises. Source: S&P Global Ratings' estimate based on company annual reports.

Chart 10

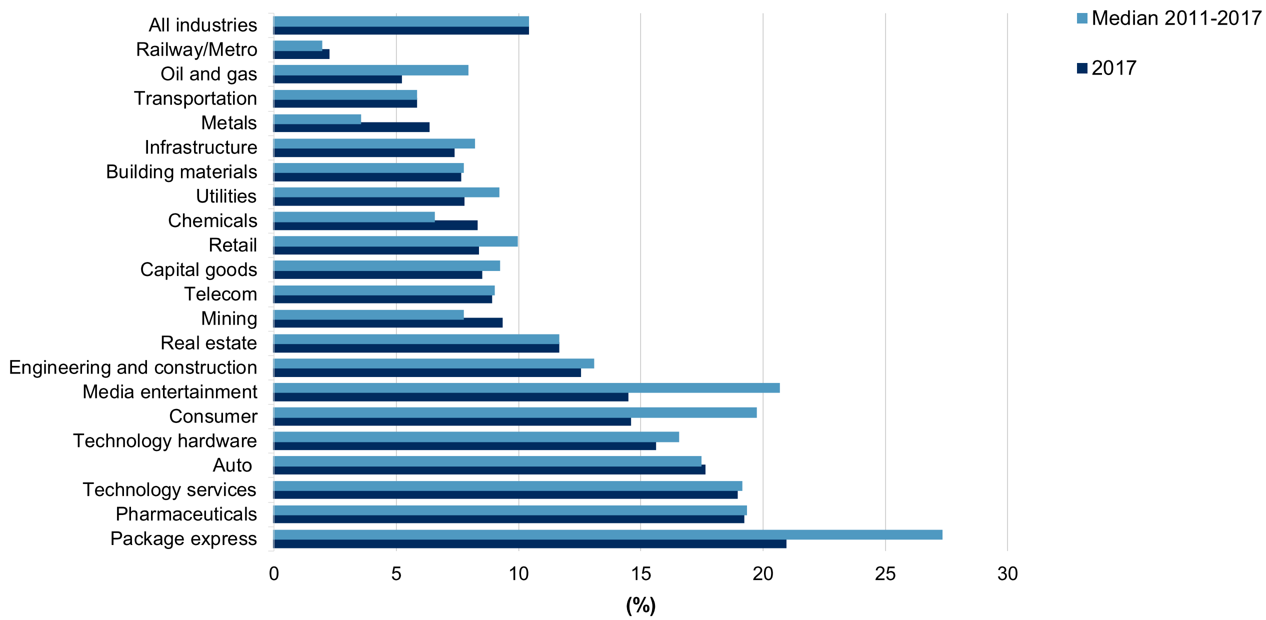
China's Top Corporates: Gross Debt To EBITDA By Sector



Source: S&P Global Ratings' estimate based on company annual reports.

Chart 11

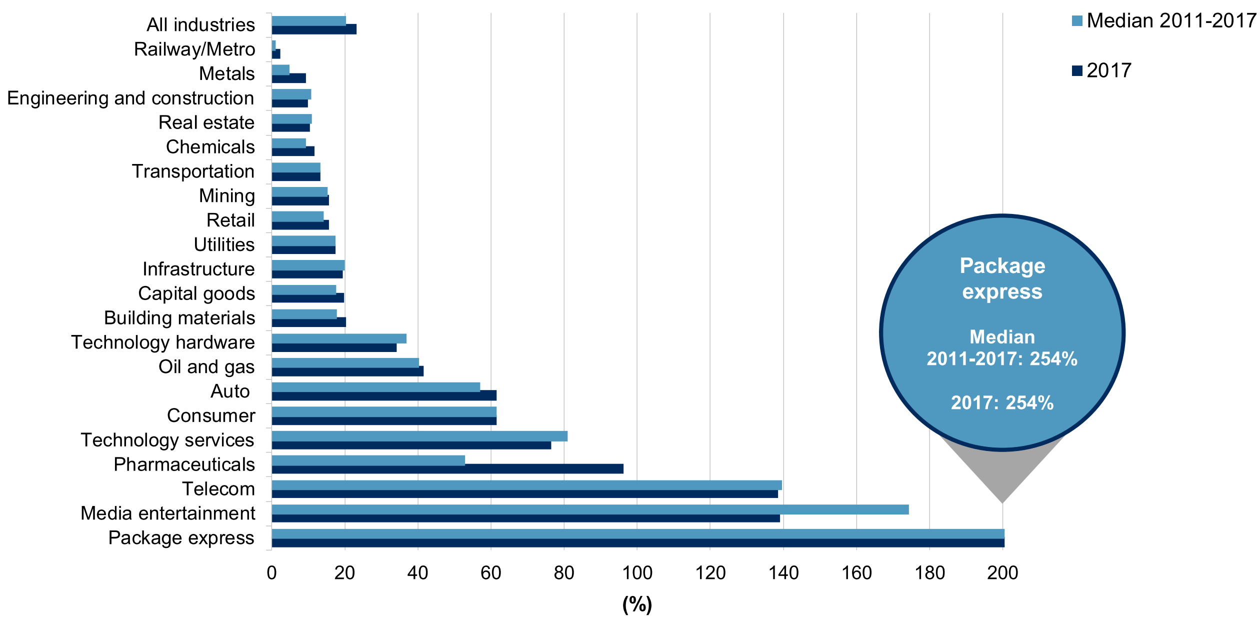
China's Top Corporates: Return On Capital By Sector



Source: S&P Global Ratings' estimate based on company annual reports.

Chart 12

China Top Corporates: Funds From Operations-To-Gross Debt By Sector



Source: S&P Global Ratings' estimate based on company annual reports.

Related Criteria And Research

Related Criteria

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This report does not constitute a rating action.