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China's Top Corporates Face Elevated Financial Risks As Economy Slows

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HONG KONG (Standard & Poor's) Oct. 28, 2015--Disciplined financial management will become more important for Chinese corporations as economic growth slows and lenders turns cautious on lending due to elevated financial risks. That's according to a report that Standard & Poor's Ratings Services released today, titled: "The Worst Isn't Over For China's Top Corporates." The report surveys China's top 200 companies by revenue, bond issuance, and market capitalization, and assesses the industry risks for the 19 major sectors.

"Financial risks are still high for Corporate China. Many companies are heavily debt-laden and will be vulnerable to any drastic slowdown in economic growth or changes in credit conditions," said Standard & Poor's credit analyst Terry Chan.

But the deterioration in financial risks at least appears to have slowed in 2015. In addition, corporate bond defaults have been limited although a few high-profile defaults have shattered long-held perceptions of the invincibility of state-owned enterprises.

"If defaults do increase meaningfully, corporates could start to aggressively cut capital expenditure and investments, which would likely depress even further the investment growth driver for the Chinese economy. In turn, that could reduce demand for commodities and capital goods from countries with large exposure to the China investment story," said Standard & Poor's credit

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analyst Christopher Lee.

We expect demand to remain sluggish across many industries for the next 12-18 months due to more cautious capital spending, at least, squeezing margins and constraining business confidence. The sectors most vulnerable to the tough conditions for this year and next are capital goods and metals and mining.

The recent correction in the property market and the sharp decline in new construction and land acquisitions have an obvious knock-on effect for related industries, including steel and building materials.

In a stressed scenario, Standard & Poor's expects lower investment to trim China's annual GDP growth to 5.3% in 2016 and 5.1% in 2017.

"Any drastic slowdown in China's economic growth, which is not our base case, is likely to trigger multi-notch downgrades among several industries, such as building materials, metals and mining, real estate developers, and transport-cyclical," Mr. Chan said.

China's highly indebted heavy industries continue to have worse financial metrics than global peers'. So while the deterioration in financial risks may be moderating, there are still meaningful downside risks to credit profiles for China corporates.

"Next year looks to be one when China's corporate sector should aim to rebalance their financial risk profiles against an environment of meaningful downside risks to economic growth, and potentially volatile credit market as the U.S. raises interest rates," Mr. Lee said.

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