2015 China Auto Finance Report

Deloitte China Automotive Service
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Introduction

China's auto market is facing an inflection point after a "golden decade". Due to economic downturn and slackening demand, China's vehicle sales slumped in 2015, with a growth rate of 7.6 percent in January slumping to negative growth of 2.3 percent in June. Recently, the China Association of Automobile Manufacturers has also lowered its growth estimate for annual sales in 2015 from 7 percent to 3 percent, and modest growth will become the norm for China's auto market in the future.

However, an intensifying imbalance between production and sales has pushed auto manufacturers to clear out their inventories through a series of car purchase incentives, which may hurt low-profit new vehicle sales for auto dealers. Meanwhile, as the Chinese government continues to strengthen its corrective measures on auto repairs and parts, profits and competitiveness of traditional auto dealerships' aftersales service will erode further.

Resting on the most valuable and vibrant part of the auto industry's value chain, financial services will be a huge engine to drive industry transformation and consumption activities as well as enable manufacturers to profit early during the transformation. After extensive expansion and development, China's auto industry deeply needs to transform and refine its system. Creative and effective financial services are an important measure to guard against the effects of slowdowns in traditional services.

Since the announcement of *Administrative Rules Governing the Auto Financing Company* in 2004, the domestic auto finance market has already seen a decade of development. During this period, the domestic auto consumption has grown over 3.6 times. Foreign auto manufacturers actively build factories and expand their capabilities to meet growing demand, but give limited effort to developing high value-added services, such as auto finance. According to the 2014 China Auto Finance Company Industry Development Annual Report issued by the AFC Association Standing Committee of China Banking Association, China's auto credit market just surpassed RMB650 billion in 2014, with a compound growth rate of over 14 percent between 2012 and 2014, and an auto finance penetration rate that exceeded 20 percent.

Commercial banks' auto consumption credit held a dominant position in the early stage of market development. In recently years, auto finance companies have continuously expanded their investments due to relaxed access controls and improved regulatory environment. However, the bottlenecks still prevent the auto finance market's further development, including policies, financing channels, scale, and commercialization. As a result, more flexible and high profitability leasing models are still in the early development phase.

As Millennials, those born in the 1980s and 1990s, have become the main source of purchasing power in the industry, demand for low down payments and low interest financial products has increased. With more sophisticated regulations announced for the leasing industry, auto manufacturers, dealer groups, and third party companies have launched various products and services in this area. China's auto finance market should see high-speed growth in the next five years. Deloitte expects that the penetration rate of China's auto finance will reach 50 percent in 2020 with the market size expected to exceed RMB two trillion.

Another driving force is that internet giants, including Alibaba, Tecent, and P2P online loan companies have started to engage in auto finance, which adds huge competitive pressure to commercial banks and auto finance companies. Internet companies' continuous innovation in data accumulation, user experience, and deal payment will accelerate the development of diversified business models for the auto finance market.

Deloitte has been following developments in China's auto finance market and drafted this white paper based on our research. The report explores recent innovations in the auto finance field and examines the development of a few new major models in China. In China, the auto industry has been marching towards an "Internet era". Though Internet Finance is no longer a buzzword, the term maintains huge potential in the context of auto finance. The trend involves new financing channels that make Internet a principal part of auto finance.

Based on our in-depth knowledge of China's auto and auto finance industries, we hope to help readers get a closer look at the industry's major players and innovative business models. By examining the industry's present and future, we wish to facilitate the continuous innovation and steady development of auto finance in China.

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1. Auto Finance Industry Overview

Summary:

- **Auto finance penetration was only 20 percent in 2014, considerably lower than other developed countries, meaning there is room for future growth. Deloitte expects that China's auto finance penetration rate will reach 50 percent by 2020**
- **Millennials are more open to auto finance products, which should attract more market players to join the competition and spur market development**
- **The Internet companies' involvement in auto finance brings more energy to the industry and negates traditional financial organizations' advantages**
- **Consumption credit remains a major model, while leasing and other new models will enjoy rapid growth**

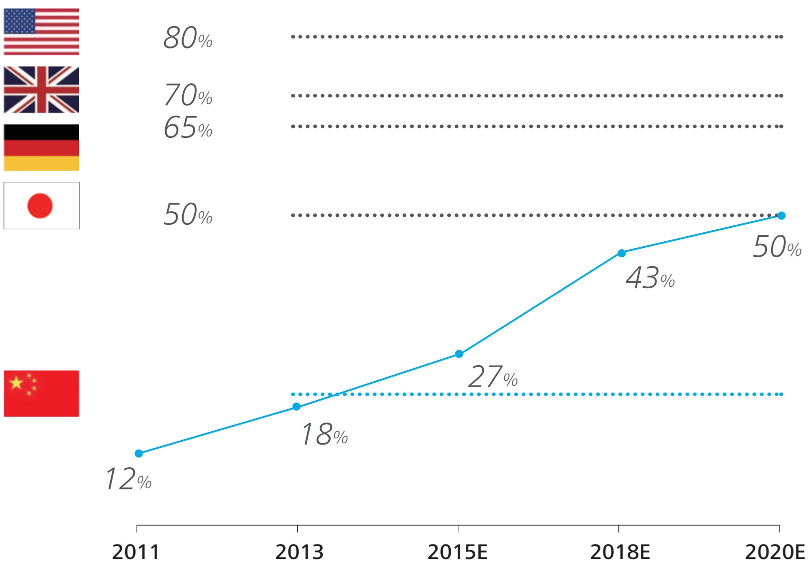
Since 2009, China's new vehicle sales have exceeded the United States meaning China has become the world's largest new car market, with Vehicle Parc reaching 140 million in 2014. In terms of auto aftermarket services, China exhibits a considerable gap in scale and mature development compared with well-established markets. Following a trajectory similar to these markets, auto finance should play an important role in China as the vehicle sales and production mechanisms mature.

Compared with developed markets that boast average penetration rates above 50 percent, China's auto finance penetration rate is low. According to statistics from Experian, a credit agency, 84 percent of new vehicle sales in the United States in 2014 were purchased with credit. By the end of 2014, China auto finance penetration rate was only 20 percent, with huge room for improvement.

With steady growth of Vehicle Parc and growing customer demand, China's auto aftermarket has huge potential. Further auto finance development will enhance auto aftermarket services' profit, eliminate the asymmetry between industrial development and value-added services, and facilitate the industry's transformation and upgrade.

Defined broadly, Auto finance refers to financing activities in vehicle manufacturing, distribution, purchase, and consumption, while narrowly defines the term means financing or other financial services offered to consumers or dealerships in the sales cycle, including the loans for auto dealers' show room construction, equipment, and inventory, as well as consumer loans, leasing, and insurance.

Figure 1.1: Penetration Rate of China Auto Retail Finance Products (2011-2020E)



Note: the penetration rate represents the social penetration rate, including bank, AFC and leasing companies, etc.
Source: The 10th Anniversary of China's Auto Finance Summit, CAAM, NBS, Deloitte Analysis

1.1 Drivers for industry development

- **Younger generation is more receptive to auto credit loans**
  Data from World Bank shows that China's per capita GDP reached US$7,594 in 2014. Advancements in urbanization and growing purchasing power upgraded the consumption structure, and accelerated automobile consumption. Meanwhile, as Millennials gradually become core auto consumers, they are more open and receptive to auto mortgage and leasing products. With an increasing number of auto consumers considering abundance and flexible car loan products as important factors when purchasing a car, it is expected that auto retail finance will improve its market penetration rate in accordance with this change in consumption structure.

  According to Deloitte's latest research on Chinese auto consumer[1], around 90 percent of Millennial consumers plan to purchase or lease a car in the next five years. For them, the main reasons for not purchasing (or delaying purchase of) a car are insufficient affordability, mobility met by walking and public transportation, and concerns about high car maintenance costs. Heavily influenced by the Internet, Millennial consumers are more open to new information and products than previous generations. Millennials are paying attention to auto finance products such leasing—popular in Europe and the United States—which enables consumers to purchase or use a car at a lower cost.

- **Personal credit rating system grows more sophisticated**
  Currently, the Central Bank's national personal credit information database is the foundation of the finance credit system, but it has several limitations, including data dimension, collection channels, and coverage. By the end of 2013, the database included information on about 800 million people; among them, only 320 million were approved for credit and nearly 500 million were not covered by the credit system. Due to the lack of credit data and failure to provide certificates of house property or certificates of large deposits, some consumers are prevented from getting car loans from commercial banks.

  With the inception of personal credit business' marketization, auto finance companies, leasing companies, small-loan companies and P2P companies can not only complete client qualification checks, grant credit through third-party platforms' credit data, and cover the customer segments that are currently under served by commercial banks, but also utilize a big data credit rating system to effectively control risks in every aspect including pre-lending review, lending period, and post-lending management.

- **Financing channels broaden**
  Domestic auto finance companies have three financing channels: shareholders' deposits, bank loans, and issuing financial bonds. Among them, bank loans are the main choice. For a long time, auto finance companies have been competing with commercial banks, but they have also had to rely on banks to finance business expansion. Relying on a single funding channel drives up auto finance companies' lending interest rates and lowers the competitiveness of financial products.

  In recent years, the Central Bank and China Banking Regulatory Commission (CBRC) have backed the expansion of auto finance companies' financing channels with various degrees of regulatory support. For example, CBRC issued a notice in late 2014 indicating that the existing approval system for credit asset securitization will be replaced with a business recording system. CBRC will no longer approve issuances of securitization products on a case-by-case basis. The Central Bank and Chinese Securities Regulatory Commission (CSRC) also issued a similar ruling to replace the approval system with a registration system. Following registration, rapid growth of the securitization of credit assets should alleviate auto finance companies' liquidity issues. In 2014, several auto finance companies-including Shanghai GM, Volkswagen, Toyota, Dongfeng Nissan, BMW, Ford and GAC Group—issued over RMB150 billion personal auto mortgage-backed securities, achieving 35 percent of compound growth compared to RMB1.99 billion by the end of 2008.

- **Legal and regulatory environment improvements**
  In order to encourage healthy and swift auto finance development, the government has made specific revisions and adjustments on certain regulations and polices to deal with the new situations and issues emerging from the development in the auto finance services industry, and formed a supervisory mechanism to monitor new policies and regulations related to auto finance. From the revised *'Administration of the Finance Companies of Enterprises Groups Procedures'* issued by CBRC in 2006 to *'Drafts of Credit Management Regulations'* published by the State Council in recent years, a sound legal foundation has been provided to facilitate the development and upgrade of the auto finance services industry.

[1] The 2014 Deloitte's Global Automotive Consumer Study – The Changing Nature of Mobility Exploring Consumer Preferences in China, October 2014

Table 1.1: Policies Stimulate the Growth of Auto Finance Industry

	Time	Issuance Department	Policy	Effects
1	2004	The State Council	Amendment of *'Measures for the Management of Auto Loans'*	Expands non-banking financial organizations that operate in the auto finance business, allows various kinds of organizations to compete with each other in the vehicle loan market, which is no longer monopolized by banks.
2	2006	China Banking Regulatory Commission	*'Measures for the Administration of Finance Companies of Enterprise Groups'*	Permits qualified finance companies to establish branches; in terms of business scope, allows finance companies to develop related businesses with strengthened fund centralized management, and cancel unrelated with new market positioning.
3	2007	The State Council	*'The Real Right Law of the People's Republic of China'*	Clearly defines the concepts related with auto finance business for the first time, such as floating charges, mortgage registration, and disposal of mortgaged property to sweep away policy obstacles concerning auto finance operations.
4	2007	The State Administration of Industry and Commerce	*'Measures for Chattel Mortgage Registration'*	Simplifies movable property registration procedures, readjust the scope of pledgers; extend the scope of collaterals; transfer to and identify registration departments as industrial & commercial administrative departments at county level where the pledger locates; change the nature of mortgage registration to effectively facilitate the growth of auto finance industry.
5	2008	China Banking Regulatory Commission	*'Administrative Measures for Auto Finance Companies'*	Expands the business scope and financing channels of auto finance companies, readjust administrative measures for auto finance companies in entry conditions, business scopes, and risk management indicators.
6	2008	The State Council	*'Plan on Adjusting and Revitalizing the Auto Industry'*	Further revises and improves auto loan system, promote and regulate auto consumption loan business.
7	2009	The State Council	*'Credit Management Ordinance (Consultation Draft)'*	Plays an important role in establishing a credit system, stipulates general regulations which should be obeyed when credit institutions develop credit businesses and offer guidelines in the credit process.
8	2009	The Central Bank & China Banking Regulatory Commission	*Public Notice of The People's Bank of China, China Banking Regulatory Commission [2009] No. 14*	Grants qualified auto finance companies to issue bonds, and expand their financing channels.
9	2014	China Banking Regulatory Commission	*Notice of the General Office of the China Banking Regulatory Commission on the Workflow for the Recordation Registration of Credit Asset Securitization*	Accelerates efforts to promote credit asset securitization by replacing the approval system for credit asset securitization with a business recordation system, as decided at the 4th meeting of the Inter-Ministerial Joint Meeting for Financial Regulation and Coordination and the 8th chairman's meeting of the CBRC in 2014.
10	2015	The Central Bank	*Announcement No. 7 [2015] of the People's Bank of China—Announcement on Issues concerning the Administration of the Issuance of Credit Asset-Backed Securities*	Abolishes need to approve credit assets securitizations individually, adds issuance limits; further cuts financing costs of auto finance companies.

Source: Public Policy Information, Deloitte Research

1.2 The development of auto finance

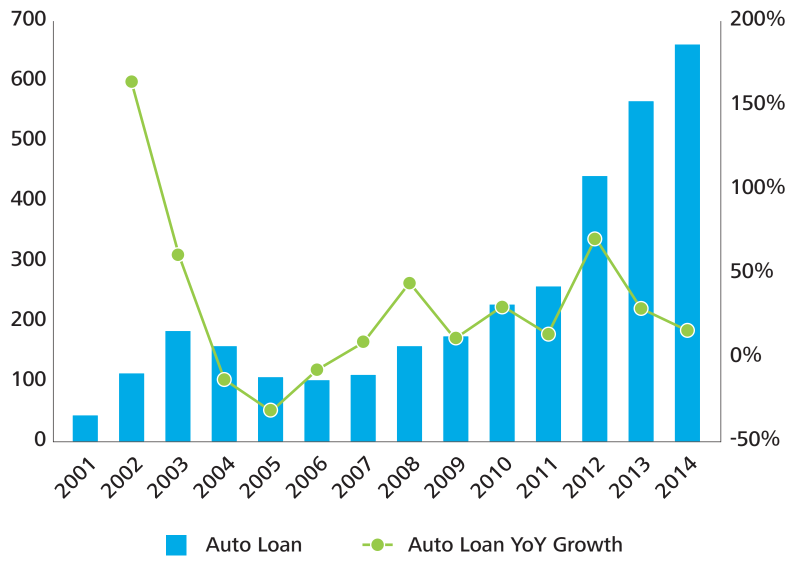
There have been three major phases in recent auto finance development in China.

- **2001-2003: commercial banks monopolize the market**
  The spurt of China auto market growth set the stage for the commercial banks' aggressive expansion of their auto credit loan business. Statistics from the Central Bank suggested that by the end of 2003, auto consumer loan balance accounted for 10 percent of personal loan balance in the financial institutions. Due to credit system shortages, inadequate post-lending management, and low car prices, the percent of bad loans increased sharply to nearly 30 percent of the commercial banks' personal auto loans. Afterwards, certain state-owned banks and joint-stock banks started to downsize the auto loan business. The banks mostly transferred credit risk to the particular insurance companies that provided guarantee insurance for the auto loans. As the loss ratio of car loans increased, it pushed the insurance companies to exit the market temporarily.

- **2004-2007: auto finance companies enter the market**
  The release of *'Administrative Measures for Auto Finance Companies'* allowed foreign auto manufacturers to establish auto finance institutions for the first time and clearly defined the access thresholds, business scopes, operation areas and legal liabilities. Auto finance companies had not yet been able to expand their scales due to the inflexible interest rate, monotonous business models, deficient sales network, and service quality, coupled with limited funding sources. However, the establishment of auto finance companies did break the status quo of single participant in China's auto retail finance market, and speed up the industry competition.

- **2008-present: competition diversifies**
  A revised version of *'Administrative Measures for Auto Finance Companies'* was released in 2008. It eliminated regulatory barriers, such as the single funding channel issue, that had inhibited auto finance companies from increasing scale. In addition, the revisions added a new session on leasing and formally defined auto finance companies' three core businesses.

Figure 1.2: China's Auto Loan Market Size between 2001-2014 (RMB1 billion)



Source: Wind

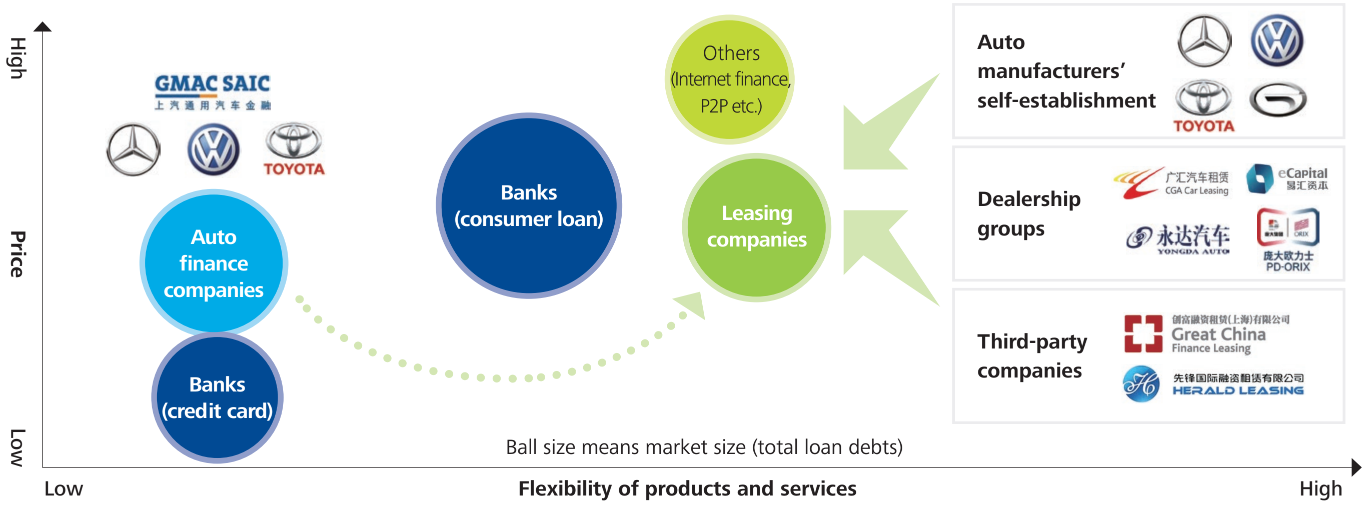
According to statistics from the China Banking Regulatory Commission, by the end of 2014, there were 18 auto finance companies in China with total assets of RMB340.3 billion, a loan balance of RMB320.4 billion, net profits of RMB5.88 billion, and compound growth of 42.5 percent, 43.5 percent, and 131.7 percent respectively compared with those in 2007. The annual accumulative car loans offered to dealerships' inventory was equal to 3.47 million cars, retail loans for 2.26 million cars, and personal auto consumption loans accounted for over 55 percent of the banking financial institutions (excluding credit card purchase instalment payments). The average capital adequacy rate of auto finance companies was 16 percent and the non-performing assets ratio was 0.38 percent.

1.3 Existing products and development landscape

At present, auto consumption loans are the main part of China's auto retail financial services, occupying about 85 percent of the market, while leasing and car rental have small scales, taking up about 15 percent of the market. The auto finance industry has attracted numerous organizations including banks, auto finance companies, leasing enterprises, small-loan companies, bonding companies and Internet finance companies to join the game.

By the end of 2014, 54 percent of domestic personal auto consumption loans were provided by commercial banks, and auto finance companies occupied 26 percent of the market share, and leasing companies took up 10 percent of the market.

Figure 1.3: China Auto Finance Competitive Landscape and Major Players



Source: Deloitte Analysis

Table 1.2: Advantages and Disadvantages of Major Players in Auto Consumer Finance

Major Player	Regulatory Body	Advantages	Disadvantages
Banks	China Banking Regulatory Commission	Plenty of branches, low funding cost; the lending rate is subject to the Central Bank's benchmark interest rate	Often need to mortgage the housing property and bring in the bonding company; need to improve process efficiency, professional knowledge in the auto industry, and consumer satisfaction. Insufficient experience in risk evaluation, control, and disposition of default vehicles
Auto finance companies	China Banking Regulatory Commission	Provide better professional services and understanding of clients; backed by OEMs; low down payment with long payment circle, and highly flexible	High funding costs, hugely rely on OEMs interest rate subsidies to provide low to no interest rate's products
Leasing companies	Ministry of Commerce	Easy to apply, no need to pledge fixed assets like house property; flexible in the down payment, payment circle and method; able to provide rich and diversified products, which attracted OEMs and dealership groups to join	Single funding channel with high funding pressure, difficult increase scale, higher lending rate than auto finance companies
Others: Bonding companies and Internet finance companies	Local regulatory body/ Financial regulatory departments[2]	In the infancy phase with a wide variety of products and channels	Huge operation and control risks as the business model is in in its infancy and there is a lack of experience

[2] Financing bonding companies are supervised by local regulatory departments, but non-financing bonding companies have no corresponding regulatory departments; *Guidance on the Promotion of the Healthy Development of Internet Finance* enacted by ten ministries and commissions including the Central Bank notes that, banking financing regulatory organizations will classify and regulate the business areas of the Internet finance companies accordingly.

2. Auto Leasing

Summary:

- **China's auto leasing market remains in an early stage of development, but the market is embracing fast growth with huge potential in the near future**
- **Specialized auto leasing companies, OEMs, auto dealers, and other leasing companies from the banking system are actively engaged in the market and exploring appropriate business models to capitalize on upcoming growth opportunities**
- **The regulatory bodies of free trade zones have introduced a series of favorable policies, such as streamlining the approval process, providing subsidies and tax benefits, and allowing additional financing channels, to encourage the development of local leasing industry. Shanghai Free Trade Zone has become the top choice of location for many auto leasing companies**

2.1 Auto leasing industry overview

Business models

Auto leasing involves the leasing company using vehicles as the subject, then based on the lessee' choice of vehicle and supplier, leases the automobile from the supplier, in accordance with contract agreements, for the lessee to possess and use and charge rents from the lessee. In auto leasing mode, consumers can only pay agreed monthly rents after giving some guaranteed money, and then they may have the ownership of the car if they choose to pay a small balance payment. Leasing companies enable purchase of tax, premium, warranty extension, and accessories for a financing portfolio. Compared with traditional banking auto consumer loans, auto leasing features low usage barriers, more flexible product portfolios, and higher transaction efficiency.

Simple products and bank-led homogenization of traditional credit modes stunts diversified competition. Regulated by the Ministry of Commerce, auto leasing companies can disregard the limitation set by China Banking Regulatory Commission, namely 20 percent and 50 percent of down payment for new and second-hand vehicles, therefore, they have higher flexibility in down payment, loan circle, and repayment modes, and gain significant advantages through reduced loan requirements, simplified approval procedures, improved credit granting, and loan pace compared with banks, and also stimulate differentiated competition among the industry.

Potential in auto leasing market

According to Deloitte's research on auto leasing's penetration into overseas and domestic markets (the proportion of leased vehicles to the passenger Vehicle Parc), by the end of 2014, the leasing penetration rate of domestic passenger vehicles hovered around 2 percent. While North American markets, about 50 percent of consumers purchase cars via leasing. In other words, the domestic auto leasing market has huge potential.

Additionally, several internal and external trends will lead to rapid growth of the auto leasing market in the future.

Internal factors

- For manufacturers, auto leasing can reduce requirements to use/ purchase new cars so as to attract more clients and boost new car sales.
- Developing leasing business helps dealerships move inventory and increase supply of used vehicles. Moreover, provisions of bundled services including auto insurance, warranty extension, aftersales, auto components, and accessories will improve the rate of retuning to factories after sales, fully exploit the value of an automobile's lifecycle, and help leasing develop into a new source of profit growth in addition to new car sales and maintenance.
- Professional leasing companies earn interest incomes and commission incomes, and gain profits through difference in price of reselling used vehicles at the same time.

External factors

- More and more cities announce restriction policies on car-purchases and license plates, which markedly increases customers' costs creates a strong demand for the auto leasing market.
- Enjoying excessive consumption and installment, Millennial consumers are more tolerant of auto leasing.
- Leasing can be deducted for tax, which encourages more corporate clients to choose leasing for reducing their cash pressure and tax bearing.
- Shanghai, Shenzhen Qianhai, and Tianjin Binhai Free Trade Zones provide preferential policies and diversified financing channels for leasing companies. For example, leasing companies registered in the free trade zones receive loan products with higher flexibility.

2.2 Changes in policies and regulations

To facilitate healthy and ordered development of the auto leasing industry, the Ministry of Commerce and China Banking Regulatory Commission have introduced several policies and normative documents to identify the market access, tax policies, and regulatory rules of the industry. In the Guidance on the Acceleration of the Development of Leasing Industry issued by the State Council in September 2015, the leasing market can be actively expanded in household products like cars and leasing companies are encouraged to cut financial expenses through financing options including bonds, share issuance, and asset-backed securitization.

Policy comparison of the auto leasing industry in major cities

Currently, the Tianjin Binhai, Shenzhen Qianhai, and Shanghai Free Trade Zone are keen to advance the development of their local leasing industries, and take the lead in establishing a suitable environment to develop leasing businesses. In 2010, the Tianjin Municipal Government introduced the first local regulation, *Opinions on the Promotion of Leasing Industry's Development of Tianjin*, and utilized experimental policy advantages in Binhai New District to provide a series of favorable policies and incentive mechanisms for leasing enterprises. *The Framework Plan of China (Shanghai) Pilot Free Trade Zone* issued by the State Council in September 2013 and the *Opinions of the PBOC on Financial Measures to Support the China (Shanghai) Pilot Free Trade Zone* introduced by the Central Bank in December 2013 are supportive of developing domestic and foreign leasing services and provide simplified preferential policies for leasing businesses exclusive to free trade zones. In January 2014, Shenzhen city announced *Pilot Opinions on the Promotion of the Development of Leasing Industry in Qianhaiwan Free Trade Port Zone* to support the leasing industry of Qianhai in three ways including market access, custom polices and cross-border financing. Therefore, cross-border RMB loans which has already piloted in Qianhai becomes a significant advantage to develop its leasing industry.

Table 2.1: Introduced Policies and Regulations on Auto Leasing Industry

Time	Regulation	Effects
February 2005	• Administration of Foreign Investment in the Leasing Industry Procedures published by the Ministry of Commerce	• Officially identified that leasing can include vehicles • Auto leasing's gaining positive identification for the first time
January 2008	• Administrative Rules Governing the Auto Financing Company enacted by China Banking Regulatory Commission	• New leasing business • Added financing business including interbank offered credit, financial bond issuance, broadened financing channels of auto finance companies
September 2013	• Regulatory Measures for Financing Leasing companies and Approval Guidelines on the Access of Foreign Investing and Financing Leasing Companies introduced	• Strict control over tax base of value-added tax in the leasing
March 2014	• Measures for the Administration of Leasing Companies	• Leading capital of various ownerships into leasing industry, promotion of commercial banks to establish pilots in leasing companies
September 2015	• Guidance Opinions on Accelerating the Development of the Finance Leasing Industry issued by the State Council	• Actively encouraged leasing companies to finance through the bond market, supporting qualified leasing companies to finance through issuing shares and asset-backed securitization

Table 2.2: Comparison of Major Policies between Leasing in Shanghai Free Trade Zone, Shenzhen Qianhai, and Tianjin Binhai

Favourable policy	Shanghai Free Trade Zone	Shenzhen Qianhai	Tianjin Binhai
Fiscal subsidies	• Subsidy for settlement: A subsidy of RMB five million to those with a registered capital of RMB100-500 million; RMB10 million to those with a registered capital of RMB500 million-1 billion; RMB15 million to those with a registered capital of over RMB one billion • Special subsidy: A subsidy of 0.5% of their total investment for those with accumulatively financing of no less than RMB50 million for companies in the zone in that year	• Companies in modern service industry that meet policy requirements can apply for comprehensive pilot special fund to Qianhai Management Bureau	• Fiscal subsidies were ended (as of December 31, 2012)
Tax policies	• A preferential drawback policy of value-added tax for companies with a registered capital of RMB170 million and over 3% VAT tax	• A preferential drawback policy of value-added tax for companies with a registered capital of RMB170 million	• Qualified leasing ships can be exempted from tax rebate and valued-added tax • The lessee's asset sales in financing sale-and-leaseback business can be exempted from valued-added tax and business tax
Personal favourable polices	• Subsidy for house purchase: a subsidy for house purchase of 1.5% of the house price • A subsidy of RMB200,000 to the senior executives of those with a registered capital of over RMB1 billion; no exceed 50% of its headcount about the total number of subsidized talents of one leasing company	• Qualified foreign top talents and badly-needed talents granted a subsidy based on the difference between domestic and overseas personal income taxes can be exempted from personal income tax	• Personal incentives in commodity house purchase, cars and personal income tax were ended (as of December 31, 2012)
Approval process	• A rapid process of business license registration: about two and a half months (for foreign investing and leasing companies)	• Generally three to four months taken for approval (for foreign investing and leasing companies)	• Generally three to four months taken for approval (for foreign investing and leasing companies)

2.3 Existing products & services

Currently, leasing has two modes: direct leasing and sale-and-leaseback. For direct leasing, the leaser first purchases cars from manufacturers and leases them to the lessee; the lessee pays monthly rent and pays the residual value of the car at the end of its lease term, with car ownership transferring from leaser to the lessee. As for sale-and-leaseback, the lessee sells his or her own car to the leasing company and then rents it back by paying a monthly fee, and regains the ownership at the end of the lease term. This method enables the lessee to activate fixed assets for short-term liquidity.

In direct leasing, leasing companies own cars which are registered in the name of the companies; for sale-and-leaseback mode, the lessee's license plate can be still used for the car which dispels the lessee's worries to a certain extent.

Table 2.3: Main Categories of Leasing Products

Leasing phase	Backbone	Direct leasing	Sale-and-leaseback
Starting phase	Leasing companies	Purchase cars and lease to clients for use	Purchase cars from clients and lease to them for use
Midterm phase	Clients	Pay rent for the right of use	Have car ownership after paying rents
	Leasing companies	Have car ownership	Control risks through mortgage and assurance
Ending phase	Clients	Gain car ownership (optional)	Regain complete car ownership

Case analysis #1: All Trust Leasing

As the leading passenger vehicle dealership group and leasing service provider in China, China Grand Auto has established an automobile dealership network covering 24 provinces, cities, and municipalities, owned 454 "4S" stores, and sold 50 passenger-vehicle brands, with the number of 4S stores at mid-to-high-levels accounting for 94 percent by the end of 2014.

A wholly-owned subsidiary of China Grand Auto, All Trust Leasing, has provided over 200,000 consumers with leasing services for car purchases and offered used vehicle leasing and trading services for over 50,000 customers, which in recent years have developed into core businesses with the rapid growth and high profits for China Grand Auto Group. In 2013, its revenues of auto leasing business occupied 1.31 percent of CGA's total revenues, with a profit proportion of up to 25 percent, and in the first half year of 2014, the profit contribution of the auto leasing business to the group climbed to 26 percent, though its revenue accounted for less than 2 percent.

Although All Trust Leasing rapidly improving its penetration rate depends on the Group's channels, it used external SP mode to expand its market by leasing over 100,000 cars in 2014. Regarding its products, All Trust Leasing provides customized services including "Balloon Financing", "Elite Financing", and "Happy Financing" for different customer segments offering high flexible down payment, leasing terms, and balance payment methods; moreover, a wider range of financing, financing portfolio services amid purchase taxes, insurance expenses, and accessories can further lower the threshold for car purchases.

However, All Trust Leasing may face issues including service standard control, a talent shortage in auto finance, and high financial expenses for agencies.

Having issued "Huiyuan the First Stage," a management program for special assets, in 2013, CGA has become the first company with an auto leasing background to issue asset-backed securitized products in China, allowing it to activate inventory assets and broaden financing channels.

Meanwhile, cooperating with Alibaba and Autohome respectively, All Trust Leasing offers integrated online and offline service throughout a car lifecycle with regard to selection, loan, and vehicle insurance and used vehicle loans to streamline service and lower operating costs; in addition, docking with e-commerce platforms, the company improves sales knowledge and in-store services to better the conversion rate.

Overview on All Trust Leasing's Products & Services

Products & services	Features
Car rental	Provisions of long-term car rental over one year mainly targeting enterprises
Leasing	Inclusion of direct leasing and sale-and-leaseback, and the business scale of the latter accounts for 95% of the total business
	Provisions of several payment modes with a down payment range of 0% to 50%, selection of a lease term of 1-5 years with a balance payment range of 0%-70%
Used vehicle leasing	Down payment of 0%-50% with a lease term from 1 to 3 years

Case analysis #2: Mercedes-Benz auto finance

Established in August 2012, Mercedes-Benz Leasing Co., Ltd. is the first automotive brand in China to provide leasing solutions to both enterprises and individuals, focusing its services on leasing, especially sale-and-leaseback business. The company launched the first service for lease-purchase with value retained in China. Its finance penetration rate is about 20 percent, so one out five cars they sell are purchased through financing.

In contrast with other leasing products, the down payment and total payment are much higher in the mode of lease-purchase with value retained, whereby consumers need to pay 10 percent of the total payment as down payment along with 10 percent as a deposit (the deposit will be returned after the lease term) in a lease term of 24-36 months, and the lease term chose relying on annual mileages. Finance companies work out the vehicle's lowest value retained according to its annual mileages, service life, and vehicle model. Consumers can either pay the balance payment to gain the vehicle's ownership after its lease term or use the lowest value retained of the vehicle to offset the amount of a Mercedes vehicle of another model and gain the right of use of the new vehicle after making up the price gap, or just return the vehicle to the dealership. It is worth noting that the purchaser must pay vehicle insurance, taxes, license plate, and maintenance expenses, which are not covered in financing. Therefore, though payments are low, total usage cost for a consumer increases to some extent.

As an auto leasing company affiliated to a manufacturer, Benz Leasing's products are supported by manufacturers' channels and interest subsidies through which it provides products with no interest rate or interest free in order to improve its market competitiveness.

Mercedes-Benz's Leasing Products & Services (Take A200)

Lowest down payment	Deposit	Lease term (month)	Monthly rent	Lowest value retained (residual value)
10%	10%	24	5,754 (Mileage 15,000km/yr)	134,830~158,182 Three options after the lease term • Replacement to upgrade: pay the part exceeding the lowest value retained • Returning the car: return it within agreed mileages meeting wear requirements • Purchasing the car: purchase it by paying the lowest value retained
			5,846 (Mileage 20,000km/yr)	
			5,949 (Mileage 25,000km/yr)	
		36	4,728 (Mileage 15,000km/yr)	
			4,820 (Mileage 20,000km/yr)	
			4,917 (Mileage 25,000km/yr)	

2.4 Competition in the auto leasing industry

Thanks to the remarkable contributions of leasing to business growth and profits, leasing companies have experienced fast development in the auto industry, consequently, enterprises of different types are engaged in the auto leasing market through different forms including self-making, joint venture, investment, and cooperation. At a time when the auto market has seen limited growth along with large losses for dealerships, all major stakeholders will benefit from the auto leasing's activities in the value chain including new vehicles, used vehicles, and aftersales services.

Table 2.4: Analysis on the Main Players' Features in Auto Leasing Market

Category	Examples	Features	Regulatory department
Commercial bank-affiliated	• ICBC Leasing • BC Leasing • CDB Leasing • MS Leasing • Huarong Leasing etc.	• Well-financed and low financial expenses • High process efficiency due to short credit approval process • Less-specialized, limited sales channels and deficient understanding of customers	China Banking Regulatory Commission
Professional leasing companies	• Orix Leasing (China) • International Far Eastern Leasing Co., Ltd • Herald Leasing etc.	• Centered on leasing businesses to provide professional integrated services for customers • Strong experience, high process efficiency and big talent pools • Limited service network	Ministry of Commerce
Manufacturer-affiliated	• Mercedes-Benz Leasing • Toyota Financial Services • Anji Leasing • Volkswagen New Mobility	• Auto manufacturing capability, a second sales revenue through recycled, repaired, and used vehicle leases • Business collaboration between new vehicles and used vehicles	Ministry of Commerce
Dealerships-affiliated	• Lei Shi Hong Financial Lease • All Trust Leasing Co., Ltd • Huiyu (Shanghai) Leasing Co., Ltd • Shanghai Yongda Leasing Co., Ltd etc.	• Covered with wider channels, holding many contact points with end consumers • Insight into customers' actions	Ministry of Commerce

2.5 Limitations to industry development

- **Lack of a uniform registration system for leasing property**

  Currently, vehicles are registered as leases by the vehicle administration office, but the Central Bank and the Ministry of Commerce have also established corresponding systems for leased automobiles, whereby the same motor vehicle may be registered as property in several leasing registry systems and the vehicle administration office. For specific cases of auto leasing, it is likely for the lessee to register in many systems, pledge and transfer the vehicle. Especially in the sale-and-leaseback planning, the lessee can pledge the vehicle to different leasing companies or pawn it, all of which will increase the fund risk for leasing companies. However, the leaser will bear the risk of joint liability given a lessee accident.

- **Poor competence in credit evaluation**

  As auto leasing companies are not included in the personal credit system of the Central Bank, the basis of credit risk evaluation for the lessee is restricted, especially in some situations such as authenticity evaluations for applicants' identities and materials, checking whether the dealer reports a wrong price or lower loan standards, all of which will reduce the risk control capability of the leaser's pre-loan management.

- **Inefficient evaluation system for used vehicles**

  One key premise for auto leasing businesses is a complete exit mechanism of leased assets. For example, if the lessee chooses to cancel the lease after the lease term or defaults during the lease term, the leaser can use a complete mechanism to dispose the property into cash, in this case, leasing or selling the vehicle again through a fair and transparent system to assess and price the used vehicle. However, the absence of evaluation standards for used vehicles and an inefficient pricing mechanism for residual value influence the pricing of leasing products and cut their competitiveness in the auto consumer loan market.

- **Uncertainty of Value-added Tax for sale-and-leaseback business**

  Following the change from a business tax to a value-added tax for the sale-and-leaseback business, the State Administration of Taxation clearly identifies that the principal part corresponding to the vehicle in transaction can be exempted from value-added tax only if the leasing company acquires the lessee's "zero-rating" invoice issued by the tax authority presiding over the lessee's location; but in practice, as different tax authorities have different understandings of "zero-rating" invoices, it is difficult for the lessee (especially for individual users) to obtain the invoice. Currently, most leasing enterprises have not yet paid value-added taxes for the principal part in sale-and-leaseback practices to maintain the competitiveness of their financing products, which is defaulted by the tax authorities in most cases. Nevertheless, uncertainties still remain in the value-added taxes of the sale-and-leaseback businesses.

3. Car Rental

Summary:

- **China's rental market is still in its early development phase with huge future potential. Currently, the long-term rental service is most common, but the short-term rental service is growing fast**
- **China's rental market attracts many participants but is highly fragmented in contrast to mature markets. However, the situation will be improved as China's auto market matures**
- **Six key factors are required for enterprises' successful operation in the asset-based and low-profit auto rental industries, while lack of effective release into the market and financing difficulties severely affect the development of these enterprises**
- **The emergence of the P2P car rental model brings great challenges for traditional models, and if in violation of policies, these businesses face many uncertainties and risks**

3.1 Car rental industry overview

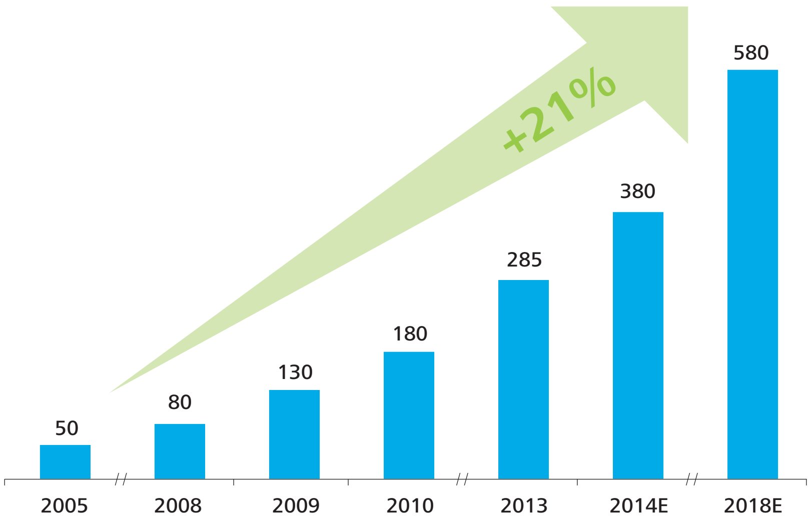
China's car rental industry is in its early stages of development, but has great potential

China's car rental market is categorized as long-term rental (if the lease term exceeds six months) and short-term rental, according to industry conditions. Different from mature markets centered on short-term businesses, the market in China focuses on long-term rental along with short-term business new at the moment yet growing rapidly, with momentum expected to continue.

Due to asset-light demand, multinational corporations use rental to capitalize on non-core businesses such as fixed assets investment and equipment procurement, and lower their asset liability ratios. Government car reform accelerates car usage of the government institutions and state-owned enterprises and transfers it to the rental market; under great pressure due to environmental pollution and traffic jams, nine cities in China carry out car-purchase restriction, which curbs customers' car-purchases, leading consumers to shift to rent cars at low costs for mobility. Driven by these factors, the car rental market in China is expected to reach a market size of RMB58 billion in 2018, doubling on that of 2013.

Figure 3.1: Rental Market in China Develops Rapidly

Unit: 100 million yuan



Since most short-term rental business comes from individual customers, future rental development in China will mainly benefit from:

- As the per capita disposable income goes up, customers' car demands for reasons of commerce and leisure travel should also increase.
- There is still a growth gap between the number of licensed drivers and that of private cars. As more and more cities adopt car-purchase restrictions, consumers should tend to choose rental in order to save on expensive maintenance costs and parking expenses.
- The development of an alternative rental market: insurance companies and dealerships provide alternative rental services for customers who are repairing or maintaining their cars.

While most long-term business comes from enterprises, future rental development in China will mainly benefit from:

- Increased corporate car demand: multinational companies and small and medium-sized enterprises' asset-light requirements and financial optimization increase their demand for car rental.
- Asset-light operation: enterprises need an asset-light balance sheet to control cash flow.
- The reform on the government's Vehicle Parc: the reform on government cars limits the number and models of cars purchased, meanwhile, SOEs reduce their service cars following the government, which pushes the government and enterprises to turn to the rental market for cars.

3.2 Competition in car rental industry

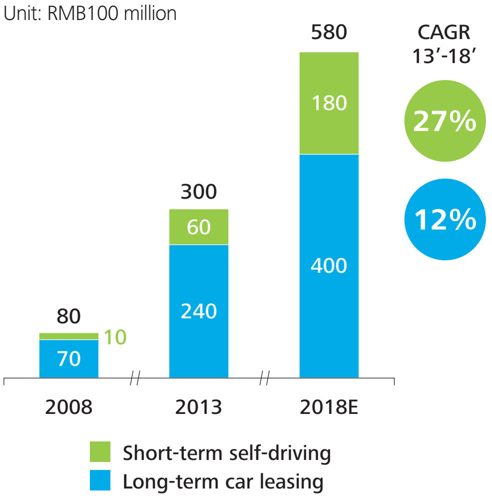
China's rental market attracts an enormous number of participants but is highly fragmented compared to mature markets, with merely 14 percent of the market share held by the top five auto rental companies in China (Figure 3.3). However, the situation should improve as China's auto market develops.

China's car rental market has various participants including domestic private auto rental companies, international rental companies, and auto OEMs. Among the 10,000 car rental companies in China, most of them are operating with a fleet of only about 50 vehicles on average. By the end of 2013, the top five held merely 14 percent of the market share, which is remarkably fragmented in contrast with mature markets. The main reason is that most car rental companies were small-sized, local firms. Though some enterprises have rapidly expanded their fleets and businesses with the help of external funds, the market share they seized is much lower than that of sizable foreign companies. Meanwhile, as the main car rental markets, some first-tier cities have difficult markets to access, which also has negative impacts on the development of enterprises.

With significant advantages over small, local companies regarding financial strength, license plates, management costs, and marketing tools, the leading enterprises are expected to seize more market share as the market develops. It is worth noting that these leading enterprises focus more on short-term rentals (China Auto Rental, eHi Auto Services, etc).

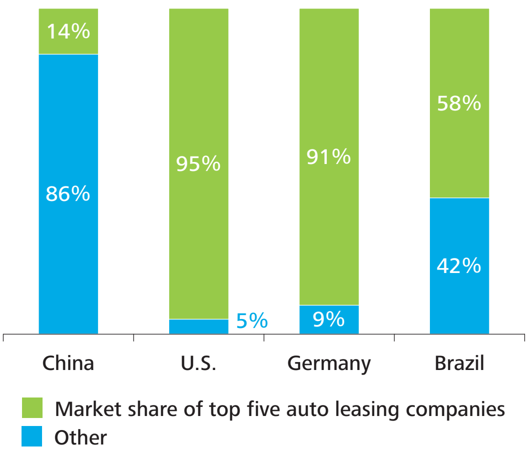
Figure 3.2: Overall Scale and Growth Rate of Car Rental Market Segments

Unit: RMB100 million



Source: Deloitte Analysis

Figure 3.3: Comparison of Industry Centralization between China's Market and Mature Markets (2013)



Leading car rental companies in China can be divided into three categories according to business types:

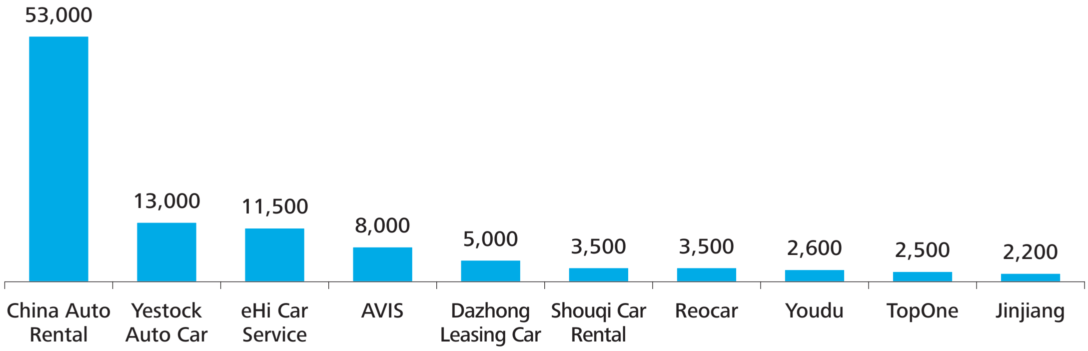
Domestic private car rental companies (China Auto Rental, eHi Auto Services, etc.): these enterprises focus more on short-term rental businesses, and have more business locations, license plate sources, and financial strength; these companies have seen fast growth and have built a closed business loop of car procurement-rental-used car sales. Moreover, they are also actively engaged in creative service areas like special cars, chauffeur driving, and time-sharing leases. It should be noted that some shares of most of these enterprises are held by foreign investors.

International rental companies (Hertz, Enterprise, AVIS, etc.): except those actually owned and operated by international car rental giants, these enterprises are not developing quickly in China because they focus more on risk control and cooperate with domestic auto companies. However, they are more experienced in operating modes and concerned with consumers' experiences.

State-owned companies (Shouqi, Dazhong, etc.): put more emphasis on long-term businesses with abundant sources and longer history of operation in China.

Deloitte believes that these three kinds of enterprises can coexist in the future due to each having its own distinct features. However, in terms of scale and growth, private rental companies with larger scales that use their capital properly have more advantages. Small and medium-sized companies with little financial strength, small fleets, and poor service experiences may be knocked out of future competition.

Figure 3.4: China's Car Rental Market Attracts Various Participants



Source: Deloitte Analysis

3.3 Success factors & challenges for car rental industry

Regarding economy of scale, a company increasing its business scale has two advantages: lower car procurement costs and decreased operating management expenses. Six key factors are required for rental companies to operate successfully in the industry with heavy assets but low profits and highly homogenized services:

1. Varied, streamlined, and steady financing channels for companies to expand their fleets and diversify vehicle models in this heavy-asset industry.
2. Many cities in China have limitations on the issuing of license plates, which has become an access threshold for rental companies that hope to increase scale across the country.
3. Increasing the coverage and improvement of direct operations and franchisees throughout the country, meeting individualized demands like multiple car drop-off locations and providing a rapid, convenient, and comfortable service experience.
4. Offering a more competitive pricing for leases while keeping price to some extent relative to procurement cost.
5. Various categories of services such as provisions of value-added services including non- deductible insurance, GPS, roadside services, home delivery, and multiple return locations.
6. Brand recognition. Consumers are prone to choose chain stores with brand guarantees and standardized services compared with small-sized car rental companies.

Industry challenges

- **Shocks from emerging patterns**
  In the past year, P2P car rental companies have emerged rapidly and gradually spread to second and third-tier cities after building up networks in first-tier cities. Lacking limitations to operating costs in vehicle procurement, construction of business locations and personnel management, these Internet companies have advantages in fleet size, varieties of vehicle models, service process, product experience, and individualized demands.

- **Large investments but limited financing channels**
  China Auto Rental, eHi Auto Services, and Yestock Rental Car have fleets of over 100,000 cars and generally replace them every three years. China Auto Rental launched on the stock market last year and completed its primary accumulation of capital. However, for small and medium-sized auto rental companies, most funds come from private lending with high interest rate because most bank loans require vehicle operating permits with strict approval processes.

- **Market demands lack momentum**
  As the main rental markets, first-tier cities like Beijing and Shanghai have imposed tough access limitations on auto rental, so that car rental companies must be certified by the Ministry of Commerce, and operating license plates should be issued for vehicles. Meanwhile, drivers also must obtain special plates. Limited supply from the rental end decreased market demand.

- **Low industry profitability and a lack of applicable profit models**
  Higher operating costs for expanded rental coverage to other regions, along with intense competition leads the profit rate of the industry drop; some short-term rental companies operate at a loss in order to occupy the market. Relying on its scale advantage, China Auto Rental has established its closed business loop of vehicle procurement, rental, operating, and trading of used vehicles.

- **Inadequate market credit system**
  Lost cars and illegal mortgages have had a severe impact on auto rental customer experience. Establishing a rental consumer credit system contributes to rental companies' multidimensional and systematic evaluation on the lessee, and helps prevent malicious mortgages and default on the platform.

- **Lack of industry standards and legal regulations**
  As the *Provisional Regulations on the Administration of Auto Rental Industry* was abolished in 2007, the auto rental industry has reached a precarious situation with no legal guidance. Some provinces and cities implement an administrative permit system and some cities follow a register system. Nevertheless, without a unified industry standard the auto rental industry will have hampered development.

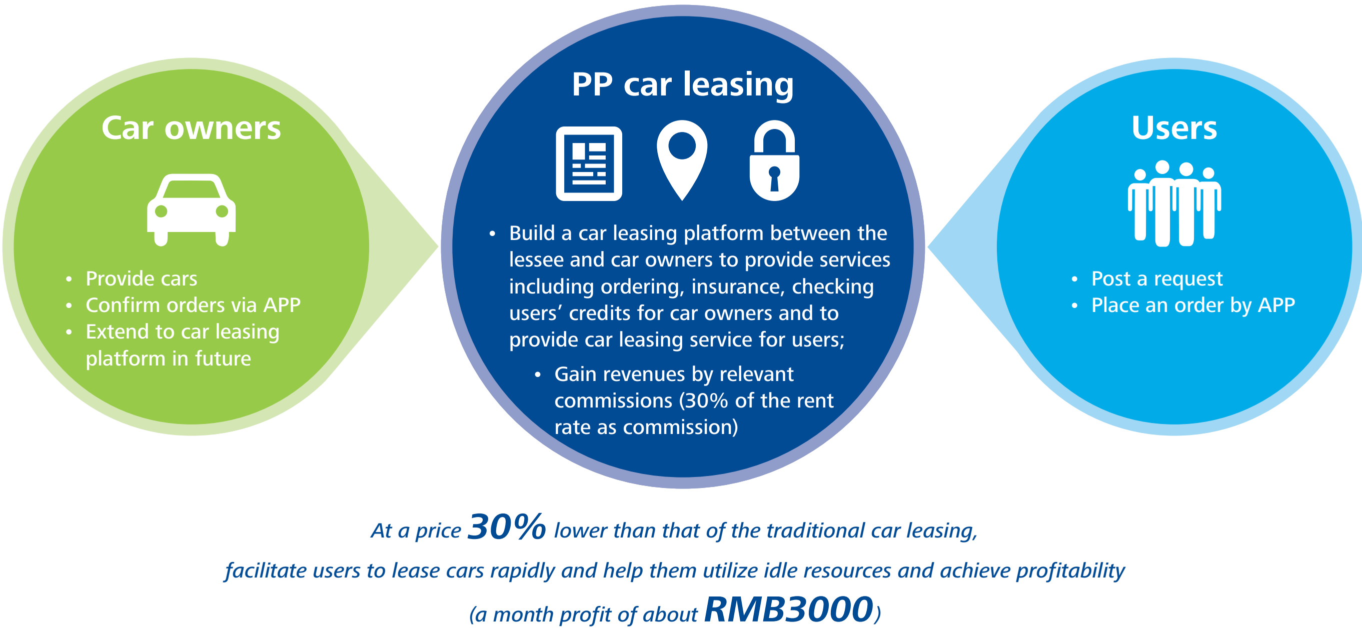
3.4 New trends for car rental industry

According to statistics, China's private Vehicle Parc has reached 123 million. A large amount of private vehicles are idle, with a usage rate less than 10 percent per day, except regular daily commute time. With increased traffic congestion, extended car-purchases, and driving restrictions in many cities along with increasing repair, maintenance, and parking costs, the car sharing model with its low cost, pay-per-use model and high flexibility appeals to Millennial consumers.

The emerging P2P car rental model

So-called P2P car rental refers to when owners of private cars post use of their idle cars on the Internet and gain a certain proportion of income by rental their cars based on the time of day. Potential lessees can check for cars nearby and complete their orders and deals through mobile Apps. Compared with traditional rental, P2P car rental saves on expenses such as car procurement, repairs, maintenance, and parking; it offers lower rental prices and a better selection.

Figure 3.5: P2P Car Rental Model



P2P car rental model – development constraints

- **Regulatory risk**
  P2P car rental model encroaches on some policies due to risk of being suspected as illegally operations for private car owners to gain benefits from rental their own cars
- **Rights and liability risk**
  Leased car traffic accidents pose risks as difficulties exist in defining and taking liability, although the current platform has terms to define the liabilities for the car owner
- **Market risk**
  The emerging P2P car rental market has potential dangers in checking the lessee's identity, evaluating car condition, and peccancy processing, which may affect customer demand
- **Cost risk**
  Sustained investments are required in hard and soft wares, system services, and premiums for P2P car rental

4. Used Vehicle Finance

Summary:

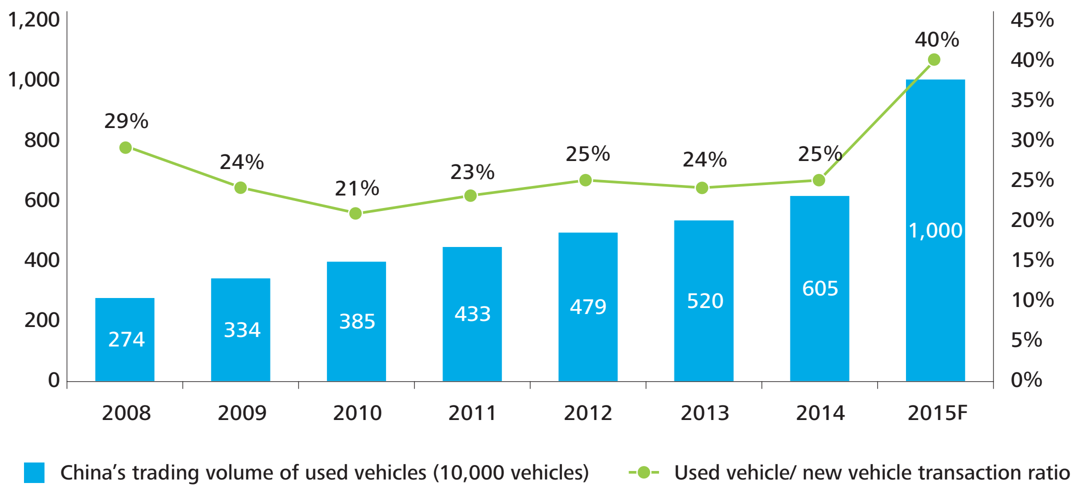
- **The used vehicle market in China is still in its initial stage of development with a highly fragmented market landscape, but the integration trend is accelerating and consumers' awareness and acceptance of used vehicles is also on the rise. Therefore, the used vehicle market should provide a major profit stream for auto dealers**
- **As diversified online used vehicle transaction and service platforms continue to spreading rapidly, many OEMs and dealership groups are also increasing involvement in the used vehicle business**
- **The optimization and introduction of regulations on the used vehicle market are under discussion among related departments. Policies in relation to used vehicles should improve in the future**
- **Used vehicle finance faces certain restrictions. However, with market development, some innovative models for used vehicle finance have already emerged**

4.1 Used vehicles market overview

In 2014, over 6 million used vehicles were traded in China, a year-on-year growth of 16.33 percent, with a total traded amount of RMB367.565 billion, a rise of 26.03 percent. There were 9 percent more traded cars than new cars, up 8 percent from the year before. In the first half (H1) of 2015, compared with the slow-growing new vehicle market, the used vehicle market maintained rapid growth, recording 4.61 million trades, a rise of 6 percent year-on-year, 2 percent higher than new cars. It is estimated that in 2016 China's total trade volume of used vehicles will rise by 25 to 28 percent, surpassing 10 million cars.

Though China has become the world's biggest vehicle market—surpassing the United States in 2009—used vehicles traded that year were only a quarter of those in the United States. The trade volume of used vehicles is 3.3 times that of new vehicles in the United States, and 2.3 times in Germany, while in China, the ratio is only 0.37 (Figure 4.1). This gap between China and mature markets in Europe and America indicates that China's market still has huge potential.

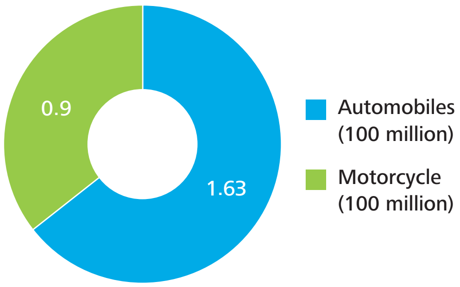
Figure 4.1: Growth Trends for China Used Vehicle Market in 2008-2015



Source: Wind, China Automobile Dealers Association (CADA)

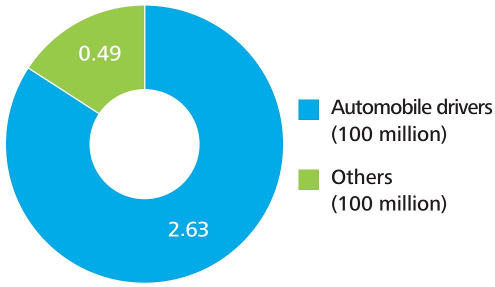
Motor Vehicle Parc

Total Vehicle Parc: 270 million
(Note：Including automobiles & motorcycles, as of 30 June 2015)



Motor Vehicle Drivers

Vehicle Drivers: 312 million
As of 30 June 2015



Automobile Parc

By the end of 2014, the parc was over one million in 35 cities , and over two million in 10 cities including Beijing, Chengdu, Shenzhen, Tianjin, Shanghai, Suzhou, Chongqing, Guangzhou, Hangzhou, Zhengzhou.

Regarding supply, the Vehicle Parc in China reached 160 million, with an average age of four years, still a wide gap with vehicles in the United States (Vehicle Parc: 280 million, average age: 11.4 years). Although growth has cooled, China remains first in new vehicles sales across the world. It is estimated that by 2020 China's Vehicle Parc will exceed 200 million and provide sufficient supply for used cars. It is calculated that Chinese customers keep their cars for 4.5- 6.3 years on average. It is expected that there will be a large amount of used vehicles in good condition and with less than five years on them flowing into the market, which will help change the stereotypical, customer-held image of used vehicles: that of inconsistent quality, non-transparent prices, and no guarantee of aftersales services.

Considering demand, since car-purchase restrictions were implemented, license plates have become scarce resources. To some extent, the restriction stimulates used vehicle replacement and increases used car transactions in cities with such restrictions. In addition, with increased urbanization and the gradual increase in per capita dispensable income, consumers are more tolerant of used vehicles. At the same time, with increased expectations for issuing of a temporary property rights registration system, value-added taxation on used vehicle transactions, and the cancellation of the restriction on used vehicle's migration, it is estimated that by 2020 sales of used vehicles will hit 20 million with the ratio of used and new car transactions expected to reach 1:1. Calculating based on Ministry of Commerce statistics that put average car price at RMB60,000, used car transactions will exceed RMB1 trillion by 2020.

At present, China's used vehicle market features high fragmentation and regionalization. Almost 70 to 80 percent of trades are contributed by independent dealers (including small auto dealerships and scalpers in the market) distributed in different markets. Meanwhile, due to uneven economic development and regulatory standards (for example, stricter restrictions on used vehicle migration are implemented in certain cities), the residual value of used vehicles varies city to city.

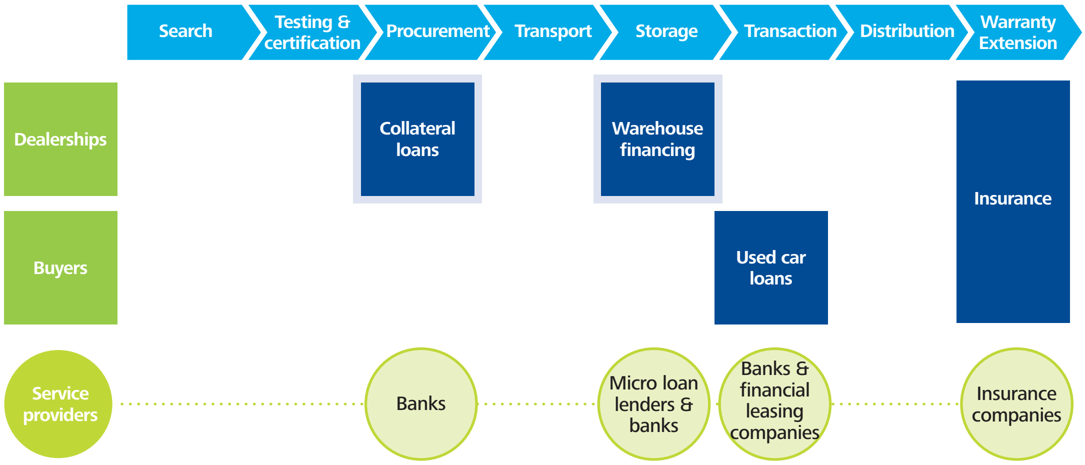
In recent years, as the focus of the auto industry value chain has shifted to the aftermarket, venture investments and entrepreneurs have considered the used vehicle market as the next great opportunity, with significant changes taking place in the market's competitive landscape. In response, auto manufacturers and 4S store groups have launched used vehicle certification businesses, hoping to provide powerful brand endorsement for identification and assessment of used vehicles.

At the same time, since 2013, a dozen used vehicle e-commerce platforms have sprung up. These Internet companies can aggregate fragmented used vehicle sources and precisely match sellers and buyers; moreover, the companies can connecting all parts of traditional used vehicle circulation, easing information asymmetry, combating lack of transparency regarding vehicle condition and price, the absence of integrity, and other problems in the industry, so as to ultimately drive the market to be standardized and fair. Used vehicle e-commerce platforms are still in early stages of development, with small market share, but such platforms are likely to become the main distribution channel of used vehicles in the future.

4.2 Existing product & market landscape

Currently, the major models in China's used vehicle financing market are consumer loans and aftersales insurance extension services, while the dealerships' inventory financing only holds a small market share. Auto finance companies, leasing companies, and banks are major competitors in the used vehicle consumer loans market. In the industrial chain of used vehicle financing, the above enterprises mainly target their businesses on purchase, inventory, transaction, and insurance extension (Chart 4.2).

Figure 4.2: Service Chain of Used Vehicle Financing



The new Administrative Measures of Auto Loans for auto finance companies stipulates that the down payment of used vehicle shall be no less than 50 percent of the given certificated price, and the loan term shall not be over 3 years. To skip over the limitation for down payment, auto manufacturers, dealership groups begin to set up leasing companies to offer more flexible and diversified finance products for used vehicle purchasers.

Table 4.1: Comparison of Used Vehicle Loan Products

	XIN (Half payment)	PAHAOCHE (HAOCHE Loan)	CAR KING USED VEHICLE SUPERMALL	ALL TRUAT LEASING
Ratio of down payment	50%	20-50%	Down payment minimized to zero	30% Down Payment
Loan term	2 Years	1-3 Years	1-3 Years	1-3 Years
Loan rate	N/A	About 11%	About 13%	About 18%
Product differentiation	No monthly installment; paying off balance payment or returning the car after the loan term	Integration of vehicle loan and insurance services, with clear synergy effects	For medium – and high grade cars; determining balance payment based on value retained	No restriction on car brands when financing

Table 4.2: Comparison of Advantages and Disadvantages for Players in Used Vehicle Retail Financing

	Capital Resource	Product Features	Advantages	Disadvantages
Commercial banks	Deposit	• Down payment no less than 50% • High credit requirement: some banks require house property as collateral or other tangible assets certificate from vehicle purchasers • Strict restriction on vehicle age and condition, mileage, assessed price and brands • Slow in approval and loan lending	• Low interest rates, low capital cost	• Reliance on third party's assessment on vehicles' residual value may rise risks of false assessment or overvaluation, exposing bank lending to more risks. • High cost to recover loans once a default happens; Lack of experience in used vehicle disposal
Auto finance companies	Bank loans, inter-bank borrowing and asset securitization	• Down payment minimized to 10% or even zero	• Professional used vehicle certification service and brand endorsement	• Some auto finance companies only serve used vehicles with certificated brands excluding other brands
Dealerships-affiliated	Bank loans and asset securitization	• Flexible down payment ratio, interest rate and balance payment	• Professional used vehicle service platform including offline check and assessment business • Diversified sales channels penetrating into third-to- forth tier cities; close to customers	• High financing cost and continuous capital support required for scale-up
E-commerce platforms	Cooperating financial institutions	• Fast online approval, only need ID card, driving license and bank card	• Traffic advantage	• Less diversified products at present
Internet giants	Small loan companies	• Zero down payment, 10% deposit + the first installment payment • With data on consumer behaviors and consumption as credit base	• Personal credit system: keeping pace with data about consumers' multi-dimensional transaction, socialization, and behaviors and lowering fraud risk	• Systemic risk of bad debt

Loaning to used vehicle dealerships wholesale

In the used vehicle transaction chain, over two-thirds of transactions are completed by independent used vehicle dealerships. However, traditional financial institutions would not consider them as ordinary small and medium-sized enterprises to provide comprehensive credit. In addition, it is hard to get bank credit by using used vehicles as mortgages. Consequently, most financing demands from used vehicle dealerships cannot be met yet. At present, used vehicle inventory and logistics financing are mainly realized via non-banking channels such as collateral loans, small loan companies, inter-bank borrowing, pawn financing, private lending, and so forth.

Over the past year, many business models, including used vehicle online transaction websites and online retailers, have developed rapidly. Used vehicle e-commerce platforms not only accumulate transaction records, but also have access to multi-dimensional dealership data such as inventory structure and vehicle valuation. Thus, e-commerce platforms can provide a basis for future examination on dealerships' financing qualifications.

Take UXINUXIN as an example, relying on XIN, a domestic e-commerce platform for used vehicles, it provides inventory financing services with 1.5 percent monthly interest for approximately 20,000 used vehicle dealerships, no physical mortgage or guarantee needed. Having control over key financial indexes of used vehicle dealerships, including comprehensive information about warehouses, sales records, capital turnover, and status of operation, these e-commerce platforms are able to build data models and identify loan commitment. As for post-lending management, UXINUXIN has adopted the E-mortgage approach—the offline team collects and checks inventory information by spot inspection, and install POS machines for offline transaction sites to get a precise control on dealerships' trade information and capital flow.

4.3 Used vehicle financing – development constraints

In the short run, the development and innovation of used vehicle financing will be impacted by the following factors:

- **Restrictions on used vehicle migration**
  Over the past year, restrictions on used vehicle migration have been implemented in many cities, which limit the interregional and cross-provincial circulation of used vehicles failing to satisfy national emission standards, leading to falls both in sales and price of used vehicles with low environmental protection standards. Also, these restrictions break the balance between the market's supply and demand as well as cause some used vehicle dealerships to suffer losses from inventory overstocks. According to the China Automobile Dealers Association, 314 cities in China set emission restrictions on immigrated vehicles, among them 13 cities allow cars immigration conforming with national V emission standards, 250 cities are open to cars conforming with national IV emission standards, 48 cities allow cars meeting national III emission standards, and only 3 cities allow immigration of vehicles satisfying national II emission standards.

- **Temporary property rights registration system**
  The lack of temporary property rights registration system prolongs the replacement cycle of used vehicles. In cities with car-purchase restrictions, used vehicle sellers first must register newly bought used vehicles under their own names, and then transfer the ownership to the car buyer to finish a trade. However, since vehicle dealerships have to get purchase quotas before buying used vehicles, the enterprises' operation costs are increased. For sellers, only when the ownership transfer is finished can they get an updated quota. In addition, temporary property rights will legalize used vehicle trading, reducing unnecessary legal or financial disputes and lowering transfer risks in used vehicle trading. So far, the administration of quota transfer for used vehicle trading has only been launched in Tianjin.

- **Monitoring and evaluation standards for used vehicles**
  At present, the monitoring of used vehicle condition is still subjective, meaning it depends on the monitor's experience and expertise. Since the industry has no uniform evaluation system, the main factors influencing the residual value of used vehicles, such as historical transaction records, risk records, and maintenance records are controlled by different agencies. The *Technic Regulations for Used Vehicle Evaluation* released by the Standardization Administration of China in June 2014 is the first national standard for used vehicle evaluation in China. It decreed that the China Automobile Dealers Association will designate qualified third parties or used vehicle operating businesses to assess used vehicles in 104 categories, including the exterior, the engine compartment, the auto start, and perform a driving test, and then complete the Technical Condition Chart for used vehicles as an appendix for the transaction contract. However, as the terms are not legally binding, the Standard has not yet played a decisive role in the regulation of the assessment system.

- **Overloaded tax burden**
  Under the current system, the central government exempts value-added tax on individual used vehicle transactions if the deal sum does not exceed its original value; however, for used vehicle corporations, they have to pay 2 percent of the total turnover as value-added tax, which greatly reduces their profit margin.

As China's Vehicle Parc constantly increases, the strong development of used vehicles has become an important part influencing the sustainable development of the Chinese auto market and the transformation of dealerships' business model. Therefore, related national ministries and commissions have started policy research on the used vehicle market. For instance, at the 2015 Annual Meeting of China Automobile Dealers Association, Chen Yuehong, Director of Department of Market System Development of MOFCOM, said that three out of MOFCOM's five focuses in developing the auto market target used vehicle market development:

1. Conduct research and adjustments on the policy of transaction value-added tax (VAT), explore and set up a VAT policy in which the added value generated in circulation will be recorded as the basis for taxes, replace the tax imposed on the total added value with one on the tax difference between VAT on sales and input VAT to relieve burden on corporations, help auto dealerships develop used vehicle replacement businesses and make greater efforts to support used vehicle brand management.
2. Conduct research and establish a temporary property certificate system by replacing the property right transfer registration with temporary property right registration for used vehicles in circulation to reduce the operating and management costs and increase circulation efficiency.
3. Actively study the differentiated insurance premium policy based on vehicle age so as to accelerate the circulation of used vehicles and guide vehicle owners to change vehicles rationally and optimize vehicle lifecycle.

5. Online Auto Finance

Summary:

- **2014 could be viewed as the year of inception for online auto finance in China, with diversified market players who seek complementary resources**
- **OEMs begin to leverage online finance products as a differentiator to boost new car sales**
- **Online companies utilize existing credit checks and big data tools to inventory the financing and supply chain financing businesses**

5.1 Online auto finance market outlook

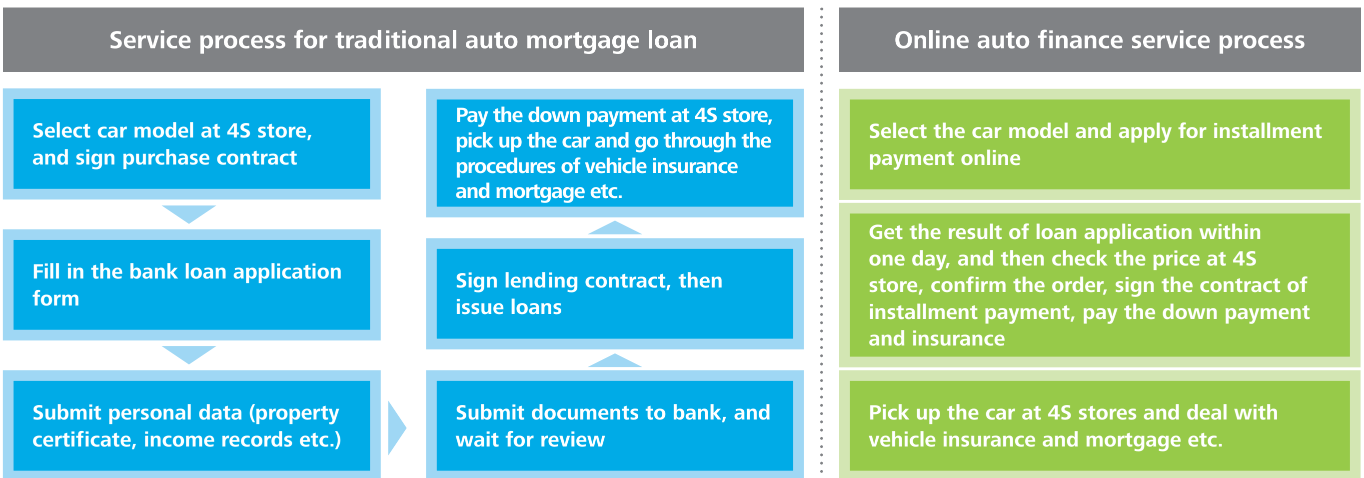
The auto industry has slowed down since 2011 after high growth in 2009 and 2010, and the profit model mainly driven by new car sales and maintenance services is gradually being replaced. As auto industry development heads in a new direction, online auto finance is expected to restructure the whole service process of the auto industry.

Millennials' buying power provides a great development opportunity for online auto finance. This segment features high reliance on the Internet for shopping. Millennial consumers are not only good at querying and comparing prices via Internet, but also more accustomed to complete transactions via online payment. Besides, they are more tolerant of collateral loans, installment payments, leasing, and other flexible credit products. However, lack of credit history and credit records means these consumers are often denied by traditional financial institutions.

Auto manufacturers, dealerships, banks, insurance companies, and other financial institutions are engaged in online auto finance to some extent. Auto manufacturers and dealerships should seek further business development in this sector rather than focusing on traditional businesses. With advantages in capital and rich experience in the financial industry, financial institutions have a share in the market of online vehicle loans and insurance. Developing alongside online auto, some non-auto enterprises also step into the value chain of the auto industry, diversifying the auto industry. In China, both Tencent and Alibaba are engaged in online auto finance. Collaboration between auto industry enterprises has been further strengthened to share resources and provide better consumption experiences for consumers.

5.2 Existing products & services for online auto finance

Online auto finance is both the result of the O2O development of traditional auto consumption credit services as well as the effective integration of the auto industry with online finance platforms, taking advantage



of Internet capabilities such as disintermediation and diversified channels. In accordance with business division, online auto finance covers consumer credit or leasing (including used vehicles), dealerships' wholesale loans (including used vehicle dealers), supply chain finance, and other financing businesses.

Development trend of auto consumer credit

- **O2O development of auto consumer credit**

The emergence of auto e-commerce helps attract consumers online and provides information about customer preferences. However, due to the big gap between offline and online prices and overall asymmetry of information, e-commerce platform order conversion rates stand at a low level.

Since 2014, several auto manufacturers have launched online vehicle loan application and pre-examination businesses on e-commerce platforms or their official websites to provide consumers access to suitable loan schemes in advance, shorten the approval period, and limit the frequency of required customer trips to 4S stores. Meanwhile, flexible adjustments on down payments, repayment periods, and repayment methods have also met various customer demands.

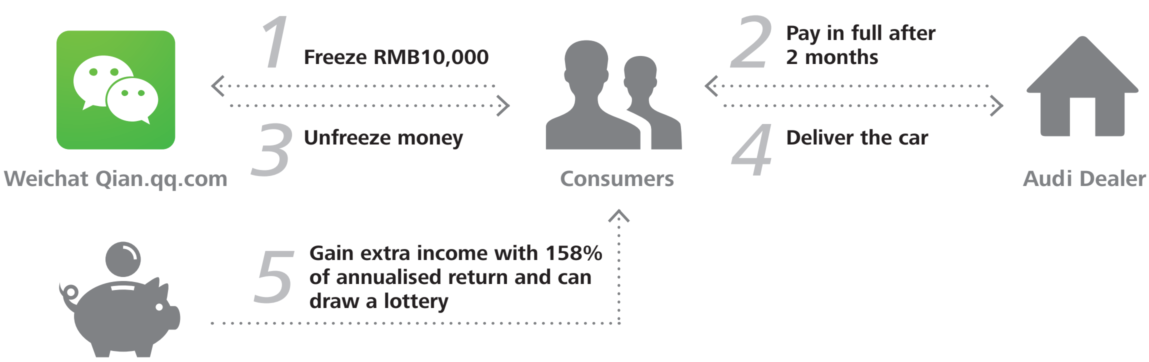
Given considerable interest subsidy of auto manufacturers and auto finance companies pay for auto credit products, financial products will gradually become a promotional tool as well as a differentiator for manufacturers. With integrated services combing online and offline services, they will ultimately guide consumers to 4S stores to bargain and pay for their cars, and furthermore to generate purchases of a series of aftersales products such as vehicle insurance, roadside assistance, maintenance, etc. In this way companies create a closed loop of auto consumption finance.

- **Online credit and auto financial products**

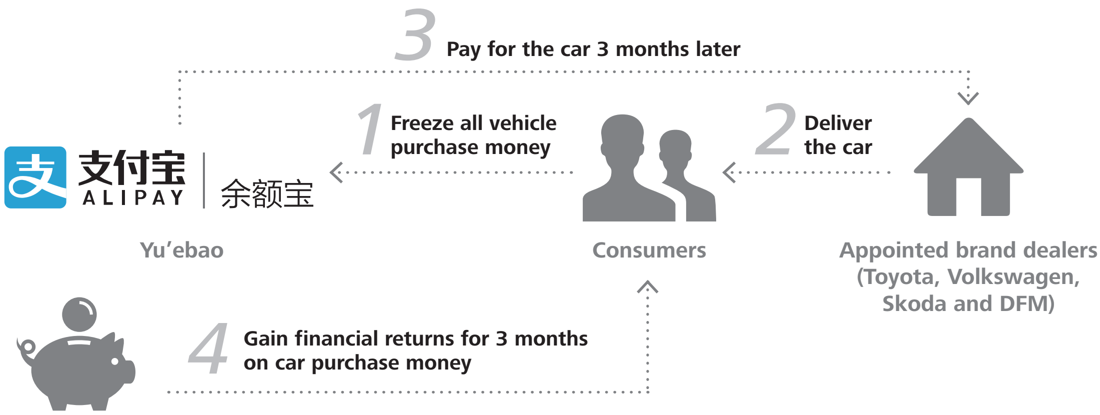
Internet companies, especially Alibaba and Tencent, have had their eyes on the auto industry for quite some time. These companies control a large amount of transaction data and socialization data, and hope to expand the usage of their third party payment tools and effectively recognize consumer groups with strongest purchasing power. In addition to cooperating with auto manufacturers to raise order conversion rate, Alibaba also collaborates with third party financing companies and leasing companies to issue new vehicle installment payment services and used vehicles leasing services. With the Big Data risk control model provided by ANT FINANCIAL, leasing companies and auto finance companies are able to provide comprehensive credit to consumers with responsible online shopping records, helping them get loan limits ranging from RMB20,000 to RMB200,000.

Other than utilizing the advantage in personal credit business, Yu'ebao and Qian.qq.com have launched respective financial products targeting car purchases. Cooperating with FAW-Audi, Tencent froze RMB10,000 financial capital via Qian.qq.com so that some consumers who successfully bought an Audi A3 could obtain cash benefits. In addition, ALIPAY cooperates extensively with auto manufacturers. Once car purchase funds were frozen on Yu'ebao, the cars could be taken away from dealers. Within three months, the frozen money was still in consumer's accounts, and consumers could make profits for these three months. After the three months, ALIPAY paid the money to dealers.

For auto manufacturers, cooperation with Internet companies can increase sales of new vehicles, open up new marketing channels, and obtain large amounts of Weichat and ALIPAY user groups. Besides, online financial consumers are willing to accept new things, therefore they are suitable groups for testing auto finance.



Note: Online auto finance products issued by Weichat Qian.qq.com



Note: Online auto finance products launched by Yu'ebao

Trends in dealership inventory financing

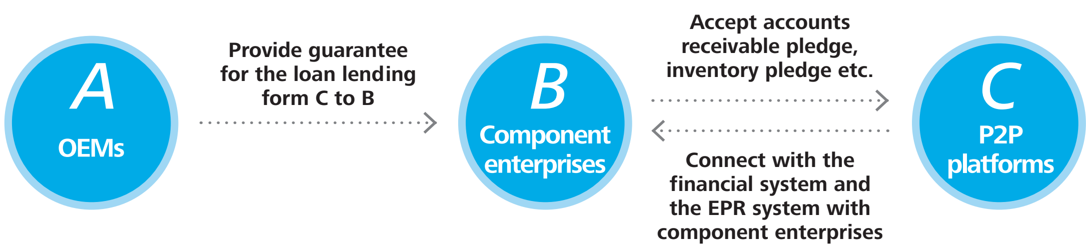
Compared with diversified, large-scale dealership groups with stronger capital resources and multiple financing channels, second-level automotive dealers, as one of the distribution channels of 4S stores, lends less money with shorter repayment periods. However, dealerships' high inventory warning in the first half of the year means some manufacturers' inventory will pile up, therefore reducing profit margins and putting many enterprises at risk of damaging capital chains.

With broad capital channels and a short turnover period, P2P platforms can easily match the financing demands of small-and-medium dealerships. Generally speaking, online loan platforms have to investigate dealerships' turnover and financial situations, exam the borrower's credit qualifications, crosscheck vehicles by assigning evaluators or vehicle evaluation agencies for guarantying the value of vehicle. Finally, they will package dealership information and their financing demands as an investment objective and post this to online loan platforms, to transfer the creditors' rights to various investors. With a short approval process and timely lending, these platforms greatly reduce the capital pressure for dealers.

Internet supply chain finance

As core enterprises in the auto industry value chain, auto manufacturers always postpone the payment of accounts payable to component suppliers to prolong the payment term and ease their financial pressure. Therefore, most of those upstream component manufacturers have faced urgent financing demands for quite a long time—especially those keeping a long average cash turnover period—and they usually offset their cash liquidity through credit financing. Traditional supply chain finance service providers offer loan businesses to component manufacturers and mid-and-downstream enterprises with capital constraints based on the credit level and the actual transaction data of core enterprises in the supply chain (e.g., OEMs) by way of accounts receivable pledges, inventory pledges, commercial note discounts, and others.

Advantages of the P2P platform in supply chain finance include: connecting the flow of information, business flow, logistics of upstream and downstream enterprises, recording transaction data, operation conditions, digitized financial status and other information, and meanwhile, connecting with the financial system and the EPR system of enterprises with financing needs and monitoring the order, inventory, transportation and cash flow of financiers online to greatly reduce the risk control costs.



6. Conclusion and Outlook

Since the second half of 2014, China's auto market has slowed down considerably, and neither considerable discounts nor new vehicle models can reverse this trend of decline. In addition, dealers' inventory has piled up. In the first half of 2015, the dealers' inventory coefficient has been above the warning level for several months.

The China Automotive Industry Association has lowered the sales expectation of 2015 from 7 percent set early this year to 3 percent, as it is estimated that the growth of the Chinese auto market will decline continuously, dividing from its previous momentum. Thus, adjusting income models and profit structures will be some of the major methods for auto dealers to avoid decline.

1. Effects from increases in scale in the auto industry are weakening gradually, and profits of new car sales will be further decreased. The overall driving force and competitiveness of the industry extend to aftermarket services such as auto finance. Thus auto manufacturers must refine and diversify operating methods to increase sales.

2. The policy pressures from increasing number of middle and big cities adopting car-purchase restrictions and limitations on the cross-regional circulation of used vehicles will restrain demand for both new vehicles and used vehicles to some extent.

3. Emerging alternative services such as taxi-hailing software and carpooling APPs also postpone some customers' vehicle purchase plans.

Judging from the experience of mature markets, auto finance is not only an important tool to achieve differentiated competition for auto manufacturers and dealers, but also a major profit stream with stable growth. As Millennials have grown to be the main purchasing groups in the auto market, the design, function, power, marketing points, and promotion methods of vehicles should witness significant changes. Among these changes, the engagement and importance of auto finance in the whole process of vehicle purchases should rise gradually. Auto manufacturers must seize this opportunity and cooperate with third party credit companies and e-commerce platforms to pre-authorize vehicle loans and transfer effective information about potential clients to 4S stores, so as to stimulate the sales of new cars; and at the same time, by applying interest rate tools, cash discounts, and other measures, attract new clients, and make marketing and promotion targeting on different vehicle models to optimize dealers' sales structures.

Commercial banks, vehicle manufacturers, and dealerships are also facing with challenges from latecomers when providing diversified financial services. Insurance companies, bonding companies, small loan businesses, and P2P online loan platforms have entered into the auto financial sector consecutively, and started to compete for different market segments in accordance with individual advantages and differentiated positions. Manufacturers, dealerships, and other traditional operators are actively cooperating with emerging market players when building their own business foundation. In the long run, auto finance is bound to provide the new growth engine for China's auto market and play a vital role in the structural adjustments in the industry.

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