



China NPL – Market Report

2021 Q1



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Market Report in China NPL Market

2021 Q1

A publication from:



Notice to Readers

This Report, undertaken jointly by Zheshang Asset Research Institute and Pepper Group (China), provides readers with a better scope to understand the dynamics and recent activities within China's NPL market. It has released its first edition in August 2020 and will be published on quarterly basis to focus on current government regulations and policies, recent industry activities, insight into primary and secondary market of NPL transactions and online judicial auction market.



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Chapter 1: NPL Market Update

“The increases in NPL disposal at different levels are expected to be incremental, and regulators will be keeping a very close eye on the maintenance of financial stability”

Chinese Banks Disposed of US\$467 billion Non-Performing Loans (“NPL”) in 2020

At the inaugural 2021 Work Meeting held on January 26, 2021, China Banking and Insurance Regulatory Commission (“CBIRC”) indicated that Chinese banks disposed of a record-breaking RMB 3.02 trillion (US\$467 billion) in NPLs in 2020, with the total disposal amount during the period from 2017 to 2020 more than the total for the preceding 12-year period.

In the Work Meeting, CBIRC highlighted that in 2020, China has made decisive achievements in preventing and resolving financial risks, including but not limited to, dealing with those overly risk-taking financial institutions such as Baoshang Bank and Anbang Insurance Group, cracking down on the shadow banking system, zeroing out peer-to-peer lending businesses, and steadily promoting the risk management of high-risk small and medium-sized banks, insurance and trust institutions. CBIRC has also pledged to tighten oversight of fintech companies, curb real-estate lending and push ahead with asset management business reform as laid out in its key tasks for 2021.

Comments: To keep financial risks under control, China will continue accelerating the NPL disposal by broadening NPL disposal channels and taking steps to welcome international market players at both the national and local level. However, as the objective of ensuring financial stability in China remains a paramount policy consideration for Chinese regulators, a full “opening of the floodgates” of China NPL market to foreign investors will not occur in the short term. Accordingly, we can expect Chinese regulators to continue to adopt a gradual and incremental approach to reform and open up the NPL market requiring strict compliance with regulatory requirements to prevent systemic risks.

China’s Massive US\$3.1 trillion Retail Mutual Fund Market Attracts Foreign Capitals

Schroders PLC, on February 18, 2021, filed an application with the China Securities Regulatory

Commission (“CSRC”) to establish a public mutual fund management company (“MFC”) in the Mainland.

Five other foreign managers have applied for the MFC license, which includes Alliance Bernstein, New York-headquartered Van Eck, Blackrock, Neuberger Berman, and Fidelity. So far, only Blackrock has received the license in August last year, while others are still awaiting regulatory approval from CSRC. Moreover, the overseas shareholders of some related joint ventures, including Morgan Stanley Huaxin Fund Management and China International Fund Management, are set to take full ownership of their JVs.

Comments: The move of those foreign managers follows China’s lifting of overseas ownership limits in the mutual fund sector on April 1, 2020, allowing foreign managers to create wholly-owned public mutual funds and to take 100% ownership of their joint ventures with domestic firms. The CSRC flagged the removal of ownership caps as part of several measures to accelerate the opening of China’s financial sector, and China has been accelerating the liberalization of its financial market over past few years, which meets demand from foreign institutions eager to get a piece of the country’s multitrillion-dollar asset management industry and other sectors.

Provincial Asset Management Companies (“AMCs”) Are Seeking for Enhancing Capital Strength

Shaanxi Asset, one provincial AMC in the Shaanxi province, successfully issued USD bonds of US\$200 million with a 3-year maturity and 3.2% interest rate on March 11, 2021, which is the first USD bonds issued by a government-owned enterprise in the Shaanxi province, and simultaneously, sets a new low for the interest rate of bonds issued by provincial AMCs.

Guohou AMC, one provincial AMC in Anhui province, successfully priced its senior unsecured USD bonds of US\$100 million with a maturity of 2 years and 11 months, and interest rate of 4.5%, and Bank of Jiujiang provided the standby letter of credit support for this issuance.

Comments: Following Guohou AMC and Zhongyuan AMC, Shaanxi Asset becomes the third provincial AMC issuing USD bonds. In recent years, provincial AMCs' financing needs have increased significantly, and they are seeking ways to enhance their capital strength, including attracting strategic investors, increasing capital, and issuing bonds, in response to the continued surge of NPL supply.

Personal NPL Portfolios Were All Sold at a Premium

On March 1, 2021, the first batch of personal NPL portfolios were publicly bid. Among the four portfolios, three were from the Industrial and Commercial Bank of China, with personal consumer credit loans and credit card overdrafts as underlying assets, and one was from the Ping An Bank, with personal business credit loans as underlying assets.

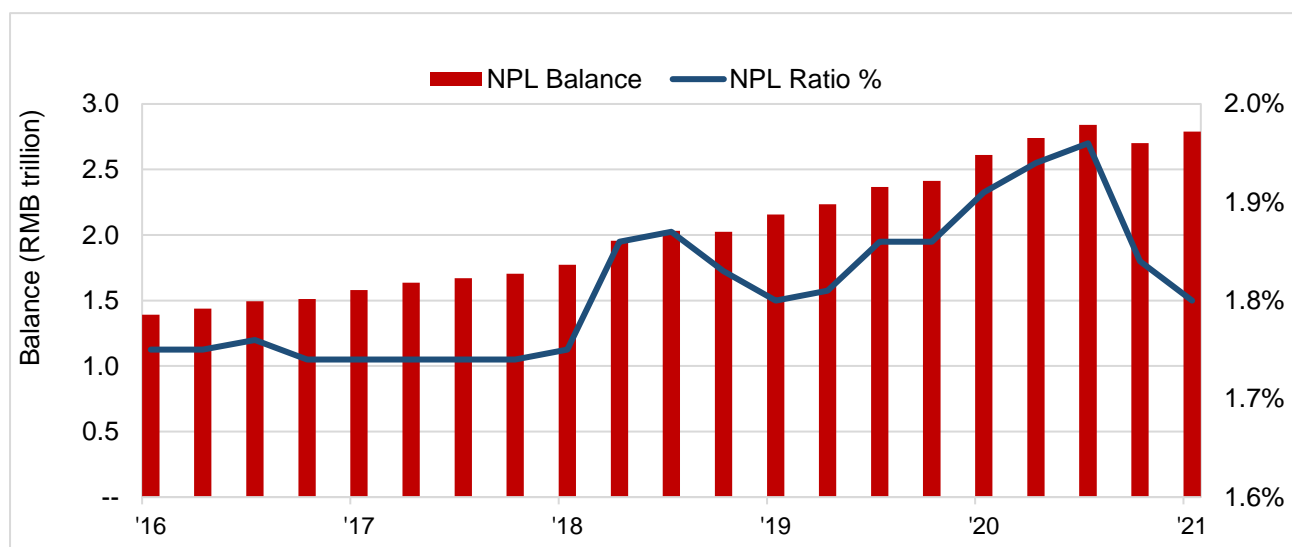
The transfer announcement received widespread market attention, and approximately 16 interested

purchasers applied to participate in the bidding, covering both national and provincial AMCs. With high participation enthusiasm, 9 interested purchasers have offered quotations for the most popular portfolio, and its number of quotation rounds has reached up to 44.

In the end, the four portfolios were all transacted at a premium, of which the highest transaction price was RMB 3.6 million.

Comments: Allowing commercial banks to transfer personal NPLs in batches means that banks' disposal channels have been further expanded. At present, it appears that the personal NPL transfer business is still under testing for the banks and AMCs to establish such business relations and familiarize themselves with the business process. Many details such as the pricing methods and profit models for personal NPLs still require some time to explore and develop.

Exhibit 1-1 NPL Balance in China Commercial Banks



Source: China Banking and Insurance Regulatory Commission

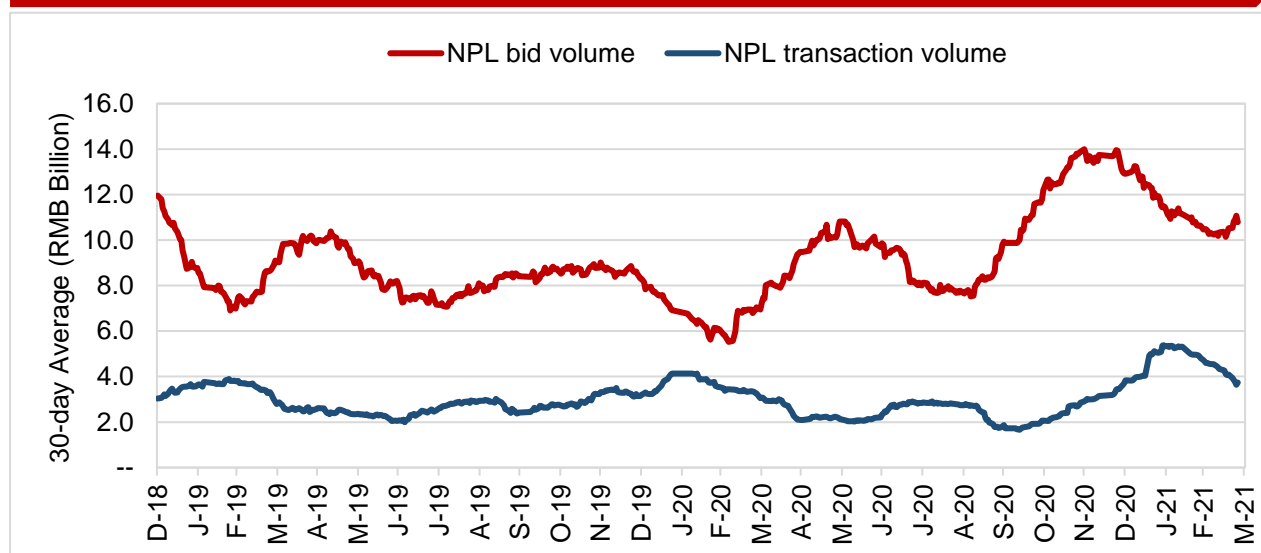
As of the end of the first quarter, the NPL balance of China commercial banks was RMB 2.8 trillion (US\$429.0 billion), an increase of RMB 86.8 billion during the quarter, and the NPL ratio of China commercial banks was 1.8%, with a decrease of 4 bps compared to the beginning of this year.

The State Council's March 24th decision to extend the moratorium on inclusive loans for small businesses to the end of 2021 from March-end, it is expected to mitigate delinquencies of borrowers and postpone the foreseeable increase in NPL supply. Given the uncertainties currently surrounding the regional and global economy, the asset quality of domestic institutions will still be under pressure and the trend of rising NPL levels is expected to continue in the remaining months of 2021.

Chapter 2: Overview of Recent NPL Transactions

“Starting from a higher level in bid and transaction volumes this year compared to 2019 and 2020, the NPL market shows strong stamina and is promising in 2021”

Exhibit 2-1 NPL Bid & Transaction Trend



Note: data in chart is generated daily by calculating the latest 30-day moving average of the volume of bid or transaction cases
Source: Public Information, Zheshang Asset Research Institute

Over the first quarter of 2021, the NPL bid volume continued its retracement but showed an upward trend at last, and the transaction volume started its retracement after reaching a high level at the beginning of the year. Due to the production halt early last year affected by the Covid-19, the volumes of NPL bid and transaction in Q1 2021 were much higher than the volumes in the same period last year. Therefore, the liquidity of the NPL market in Q1 2021 has increased more than that of last year but has declined compared with the end of 2020.

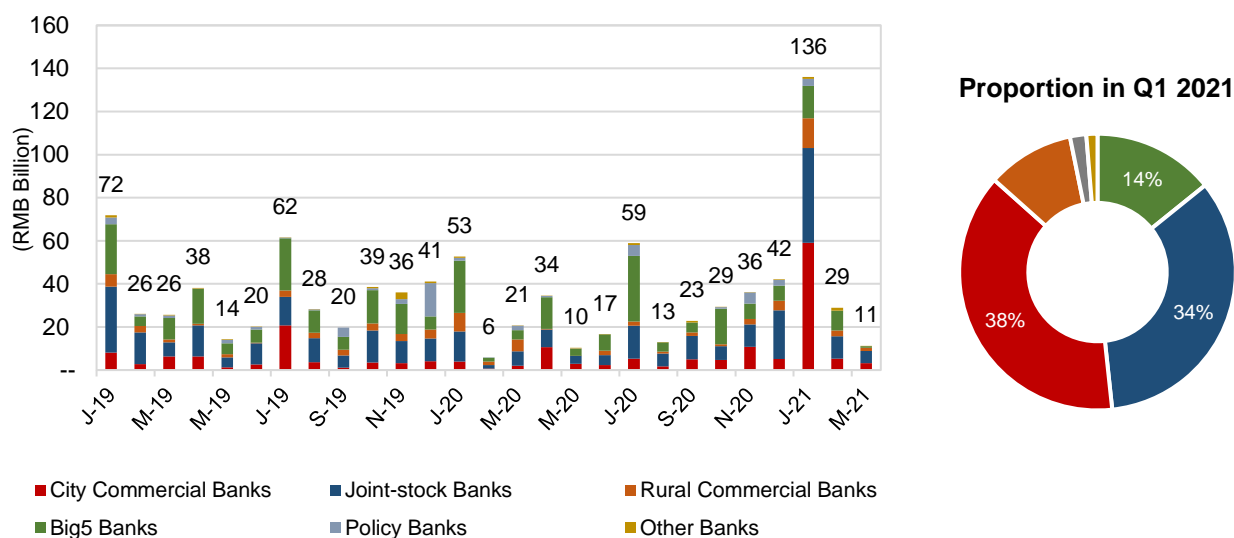
Breakdown of NPL Transaction Volume by Market

Generally, only licensed AMCs (national AMCs and provincial AMCs) are allowed to purchase NPLs on a “bulk” basis from Chinese banks (3 or more NPLs per the current definition of “bulk” transfer). The acquisition of NPL portfolios directly from Chinese banks or other Chinese financial institutions is referred to as a **Primary Market Transaction**.

The acquisition of NPL portfolios from licensed AMCs by investors (both domestic and foreign) and the subsequent transfer of NPL portfolios among investors are referred to as **Secondary Market Transactions**.

This Report encloses primary market transactions and part of secondary market transactions, which only includes transaction data from the trades made by licensed AMCs to investors and does not include any transaction between two private investors.

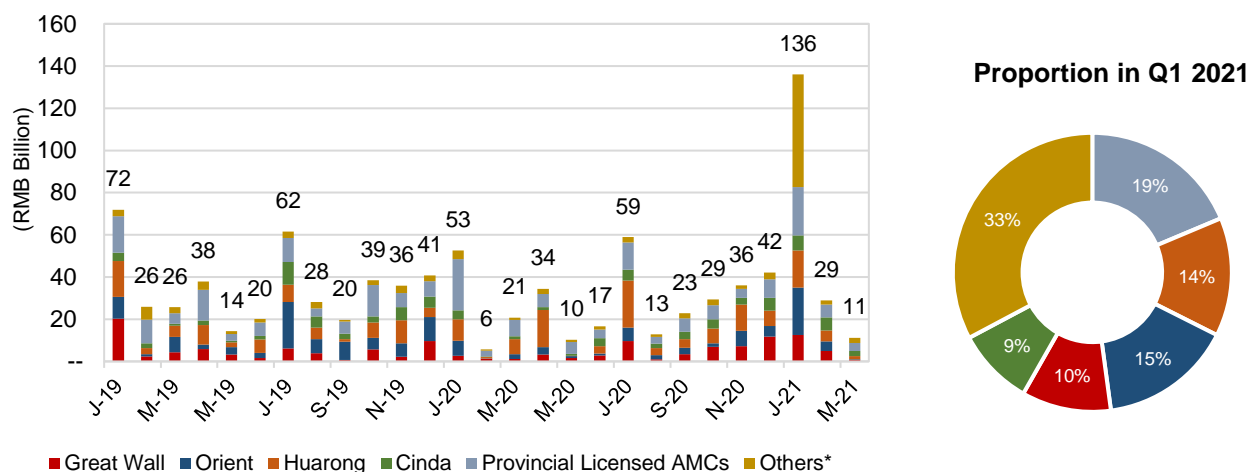
Exhibit 2-2 NPL Transaction Volume – Seller Breakdown in Primary Market



Source: Public Information, Zheshang Asset Research Institute

In Q1 2021, the total size of NPL transactions from banks was around RMB 176.0 billion. Other than the continued dominant market position of large joint-stock banks, the sudden increased proportion of city commercial banks from its previous average level of 13%-16% is mainly from the Shanxi province, which may relate to the local Government's reorganization plan for five city commercial banks in the Shanxi province, as one of the most important tasks in that process is to resolve the existing bad loans in the five original banks.

Exhibit 2-3 NPL Transaction Volume – Buyer Breakdown in Primary Market



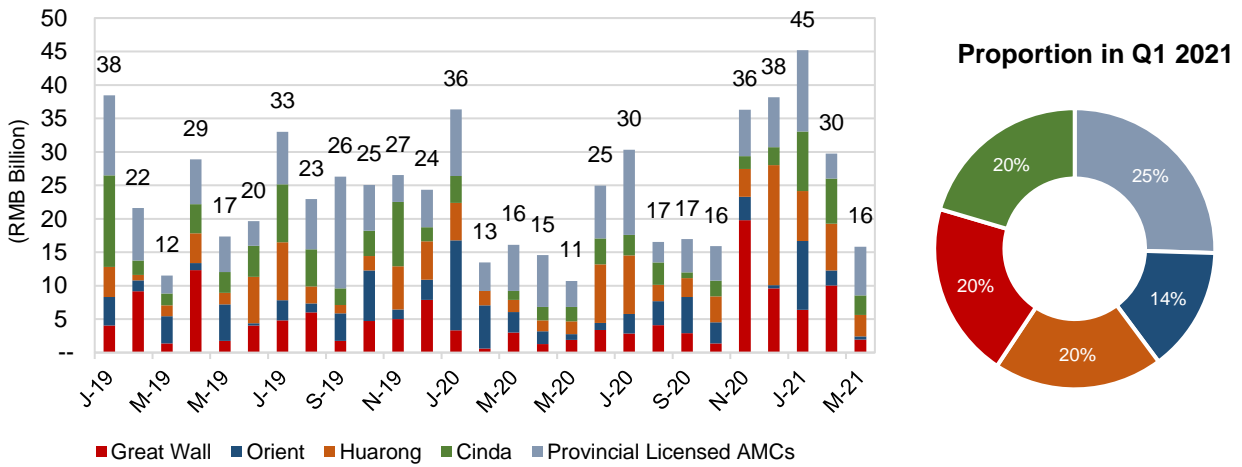
Note*: "Others" here refers to institutions without AMC license, mainly private enterprises, foreign institutions, and individual investors.
Source: Public Information, Zheshang Asset Research Institute.

Among the buyers in China's primary NPL market, the Big 4 AMCs (Huarong, Cinda, Orient, Great Wall)^[1] purchased about RMB 85.5 billion, provincial licensed AMCs purchased about RMB 32.9 billion, and other investors purchased about RMB 57.7 billion. The acquisition scale of all institutions increased year-on-year, and the acquisition scale of institutions without AMC license increased the most, about 10 times, mainly because in the Shanxi province, one Government-funded company (just established in December of 2020) played an important role in the reorganization plan mentioned above, by taking over the bad loans from the five city commercial banks involved in the plan^[2].

Note^[1]: China Galaxy AMC was formally established in December of 2020 and has not started its business yet, so in this report, we will still use the "Big 4 AMCs" as national AMCs for data statistics until Galaxy AMC conducts real business.

Note^[2]: According to the disclosed information on Shanxi Property Rights Exchange, during January 2021, Jiangxi Rongjin Zhenxing Private Equity Fund Co., Ltd., fully controlled by Department of Finance of Jiangxi Province and State-owned Assets Supervision and Administration Commission of the State Council of Jiangxi Province, has purchased NPLs of around RMB 47.5 billion from the local city commercial banks.

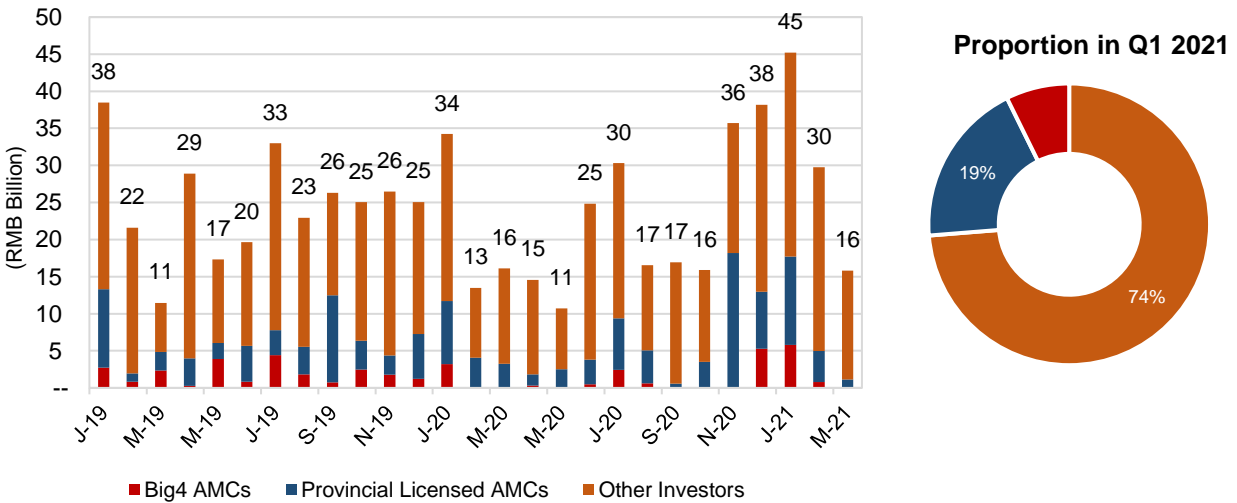
Exhibit 2-4 NPL Transaction Volume – Seller Breakdown in Secondary Market



Source: Public Information, Zheshang Asset Research Institute

Total NPL sales from licensed AMCs in Q1 2021 have increased year-on-year to RMB 90.7 billion, and among the Big 4 AMCs, Cinda AMC has the largest proportion of NPL transactions, while Orient AMC has the smallest proportion. Regardless of the bid scale or transaction scale, the Big 4 AMCs still maintain the dominant sellers in the secondary market.

Exhibit 2-5 NPL Transaction Volume – Buyer Breakdown in Secondary Market



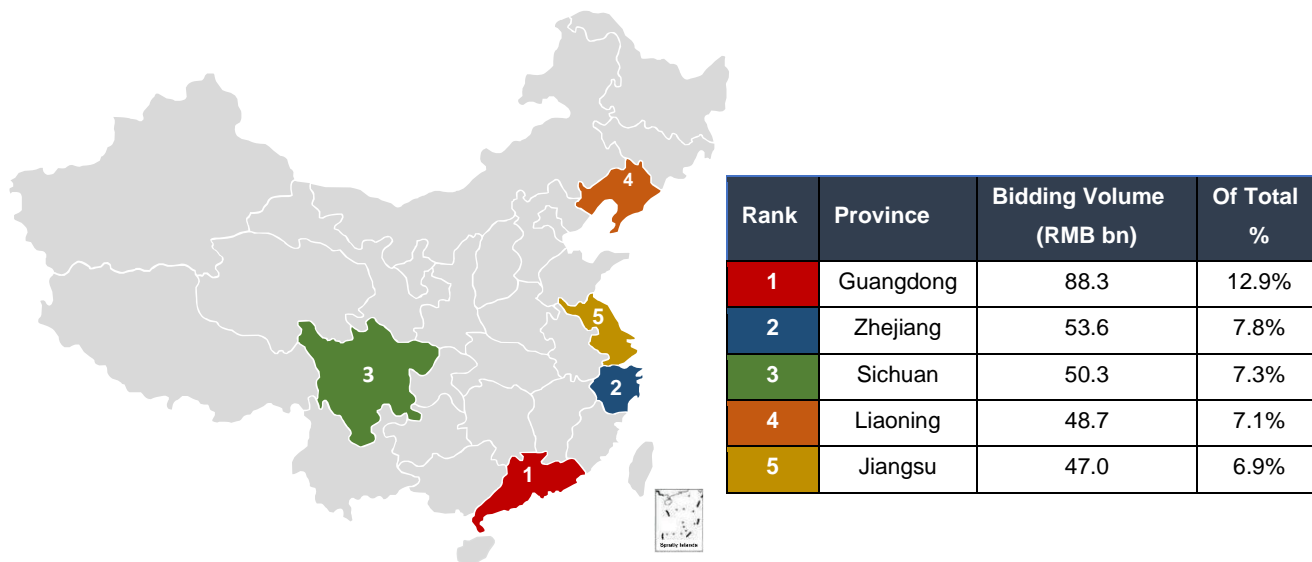
Source: Public Information, Zheshang Asset Research Institute

For NPLs sold by licensed AMCs in the secondary market, around RMB 67.0 billion were purchased by investors other than licensed AMCs, RMB 17.2 billion were purchased by provincial licensed AMCs, while the Big 4 AMCs purchased RMB 6.6 billion.

The secondary market remains a primarily non-licensed-AMC investors market, where the lack of policy requirements and government guidance found in the secondary market creates a more competitive and price-sensitive market dynamic.

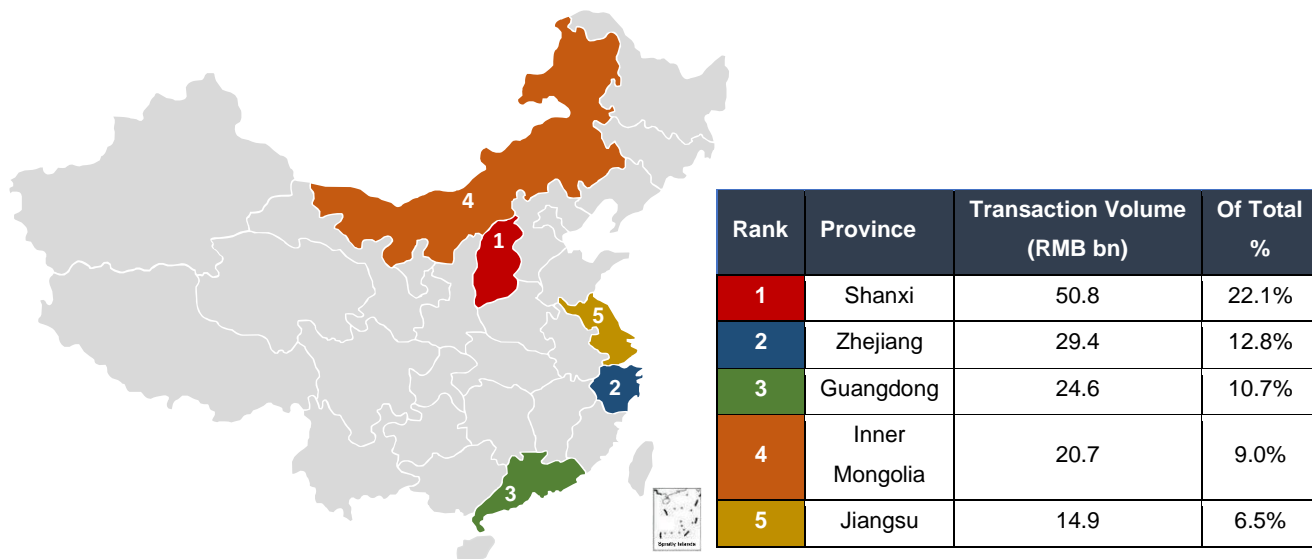
NPL Bid & Transaction Volume Distribution

NPL transactions were heavily concentrated in a small number of provinces, with the top five accounting for 42% of total NPL bids in Q1 2021. We note that NPL activity has a positive correlation with the size of its regional economy and the NPL level, as the top-five provinces all have a large scale of economy and relatively high NPL balance.



Source: Public Information, Zheshang Asset Research Institute

Likewise, NPL transactions were also heavily concentrated in Q1 2021. Shanxi province accounted for the largest transaction volume due to the reason mentioned before in Page 5, followed by Zhejiang province, Guangdong province, Inner Mongolia, and Jiangsu province. Together, these five provinces accounted for 61% of the volume of total Chinese NPL transactions.



Source: Public Information, Zheshang Asset Research Institute

Considering the scale of NPL bids and transactions, the NPL market activities in the Yangtze River Delta and the Pearl River Delta are rich and stable as the NPL market is more active in developed regions, and in the Shanxi province and Inner Mongolia, the NPL transaction volume is also in an increasing trend, indicating that they are the areas that investors need to pay close attention to.

Chapter 3: Overview of Online NPL Auctions

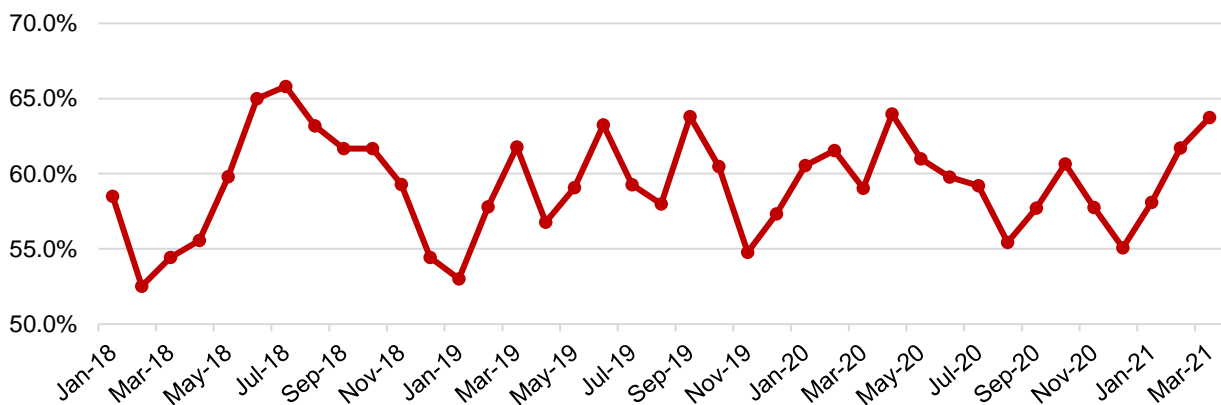
“Online auctions have remained stable, averaging a discount of around 65% to face value / underlying principal”

While online NPL auctions occur in all provinces across China, the majority of the provinces only host a relatively small number of online auctions. In Q1 2021, there was a total of 720 NPL transactions on the Taobao platform nationwide, among which Shandong province has the largest number with 208 transaction cases, followed by Zhejiang Province with 107, Guangdong province with 69, and Jiangsu province with 58.

From the perspective of online NPL auction prices, the principal discount rate for NPL transactions in Q1 2021 was in an upward movement, reaching a relatively high level in these two years. Judging from the current trend, the average principal discount rate for NPL transactions nationwide is around 65%.

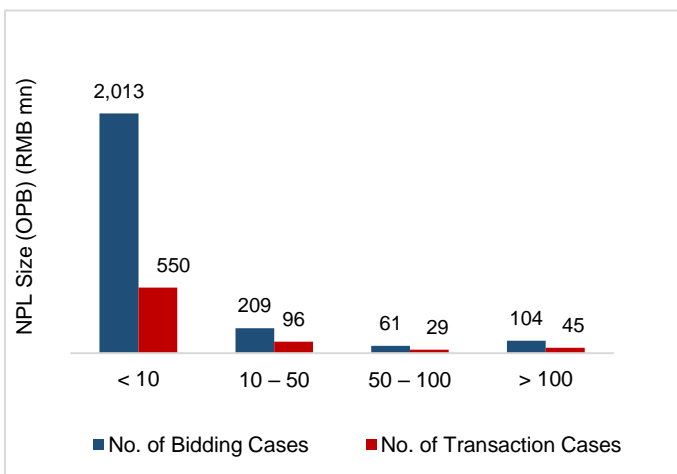
NPLs listed on online auction platforms only account for a small fraction of China’s NPL market and are not a proxy for the broader NPL market. However, changes in the direction of online NPL auction prices appear to be shaped by the same macroeconomic trends that determine how the broader market prices NPLs. Therefore, this data could be used as a reference basis for market pricing trends while the market prices for specific regions would still require on-site investigation.

Exhibit 3-1 NPL Auction Transaction Cases - Discount Rate on Claim OPB %



Source: Public Information, Zheshang Asset Research Institute

Exhibit 3-2 Size (OPB) Distribution of Auctioned NPLs (RMB Mn)



For size (OPB) distribution of online NPL auction cases, over Q1 2021, about 80% of both bidding and transaction cases were of size below RMB 10 million, from which we could see that the small-size NPLs were the main assets sold in online platforms and targeting to those local individual buyers and small-scale institutional buyers. As for large-size NPLs of size above RMB 100 million, there were 104 bidding cases and closed at 45 transaction cases, among the bidding cases, the largest one was RMB 1.23 billion, while among the transaction cases the largest one was RMB 1.01 billion.

Source: Public Information, Zheshang Asset Research Institute

Chapter 4: Overview of Collateral Judicial Auctions

“Online auction market of collaterals ^[1] performs well with larger volume and higher liquidity in 2021 Q1, especially for those popular residential and industrial collaterals, whose realization price has seen an upward trend both quarter-to-quarter and year-to-year”

Overall Judicial Auction Summary

The following data for collateral auctions covers all auction records, including 1st auction cases, 2nd auction cases and sale-off cases. The number of 1st auctions reflects the actual number of auctioned assets (in other words, the assets in 2nd auction and sale-off stage have failed in their corresponding 1st auction) and the change in the number of 1st auctions represents the actual change in the size of the online collateral auction market. Moreover, the proportion of 1st auctions to the total auctions reflects the liquidity of the online auction market in a positive correlation.

In Q1 2021, there was a total of 122,212 auction cases of collateral (Real Estate) nationwide across all major online auction platforms, which was a year-on-year increase of 26.3%. Exhibit 4-1 below illustrates that the total number of auctions in Q1 2021 only decreased year-on-year in the two provinces of Anhui and Sichuan while it increased in other provinces and province-level municipalities ^[2].

Exhibit 4-1 No. of Collateral Online Auctions in Main provinces and the YOY changes %

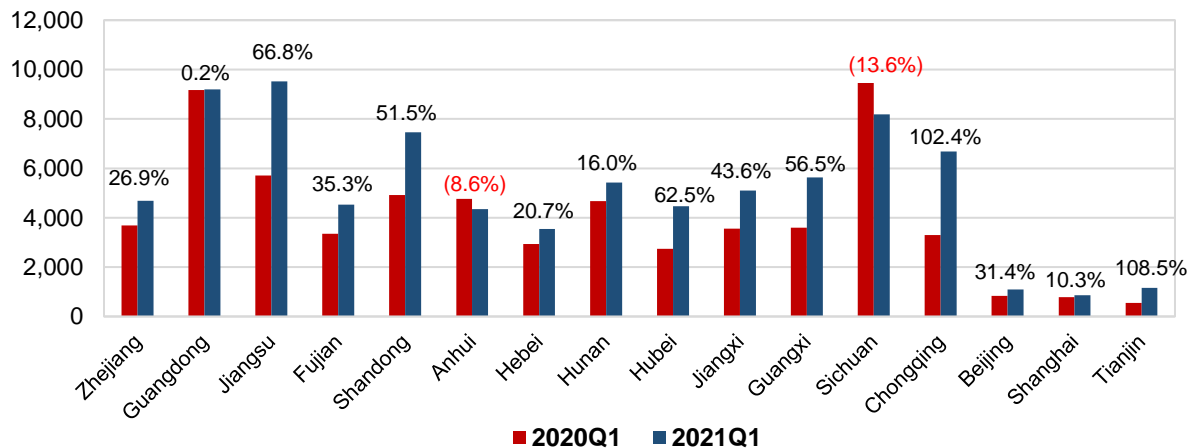
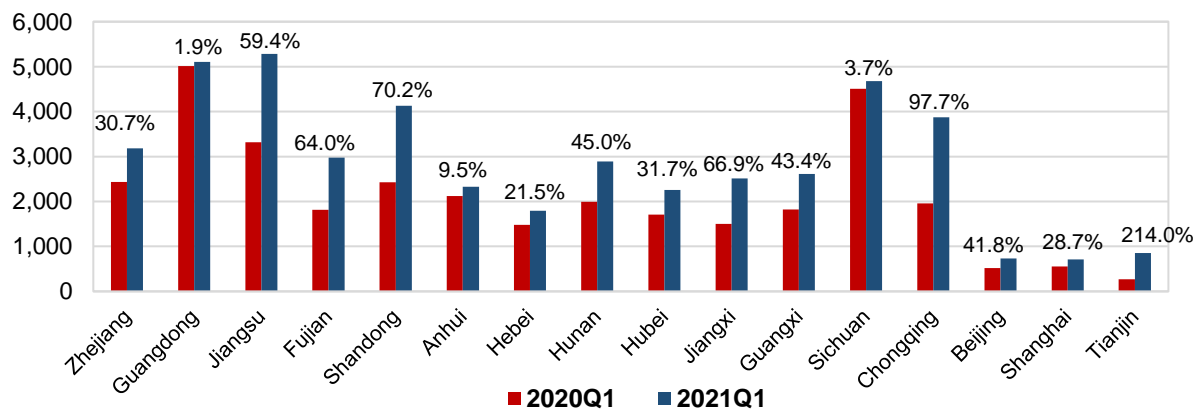


Exhibit 4-2 No. of Collateral 1st Online Auctions in Main provinces and the YOY changes %



Source: Main online auction platforms, Zheshang Asset Research Institute

Note ^[1]: Not only collateral, but some seized properties of NPL will also be listed and auctioned in online judicial auction platform. Hereafter collectively called “collateral” for better description.

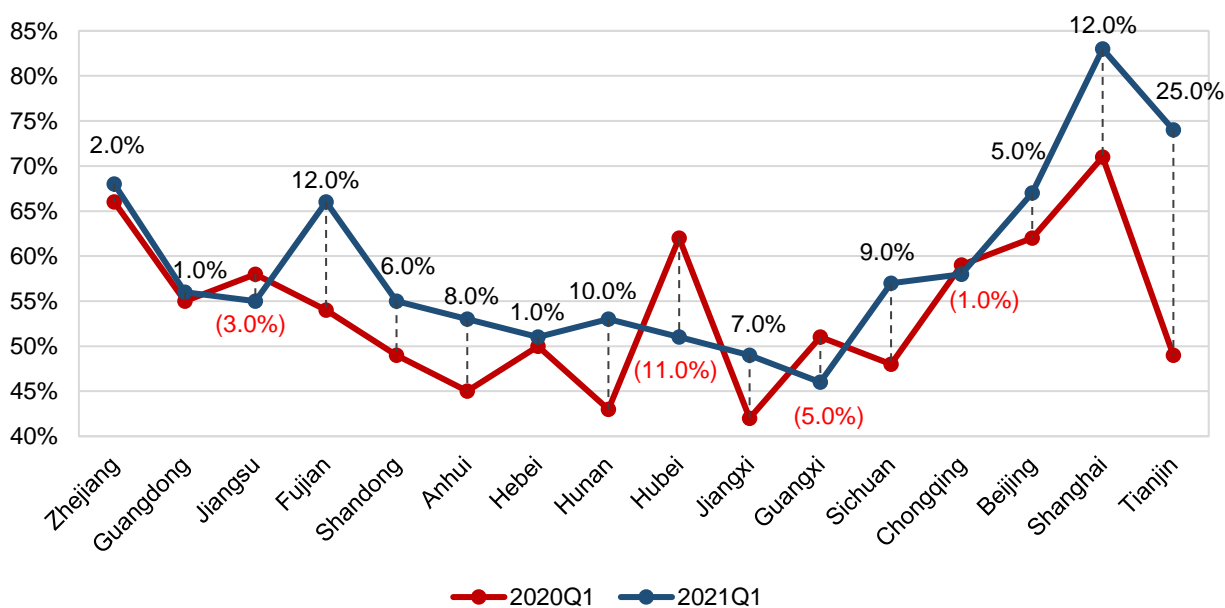
Note ^[2]: A province-level municipality, formally a municipality under the direct administration of central government, is the highest level of classification for cities used by the People’s Republic of China, currently including Beijing, Tianjin, Chongqing and Shanghai.

In Q1 2021, there was a total of 67,459 1st auction cases of collateral (Real Estate) nationwide on major online platforms, a year-on-year increase of 2.7%. In terms of different provinces as Exhibit 4-2 above, the number of 1st auctions in Q1 2021 in all provinces and province-level municipalities increased year-on-year, and among them, the increases in Jiangsu, Fujian, Shandong, Hunan, Jiangxi, Guangxi, Chongqing, Beijing, and Tianjin exceeded the national average.

The number of 1st auctions accounted for 55.2% of the total number of auctions nationwide, a year-on-year increase of 2.7% compared with Q1 2020. As demonstrated in Exhibit 4-3 chart, all province-level municipalities excluding Jiangsu, Hubei, Guangxi, and Chongqing, have seen the proportion of 1st auctions to total auctions increase, which indicates that except Jiangsu, Hubei, Guangxi, and Chongqing, the market liquidity of judicial auctions all increased in other 12 provinces and province-level municipalities.

Among the 16 provinces and cities, Guangdong, Sichuan, and Jiangsu have the largest market scale, and Zhejiang, Fujian, Shanghai, Beijing, and Tianjin have the best market liquidity, primarily due to the relatively strong performance of local real estate, and the robust market demand.

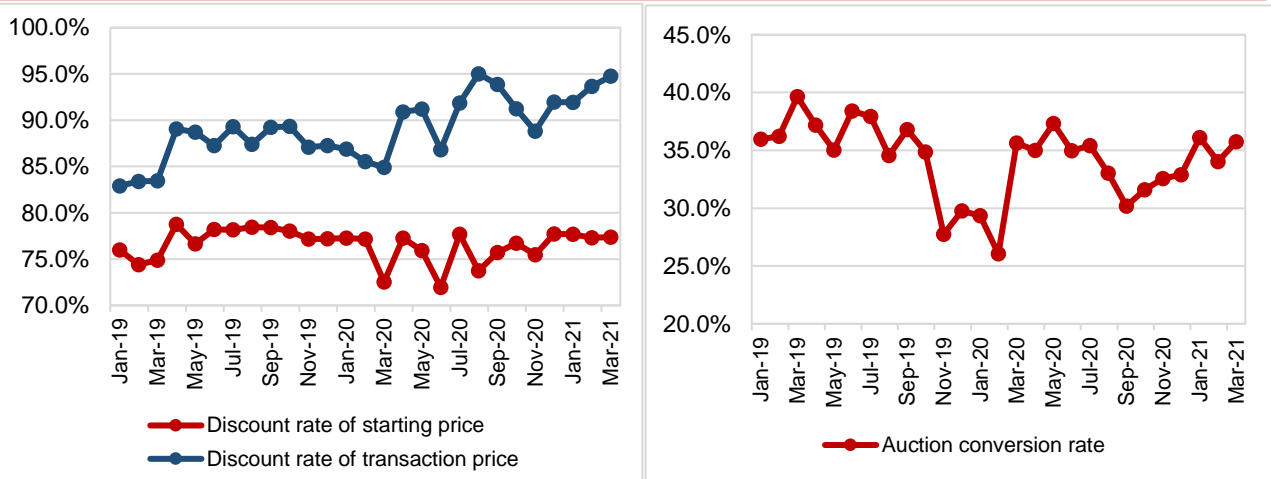
Exhibit 4-3 Proportion of No. of 1st Auctions to No. of All Auctions %



Source: Main online auction platforms, Zheshang Asset Research Institute

Judicial Auctions by Asset Type

Exhibit 4-4 Residential Collateral Auction – discount rate & conversion rate % in state level



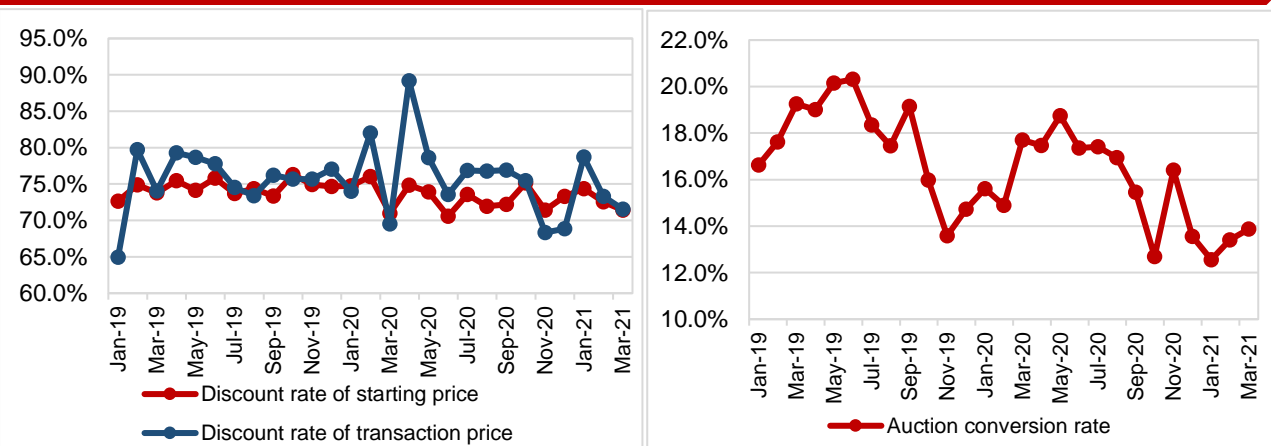
Note: the discount rate is the starting price or transaction price to the collateral valuation price, and the conversion rate is the # of successful auction cases to all auction cases ^[1]

Source: Main online auction platforms, Zheshang Asset Research Institute

In Q1 2021, the price of residential collateral auction transactions has seen an upward trend, at an overall higher level than that of 2020, whilst simultaneously, the gap between the transaction price relative to the starting price has gradually widened, indicating the residential assets auction premiums are expanding.

The conversion rate of residential assets has exhibited slight volatility in Q1 2021, and higher than that in Q1 2020.

Exhibit 4-5 Commercial Collateral Auction – discount rate & conversion rate % in state level

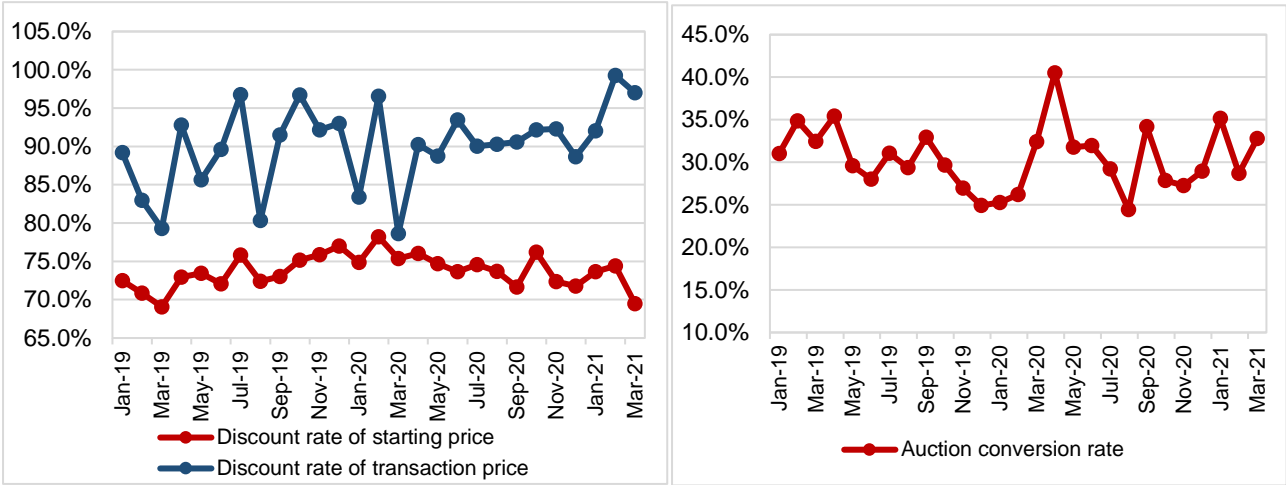


Source: Main online auction platforms, Zheshang Asset Research Institute

In Q1 2021, the price was showing a downward trend for commercial assets auctions, where the average level was slightly lower than that in the same period of 2020, and the price premium was shrinking between the transaction price relative to the starting price. The conversion rate was increased but at an overall lower level than Q1 2020.

Note ^[1]: As the 1st auction, 2nd auction and sale-off cases of the same collateral are not linked to each other in online auction platforms and cannot be identified, the conversion rate of the collaterals sold in the 2nd auction or sale-off stage is not 100%, which leads the overall level of conversion rate here lower than the actual situation in the market.

Exhibit 4-6 Industrial Collateral Auction – discount rate & conversion rate % in state level



Source: Main online auction platforms, Zheshang Asset Research Institute

In terms of auction prices, the overall discount rate of the transaction price for industrial collateral auctions slightly fluctuated in Q1 2021 displaying an upward movement, with the average level higher than that in Q1 2020. At the same time, the premium of the transaction price relative to the starting price was quite large and is still expanding. The conversion rate fluctuated and was slightly higher than that in Q1 2020.

Recovery levels for collateral auctions of residential and industrial real estate at around 35% are comparatively better than those for commercial real estate which features conversion levels below 20% in recent years, because residential and industrial assets are more popular in the market, which also drives the higher price premium of residential and industrial assets as people are willing to pay more for these two types of assets.

Collateral Judicial Auction Overview in Zhejiang Province

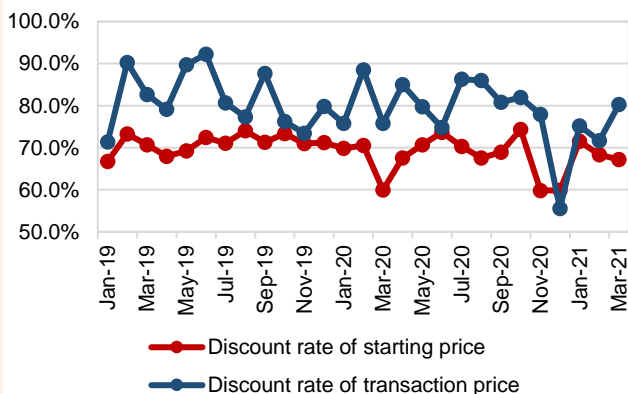
In Q1 2021, there were 4,679 online collateral auctions across major platforms in the Zhejiang province, a year-on-year increase of 26.9%. Except for Hangzhou, Wenzhou, and Jinhua, the other 8 cities in Zhejiang saw an increase in the number of collateral auctions year-on-year.

In Q1 2021, there were 3,179 1st auctions in the Zhejiang province on major platforms, a year-on-year increase of 30.7%. In the same period, the number of 1st auctions accounted for 67.9% of the number of total auctions, increasing 2% year-on-year. Except Jinhua, the number of 1st auctions across other 10 cities have risen year-on-year. And except Ningbo, Quzhou, Zhoushan, and Taizhou who saw weakness in market liquidation, the proportion of 1st auctions to total auctions for the other 7 cities increased or consistent year-on-year.

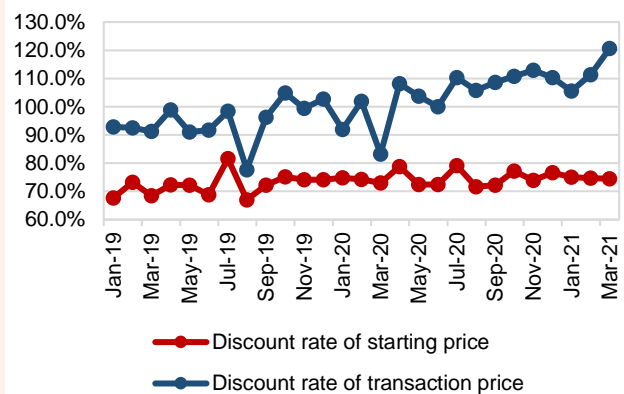
With respect to the price of commercial auctions illustrated below, the average discount rate was decreasing for starting price while increasing for transaction price, so the premium of the transaction price relative to the starting price was gradually expanded over Q1 2021, but both the overall discount rate and the premium level are relatively lower than those in Q1 2020.

For industrial collaterals, the discount rate of transaction price in Q1 2021 has increased significantly and reached the highest level from the beginning of 2019. The premium of the transaction price relative to the starting price has kept the increasing trend in Q1 2021, which is also larger than that in previous months.

Commercial Collateral in Zhejiang Province



Industrial Collateral in Zhejiang Province



Source: Main online auction platforms, Zheshang Asset Research Institute

Collateral Judicial Auction Overview in Guangdong Province

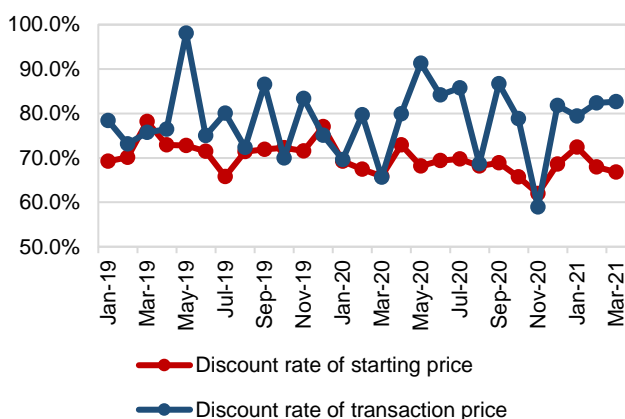
In Q1 2021, there were 9,198 online auctions across major platforms in the Guangdong province, slightly increasing 0.2% year-on-year. Except for Foshan, Zhanjiang, Heyuan, Yangjiang, Qingyuan, and Yunfu, the other 11 cities saw an increase in the number of collateral auctions.

In Q1 2021, there were 5,106 1st auctions on major platforms in the Guangdong province, a year-on-year increase of 1.9%. In the same period, the number of 1st auctions accounted for 55.5% of the number of total auctions, a year-on-year decrease of 2.6%. Except Guangzhou, Foshan, Shaoguan, Zhanjiang, Huizhou, Qingyuan, and Yunfu, the other 10 cities saw an increase in the number of 1st auctions in Q1 2021. As for the proportion of 1st auctions to total auctions, except Shenzhen, Shantou, Zhanjiang, Zhaoqing, Jiangmen, Heyuan, Yangjiang, Qingyuan, Dongguan, and Zhongshan, the proportion in the remaining 7 cities in Q1 2021 has decreased year-on-year.

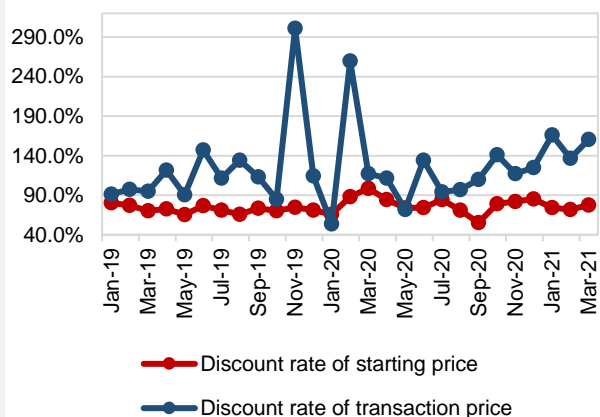
For commercial collaterals, the discount rate of transaction price has risen slightly in Q1 2021, and the overall level was higher than that in Q1 2020. The premium of the transaction price relative to the starting price has expanded.

For industrial real estate, the discount rate of transaction price fluctuated slightly in Q1 2021 while that of starting price was quite stable. If not considering the peak value of transaction price in February 2020, the average level of the discount rate of transaction price in Q1 2021 was higher than that in Q1 2020, and the premium of transaction price related to starting price has also expanded compared with that in Q1 2020.

Commercial Collateral in Guangdong Province



Industrial Collateral in Guangdong Province



Source: Main online auction platforms, Zheshang Asset Research Institute

Sponsoring Organisations



Zhesang Asset Research Institute was registered and established in Shanghai Free Trade Zone in March 2014. It is a market-focused research institution wholly owned by Zhejiang Zhesang AMC, and is a research institution of Zhesang AMC Strategic Planning, Business Innovation and Talent Training Intellectual platform. The Institute has become one of the research institutions with complete functions, strong strength, and fruitful results in the field of special asset management.

The Institute has gradually established a set of research systems with its own development characteristics, and also has pioneered industry benchmarking studies such as Taobao auction research and regular NPL market transaction reports in China and compiled and issued the first industry journal "Zhesang AMC Insight" among all provincial AMCs. The Institute has successively completed a number of research topics, such as Zhesang AMC Development Strategy Planning, Regional Financial Stability and Industrial Transformation Fund Research, State-owned AMC Innovation Development Strategy, and Supply Chain Finance Model Innovation and Expansion. The Institute has established extensive contacts with many domestic educational institutions, enterprises, and social intermediary organizations, and has carried out various forms of cooperation and exchanges.



Pepper Group is a globally diversified financial services company that invests, owns, manages, and builds high growth, innovative lending and asset servicing businesses. Pepper's businesses are active across the credit spectrum, covering consumer, residential and commercial assets, with investment platforms across the UK, Europe, Asia and Australia. As proactive owner-operators, Pepper takes a deep interest in building organic growth and use our expertise to support the local management team with further expansion opportunities.

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Disclosures

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