

## Evergrande: How far can the spill-over reach?

### Executive Summary

*We collaborate with our equity research on CMBI's inaugural joint analysis between the credit and equity team to explore what will be spill-over effect if Evergrande defaults. Thanks Jeffrey, Gigi and Wayne, our colleagues in equity research, for their meaningful discussions and significant contribution to this piece.*

#### Will the Evergrande saga trigger a global financial crisis as Lehman did?

We don't think so. While some of the Chinese property developers including Evergrande are highly levered, the leverage of them is by no mean close to the levels of financial institutions and the levels of Lehman right before its bankruptcy. We also expect the Chinese government to guide Evergrande to a soft landing. Hence, we believe that the debacle of Evergrande will not be as far-reaching and devastating as Lehman did.

#### ... or a systemic risk in the banking sector of China?

Unlikely! We estimate that Evergrande's domestic bank borrowings are equivalent to 0.14% of the total outstanding bank loans in China. In our base case, if Evergrande defaults, the impact to banking sector's core T1 CAR will be 9bps and 33bps decline to 10.41% and 10.17%, respectively. See Appendix 1. That said, the impact to individual banks varies. Amongst listed regional banks such as Bank of Suzhou (002966 CH), we believe that none of these listed banks will see core T1 CAR to fall below regulatory threshold of 7.5%. Amongst systemically important banks such as China Minsheng Bank (1988 HK), they may need to replenish capital since they have a higher minimum core T1 requirement of 8.5%.

#### What will be the impact on the Chinese property sector and value chain?

Limited impact in operational front but a more pressing spill-over effect is the near-term funding access of the developers. YTD, the gross USD bond issuance of the sector declined 27% to USD32.7bn (only USD8.2bn over the past 3 months, compared USD16.8bn over the same period last year). In the remaining of 2021 and 1H22, there will be USD27bn offshore bonds due among 47 developers.

#### Will the regulatory environment on the property sector be loosened?

A material loosening of tightening measures in the near-term is unlikely. The key to monitor is the pace of mortgage approval process in the near-term.

#### How should we position in the USD bonds of the Chinese property sector?

As we discussed in our sector piece ([When dust is settling](#)), we believe that the spill-over effect of Evergrande to the sector should be diminishing, and the damage from the market de-rating is more or less done. While we do not see a strong catalyst for the sector to outperform, we expect the sector's performance to be more "de-coupled" from that of EVERRE/TIANHL. **Our decoupling picks are China South City, Dafa, Jiayuan, Kaisa, Redsun, Yuzhou and Zhenro. We also like short-dated ideas on credits with high certainty on near-term refinancing plan such as DEXICN'22s, GRNLGR'21-22s, MOLAND 22s, REDPRO 22s and RISSUN'8.95%'22. We replace FTHDGR'21s with GZRFPR 5.75%'22 in view of the higher funding certainty after GZRF secured USD1.0bn shareholders' financing lately.**

#### How about the positioning of Chinese property stocks?

The current equity valuation is at the historical low due to the tight policies, weakening fundamentals and concerns of Evergrande's contagious risks. However, the policy loosening is needed for the sector re-rating. We think a broad loosening may only come in late Oct'21 after more data points such as property investments and the standing bureau meeting that would deliver the key message on property sector. So at this point, we expect very volatile market in the sector driven by Evergrande news and prefer the quality names **CR Land** and **Longfor**.

### Credit Strategy

**Glenn Ko 高志和**  
(852) 3657 6234  
glennko@cmbi.com.hk

**Polly Ng 吴宝玲**  
(852) 3657 6234  
pollyng@cmbi.com.hk

**Wilson Lu 路伟同**  
(852) 3761 8918  
wilsonlu@cmbi.com.hk

**James Wen 温展俊**  
(852) 3657 6291  
jameswen@cmbi.com.hk

### Equity Research

**Jeffrey Zeng 曾展**  
(852) 3916 3727  
jeffreyzeng@cmbi.com.hk

**Gigi Chen 陈喆**  
(852) 3916 3739  
gigichen@cmbi.com.hk

**Wayne Fung 冯键嵘**  
(852) 3900 0826  
waynefung@cmbi.com.hk

## Evergrande: How far can the spill-over reach?

### Will the Evergrande saga trigger a global financial crisis as Lehman did?

Table 1: Lehman Brothers and China Evergrande Group Comparisons

USD mn	Lehman Brothers Holdings Inc.	China Evergrande Group
Date	31 May'08	30 Jun'21
Equity (excl. MI)/Total Asset ratio	3.02%	8.03%
Total Liabilities	668,573	302,544
Total Bond Outstanding	149,173	28,078

Source: Company disclosure, CMBI

We don't think so. While some of the Chinese property developers including Evergrande are highly levered, the leverage of them is by no mean close to the levels of financial institutions and the levels of Lehman right before its bankruptcy. In addition, investor base of Evergrande is much narrower, taking cues from the significantly smaller outstanding bonds of Evergrande compared that of Lehman by the time of its bankruptcy. We also expect the Chinese government to guide Evergrande to a soft landing. Hence, we believe that the debacle of Evergrande will not have as far-reaching and devastating impact as that of Lehman.

### .... or a systemic risk in the banking sector of China?

Unlikely! The risk to the whole banking system should be contained though the damage to individual banks varies.

As at Jun'21, Evergrande had interest-bearing borrowings of RMB572bn. We estimate that cRMB220bn were borrowings from domestic banks, this is equivalent to 0.14% of the total outstanding bank loans in China. The remaining cRMB350bn is comprised of bonds of cRMB180bn and cRMB170bn other loans, of which majority would be trust loans and other wealth management products. As at 31 Aug'21, the total outstanding balance of trust products in China was RMB5,350bn.

Given the fully collateralized status of property loans and improved risk management capabilities of banks, we believe the negative impact on Chinese banking sector if Evergrande defaults should be manageable. In our base case (assuming only Evergrande defaults on bank borrowings) and worst case (10% of developers' borrowings default), the impact to core T1 CAR to the Chinese banking sector will be 9bps and 33bps decline to 10.41% and 10.17%, respectively. See Appendix 1.

That said, the impact to individual banks varies. Amongst listed regional banks, we estimate Bank of Suzhou (002966 CH), Bank of Jiangxi (1916 HK), Bank of Jiujiang (6190 HK), China Zheshang Bank (2016 HK) and Shengjiang Bank (2066 HK) will see most capital hair-cut (8-27%) among the listed regional banks, assuming 100% write off of Evergrande loans and all losses are recognized in core capital. Nonetheless, we believe that none of these listed banks will see core T1 CAR to fall below the 7.5% regulatory threshold.

Amongst systemically important banks, China Minsheng Bank (1988 HK), Bank of Jiangsu (600919 CH), China CITIC Bank (998 HK) and China Everbright Bank (6818 HK) may need to replenish capital since they face a higher minimum core T1 requirement of 8.5%.

For non-listed banks, we estimate the core T1 CAR of Hankou Bank, Guilin Bank, Guiyang Rural Commercial Bank will likely drop below 7.5% regulatory threshold and need to replenish capital.

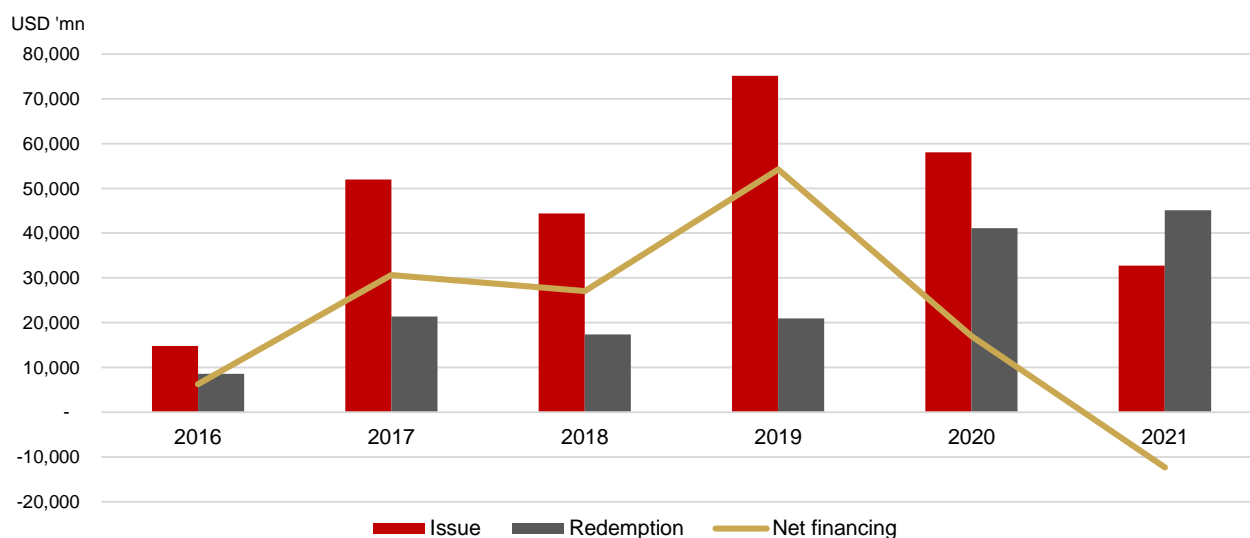
## What will be the impact on the Chinese property sector?

Limited impact in operational front but the more pressing spill-over effect is the near-term funding access of the developers.

In 2020, Evergrande ranked second in terms of nationwide sales but only accounted for c4% of the national sales. The company has been aggressive in cutting prices to destock and shore up its liquidity. Developers such as Country Garden with more overlaps in lower-tier cities with Evergrande will be affected more. Nonetheless as per Country Garden, only saleable resources of RMB9bn (vs its total saleable resources of RMB507.7bn in 1H21) were affected by these price cut.

Indeed, we would argue that Evergrande is facing its current plight partly because of the tight credit environment and slowing property sales in China. What Evergrande is facing is what the whole industry is facing, the difference is Evergrande is more aggressive in terms of business and financial management than some of its peers. According to NBS, domestic loans to developers in 8M21 declined 6% yoy to RMB1.7tn. The incremental loans to developers in Aug'21 was RMB151.6bn, the lowest since Oct'16. The incremental mortgage loan in Jul and Aug'21 were RMB397.4bn and RMB425.9bn, well below RMB442.6bn and RMB515.6bn in May and Jun'21, respectively. At the same time, property sales by GFA in Jul'21 and Aug'21 declined to 130.1mn sqm and 125.5mn sqm from 160.8mn sqm and 222.5 sqm in May'21 and Jun'21, respectively while property sales by value lowered to RMB1.3tn in both Jul and Aug'21 from RMB1.7tn in May'21 and RMB2.2tn in Jun'21, respectively.

**Figure 1: China High Yield Real Estate Offshore Bond Net Issuance**



Source: Bloomberg, CMBI

We are more concerned of the funding access of developers especially if the pace of mortgage approval process remains slow. Since mid-May'21, the sector had experienced a sharp de-rating, returned a negative 17% vs. a negative 6% of Asia HY market. As a result, we saw a significant decline in issuance. YTD, the gross USD bond issuance of the sector declined 27% to USD32.7bn (only USD8.2bn over the past 3 months, compared USD16.8bn over the same period last year). In the remaining of 2021 and 1H22, there will be USD27bn offshore bonds due among 47 developers (See Table 2 and 3 in the next pages). The refinancing environment is challenging, especially for smaller and B-rated developers.

Table 2: China Property Developers Offshore USD Bond Maturity Profile

Issuer (USD 'mn)	Ticker	2H'21 Maturity	1H'22 Maturity	2H'22 Maturity	Total Maturity
Agile Group	AGILE	200	500	600	4,947
China Aoyuan	CAPG	0	688	250	3,203
Central China Real Estate	CENCHI	400	0	500	2,857
China SCE Group	CHINSC	0	500	0	2,650
China Jinmao	CHJMAO	0	700	0	4,550
CIFI Group	CIFIHG	0	585	0	4,576
Country Garden	COGARD	0	425	700	11,694
China South City	CSCHCN	0	694	277	1,566
China Resources Land	CRHZCH	0	0	0	2,550
Dafa Properties	DAFAPG	0	280	360	640
Dexin China	DEXICN	0	200	350	550
China Evergrande Group	EVERRE	0	3,475	0	14,001
Tianji Holdings	TIANHL	0	0	2,645	5,235
Fantasia	FTHDGR	749	297	849	3,858
Seazen Group	FUTLAN	0	400	0	1,150
Seazen Holdings	FTLNHD	350	500	200	2,554
Greentown China	GRNCH	0	0	0	1,600
Greenland Holdings	GRNLGR	550	1,100	1,070	5,070
Guangzhou R&F	GZRFPF	200	725	660	5,285
Jiayuan International	JIAYUA	0	236	200	1,612
Jingrui Holdings	JINGRU	195	190	410	1,385
Jinke Properties	JINKE	0	0	0	325
Radiance Group	JNHUIG	250	300	0	800
Kaisa Group	KAISAG	400	1,697	1,700	12,174
KWG Group	KWGPPO	0	250	900	4,311
Longfor Group	LNGFOR	0	0	450	2,750
Logan Group	LOGPH	0	250	300	3,930
Modern Land	MOLAND	250	200	300	1,348
Poly Real Estate	POLYRE	0	0	0	1,500
Powerlong Real Estate	PWRLNG	0	200	500	2,070
Redco Group	REDPRO	0	285	321	1,022
Redsun Properties	REDSUN	100	450	250	2,015
Redsun Properties	HONGSL	0	0	275	275
Risesun Development	RISSUN	0	780	0	780
Ronshine China	RONXIN	150	688	700	3,160
Shimao Group	SHIMAO	820	0	1,000	6,540
Sinic Holdings	SINHLD	246	453	0	699
Sino-Ocean	SINOCE	0	500	0	4,020
Sunac China	SUNAC	0	600	600	7,762
Yango Group	SUNSHI	0	500	0	2,292
Fujian Yango Group	YANGOG	72	110	200	1,597
Times China	TPHL	0	425	0	3,075
China Vanke	VNKRLE	220	0	0	4,794
Yuexiu Property	YUEXIU	0	0	0	1,700
Yuzhou Group	YUZHOU	0	592	120	5,769
Zhongliang Holdings	ZHLGHD	595	550	450	1,795
Zhenro Properties	ZHPRHK	200	370	550	3,700

Source: Bloomberg, CMBI

**Table 3: China Property Developers Total Bond Maturity Profile**

Issuer (USD 'mn)	Ticker	2H'21 Maturity	1H'22 Maturity	2H'22 Maturity	Total Maturity
Agile Group	AGILE	468	721	1,039	6,053
China Aoyuan	CAPG	217	688	250	4,444
Central China Real Estate	CENCHI	618	0	500	3,075
China SCE Group	CHINSC	0	500	0	2,650
China Jinmao	CHJMAO	0	968	279	6,562
CIFI Group	CIFIHG	600	944	128	7,789
Country Garden	COGARD	474	513	700	15,726
China South City	CSCHCN	0	783	474	1,852
China Resources Land	CRHZCH	0	0	752	6,267
Dafa Properties	DAFAPG	0	280	360	640
Dexin China	DEXICN	0	200	350	550
China Evergrande Group	EVERRE	0	5,776	1,321	22,008
Tianji Holdings	TIANHL	0	0	2,645	5,235
Fantasia	FTHDGR	990	297	1,554	4,804
Seazen Group	FUTLAN	0	400	0	1,150
Seazen Holdings	FTLNHD	1,012	1,423	617	5,616
Greentown China	GRNCH	217	745	667	6,900
Greenland Holdings	GRNLGR	550	1,347	1,070	5,471
Guangzhou R&F	GZRFPF	374	1,932	1,844	8,617
Jiayuan International	JIAYUA	-	236	200	1,612
Jingrui Holdings	JINGRU	195	190	481	1,668
Jinke Properties	JINKE	277	501	388	2,298
Radiance Group	JNHUIG	716	392	377	2,365
Kaisa Group	KAISAG	400	1,697	1,700	12,174
KWG Group	KWGPPO	348	392	1,815	7,215
Longfor Group	LNGFOR	289	1,656	842	9,490
Logan Group	LOGPH	1,142	687	1,014	7,592
Modern Land	MOLAND	250	200	300	1,348
Poly Real Estate	POLYRE	442	221	0	7,933
Powerlong Real Estate	PWRLNG	799	593	876	4,325
Redco Group	REDPRO	0	285	321	1,114
Redsun Properties	REDSUN	100	450	250	2,015
Redsun Properties	HONGSL	0	0	275	275
Risesun Development	RISSUN	0	780	590	1,446
Ronshine China	RONXIN	150	688	700	3,160
Shimao Group	SHIMAO	1,004	661	1,430	8,424
Sinic Holdings	SINHLD	246	453	0	699
Sino-Ocean	SINOCE	314	1,044	385	8,055
Sunac China	SUNAC	906	1,929	790	11,711
Yango Group	SUNSHI	387	1,042	676	4,516
Fujian Yango Group	YANGOG	284	430	200	2,129
Times China	TPHL	683	425	400	5,348
China Vanke	VNKRL	636	371	352	9,649
Yuexiu Property	YUEXIU	613	690	446	8,822
Yuzhou Group	YUZHOU	291	1,114	555	7,017
Zhongliang Holdings	ZHLGHD	595	550	450	1,795
Zhenro Properties	ZHPRHK	541	617	697	4,937

Note: Maturity determined as earlier of Next Puttable Date and Maturity Date  
 Source: Bloomberg, CMBI

#### .... and that on value chain?

Limited in general as the client base of construction contractors and construction machineries (tower crane and concrete machineries) is diversified. Indeed, GFA under construction nationwide grew 8% yoy to 9bn sqm in 8M21. We take additional comfort that the central government and Evergrande's priorities are to ensure the resumption of construction work and timely deliveries.

So far, the delay in the payments of commercial bills and receivables appear not to be widespread. The impact on different players depends more on their individual exposure to Evergrande. For example, Nantong Sanjian, a construction company with Evergrande as one of its major clients, completed an exchange offer for its USD bonds in Oct'20 to extend the maturity for another 2 years to Oct'22. Nantong Sanjian blamed the needs to conduct an exchange offer partly to the payment deferral by Evergrande. Media reports that Nantong Sanjian recently suspended construction work of two Evergrande projects (in Henan and Jiangsu) due to overdue commercial bills and receivables.

Suning, a strategic investor of Evergrande, went into liquidity issues and recently failed in its consent solicitation for extending the maturity of its USD bonds (o/s USD600mn) due on 11 Sep'21.

Ehouse posted a net loss of RMB1.6bn in 1H21 (vs 1H20 net profit of RMB105mn), due to the loss allowance of RMB1.9bn resulting from the expected credit loss on receivables from Evergrande, one of its largest customers. We believe that Ehouse's near-term liquidity should be adequate even if further write-down of the remaining RMB2bn receivables from Evergrande is likely.

#### Will be the impact to the regulatory environment on the property sector?

A material loosening of tightening measures in the near-term is unlikely. The primary objective of the central government is social stability. Hence, policy priorities will be to ensure timely projects delivery and settlement of construction expenses, as well as the redemptions of wealth management products by retail investors. To this end, a more relaxed credit environment to guide Evergrande for a soft landing and contain the spill-over effect is likely, as evidenced by PBOC's recent liquidity injection into the banking system. The key to monitor is the pace of mortgage approval process in the near-term.

#### How should we position in the USD bonds of the Chinese property sector?

As we discussed in our sector piece ([When dust is settling](#)), we believe that the spill-over impact of Evergrande to the sector should be diminishing, and the damage from the market de-rating is more or less done. While we do not see a strong catalyst for the sector to outperform, we expect the sector's performance to be more "de-coupled" from that of EVERRE/TIANHL. Developers with improving credit story, more evenly distributed debt maturity profile and diversified funding channels will gradually resume access to the USD bond market, supported partly by the investors' high cash level and low net issuance YTD. **Under this backdrop, our decoupling picks are China South City, Dafa, Jiayuan, Kaisa, Redsun, Yuzhou and Zhenro. We also like short-dated ideas on credits with high certainty on near-term refinancing plan such as DEXICN'22s, GRNLGR'21-22s, MOLAND 22s, REDPRO 22s and RISSUN'8.95%'22. We replace FTHDGR'21s with GZRFPR 5.75%'22 in view of the higher funding certainty after GZRF secured USD1.0bn shareholders' financing lately.**

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## How about the positioning of Chinese property stocks?

For the equity side of the property sector, the current valuation is at the historical low due to the tight policies, weakening fundamentals and concerns of Evergrande's contagious risks. However, the policy loosening is needed for the sector re-rating. We think a broad loosening may only come in late Oct'21 as 1) the deciding indicator, property investment, is still growing at 10% yoy in 8M21 and historically the policy change was only triggered after it dropped to 5% yoy or below. Due to the weak data in Sep'21, we may see YTD property investment growth decelerate to 5% in Oct'21; 2) standing bureau meeting in late Oct'21 that would deliver the key message on property sector. The government would move quickly only after the tone would have changed towards the sector. So at this point, we expect very volatile market in the sector driven by the Evergrande headlines and prefer the quality names **CR Land and Longfor** on their healthy balance sheet, high-quality land banks in Tier 1-2 cities and stable rental income so they can do anti-cycle land acquisitions to widen the gap over others.



## Appendix 1

To gauge the potential capital erosion due to defaults of real estate developers, we conducted a scenario analysis based on the following assumptions:

- Investment exposure to property developers: Since most of fixed income investments are not backed by collaterals, banks are quite conservative on these investments. Given most bonds held by banks are issued by government and other highly-rated issuers, we assume banks' exposure to property bonds and other real estate investment vehicles are approximately 10% of property loans.
- We assume 30% recovery of principal on property loans and 0% recovery on bond investments. The assumption of 30% recovery ratio is on the conservative front, compared to the market consensus on the recovery ratio of China Fortune Land Development (CFLD). We set bond investment recovery to be zero because it is not collateralized.
- We assume that banks' provision and NPL balance remain unchanged. Thus, all the unrecovered loss will be deducted from core capital.
- The industry average loan loss reserve ratio of banking sector was 3.39% at end-1H21. Therefore, we assume that banks have already taken 3.39% loan loss reserve on the property development loan.
- As feedback from banks, little possibility on mortgage default because borrowers have already pay at least 30% down payment and mortgage default will hurt their personal credit record. No incentive on defaulting the mortgage. Hence, we assume no incremental default on mortgage.
- For the assumption of property loan defaults, we make three scenarios:
  - **Base case scenario:** Evergrande is down but other developers do not default the lending;
  - **Worst case scenario:** We assume 10% of the developers' borrowings (including loan, bonds and other financial vehicles) default;
  - **Best case scenario:** Local government or other institutions bail out Evergrande.

### China banking industry: Potential loss on Evergrande case

(RMB bn)	Total exposure	Loan	Other investment
Risk exposure (Evergrande)	220	200	20
Risk exposure (all developers)	13640	12,400	1,240
Recovery of principal	27%	30%	0%

(RMB bn)	Total loss	Provision taken in advance	Capital deducted
<b>Base case (Evergrande bankruptcy)</b>	<b>160</b>	<b>7</b>	<b>153</b>
Worst case (10% default rate)	992	421	571
Best case (Government bailout)	0	-	0

Source: CBIRC, CMBI



## China banking industry: Potential impact on capital adequacy

	1H21	Worst Case Scenario	Base Case Scenario	Best Case Scenario
<b>Balance (RMB bn)</b>				
<b>Potential loss</b>	-	<b>571</b>	<b>153</b>	<b>0</b>
Core capital	18,528	17,957	18,375	18,528
Total tier-1 capital	21,017	20,446	20,864	21,017
Total capital	25,565	24,994	25,412	25,565
RWA	176,538	176,538	176,538	176,538
Loan balance	158,962	158,962	158,962	158,962
NPL balance	2,791	2,791	2,791	2,791
Loan loss reserve balance	5,393	5,393	5,393	5,393
<b>Ratio</b>				
<b>Core tier-1 CAR</b>	<b>10.50%</b>	<b>10.17%</b>	<b>10.41%</b>	<b>10.50%</b>
Tier-1 CAR	11.91%	11.58%	11.82%	11.91%
CAR	14.48%	14.16%	14.39%	14.48%
Loan loss reserve ratio	3.39%	3.39%	3.39%	3.39%
Provision coverage	193.2%	193.2%	193.2%	193.2%
NPL ratio	1.76%	1.76%	1.76%	1.76%

Source: CBIRC, CMBI

CMB International Securities Limited

Fixed Income Department

Tel: 852 3761 8867/ 852 3657 6291

[fis@cmbi.com.hk](mailto:fis@cmbi.com.hk)

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