JCAP

Debt Report

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Evergrande Real Estate Group Ltd. (3333 HK)

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Evergrande	
Reported Net Debt	58.4%
J Capital's Net Debt Assessment	149%
Hidden/Reported	**160%**

Highlights

US Borrowings	USD 1.85 bln
CNY Borrowings	RMB 66.08 bln
J Cap Estimated Debt	**RMB 117 bln**
Hidden/Reported	**162%**
Net debt/Adjusted inventory	46%

Bonds at risk

Evergrande 2015	USG3225AAA19
Amount	USD 1.35 bln
Coupon	13%
Issuer Rating (M/S&P/F)	B1/BB-/BB+

Last days

+ Struggling to pay

We believe that Evergrande may have to borrow money as soon as it pays its RMB 5.5 bln bond due on January 19 in order to meet basic operating commitments. On January 6, the company filed a request to amend the terms of notes due 2015 and 2016, providing a fee of 37.5 bps to compensate brokers. Moody's did not change its B1/B2 rating. But the covenant further weakens bondholders' rights and supports our view that Evergrande will not have the money to pay USD 1.35 bln in senior notes due 2015.

+ Halted construction on sold projects

Visits to Evergrande projects in Guiyang, Hainan, Hebei, Chongqing, Harbin, and elsewhere have revealed projects portrayed as partially or mostly sold that have actually halted and have little hope of being completed or occupied. Many mature projects have occupancy under 20%, and some delivered projects lack basic utilities. We believe this impairs their viability and makes resale value negligible.

+ Cash flow problems exacerbated by falling sales

Evergrande reported its sales for December 2013 at 287,000 square meters, down 76.5% from December 2012, to finish the year up 8.8% on total sales value. Of other reporting property companies, only Vanke reported lower sales, with a 22% drop. We believe that the fall represents a key milestone to insolvency. Evergrande is borrowing more than it is repaying, and our estimates suggest that, without annual borrowings in excess of the company's ability to generate cash flow, the company will not be able to deliver projects under construction. We believe that Evergrande needs at least RMB 28 bln each year in new borrowings just to keep its lights on.

+ Off balance sheet obligations exceed revenue

In a note to the 2013 Interim, Evergrande revealed that its buyback obligations exceed total 2012 sales. Although a portion of these obligations represent guarantees for good mortgages, the buybacks are also just what they sound like: guarantees to institutional buyers that Evergrande will repurchase the properties. In that sense, a large portion of Evergrande sales must be viewed as hidden debt.

The broken Chinese dream

Evergrande has little chance of ever generating positive operating cash flow other than through accounting tricks, like adding to capitalized interest.

The Evergrande model is breaking. The most ambitious of all Chinese developers was already close to insolvency when it IPOed in 2009 and has used cash raised in public markets to further the most aggressive utopian construction project the planet has seen since the pyramids and the Great Wall. Now, throughout the country, Evergrande projects are either sold but not delivered or delivered but not occupied. Evergrande more than any other developer managed to persuade buyers that its developments would appreciate in price, and speculators bought years in advance of delivery. Given the phenomenal success in positioning itself as purveyor of a new class of valuable asset, the company should now be hugely profitable, even as buyers of its apartment units sit furious in housing that lacks utilities and basic services. Instead, Evergrande has had negative operating cash flows every year of its existence, including through the first half of 2013. Now that the glory days of Chinese property are ending, Evergrande has little choice but insolvency.

Sales office of the Evergrande Metropolis in Guiyang. Phase 1 units have been delivered to owners, but there is no gas or water. Phase 2 is on sale now. Photo by J Capital January 2014.

KEY RISKS

- Inability to deliver pre-paid units
- High off-balance sheet liabilities

Summary case

We believe that Evergrande is dependent on debt financing simply to stay afloat. The company issued a USD 1 bln bond in November and, in December, at least RMB 2 bln in new trusts for which the company must pay up to 20% for longer-term debt, and yet we believe this new cash is insufficient even to meet outstanding obligations. We think Evergrande will need new cash in the current quarter to meet its RMB 5.5 bln bond payment.

Evergrande's debt, like that of many mainland developers, runs the gamut from bond issues to bank borrowings, off-balance-sheet obligations, and debts to the company's own customers. It is probable that a significant portion of Evergrande's sales actually represent loans from customers for apartments that Evergrande has committed to repurchase at a premium.

Evergrande has been generating negative operating cash flow since its debut in Hong Kong and relies on financing cash flows to engage in its aggressive construction program. An undetermined portion of receipts in advance from customers, which stood at RMB 43 bln in the first half of 2013, represents financial debt, which Evergrande repays through buyback agreements.

Despite the company's claim at the end of 2013 H1 that its net debt has been reduced to 58.4% from 97.1% in the previous period, by the end of 2013, net debt as counted by Evergrande was again up to around 85%. Furthermore, we believe that Evergrande has disguised debt as equity and in reality has far higher net debt than disclosed. We calculate a minimum of 150%.

Evergrande admits that more than 100% of 2012 sales are committed to buyers in buyback agreements. At least some of these buyers may well be Evergrande's own affiliates. We believe that at least half of the reported RMB 68 bln must be viewed as debt. Should we add RMB 34 bln to Evergrande's reported debt, then the debt/equity balloons to 150%. But this is not the only problem: we believe that pre-sales revenue has been diverted into land purchases and that a significant portion of sold units cannot be delivered unless Evergrande can bring in new borrowings. We believe new borrowings will be very difficult other than for short terms and at extortionary levels of interest.

This could mean a default on bonds.

➲ The sharp increase in ASP in December on one-quarter last year's volume is implausible.

Evergrande has been more successful than any other Chinese developer in selling an investment proposition on a grandiose scale. Its well-tested method begins with acquiring parcels of land that adjoin major cities but lie outside the urban area that is subject to restrictions on purchases for investment purposes. Evergrande then builds to a scale that can only be described as megalomaniac. The sheer size of the developments suggests substance and permanence. The design templates evoke European models—Venice, Spanish villas—and the model units invariably contain heavy carpets, sunken bathtubs, coffee table books, bottles of faux champagne in ice buckets, and, in the kitchen, glass jars full of dried pasta: all things that no real Chinese family would have at home but that suggest an opulent, indefinite future.

Without the new USD 1 bln in senior notes issued in November at 8.75%, Evergrande would have run out of cash in the autumn and finished 2013 with a negative cash balance of around USD 500 mln. The company's accounts make it clear that Evergrande urgently required another USD 1 bln just to get through 2013.

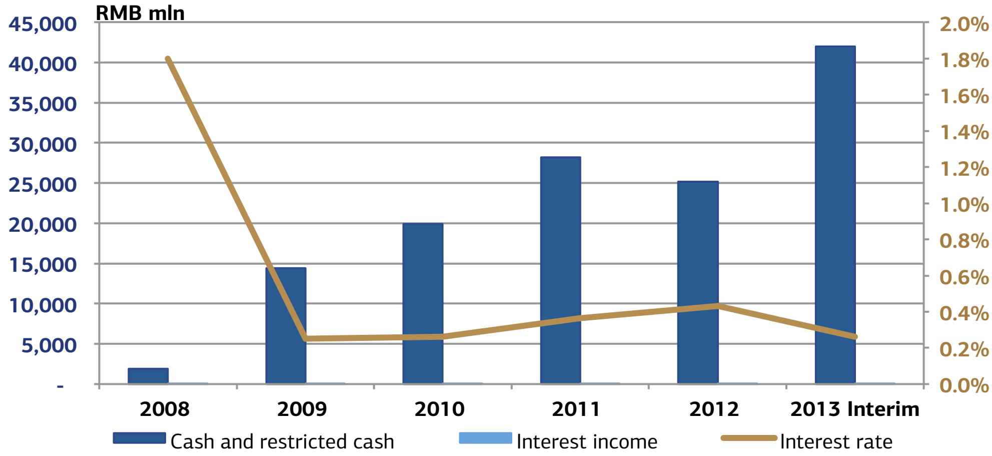
At the end of 2013 H1, the group had a land reserve of 145 mln sqm, up 3.2% since the end of 2012. New land reserves of 14.56 mln sqm in 29 cities. Gross Floor Area is generally roughly equivalent to the land reserve. So, at a living area of 30 sqm per person, Evergrande's current land reserve could house more than 5 mln people.

The cash balances

We believe that investors should question the availability of Evergrande's cash balances. The company disclosed RMB 32.98 bln in cash and equivalents as of June 30, 2013 and an additional RMB 41.97 bln in restricted cash. The company discloses that both types of balances earn floating bank rates. Yet, since 2008, when balances earned a relatively reasonable rate of 1.8%, Evergrande's calculated interest on cash has come down to 0.26%. Standard interest on bank deposits in 2013 in China was

3.25% for a one-year term, and many smaller banks are offering deposit rates as high as 6.5% to woo cash. Checking accounts can bear interest as low as 0.35%, but it is rare indeed for corporations to maintain such low balances that they are ineligible for even the standard 2% three-month rate.

Chart 1. Evergrande interest on cash deposits



Source: Company filings

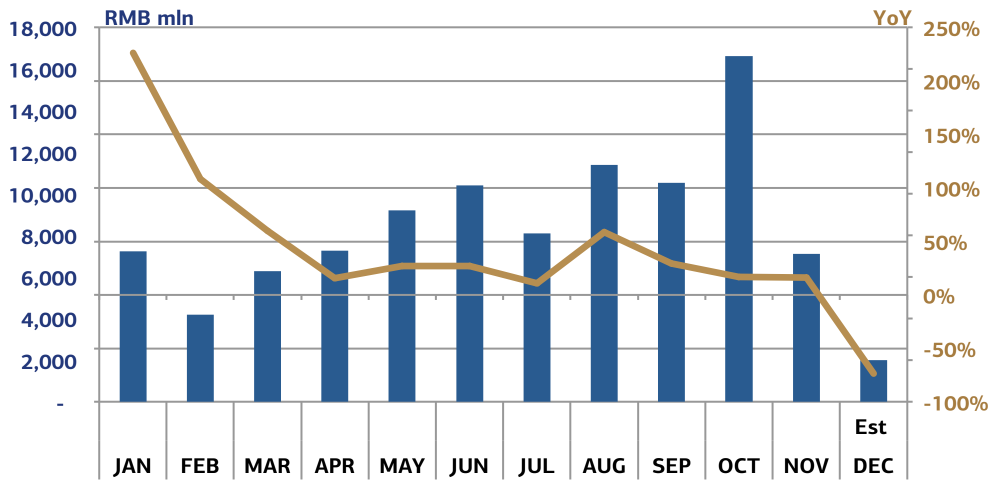
If 100% of Evergrande's cash balances earned China's standard interest rate on deposits, Evergrande's calculated cash and cash equivalents would be only RMB 3.3 bln rather than the reported RMB 41.9 bln.

We therefore believe that Evergrande's cash balances must be less liquid than implied by its accounting treatment and may be out on loan or in other ways unavailable for the payment of interest. Evergrande does not report balances in USD but it is also possible that the company has converted some of tis cash and placed it in low-yield deposits overseas.

2013 results

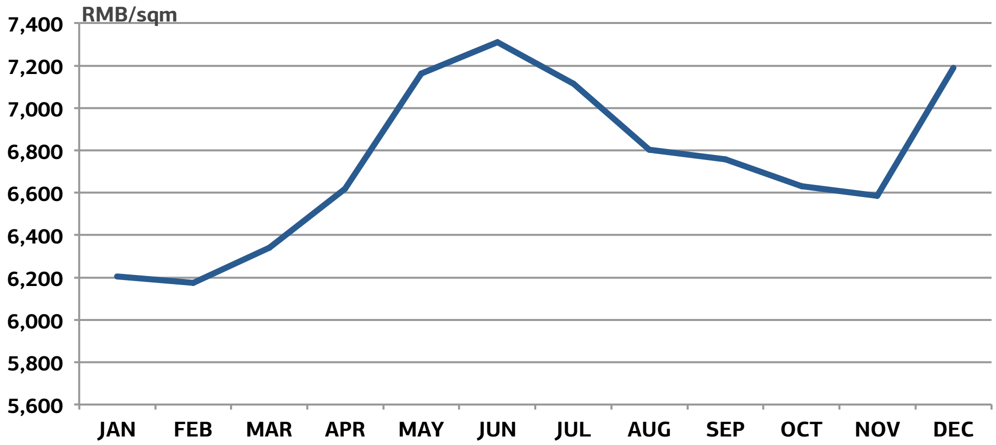
Unaudited 2013 full-year results are just in, and they show a marked downward trend.

Chart 2. 2013 monthly sales revenue trend



Source: Company filings

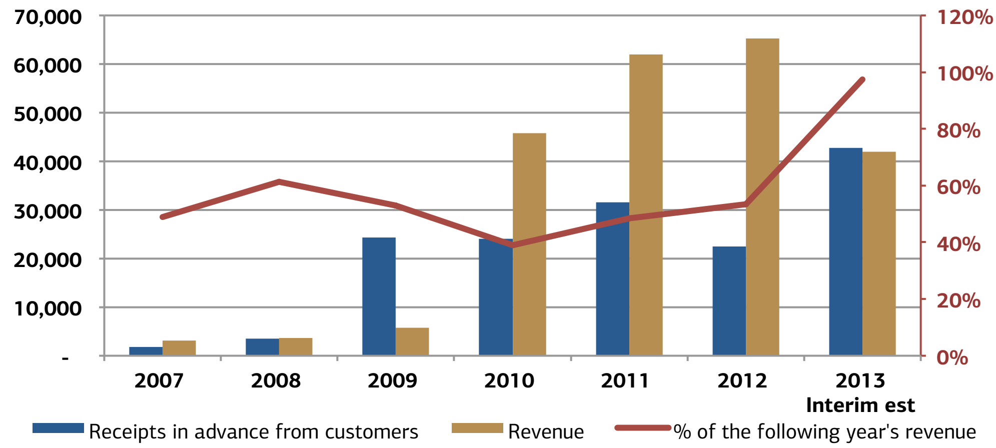
Chart 3. Evergrande's 2013 ASP



Source: Company filings

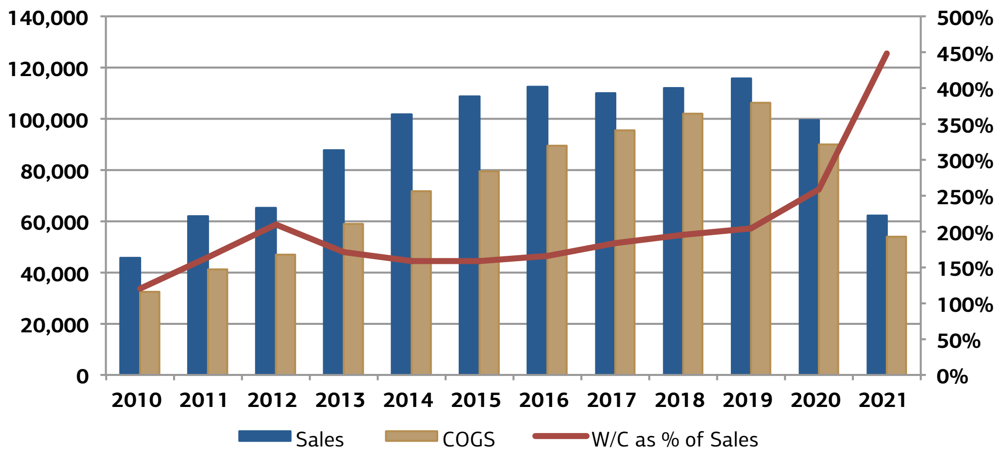
At the same time, Evergrande's working capital needs are rising much faster than the company's income. This is likely because of slowing construction cycles and a more sluggish market for pre-sales. The receipts in advance from customers have been rising as a percentage of the following year's sales.

Chart 4. Receipts in advance of sales vs. revenues



Source: Company filings, J Capital estimates

Chart 5. Working capital



Source: Company filings, J Capital estimates

Exchange risk

Currently, Evergrande has no income from outside of China, yet its hard-currency obligations amount to USD 2.35 bln. Although this represents less than 15% of total obligations, it could balloon in a depreciation scenario and poses a downside risk to Evergrande. The Reminbi has been under constant appreciation pressure over the last five years since China's stimulus program began, because the expanding money supply within the cage of a controlled currency has generated pent inflation that expresses itself in high real interest rates. Estimates of hard currency entering the country to take advantage of short-term interest rates over 10% are anywhere from USD 15-40 bln per month. However, should China have publicly acknowledged defaults or should public faith in the currency be sufficiently undermined to prompt significant capital flight, an abrupt depreciation of the currency is not unlikely.

Types of debt

Senior notes

Evergrande currently has USD 2.35 bln outstanding in bonds, at coupons between 8.75% and 13% and coming due between 2015 and 2018. In addition, it has USD 1.483 in RMB-denominated but USD-settled bonds.

Bank borrowings

As of June 30, 2013, Evergrande had RMB 33.42 bln in secured bank borrowings. Average interest rates on bank borrowings are around 7.5%.

Buyback guarantees

As of June 30, 2013, the Group arranged bank financing for some property buyers and provided a buy-back guarantee in relation to the repayment obligations of approximately RMB 68 bln for those buyers.

In other words, Evergrande's buyback guarantees for buyers as of June 30, 2013 exceeded the company's total sales revenue for 2012.

Trust loans

Evergrande borrows from trusts, which generally charge around 15-18% for their loans. The total outstanding borrowings from trusts in June 2013 equaled RMB 19.712 bln, or about USD 3.26 bln. The disclosure is as follows:

Certain group companies in the PRC that are engaged in development of real estate projects have entered into fund arrangements with certain financial institutions (the "Trustees"), pursuant to which Trustees raised trust funds and injected the funds to the group companies. The funds bear fixed interest rates, have fixed repayment terms, and are secured by the properties under development of the group companies or the shares of other group companies.

We believe that interest payments on a portion of Evergrande's borrowings are reported in other categories. For example, in the first half of 2013, Evergrande spent RMB 274.9 mln to acquire equity interests in subsidiaries. The company has already disclosed that it pledges equity in operating subsidiaries to back loans; these purchases may well have been effectively in repayment of loans. Evergrande's calculated interest on borrowings is just under 4.5%.

The company discloses very little about its trust borrowings, but some trust disclosures can be found online, although there is no way to know whether these disclosures are complete. In total, we identified RMB 8 bln in trust loans outstanding at mid-year 2013, of which RMB 4.75 bln was due by the end of 2013. A few of the trust prospectuses reveal the following details:

- Ping An has published at least two trust prospectuses:
  - In September 2013, Ping An issued RMB 174 mln to finance Evergrande's projects in Harbin at an unspecified rate of return.
  - In December, Ping An issued a RMB 1 bln trust to finance Evergrande's projects in Hohhot, Inner Mongolia offering staged interest at 9.8% for one year and 15% for three years. This means that Evergrande must be paying at least 18% for the three-year portion and possibly 20%.
- According to a news report, from January through September 2011, Evergrande raised RMB 4.6 bln from 11 trusts at fixed, two-year returns of 8-10.5%.
- In February, Evergrande issued a RMB 150 mln two-year trust to support its Phase 4-6 Oasis project in Hetan, Jiangxi, at 8.5-9%.
- In March, Evergrande issued a two-year, RMB 50 mln trust to finance Phase 2 of its Splendor project in Chenzhou, Hunan, offering a fixed 9-10% return.
- In November, Evergrande issued a RMB 1 bln trust to support its development of a project in Xiaoshan, Hangzhou.
- In July 2013, Shaanxi Trust raised RMB 20 mln for Evergrande projects in Guangxi for a two-year term at 10.25%.
- In October 2012, an Evergrande trust for a project in Zhongshan, Guangdong was dissolved by Dongguan Trust, at term, signifying that it had been paid out.

The Evergrande Taiyuan Furong 43 Trust was formed in conjunction with a foreign-trade company. Unlike most trusts, Furong 43 does not disclose in any public documents the size and term of the trust and of the return being offered.

Table 1. List of trust loans outstanding

Trusts	Issue Month	Term (Years)	Est. Rate	Amount (mln)	Due
Misc Trusts	2011	2	9.0%	4,600	2013
Dongguan Trust Zhongshan Project	Feb-12	2	9.0%	140.5	Sep-14
Ping An Evergrande Harbin	Sep-13	2	9.0%	174	Sep-15
Ping An Evergrande Hohhot	Dec-14	2	12.0%	1,000	Dec-16
Hetan Jiangxi	Feb-13	2	9.0%	150	Feb-15
Chenzhou, Hunan	Mar-13	2	10.0%	50	Mar-
Xiaoshan Hangzhou	Nov-13	4	10.0%	1,000	Nov-15
Shaanxi Trust Evergrande Guangxi	Jul-13	2	10.0%	200	Jul-15
Jilin Huafu Evergrande Yongsheng	Feb-12	2	10.0%	174.5	Feb-14
Zhongtie Trust Evergrande Chengdu	Jun-12	1.5	9.5%	155	Nov-13
Zhongrong Evergrande Hefei	Sep-13	2	8.5%	500	Sep-15

Furong 43 Evergrande Taiyuan	Oct-13				
Total				**8,144**	

Source: News reports and Trusts' prospectuses

Bank acceptances

The company has RMB 2.68 bln in deposits securing bank acceptance notes, meaning it has received short-term loans from banks to cover accounts receivable. These notes saw average discount rates before June 2013 of 4.5-5% and now can have discounts as high as 8%. The notes can be used directly in payment of debts or they can be cashed before their six-month term at the discount rate.

Banks require deposits worth at most 50% of the notes issued. For good customers, banks may require 30% or even lower deposits against the notes. This means that Evergrande had an additional RMB 5.3 bln in debt as of its June 30 report.

Given over RMB 29 bln in receivables as of June 30, we find it surprising that Evergrande does not carry more acceptances; they are ready currency in housing construction, and the under 5% rate prevalent before June 30 would have made this means of financing relatively attractive. The relatively small amount of deposits against acceptances suggests that either Evergrande's bankers require very low deposits or some of Evergrande's receivables may be of very low quality, such that banks are reluctant to issue notes against them.

Pre-sales and maintenance

Evergrande tends to push up to the limits of legal pre-sale periods and sometimes beyond, so that housing units may be sold three years and more before completion. The developments also tend to be very thinly occupied; it is not unusual for an Evergrande complex to be almost entirely sold out and yet completely empty.

In a company whose properties are expanding almost exponentially, a lengthy pre-sales period creates significant liabilities, as the company is likely to use the pre-sales income to finance land acquisition, leaving an ever-greater looming liability for the undelivered units.

The low occupancy rates in enormous complexes mean that Evergrande developments show high risk of deterioration, leading to deliveries that fail to meet contract standards. China's Internet is filled with buyer complaints about Evergrande, with allegations of units delivered without water or electricity, units that have different floor plans from those contracted for, and units without resale value. We have encountered several Evergrande developments—Qidong, Jiangsu was one and another was in Haikou, Hainan—where units had been given to construction companies or their employees, apparently in lieu of cash for work completed.

Slowing construction

For the average individual, China's property craze ended in late 2011. Since then, the regional markets have bubbled up and down, but increasingly, the buyers in the market have been institutions speculating on price appreciation. This means that financing costs have risen for developers, as the institutional buyers demand high returns. It also means that, with slower sales to end-users, developers are seeing less viability in their completed properties, which in turn undermines the sales value of new developments. And yet so much financing is dependent on pre-sales of new units that developers cannot afford to cut back on land sales and new projects. What they are doing is slowing their construction cycle, reducing the size of each phase brought to market, and extending the periods in between phases.

Evergrande is no exception. The company's projects around the country are seeing slow completion cycles and fewer properties brought to market each year. In 2013, growth in properties under development and held for sale plummeted from 49% to less than 4%. Customer advances fell from YoY growth of 58% to less than 5%. Working capital has risen to nearly 200% of sales, and we believe this number will continue to rise toward 5x or 6x annual sales.

Abandoned deposits

We have identified more than one case in which Evergrande appears to have abandoned deposits it made on land, apparently because of inability to make further payments. We found one such case in Hebei Province near the Baiyangdian lake resort, where Evergrande has a project in the nearby city of Tangshan.

According to Chinese news reports[1] and to industry sources in Hebei Province, Evergrande committed to buy land for the Tangshan project for RMB 8 bln, with Phase 1 costing USD 300 mln. Evergrande owns a 60% interest in the Tangshan project company.

But the project appears to have been abandoned. We spoke with local people, who said that Evergrande had backed out of the project and abandoned its deposit. Below is a photo of the site.

A plot of land purchased by Evergrande in Baigou, Hebei near Tangshan. Photo by J Capital, December 2013.

Prior to its IPO, Evergrande appears to have forfeited a portion of its payment for land in Qidong, Jiangsu, where the company's enormous Splendor project now sits completed but empty. Evergrande began this project in late 2006 and invested in landfill and other infrastructure to make the ocean-side project sound. However, we

[1] http://www.gaoloumi.com/viewthread.php?tid=243408&extra=page%3D1&ordertype=1&page=1

http://sjz.house.sina.com.cn/scan/2012-07-26/172961087.shtml

http://sjz.house.sina.com.cn/scan/2012-07-26/172961087.shtml

[2] See satellite photo of the site here: https://maps.google.com.hk/maps?hl=en&q=%E6%81%92%E5%A4%A7%E5%90%8D%E9%83%BD%E6%9B%B2%E9%9D%96&ie=UTF-

learned that the company failed to obtain the required license from the National Land and Resources Bureau, instead relying on permission from the local government to build the land. Evergrande had to exit a portion of the contract, at a loss of about USD 100 mln.

Selected projects

Guiyang, Guizhou

In Guiyang, the capital of Guizhou Province, Evergrande has 0.9% of its contracted sales, 2.6% of its completed properties, four projects, and a new piece of land for a project that will have 374,000 sqm of GFA. Of the projects in Guiyang, construction on one has been delayed indefinitely. The other three have been delivered to buyers but maximum occupancy is 20%, according to sales offices, and we believe 10% is more accurate.

Evergrande Oasis

Completed in 2008, the project has about 30 buildings and is reported to be 15-20% occupied and 95% sold. ASP was about 2,500 RMB/sqm and now has risen to 3,800 RMB/sqm. According to local people, the residents are mostly those relocated when the project was built. One said that he chooses to live in the village despite owning two apartments because “the electricity sometimes doesn’t work.”

Evergrande Oasis Guiyang. Photo by J Capital, January 2014.

Evergrande City

This Evergrande complex was 20% occupied at the beginning of the conversation, less than 10% when another salesperson showed up. Completed in 2011, the project is looking for investors, according to the sales office: we observed a bus out front with a group of Zhuhai speculators. The complex is 25% sold at an ASP of 4,000 RMB/sqm but the current ad on Soufun claims 5,200 RMB/sqm. Buyers are all non-Guiyang residents. The buildings are finished and have utility hook-ups, but few units appeared occupied.

An Evergrande charter bus outside Evergrande City in Guiyang carries speculators from Guangdong. Photo by J Capital January 2014.

Evergrande Metropolis

Phase 1 is complete as of early 2013, and salespeople say it has been delivered, but it is completely unoccupied, as the buildings at best have glass windows and no gas or water, while many have no windows. ASP is 3,500-4,500 RMB/sqm.

Evergrande Metropolis sales office (above) and Phase 1 building, top. Phase 2 (below) is due to be completed at the end of the year. Photo by J Capital, January 2014.

Evergrande Scenic Garden

Moving over to the east part of town, Yayuan is a villa development that only has high-rises actively under construction. Villa deliveries have been halted since 2012. Units will be cost up to 7,000 RMB/sqm, and sell for as much as 8,000 RMB/sqm. All buyers so far are not individuals, and it is 10% sold according to the sales office.

Evergrande Scenic Garden. Photos by J Capital, January 2014.

Chengdu

In Sichuan, Evergrande reports 6.3% of its completed projects, with 613,023 sqm of completed space.

Chengdu Oasis

The project is 330 mu, with construction area of 1.1 mln sqm, 65 towers of 11-32 floors each. The first phase opened for sale in 2008 and cost 4,500 RMB/sqm. The buildings are now 70% occupied. Phase 2 went on sale in 2010 for 5,500 RMB/sqm and is about 50% occupied. It was sold out in 2012. Owners want to sell. The price now is 6,500-7,000/sqm.

Chengdu Royal Garden

The project covers 100 mu, 400,000 sqm of construction area, with eight towers. Phase 1 is sold out and scheduled to be completed in September 2014. Phase 2 is on sale now and will be completed in March 2015. Phase 3 is a hotel-style residence. The project went on sale in August 2012 for 5,200/sqm. Now the price is 6,200/sqm.

Evergrande City Chengdu

The project has 685,000 sqm of construction on 254 mu of land in four construction phases. The first three have been completed and are about 60% occupied, and the fourth phase went on sale last August and will be completed in June 2015. The average price is 7,500/sqm, and there has been no change in price since the start of the project. You get 5% off for paying in cash outright, plus you get a 2% discount on the mortgage.

Qingbai River District Evergrande Atrium

On 120 mu, this development has 12 towers with 2,200 families, each occupying around 130 sqm. The first 11 towers have been 90% sold, and there are only a handful of units left in those, all over 200 sqm. They will be delivered at the end of the year. In the 12th building, there are 20 units for sale, all over 140 sqm. They will be delivered in June 2014. When the development went on sale, the price was 4,000 RMB/sqm. The price went to 5,800 RMB/sqm and now is at 4,900 RMB/sqm.

Pengshan County Evergrande Splendor

On 12,000 mu, with eight phases, of which three have been started, this is principally a villa development with 500 villas per phase. The villas in Phases 1 and 2 have been handed over to their owners, but occupancy is very low. Right now, phase 3 is on sale. It started in 2009. At the time, the price was 4,000 RMB/sqm for the villas and 2,800 RMB/sqm for the high-rises, now it is 6,000 RMB/sqm and 4,700 RMB/sqm, respectively. Phase 3 will be completed in June 2014.

Daba County Evergrande Mountains and Water City

The project covers 10,000 mu with a coverage area of 46%. There are five phases. Phase 1 covers 1,260 mu and started in March 2011 with 600 units then going for 4,880 RMB/sqm. These units were completed in June 2012 and in June 2013. Phase 2 was started in June 2013 and went for 6,000 RMB/sqm for a garden unit, 7,200 RMB/sqm, for a townhouse, and 14,000 RMB/sqm for a freestanding home. These will be completed in 2014 and 2015. The saleswoman said that no one has moved in, everyone is decorating.

Shuangliu County Evergrande Metropolis

This project consists of 17 towers of more than 30 floors each on 100 mu of land. There are 2,000 families. The units were sold out in 2012. Construction began in 2008 and the units sold for 5,800 RMB/sqm then. By 2011, the price had risen to 6,800 RMB/sqm and in 2012, to 8,030 RMB/sqm About 10% of the owners want to sell at about 7,000 RMB/sqm. Occupancy is about 25%.

Shuangliu County Royal Peninsula. Occupancy is less than 25%. Photo by J Capital, Dec 2013.

Jintang County Royal Peninsula

On 1,600 mu, this project covers 3 mln square meters of construction space. Phase 1 has been sold out and delivered. Phase 2 started selling in September 2012 at 4,000 RMB/sqm. There are 1,000 units, and they have sold 800. The remaining 200 are large units. Phase 3 will soon go on sale for 5,000 RMB/sqm, and they have sold about 20%.

Nanchong City Evergrande Oasis

This project encompasses 2.65 mln sqm of construction on 153 mu and started in 2009, selling for 4,100 RMB/sqm. By 2012, that was 6,100 RMB/sqm. Now they only have large units of 120-160 sqm left for sale. The average price now is 4,500 RMB/sqm and the units will be available in June 2014.

According to the State Land Resources Bureau, Evergrande bought land in 2009 for 600,000 RMB/sqm, about 100,000 more than the assessed price of the time. Now the assessed price is 2 mln RMB/sqm

Qidong, Jiangsu

Evergrande Splendor

The grandiose Qidong, Jiangsu seaside project, called Evergrande Splendor, at the time of Evergrande's IPO constituted about one-third of the company's land reserve. It is now a complete failure. With 11.95 mln square meters of GFA, this Venetian-themed complex was to be completed in 2011.

The January 2011 bond prospectus the company issued in Singapore described the complex as follows:

It will consist of villas, semi-detached villas, townhouses, garden-view villas, condominiums and high-rise residential buildings, as well as ancillary facilities including an upscale hotel, a large convention center, an upscale clubhouse, a sports center, a commercial center and a school.

Below is a photo of Qidong Splendor as it was in June 2013.

High rises in the Qidong complex with idle cranes. Photo by J Capital, June 25, 2013.

Bridge to the Qidong complex. Photo by J Capital, June 25, 2013.

Hainan

Evergrande currently has three projects in Hainan plus a new land reserve. The projects are the Chengmai Royal Peninsula (Yujingwan), the Danzhou Evergrande Splendor (Jinbi Tianxia), and the Danzhou Evergrande Metropolis (Mingdu), and the new land reserve is for a project variously called The Haikou Bund and Haikou Bay. Of these projects, we believe that Splendor and Metropolis have been halted and Royal Peninsula, when we visited last spring, had not been started.

Below is the brochure photo of the Danzhou Splendor followed by our photo last April.

Hainan Danzhou Evergrande Splendor as pictured on the Evergrande website.

Below: photos from Evergrande Splendor as the site was in April 2013. Construction had been halted for several months, and there was no machinery on site. Photos by J Capital

The Evergrande Metropolis site has not been started. Below is a model home at Evergrande Hainan Metropolis being advertised on the Soufun website and below is our photo of the site last April.

Evergrande Metropolis Hainan. Photo by J Capital, April 2014.

In the first half of 2013, Evergrande reported 162,405 square meters of newly completed properties in Hainan and RMB 851,293,103 in new revenue from Hainan sales. The company also acquired 711,806 square meters of land in Haikou for the "Evergrande Bund" project.

Qujing, Yunnan

Evergrande Metropolis in Qujing, Yunnan had completed Phase 1 in October 2012 and the sales staff said it was 90% sold. Now Phases 2-3 are reported under way but there appear to be no occupants. Photo by J Capital October 2012.[2]

In total, we have visited and photographed roughly half of Evergrande's projects, whether completed or under way, over about 18 months. Of projects in progress, we estimate that at least half have been halted or abandoned. Another half of the projects will see later phases canceled or curtailed.

Solvency

Given its enormous assets, Evergrande looks as if it could weather a downturn by selling down some of its assets. The ratio of adjusted net debt, including contingent liabilities, to adjusted inventory is roughly 25%, calculated as follows:

Table 2. Evergrande's adjusted inventory

Adjusted inventory	Value
Remaining land bank (mln sqm)	145
Value per sqm	800
Value of land bank	116,000
Under construction area (mln sqm)	38
Est. cost per sqm	4370
Value of projects under construction (RMB mln)	164,622
Projects for sale (mln sqm)	9.71
Est. value per sqm of projects for sale	4044.6
Est. total value of projects for sale (RMB mln)	39,265
Total value of adjusted inventory (RMB mln)	319,887
Net debt/adjusted inventory	46.23%

Source: Company reports, J Capital estimates

[2] See satellite photo of the site here: https://maps.google.com.hk/maps?hl=en&q=%E6%81%92%E5%A4%A7%E5%90%8D%E9%83%BD%E6%9B%B2%E9%9D%96&ie=UTF-8&ei=er7QUrf6NOOQigfRwIC4Bw&ved=0CAYQ_AU

This view, however, does not represent the true viability of the projects. We believe the following discounts must be applied:

Table 3. Evergrande's adjusted inventory: J Cap estimate

Adjusted Inventory	J Cap est. value
Remaining land bank (mln sqm)	145
Value per sqm	800
Est. proportion of fully owned land bank	50%
Value of land bank	58,000
Under construction area (mln sqm)	38
Est. cost per sqm	4370
Potential sale value	25%
Value of projects under construction (RMB mln)	41,156
Projects for sale (mln sqm)	9.71
Est. value per sqm of projects for sale	4044.6
Potential sale value	25%
Est. total value of projects for sale (RMB mln)	9,816
Total value of adjusted inventory (RMB mln)	108,972
Net debt/adjusted inventory	135.69%

Source: Company reports, J Capital estimates

Prioritizing debts

Unmet pre-payment liabilities

As of June 30, 2013, Evergrande was holding RMB 42.77 bln in customer pre-payments on undelivered housing units. At the stated average ASP for 2013 of RMB 6,741/sqm and with average units sizes of 100 sqm, that means that Evergrande has taken pre-payments on roughly 63,000 apartments that are as yet undelivered. Given estimated construction costs of RMB 3,570/sqm, the resulting RMB 226 mln in liabilities should be manageable for Evergrande if the company prioritizes this debt. To the extent that the buyers who have pre-paid for the units are individuals, we believe that this debt will take precedence over all others because of the reputational damage it would do to Evergrande to default on deliveries to buyers.

Trust loans

The RMB 8 bln in trust loans constitute a debt that ultimately falls to a degree on retail investors. As a result, we believe that trust debts take high priority in the total indebtedness.

Interviews suggest that China's larger trusts do not want to lend more money to Evergrande. The company therefore may have to seek loans from online platforms and its own employees, as many Chinese property companies do, but loans of this nature cost 20% or more per year.

Trust loan repayments in 2013 Q4 will have significantly depleted Evergrande's cash resources as the company goes into 2014. We expect Q1 sales across the industry to be very weak, and January, when the Spring Festival holiday falls this year, will not replenish Evergrande's coffers. The February repayment of a RMB 174 mln trust will likely send Evergrande back into the debt markets.

Land forfeiture

Land is sometimes paid for in installments over years, and we believe that Evergrande is exceptional in the way it delays payment for land resources. Evergrande avails itself of off-balance-sheet partnerships and joint ventures with buyback agreements such that liabilities for land and half-built projects are greater than they appear in the financials. We believe that a portion of the RMB 4 bln in non-controlling interests may represent agreements to purchase land or property that is being held by JV partners as collateral for debt. These partnerships probably rank relatively low in the priority of debts, but defaults would result in seizure of land and developed properties. This in turn could impact Evergrande's ability to generate revenue and cash flow.

Scenarios and milestones

1. ***Land sales***: At the end of June, Evergrande had a land bank of 145 mln square meters, which we value at Evergrande's stated blended historical price of 800 RMB/sqm. Although this valuation is conservative at current pricing levels, we note two extenuating circumstances:

    a. ***The company's record of retrieving value in land sales is weak:*** Evergrande purchased land at the market peak in 2007 and, in the very challenging year of 2008, the company sold down its land bank. We believe that offering prices for land and property in 2008 fell by 40% in some regions, including Guangdong. We believe that Evergrande sold property in Guangdong at a 40% discount in 2008 and land in Qidong, Jiangsu at a significant loss compared with the purchase price.

    b. ***Land rights are not fully secured:*** Since 2011, when short seller Citron reported on Evergrande's large balance sheet entry for "contracted but unpaid land," the company has stopped disclosing these commitments. But our interviews with local land officials indicate that Evergrande often secures land parcels with down payments of about 10% and must forfeit the money and land if it fails to make the further payments. We estimate that at least half of the land reserve is not fully paid for. Land cannot be sold until it is fully paid for and legally transferred to the buyer.

2. ***Isolated defaults***: Just as Evergrande has defaulted on deliveries of occupy-able units to buyers, so we expect defaults on less-visible loans, from "private equity" lenders and small trusts. Much of the developments will be forfeited to these creditors in the coming year.

3. ***Seeking government protection***: Our interviews suggest that, in 2008, Evergrande sought protection from creditors from the Guangdong government, which helped support the extension of new credit. We believe that Evergrande will do the same in 2014 but will need to make significant compromises, whether by forfeiting equity, taking on development of failed government projects, donating social housing or some other means.

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