



## **Evergrande - China's Lehman Moment?**

Monday's market sell-off is being attributed, in large part, to a fear of default by China property developer Evergrande. Many are referring to this situation as China's "Lehman moment", although some (including us) believe this is an exaggeration.

With an enterprise value of \$126B USD (06/30/21), Evergrande is China's second largest property developer with over 1,300 projects in 280 Chinese cities. Over the past decade, it has rapidly expanded its real estate operations, financed aggressively with debt.

The company holds interest in other consumer products enterprises (auto, entertainment, soccer club), as well and is currently in arrears on over \$100 Billion of debt. It has been paying many of its suppliers with undeveloped property and/or commercial paper due to insufficient cash flow.

Over the past twelve months Evergrande has been in a steady downward spiral, losing about 90% of its equity value after Chinese regulators imposed strict borrowing limits on the real estate sector as part of a broad campaign to deleverage the economy.

Evergrande has remained the sole top 20 developer violating multiple red lines and banks have become hesitant to roll over their debt. As such, Monday's revelations should not be much of a surprise as this is a continuation of an age-old story of excessive debt.

## **Issues for U.S. Equities**

The fear is that this possible default will spur a contagion. However, no bank has more than 2% of its loan book exposed to Evergrande, and there are no complicated debt derivatives in this case.

This financial turbulence comes at a time when China's Government has been implementing regulations on their largest Technology companies and limitations on consumer behavior (e.g. video games, private tutoring, etc.)

The regulations have been driven by the government's stated objective of improving the lives of its citizenry by lessening three burdens: namely housing, education, and healthcare, and is directly in line with the communist philosophy. China is also hoping this will help families decide to have more children.

## **The Fear**

Given that the Chinese Government has been willing to let its biggest companies such as Alibaba, Tencent, J.D., etc., lose over 50% of their market value, the fear is that they are willing to let Evergrande fail.

### **Our View**

China will restructure Evergrande to allow unfinished projects that impact its citizens to be completed.

This will fade from headline news and the market will again trade on fundamentals which we believe are improving.

As such, we anticipate a rebound from this sell-off and an upward biased market through the end of the year, with some bumps along the way.

Sincerely,

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