

E-House

# China Evergrande Group: Strategic Repositioning Toward a Sustainable Growth Model



Sponsored by



MAY 2019



# China Evergrande Group: Strategic Repositioning Toward a Sustainable Growth Model

*Over the last 15 years, China Evergrande Group has embarked on an astonishing growth path that saw its four-person team become one of the largest and most well-known real estate developers in China. The company's explosive growth was built on a 'high debt, high leverage, high turnover, and low cost' model. But those giddy days are behind it. Evergrande's old formula for success has been curtailed by government efforts to limit excessive corporate debt, with regulators sharply restricting access to credit, particularly financing through trusts and other shadow banking channels. Today, Evergrande and other top real estate developers are feeling the pinch from credit tightening as the country's economy slows down overall.*

Evergrande has had to pivot and not only look for new revenue sources, but also search for a means to sustain growth through its new low-debt, low-leverage business model. As an industry leader, Evergrande's actions are being closely watched by many as an early indication of how well China's real estate sector will be able to weather these unexpected headwinds. But in this next phase of China's real estate sector, what seems clear is that victory will belong to those that can adapt most easily to the country's changing macro environment.

## **THROUGH THE ROOF: EVERGRANDE'S EARLY SUCCESS**

In 1996, Xu Jiayin (also known as Hui Ka Yan in Cantonese), a former state-owned steel industry employee raised by a single dad in rural Henan Province, founded Evergrande Real Estate Group in the city of Guangzhou in southern China.<sup>1</sup> In 2009, Evergrande went public on the Hong Kong Stock Exchange as one of the biggest real estate developers in China. In 2016,

<sup>1</sup> “解密许家印,” 人民日报海外版-人民网, June 9, 2010, accessed April 22, 2019, [http://paper.people.com.cn/rmrbhwb/html/2010-06/09/content\\_539576.htm](http://paper.people.com.cn/rmrbhwb/html/2010-06/09/content_539576.htm).



Evergrande became a Global Fortune 500 company, with contracted sales approaching 373.7 billion RMB or US \$54.4 billion (see Exhibit 1).<sup>2</sup> A year later, Xu became the richest man in China, with a net worth of 290 billion RMB (or US \$42.2 billion).<sup>3</sup>

**Exhibit 1: Top 10 Real Estate Developers by Contracted Sales in 2016**

Developer Name	Contracted Sales (RMB Bil)
China Evergrande	373.7
China Vanke	364.8
Country Garden	308.8
Greenland Group	257.6
Poly Real Estate Group	210.0
China Overseas Land and Investment	201.5
Sunac China	150.0
China Fortune Land Development	120.0
Greentown China Holdings	113.6
China Resources Land	108.0

2017, accessed April 23, 2019, <https://www.mingtiandi.com/real-estate/china-real-estate-research-policy/evergrande-chinas-2016-sales-king-as-top-developers-boost-performance-by-82/>.

Evergrande was founded around the time the Chinese government began to abolish the nationwide welfare housing system in favor of a private housing ownership system. Back then, Guangzhou's nascent residential real estate market was dominated by large, expensive condos in the urban center, which was true as well of other major Chinese cities. As a newcomer with limited financial resources, Xu decided to focus on the mass market instead (see Exhibit 2). He began offering smaller condos in the suburbs, which had the advantage of lower land and development costs as well as potentially faster turnover in response to strong market demand.<sup>4</sup> Evergrande's focus on the mass market paved the way for its success even during turbulent times. One of its closest competitors since the beginning is Country Garden Holdings.

**Exhibit 2: Product Focus of Major Chinese Developers**

Company Name	Primary Focus	Secondary Focus
China Evergrande Group	Mass residential markets in 2nd and 3rd tier cities	Mid- to high-end residential
China Vanke	Mid- to high-end residential markets in 1st and 2nd tier cities	Mass residential markets in 1st and 2nd tier cities
China Overseas Holdings	Mid- to high-end residential	Luxury residential
Country Garden Holdings	Mass residential markets in 3rd and 4th tier cities	

Source: DBS Group Research, *China Property Sector*, report (BDS).

Evergrande gained recognition after pulling off an extraordinary feat for its first project. It managed to complete the entire project development cycle – including government approval, land acquisition, construction, sales and move-in – within a year.<sup>5</sup> Xu leveraged Evergrande's initial success to obtain loans from banks, which financed the company's aggressive expansion in Guangzhou city. In no time, its model of 'three highs and one low' (high debt, high leverage, high turnover and low cost) proved to be a winning strategy.

By the early 2000s, Evergrande was developing 13 projects across Guangzhou, making it one of the biggest developers in the city.<sup>6</sup> Meanwhile, China had fully liberalized the real estate sector, but it had also become fiercely competitive and highly fragmented. From 1988 to 1998, the number of developers in China exploded from a dozen to more than 24,000. However, the vast majority of them remained local players.<sup>7</sup> Not a single developer held more than 1% of China's residential real estate market share.<sup>8</sup>

Against this backdrop, Evergrande's dominant strategy was to build scale and outcompete the other players.<sup>9</sup> By 2004, Evergrande had expanded nationwide and was ranked among the top 10 developers in China by sales.<sup>10</sup>

Evergrande's strategy was to build a management structure with a single-minded focus on achieving scale.

<sup>2</sup> "China Evergrande Group," *Fortune*, accessed April 22, 2019, <http://fortune.com/global500/china-evergrande-group/>.

<sup>3</sup> Hurun Research, Hurun Report Releases China Rich List 2017 in Association with 36G, October 12, 2017, accessed April 22, 2019, <http://www.hurun.net/EN/Article/Details?num=5A320E03FD31>.

<sup>4</sup> Evergrande, "Evergrande Corporate History," HKEX News, accessed April 22, 2019, <http://www3.hkexnews.hk/listedco/listconews/sehk/2009/1022/03333/eevergrande-20091015-09.pdf>.

<sup>5</sup> "许家印：白手起家艰辛创业," 凤凰网财经, January 21, 2009, accessed April 22, 2019, <http://finance.ifeng.com/money/wealth/star/20090121/335245.shtml>.

<sup>6</sup> Ibid.

<sup>7</sup> 晓苏 孟, "中国房地产统计年鉴," 1999年中国房地产统计年鉴, accessed April 22, 2019, <http://www.yearbookchina.com/navibooklist-N2005110458-1.html>.

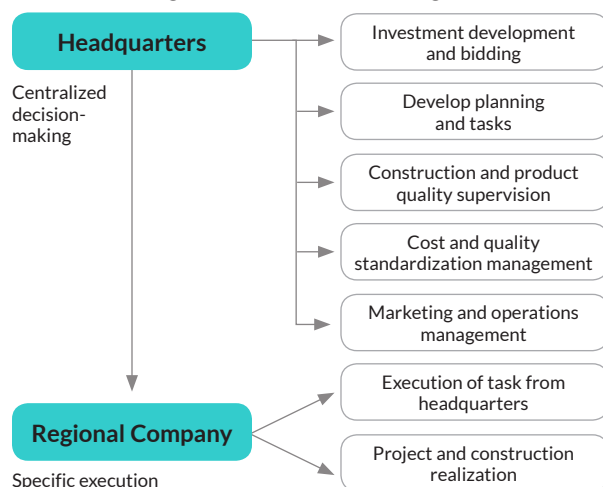
<sup>8</sup> Ibid.

<sup>9</sup> Evergrande, "Evergrande Corporate History."

<sup>10</sup> Nikki Sun, "Chinese Developer Evergrande Tightens Belt after a Decade of Audacity," *Nikkei Asian Review*, December 21, 2018, accessed April 22, 2019, <https://asia.nikkei.com/Business/Company-in-focus/Chinese-developer-Evergrande-tightens-belt-after-a-decade-of-audacity>.

Xu and his team meticulously developed more than 6,000 rules and procedures covering everything from the procurement process to staff meals so that the entire group operated in sync regardless of location.<sup>11</sup> Standardization meant that Evergrande could assemble and dispatch a project development team within two hours of being notified of a project's approval (see Exhibit 3).<sup>12</sup>

**Exhibit 3: Evergrande's Decision-making Structure**

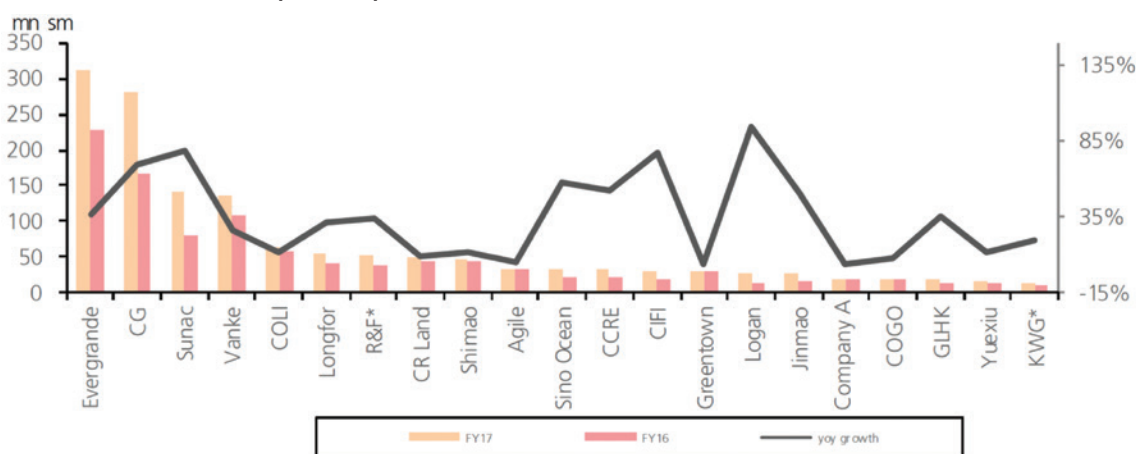


Source: DBS Group Research, *China Property Sector*, report (BDS).

Another key pillar of Evergrande's rapid expansion strategy was its vast land bank (see Exhibit 4). Since 2004, the company had been sending hundreds of employees each year to scour cities across the country for suitable lands for development.<sup>13</sup> As a result, Evergrande amassed the largest land reserves of all Chinese developers. By 2018, Evergrande held 822 pieces of undeveloped land in 228 cities, with a planned gross floor area of 305 million square meters (3.28 billion square feet) of new homes, or the equivalent of nearly 10 percent of Germany's entire housing stock.<sup>14</sup> It paid 513 billion RMB (or US \$74.7 billion) for the real estate.<sup>15</sup>

Evergrande's land purchases were made possible in part by heavy borrowing. In addition to retained earnings from strong sales, Evergrande relied on a mix of state-owned bank loans and bonds to finance its growing land bank acquisitions during its early days.<sup>16</sup> By 2008, the company had received US \$1.3 billion in convertible bonds from a group of international investors including Temasek Holdings, Deutsche Bank and Merrill Lynch in the lead-up to going public.<sup>17</sup> In 2009, the company raised US \$729 million from its IPO on the Hong Kong Stock Exchange, listing under the new name China Evergrande Group.<sup>18</sup>

**Exhibit 4: Land Bank of Top Developers in 2017**



Source: Group Research, "Revisiting Developers' Land Banks: Landbank pace Likely to Remain Fast," DBS, accessed April 23, 2019, [https://www.dbs.com/aics/templatedata/article/generic/data/en/GR/052018/180510\\_insights\\_revisiting\\_developers\\_land\\_banks\\_landbank\\_pace\\_likely\\_to\\_remain\\_fast.xml](https://www.dbs.com/aics/templatedata/article/generic/data/en/GR/052018/180510_insights_revisiting_developers_land_banks_landbank_pace_likely_to_remain_fast.xml)

11 "解密许家印," 人民日报海外版-人民网, June 9, 2010, accessed April 22, 2019, [http://paper.people.com.cn/rmrbhwb/html/2010-06/09/content\\_539576.htm](http://paper.people.com.cn/rmrbhwb/html/2010-06/09/content_539576.htm).

12 Ibid.

13 Evergrande, "Evergrande Corporate History."

14 Yizhen Jia, "Evergrande: China's Biggest Property Developer Faces Debt Crunch," *Financial Times*, November 29, 2018, accessed April 22, 2019, <https://www.ft.com/content/bdcae980-eeef-11e8-89c8-d36339d835c0>.

15 China Evergrande Group, "Evergrande Interim Report 2018," HKEX News, accessed April 22, 2019, <http://www3.hkexnews.hk/listedco/listconews/SEHK/2018/0928/LTN20180928375.pdf>.

16 Paul Panckhurst and Emma Dong, "Evergrande Charts Show a Home Builder Dicing With Danger," Bloomberg.com, October 31, 2018, accessed April 22, 2019, <https://www.bloomberg.com/news/articles/2018-10-31/evergrande-charts-show-a-home-builder-dicing-with-danger>.

17 Amy Or, "Evergrande Jumps 34% in Hong Kong Debut," *The Wall Street Journal*, November 06, 2009, accessed April 22, 2019, <https://www.wsj.com/articles/SB125745135888131657>.

18 Evergrande, "Evergrande Corporate History."

Evergrande's 'high debt, high leverage, high turnover and low cost' model yielded impressive results, with total revenue increasing from 94 billion yuan in 2013 to 311 billion yuan in 2017, representing a compound annual growth rate of 35%. Such growth, however, has been underpinned by an astonishing degree of leverage. As of June 2018, Evergrande's debt load had reached nearly 671 billion yuan.<sup>19</sup>

## A DELICATE BALANCING ACT: REGULATING CHINA'S HOUSING MARKET

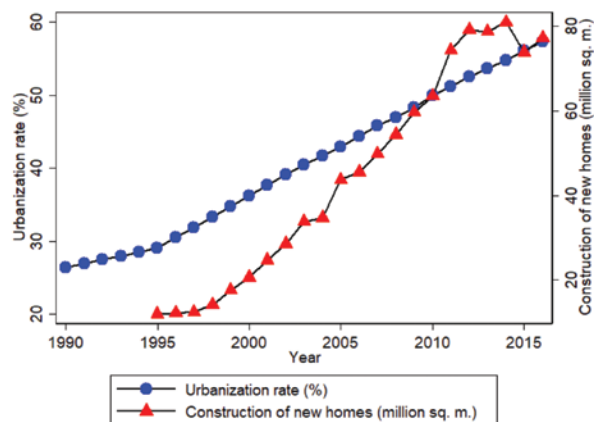
Evergrande's growth mirrored China's broader urbanization and housing boom. Strong economic growth, rising incomes, policy liberalizations in land, housing and the hukou (household registration) system, alongside fiscal and monetary reforms have combined to usher in the largest rural-urban migration in human history. The real estate sector, in turn, has been a key engine driving China's economic growth, responsible for 15% of GDP, 15% of fixed asset investment, 15% of urban employment, and 20% of all bank loans in 2016.<sup>20</sup>

When Evergrande was founded in 1996, China's urban population accounted for only 29% of the total. By 2011, that figure surpassed 50%. In 2018, China's urbanization rate reached 60% (see Exhibit 5).<sup>21</sup> During this period, an estimated 17 million people each year moved into the cities on average, fueling demand for 8 to 10 million units of housing annually. Of those, an estimated four million units were first-time purchases. Another estimated 4 to 5 million replaced homes that were lost to urban redevelopment or were upgrades that were allocated by state-owned enterprises or the government in the 1980s and 1990s.<sup>22</sup> By comparison, U.S. new housing starts in the 2000-2017 period averaged about 1.3 million units each year.<sup>23</sup>

China's housing boom is closely tied to supportive government policies. Because local governments rely on land concession income as a major source of revenue and both local and central governments rely on real estate investments to drive economic growth and job creation,

both have major incentives to grow the sector.<sup>24</sup> By 2016, the total market value of China's real estate accounted for 411% of GDP, almost twice as much as the global average of 260%.<sup>25</sup>

**Exhibit 5: China's Urbanization and New Home Construction Trends (1990-2015)**



Source: National Bureau of Statistics of China

Further, as the Chinese government controls key levers of the housing sector on both the supply and demand side, including urban land, capital, infrastructure, and the pace of rural-urban migration, it can easily relax some of these levers to stimulate the economy in the short run.<sup>26</sup> This practice has been especially common during economic downturns, with broad economic impact on retail investors. Housing prices across China, for example, rose sharply following the 2008 global financial crisis, a direct outcome of loosened credit conditions and the government's 4-trillion-yuan stimulus package (see Exhibit 6).<sup>27</sup> The government has also intervened in the other direction, trying to cool down the housing bubble to prevent it from bursting.

Investment in residential real estate has long been a very attractive option as China's financial markets remain underdeveloped.<sup>28</sup> While the government has repeatedly tried to curb rampant speculative buying

19 Jan Kot, "China Evergrande Issues \$3B in Bonds as Debt Pile Grows," Mingtiandi, January 24, 2019, accessed April 22, 2019, <https://www.mingtiandi.com/real-estate/finance-real-estate/china-evergrande-bond-issue/>.

20 Wade Shepard, "Why China's Housing Market Refuses To Crash," *Forbes*, April 05, 2016, accessed April 22, 2019, <https://www.forbes.com/sites/wadeshepard/2016/04/05/why-chinas-housing-market-refuses-to-crash/#74920ba04f83>.

21 "China Housing Statistics," National Bureau of Statistics, accessed April 22, 2019, <http://www.stats.gov.cn/English/>.

22 Lucia Kwong and Ryan Li, Asia Pacific Corporate Research, July 11, 2012, accessed April 22, 2019, [http://pg.jrj.com.cn/acc/Res/CN\\_RES/INVEST/2012/7/11/ad7a8d73-8398-44c3-9d46-fe9c08355a73.pdf](http://pg.jrj.com.cn/acc/Res/CN_RES/INVEST/2012/7/11/ad7a8d73-8398-44c3-9d46-fe9c08355a73.pdf).

23 "United States Housing Stats," United States Housing Starts | 2019 | Data | Chart | Calendar | Forecast, accessed April 22, 2019, <https://tradingeconomics.com/united-states/housing-starts>.

24 World Bank and Development Research Center of the State Council, *Urban China: Toward Efficient, Inclusive and Sustainable Urbanization*, 2014, <http://www.worldbank.org/en/country/china/publication/urban-china-toward-efficient-inclusive-sustainable-urbanization>.

25 第一财经日报, "任泽平称房地产存泡沫: 总市值占GDP比高达411%," 新浪财经, September 21, 2016, accessed April 22, 2019, <http://finance.sina.com.cn/stock/hkstock/hkstocknews/2016-09-22/doc-ixwewmf1897515.shtml>.

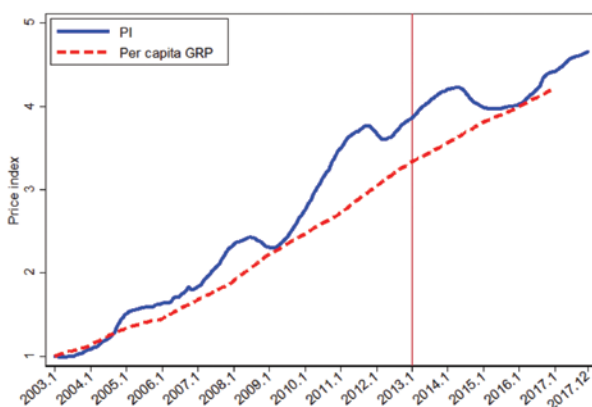
26 World Bank and Development Research Center of the State Council, *Urban China: Toward Efficient, Inclusive and Sustainable Urbanization*, 2014.

27 National Bureau of Statistics of China.

28 Chang Liu and Wei Xiong, "China's Real Estate Market" in Marlene Amstad et al. (eds), *The Handbook of China's Financial System*, 2018, <http://wxiong.mycpanel.princeton.edu/papers/HousingChapter.pdf>.

with administrative measures such as price controls and sales bans, the practice remains very popular.<sup>29</sup> Indeed, some people go to great lengths to circumvent housing restrictions. For example, married couples receive preferential mortgage rates only on their first homes, encouraging some to divorce, buy homes separately, and then remarry.<sup>30</sup>

## Exhibit 6: China's 70-City Housing Price Index, 2003-2017



Notes: Price Indices (PI) weighted by urban population to adjust for different city sizes. Per capita Gross Regional Product also provided for reference.

Source: Fang et al., 2016 and National Bureau of Statistics, see Chang Liu and Wei Xiong, "China's Real Estate Market" in Marlene Amstad et al. (eds), *The Handbook of China's Financial System*, 2018.

By 2016, Chinese policy makers were again worried that real estate speculation was consuming household income and corporate investment, and in turn depressing consumption and entrepreneurial activities. Both are areas that the government wants to promote amid a slowing economy.<sup>31</sup> To set these concerns in context, it is worth noting that China's mortgage payment-to-household income ratio had reached 0.46 in 2016. In comparison, the same ratio in the United States during the height of the 2007 subprime crisis was 0.52.<sup>32</sup>

The need to cool down the real estate sector arose in urgency when it became clear that the sector had become highly leveraged, exposing the financial system to systemic risks.<sup>33</sup> By June 2016, China's 196 listed developers had accumulated 3 trillion yuan in debt, mostly from the country's unregulated shadow banking system, up from 1.3 trillion yuan in 2013.<sup>34</sup> Direct loans to the real estate sector had reached 24 trillion yuan.<sup>35</sup> Economists feared that the slowing economy would bring down the value of land and property, which comprised nearly a quarter of Chinese bank assets.<sup>36</sup>

Since 2016, the Chinese government has made deleveraging a top economic priority targeting both financial and non-financial companies. As part of a broad supply-side reform package, China's financial regulators began by cracking down on real estate financing via shadow banking channels such as trust loans and wealth management products. Banks also were required to institute tough oversight over real estate lending. Regulators have also limited the ability of real estate companies to issue onshore bonds. Finally, local governments were compelled to adopt strict qualification criteria for developers eager to enter land auctions.<sup>37</sup>

## BRACING FOR IMPACT: EVERGRANDE'S DEBT WOES

Tightening credit conditions had an immediate impact on China's entire real estate industry. Evergrande was among the hardest hit. Before the government clampdown, Evergrande was the most leveraged real estate developer in China, with a gearing ratio more than double the next leveraged developers (see Exhibit 7).<sup>38</sup> Evergrande also tapped into shadow banking as a source of finance more than other developers, with almost 300 billion yuan (US \$43.7 billion) of debt payment coming due in 2019.<sup>39</sup> In 2017, its average financing cost was 8.09%, the third highest among major Chinese developers, and a reflection of its debt load (see Exhibit 8).

29 Yizhen Jia, "Evergrande: China's Biggest Property Developer Faces Debt Crunch," *Financial Times*, November 29, 2018, accessed April 22, 2019, <https://www.ft.com/content/bdcae980-eeef-11e8-89c8-d36339d835c0>.

30 The Economist, "When a bubble is not a bubble," *The Economist*, October 15, 2016.

31 Chang Liu and Wei Xiong, "China's Real Estate Market" in Marlene Amstad et al. (eds), *The Handbook of China's Financial System*, 2018.

32 第一财经日报, "任泽平称房地产存泡沫: 总市值占GDP比高达411%," 新浪财经, September 21, 2016, accessed April 22, 2019, <http://finance.sina.com.cn/stock/hkstock/hkstocknews/2016-09-22/doc-ixfwvmf1897515.shtml>.

33 Chang Liu and Wei Xiong, "China's Real Estate Market" in Marlene Amstad et al. (eds), *The Handbook of China's Financial System*, 2018.

34 Bruce Einhorn, "China's Housing Bubble Wobble," *Bloomberg*, October 20, 2016,

<https://www.economist.com/finance-and-economics/2016/10/13/when-a-bubble-is-not-a-bubble>.

35 Jethro Mullen, Andrew Stevens, "Billionaire: Chinese real estate is 'biggest bubble in history,'" September 29, 2016, <https://money.cnn.com/2016/09/28/investing/china-wang-jianlin-real-estate-bubble/>.

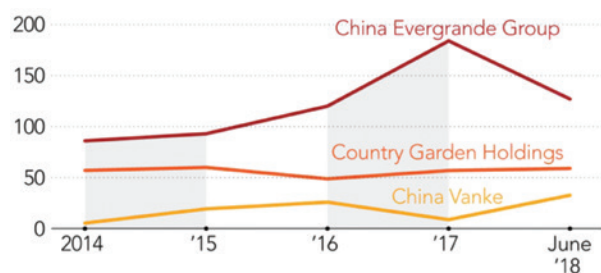
36 Deutsche Bank, *Analyzing the property exposure in China*, Market Research Report, 2016.

37 "Deleveraging & China's Real Estate Sector," Asset Management – Global, accessed April 22, 2019, <https://www.ubs.com/global/en/asset-management/insights/china/2018/deleveraging-china-real-estate.html>.

38 Nikki Sun, "Chinese Developer Evergrande Tightens Belt after a Decade of Audacity."

39 Paul Panckhurst and Emma Dong, "Evergrande Charts Show a Home Builder Dicing With Danger."

**Exhibit 7: Gearing Ratio of Major Property Developers in China (%) (2014-June 2018)**



Source: Nikki Sun, "Chinese Developer Evergrande Tightens Belt after a Decade of Audacity," Nikkei Asian Review, December 21, 2018, accessed April 22, 2019, <https://asia.nikkei.com/Business/Company-in-focus/Chinese-developer-Evergrande-tightens-belt-after-a-decade-of-audacity>.

**Exhibit 8: The Average Financing Costs of China's Top Real Estate Developers (2017)**

Company Name	Average financing cost in 2017
Peking University Resources	8.32%
Taihe Group	8.10%
China Evergrande	8.09%
Kaia	8.03%
Contemporary Home Ownership	7.70%
Central South Construction	7.63%
Times Real Estate	7.60%
Landsea Group	7.40%
Zhengrong Real Estate	7.30%
Jianye Real Estate	7.24%
China Resources Land	4.16%
China Overseas Real Estate	4.27%
Yuxiu Real Estate	4.30%
Longhu Group	4.50%
Gemdale Group	4.56%
Merchants Shekou	4.80%
Poly Real Estate Group	4.82%
China Jinmao	4.83%
Financial Street	5.01%
Binjiang Group	5.05%

Source: DBS Group Research, *China Property Sector*, report (BDS).

By 2018, China's unfavorable financing environment forced Evergrande to raise US \$1.8 billion from an

offshore bond issue at rates of up to 13.75%. Perhaps indicative of growing market wariness, Evergrande's own Chairman Xu opted to personally buy US \$1 billion of this bond issue, stating that he did so to signal his confidence in the business.<sup>40</sup> No matter. What Evergrande ultimately needed was a new model of success, one that struck the right balance between expansion, profitability, and debt sustainability.

## CHANGING GEARS: DELEVERAGING AND DIVERSIFICATION AS A SUSTAINABLE GROWTH MODEL

By early 2017, Evergrande began to make changes to its business model. "A New Evergrande," as the founder called it, would focus on improving cash flow and profitability to increase the quality, rather than just the speed, of growth.<sup>41</sup> Evergrande announced this strategic shift as a move from its long-standing 'high debt, high leverage, high turnover, and low cost' model to a 'low debt, low leverage, low cost, high turnover' model. With this, the company simultaneously began to shift toward a more asset light model in its traditional sectors while branching into new business sectors as a means to hedge ongoing risk in real estate development. These changes took place across the following lines of business.

### Finance

In 2017, Evergrande completed a large equity sale, raising 130 billion yuan (US \$18.9 billion) from strategic investors to pay off 129 billion yuan of perpetual debt. The investors included Amer International Group, a materials giant, Suning.com, a large retailer, and Shandong Expressway, a large state-owned infrastructure company.<sup>42</sup>

By mid-2018, Evergrande further paid off 61.5 billion yuan (US \$8.9 billion) of short-term debt, thereby cutting 8% in total debt as compared to 2017 — the biggest drop among the top 10 developers (see Exhibit 9). In contrast, 83% of China's top 60 developers saw their total debt load increase in the same period.<sup>43</sup> By the end of 2018, Evergrande had stabilized its debt load and the net debt-to-equity ratio had improved significantly.

40 Lianting Tu, "Evergrande Chairman Buys \$1 Billion of Its Debt in Rare Move," Bloomberg.com, October 30, 2018, accessed April 22, 2019, <https://www.bloomberg.com/news/articles/2018-10-31/evergrande-chairman-buys-1-billion-of-its-new-bond-issue>.

41 China Evergrande Group, "Annual Report 2017," Evergrande, accessed April 22, 2019, <http://doc.irasia.com/listco/hk/evergrande/annual/2017/ar2017.pdf>.

42 Ibid.

43 DBS Group Research, *China Property Sector*, report (BDS).



**Exhibit 9: Top 10 Developers by Total Debt Load (2017-H1 2018)**  
(in million yuan)

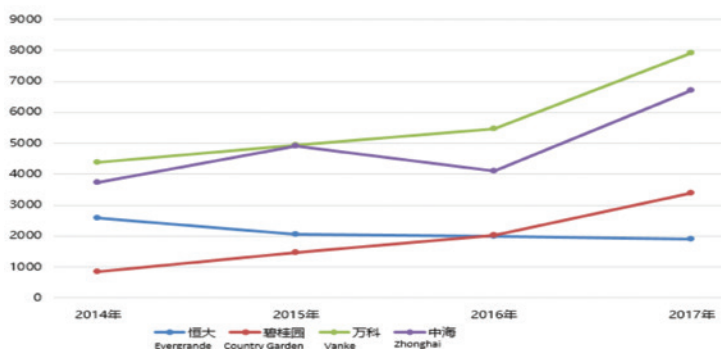
Company Name	2018 H1	2017	Change from start of period
China Evergrande	6711	7326	-8%
Country Garden	2939	2148	37%
Greenland Group	2558	2679	-5%
Poly Real Estate	2545	2046	24%
Vanke Real Estate	2269	1906	19%
Sunac China	2098	2193	-4%
China Overseas Real Estate	1746	1426	22%
R&F Properties	1591	1422	12%
Taihe Group	1472	1355	9%
China Resources Land	1359	1056	29%

Source: DBS Group Research, *China Property Sector*, report (BDS).

## Land Acquisition

Evergrande also significantly reduced its land acquisition cost on a per unit basis (See Exhibit 10). Instead of acquiring land in the open land auction market, Evergrande took advantage of its industry-leading cash reserves and acquired cash-strapped projects from smaller developers at favorable prices. In 2018, 57% of its new land parcels were acquired this way, leading to a significant drop in its average land cost from 1,889 yuan/square meter to 1,446 yuan/square meter.<sup>44</sup> In contrast, other major developers saw significant increases in their land cost.<sup>45</sup>

**Exhibit 10: Newly Added Land Bank Price (2014-2017)**  
(In yuan/square meter)

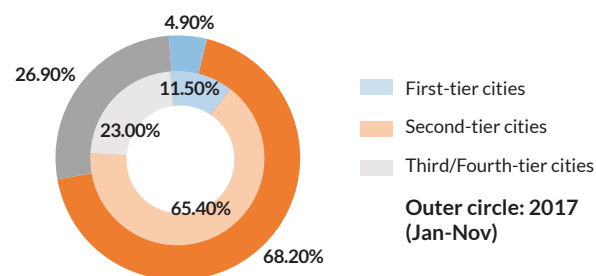


Source: DBS Group Research, *China Property Sector*, report (BDS).

## Real Estate Product Mix and Location

To boost turnover and liquidity, Evergrande further increased its share of small apartments and units in smaller tier 3 and tier 4 cities in its overall product mix, thus staying true to its origin as a mass-market housing provider. Evergrande's focus on these cities was strategic. Smaller cities are generally less affected by strict housing purchase restrictions often imposed in China's biggest cities. The share of small apartments (<50 square meters) in the company's product pipeline increased from 74.1% in 2015 to 80% in 2016.<sup>46</sup> Similarly, total sales in second-tier cities increased from 65.4% in 2016 to 68.2% in 2017 while in third- and fourth-tier cities it increased from 23% to 26.9% in the same period (see Exhibit 11).

**Exhibit 11: The Breakdown of Evergrande's Sales Performance by City Size (2016, 2017)**



Source: 凤凰网房产, “恒大”三低一高完成从大到强质变—凤凰网房产北京, 凤凰网房产, accessed April 23, 2019, [http://house.ifeng.com/news/2017\\_12\\_27-51334032\\_0.shtml](http://house.ifeng.com/news/2017_12_27-51334032_0.shtml).

## New Business Lines

At the same time, Evergrande started to diversify beyond its traditional residential real estate core (see Exhibit 12). In 2012, even before its new strategy was announced,

Evergrande started to develop or acquire a range of new business lines spanning theme parks, hospitals and electric vehicles. But the strategic shift in 2017 greatly accelerated the pace of this diversification, which Evergrande called the ‘Real Estate + Services’ model. Services would include health care (serving seniors), tourism (serving younger populations), and finance (serving society).

In late 2015, Evergrande bought a 50% stake in Sino-Singapore Great Eastern Insurance, a struggling Chinese subsidiary of Great Eastern Life Insurance, and renamed it Evergrande Life. In 2016, the company incurred a net loss of 0.4 billion yuan (US \$58 million). But by 2018, the

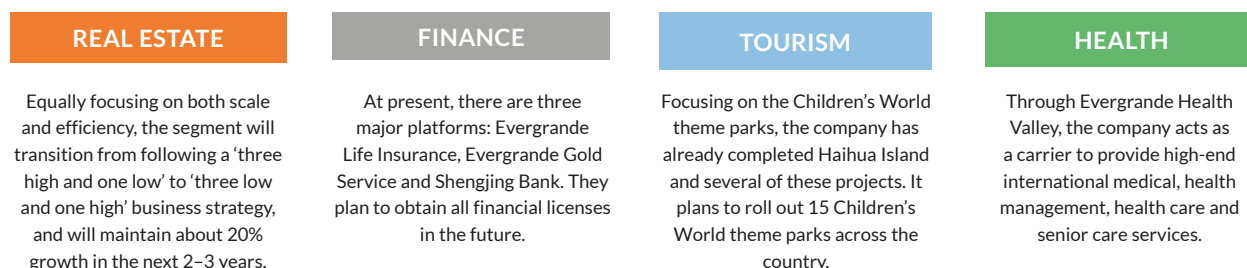
<sup>44</sup> China Evergrande Group, “Annual Report 2018,” Evergrande, accessed April 22, 2019, <http://doc.irasia.com/listco/hk/evergrande/interim/2018/intrep.pdf>.

<sup>45</sup> DBS Group Research, *China Property Sector*, report (BDS).

<sup>46</sup> DBS Group Research, *China Property Sector*, report (BDS).



## Exhibit 12: Overview of Evergrande's Four Business Lines After the Strategic Shift



Source: 凤凰房产, “恒大”三低一高”完成从大到强质变 — 凤凰网房产北京,” 凤凰网房产, accessed April 23, 2019, [http://house.ifeng.com/news/2017\\_12\\_27-51334032\\_0.shtml](http://house.ifeng.com/news/2017_12_27-51334032_0.shtml).

company had turned it around and made a net profit of 1.2 billion yuan (US \$174 million).<sup>47</sup>

In late 2017, Evergrande Health, a subsidiary of the Evergrande Group, agreed to invest US \$2 billion over three years in Smart King, Ltd., the owner of Faraday Future. In exchange, Evergrande was promised a 45% stake in the California-based electric vehicle company often depicted as a direct competitor to Tesla.<sup>48</sup>

Just a few months later, Evergrande Health opened the 647-bed Bo'ao Evergrande International Hospital in partnership with Brigham and Women's Hospital, a leading American hospital in Boston. Evergrande hopes the hospital will be the first of a network of world-class hospitals it plans to build across China.

In August 2018, Evergrande also signed an agreement with the Chinese Academy of Science, a top research institute in China, to jointly develop cutting-edge technologies in supercomputing, artificial intelligence and surgical robotics.<sup>49</sup> Evergrande hopes its \$237 million investment in high-tech research and development will make next generation technology a pillar of the company's revenue stream in the future.

Finally, the company affirmed its ongoing commitment to develop and expand its footprint in the tourism sector, targeting families with young children.

## LOOKING AHEAD: ENTERING UNCHARTED TERRITORY

While China's looser credit conditions in the past rewarded bold players such as Evergrande, the shifting macroeconomic environment forced the company to abandon its high-debt, high-leverage growth model. As a market leader, Evergrande is better positioned to turn the current credit tightness in the real estate sector into an opportunity. It may also just be too big to fail.

Diversification, however, carries major risks. Firms, such as Evergrande, are moving out of areas of core competency, meaning greater reliance and need for new talent. Acquisitions outside of a known sector also means exposure to new challenges. Indeed, it took just a matter of months before Evergrande's investment agreement with Faraday Future fell into turmoil, ultimately resulting in a substantially restructured deal. The investment also pulled Evergrande into matters of international diplomacy, with U.S. President Trump describing Evergrande's investment in Faraday Future as a threat to U.S. competitiveness.

The real estate sector will likely face greater consolidation in future years, as well as a continued need to offload assets as a means to raise capital and improve balance sheets. Only those with the means to pivot in this changed environment are likely to lead in the next phase of growth.

47 丽丹 管, “朱加麟履新恒大人寿董事长 能否担起转型重任?,” Sohu.com, July 11, 2018, accessed April 23, 2019, [http://www.sohu.com/a/240587745\\_100001551](http://www.sohu.com/a/240587745_100001551).

48 Zheng Lichun and Denise Jia, “Faraday Future Founder Settles Investment Dispute with Evergrande,” Caixin Global, accessed April 23, 2019, <https://www.caixinglobal.com/2019-01-01/faraday-future-founder-settles-investment-dispute-with-evergrande-101365340.html>.

49 Na Chen, “Evergrande Group, Top Science Institute Join Hands for Tech Edge,” Chinese Academy of Sciences, August 20, 2018, accessed April 23, 2019, [http://English.cas.cn/newsroom/news/201808/t20180820\\_196318.shtml](http://English.cas.cn/newsroom/news/201808/t20180820_196318.shtml).

## REFERENCES

- Hurun Research. Hurun Report Releases China Rich List 2017 in Association with 36G. October 12, 2017. Accessed April 22, 2019. <http://www.hurun.net/EN/Article/Details?num=5A320E03FD31>.
- China Evergrande Group. "Annual Report 2017." Evergrande. Accessed April 22, 2019. <http://doc.irasia.com/listco/hk/evergrande/annual/2017/ar2017.pdf>.
- China Evergrande Group. "Annual Report 2018." Evergrande. Accessed April 22, 2019. <http://doc.irasia.com/listco/hk/evergrande/interim/2018/intrep.pdf>.
- Chen, Na. "Evergrande Group, Top Science Institute Join Hands for Tech Edge." Chinese Academy of Sciences. August 20, 2018. Accessed April 23, 2019. [http://English.cas.cn/newsroom/news/201808/t20180820\\_196318.shtml](http://English.cas.cn/newsroom/news/201808/t20180820_196318.shtml).
- "China Evergrande Group." *Fortune*. Accessed April 22, 2019. <http://fortune.com/global500/china-evergrande-group/>.
- "China Housing Statistics." National Bureau of Statistics. Accessed April 22, 2019. <http://www.stats.gov.cn/English/>.
- Deutsche Bank. Analyzing the property exposure in China, Market Research Report, 2016.
- DBS Group Research. *China Property Sector*. Report. BDS.
- Cole, Michael. "Evergrande China's 2016 Sales King As Top Developers Boost Performance By 82%." *Mingtiandi*. January 09, 2017. Accessed April 23, 2019. <https://www.mingtiandi.com/real-estate/china-real-estate-research-policy/evergrande-chinas-2016-sales-king-as-top-developers-boost-performance-by-82/>.
- "Deleveraging & China's Real Estate Sector." Asset Management – Global. Accessed April 22, 2019. <https://www.ubs.com/global/en/asset-management/insights/china/2018/deleveraging-china-real-estate.html>.
- Einhorn, Bruce. "China's Housing Bubble Wobble." *Bloomberg*. October 20, 2016. <https://www.bloomberg.com/news/articles/2016-10-20/china-s-housing-bubble-wobble>.
- The Economist. "When a bubble is not a bubble," *The Economist*, October 15, 2016. <https://www.economist.com/finance-and-economics/2016/10/13/when-a-bubble-is-not-a-bubble>.
- Evergrande. "Evergrande Corporate History." HKEX News. Accessed April 22, 2019. <http://www3.hkexnews.hk/listedco/listconews/sehk/2009/1022/03333/evergrande-20091015-09.pdf>.
- China Evergrande Group. "Evergrande Interim Report 2018." HKEX News. Accessed April 22, 2019. <http://www3.hkexnews.hk/listedco/listconews/SEHK/2018/0928/LTN20180928375.pdf>.
- Jia, Yizhen. "Evergrande: China's Biggest Property Developer Faces Debt Crunch." *Financial Times*. November 29, 2018. Accessed April 22, 2019. <https://www.ft.com/content/bdcae980-eeef-11e8-89c8-d36339d835c0>.
- Kot, Jan. "China Evergrande Issues \$3B in Bonds as Debt Pile Grows." *Mingtiandi*. January 24, 2019. Accessed April 22, 2019. <https://www.mingtiandi.com/real-estate/finance-real-estate/china-evergrande-bond-issue/>.
- Kwong, Lucia, and Ryan Li. Asia Pacific Corporate Research. July 11, 2012. Accessed April 22, 2019. [http://pg.rj.com.cn/acc/Res/CN\\_RES/INVEST/2012/7/11/ad7a8d73-8398-44c3-9d46-fe9c08355a73.pdf](http://pg.rj.com.cn/acc/Res/CN_RES/INVEST/2012/7/11/ad7a8d73-8398-44c3-9d46-fe9c08355a73.pdf).
- Lichun, Zheng, and Denise Jia. "Faraday Future Founder Settles Investment Dispute with Evergrande." *Caixin Global*. Accessed April 23, 2019. <https://www.caixinglobal.com/2019-01-01/faraday-future-founder-settles-investment-dispute-with-evergrande-101365340.html>.
- Liu, Chang and Wei Xiong. "China's Real Estate Market" in Marlene Amstad et al. (eds). *The Handbook of China's Financial System*, 2018. <http://wxiong.mycpanel.princeton.edu/papers/HousingChapter.pdf>.
- Mullen, Jethro, and Andrew Stevens. "Billionaire: Chinese real estate is 'biggest bubble in history.'" September 29, 2016. <https://money.cnn.com/2016/09/28/investing/china-wang-jianlin-real-estate-bubble/>.
- Or, Amy. "Evergrande Jumps 34% in Hong Kong Debut." *The Wall Street Journal*. November 06, 2009. Accessed April 22, 2019. <https://www.wsj.com/articles/SB125745135888131657>.
- Panckhurst, Paul, and Emma Dong. "Evergrande Charts Show a Home Builder Dicing With Danger." *Bloomberg.com*. October 31, 2018. Accessed April 22, 2019. <https://www.bloomberg.com/news/articles/2018-10-31/evergrande-charts-show-a-home-builder-dicing-with-danger>.
- Group Research. "Revisiting Developers' Land Banks: Landbank pace Likely to Remain Fast." DBS. Accessed April 23, 2019. [https://www.dbs.com/aics/templatedata/article/generic/data/en/GR/052018/180510\\_insights\\_revisiting\\_developers\\_land\\_banks\\_landbank\\_pace\\_likely\\_to\\_remain\\_fast.xml](https://www.dbs.com/aics/templatedata/article/generic/data/en/GR/052018/180510_insights_revisiting_developers_land_banks_landbank_pace_likely_to_remain_fast.xml).
- Shepard, Wade. "Why China's Housing Market Refuses To Crash." *Forbes*. April 05, 2016. Accessed April 22, 2019. <https://www.forbes.com/sites/wadeshepard/2016/04/05/why-chinas-housing-market-refuses-to-crash/#74920ba04f83>.
- Sun, Nikki. "Chinese Developer Evergrande Tightens Belt after a Decade of Audacity." *Nikkei Asian Review*. December 21, 2018. Accessed April 22, 2019. <https://asia.nikkei.com/Business/Company-in-focus/Chinese-developer-Evergrande-tightens-belt-after-a-decade-of-audacity>.
- Tu, Lianting. "Evergrande Chairman Buys \$1 Billion of Its Debt in Rare Move." *Bloomberg.com*. October 30, 2018. Accessed April 22, 2019. <https://www.bloomberg.com/news/articles/2018-10-31/evergrande-chairman-buys-1-billion-of-its-new-bond-issue>.
- "United States Housing Starts." United States Housing Starts | 2019 | Data | Chart | Calendar | Forecast. Accessed April 22, 2019. <https://tradingeconomics.com/united-states/housing-starts>.
- World Bank and Development Research Center of the State Council, *Urban China: Toward Efficient, Inclusive and Sustainable Urbanization*, 2014. <http://www.worldbank.org/en/country/china/publication/urban-china-toward-efficient-inclusive-sustainable-urbanization>.
- 第一财经日报. "任泽平称房地产存泡沫：总市值占GDP比高达411%." 新浪财经. September 21, 2016. Accessed April 22, 2019. <http://finance.sina.com.cn/stock/hkstock/hkstocknews/2016-09-22/doc-ixwewmf1897515.shtml>.
- 孟, 晓苏. "中国房地产统计年鉴." 1999年中国房地产统计年鉴. Accessed April 22, 2019. <http://www.yearbookchina.com/navibooklist-N2005110458-1.html>.
- 凤凰房产. "恒大"三低一高"完成从大到强质变 - 凤凰网房产北京." 凤凰网房产. Accessed April 23, 2019. [http://house.ifeng.com/news/2017\\_12\\_27-51334032\\_0.shtml](http://house.ifeng.com/news/2017_12_27-51334032_0.shtml).
- 管, 丽丹. "朱加麟履新恒大人寿董事长 能否担起转型重任? ." *Sohu.com*. July 11, 2018. Accessed April 23, 2019. [http://www.sohu.com/a/240587745\\_100001551](http://www.sohu.com/a/240587745_100001551).
- "解密许家印." 人民日报海外版-人民网. June 9, 2010. Accessed April 22, 2019. [http://paper.people.com.cn/rmrbhwb/html/2010-06/09/content\\_539576.htm](http://paper.people.com.cn/rmrbhwb/html/2010-06/09/content_539576.htm).
- "许家印：白手起家艰辛创业." 凤凰网财经. January 21, 2009. Accessed April 22, 2019. <http://finance.ifeng.com/money/wealth/star/20090121/335245.shtml>.