INTERVIEW

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Credit analyst on real estate giant

"Evergrande bankruptcy has already factually occurred"

Can stumbling real estate giant Evergrande still pay its debts? Credit analyst Marco Metzler doesn't think so: He is convinced Evergrande has long been bankrupt - and is challenging the group.

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How big a threat does China's teetering real estate developer Evergrande pose to the global economy? International banks and private investors have lent the group some $23.7 billion - which they want interest on and repaid. So if Evergrande collapses, the corporation will take others with it. Recently, media such as the "New York Times" have been reporting warning signs, but experienced credit analyst Marco Metzler disagrees.

manager magazin: Mr. Metzler, in your latest analysis, you basically claim that Evergrande has long been bankrupt. What makes you say that?

Marco Metzler: The fact is that Evergrande and Citibank, as trustee and paying agent for the interest payments, have not yet officially confirmed a single payment of the interest that has been overdue for more than 30 days. The source referred to by the "New York Times" and other media is a single, allegedly anonymous creditor who is said to have told the media a few hours before the deadline that he had received the interest payment.

What do you conclude from this?

The fact that there is no confirmation of receipt of payment from any official source and that the sources are being treated in such a non-transparent manner raises concerns. There remain considerable doubts as to whether money has really flowed, and if at all, possibly only to individual creditors of the offshore bond. Here Evergrande is apparently repeating the same game as it did on October 23.

What do you mean by that?

Evergrande and Citibank have not officially confirmed $83 million in alleged interest payments at this time either. We have asked numerous investors known to us, they could not confirm any receipt of payment. In our view, this obviously means that the Evergrande bankruptcy has already effectively occurred. This also means that all other 22 bonds issued are considered to be in default under the cross-default principle.
This is how it is regulated in the bond terms and conditions. This means that bruised investors can now file for insolvency.

The fact is, so far Evergrande has not been declared insolvent. So how much is at stake for foreign investors?

In fact, according to official figures, Evergrande owes 90 percent of its loans and payments to Chinese creditors. But that by no means makes the case a purely Chinese problem. According to our latest information, international investors alone have put about $23.7 billion into 23 bonds and three large loans. Analysts at Fitch expect Evergrande to be liquidated in the event of bankruptcy. Creditors are unlikely to be paid much more than 5 percent of their claims then. In other words: International investors would then have to write off around $22.5 billion in the event of Evergrande's insolvency.

22.5 billion dollars - distributed among hundreds of foreign creditors - that sounds manageable and not like an imminent "meltdown of the global financial system," as you write in your study.

Focusing only on Evergrande and these creditors, the risk may seem manageable. But if one follows the calculations of the renowned Chinese business magazine "Caixin", Evergrande will have to find a total of around 123 billion dollars for interest and repayments within the next twelve months. In total, the foreign loans of international investors in China amount to 586 billion dollars, of which around 30 billion dollars have already defaulted in 2020. If the Chinese state does not step in to cover this, we must already consider Evergrande's bankruptcy a certainty. Moreover, we must not look at Evergrande in isolation: The completely overheated real estate sector accounts for up to 30 percent of China's economic output. Any major bankruptcy could drag down other Chinese real estate companies, banks and insurers with it.

With what consequences for other countries?

Probably with considerable consequences. According to Goldman Sachs, the foreign debts of Chinese real estate developers alone amount to around 197 billion U.S. dollars. The major international bank HSBC, for example, reports loans of $19.6 billion for the third quarter that it extended exclusively to Chinese real estate groups. In total, HSBC has extended $196 billion in credit to Chinese companies in all sorts of industries. In addition: International banks with strong Asian operations sometimes lend to wealthy Chinese, which in turn are backed by Chinese debt instruments. These loans could then also default. However, this aspect may not be seen at all at the moment.

Aren't you painting things a little too black here?

After all, the real estate sector is not the only problem facing the Chinese economy, which has recently cooled down considerably - the key words here are scarce raw materials, supply bottlenecks, massive power outages, plant and port closures and, most recently, food rationing. A possible wave of bankruptcies triggered by Evergrande will further slow Chinese growth. At the same time, we see high levels of government, corporate and private debt - China's debt-to-GDP ratio is already 230 percent of annual economic output. If supply chains come under further pressure or even break, this will have a direct impact on the USA and Europe.

The problem of supply chains and supply bottlenecks is currently much discussed. What is Evergrande's significance in this context?

More than two-thirds of Evergrande's debt, we believe, is ultimately owed by other distressed real estate developers and companies within the supply chain. A bankruptcy of Evergrande could cause the insolvency of its direct and indirect suppliers. Most of these are small and medium-sized companies that rely on large customers, not only for their business, but also for access to financing ...

... that Evergrande provides to these companies?

Yes, Evergrande often grants them this in the form of loans. These financial risks are further complicated by the particular nature of the supply chains. One key feature is non-substitutability. Unlike in the financial sector, where companies can easily switch to other products, there are no easy substitutes in a complex supply chain, especially in the short term. So, in all likelihood, a collapse of the construction company will result in a large group of suppliers not only losing their business, but also facing immediate financial hardship, which could lead to a chain of bankruptcies.

Do you think Evergrande can succeed in defusing its precarious situation by selling assets abroad and, with Beijing's help, contain what is arguably an even bigger fire in China itself?

I think S&P Global Ratings has already summed it up well in one of their reports. A government bailout would undermine the campaign for greater financial discipline in the real estate sector that the government has, after all, only recently launched. And even in the event that China did step in, it would have no impact on foreign investors because Evergrande is officially registered in the Cayman Islands. According to the May 14 law on "Mutual Recognition and Assistance in Insolvency Proceedings," the Chinese state would not pay for foreign investors' debts in such a case.

DMSA, for which you work as a consultant, defines its goal as follows: "To create greater transparency for consumers in their choice of products, investments and services." Those are likely to be Evergrande investors only in exceptional cases. So why this alarmist tone of the study, is DMSA itself invested in Evergrande?

In our view, the dangers posed by the Chinese real estate sector, not only to China, are criminally underestimated. And yes, we are invested ourselves with a comparatively small amount of $50,000 in bonds of Evergrande. For us, this is not a speculative investment, but a means to an end.

If Evergrande fails to service the next overdue interest payments on additional bonds by the Nov. 11 deadline, we as creditors will file a bankruptcy case against the company. This is not trivial, very costly, but it is possible in principle.

Much weightier investors could have done that long ago. Do you really believe that the - if I may say so - insignificant creditor DMSA from Germany can initiate insolvency proceedings against the real estate giant Evergrande?

We are concerned with principle and transparency. In our view, large companies should not simply accumulate vast amounts of debt and then fail to repay it the next moment. Evergrande and Citibank as paying agents are also behaving in a completely non-transparent manner in this process. With the purchase of the bond and a possible bankruptcy filing, we want to publicly provide clarity as to whether Evergrande will still be able to service its bonds in full in the future or is now bankrupt. We are in a fairly comfortable position here, because the other investors have a lot at stake. If Evergrande files for bankruptcy, they will lose more than these interest payments. That's why I think they're holding still. There are also market rumours that some investors and banks are deliberately not informing about the default of the interest payment in order to gain time to sell larger holdings of Evergrande bonds and shares to unknowing investors via derivatives.

Dr. Marco Metzler (49) was Senior Analyst and Director for International Insurance Groups at Fitch Ratings. He is a trained investment banker and has more than 25 years of experience in the European insurance industry as well as the rating industry. As former CFO of Prisma Life in Liechtenstein, he managed more than 1.2 billion euros in client assets. Currently, Metzler is self-employed with Dr. Metzler Rating Consulting in Switzerland and advises international insurers. In addition, as a rating expert, he holds advisory board positions in several companies, including DMSA (Deutsche Markt Screening Agentur), which earns its money with market studies, and DFSI Ratings, which produces ratings of financial products.

DMSA Deutsche Markt Screening Agentur GmbH, is an independent data service that collects and evaluates market-relevant information on companies, products and services. DMSA sees itself as an advocate for consumers, private customers and intelligent investors. The claim: to always look at companies and providers, products and services through the eyes of the customers. The customers are the focus of DMSA's work. For them, important and decision-relevant information is bundled and presented as market screenings. The aim is to create more transparency for consumers when selecting products, investments and services.

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