

The Causes and Countermeasures of Evergrande Group's Debt Crisis

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ABSTRACT: *In the context of the epidemic economy, with the influence of the country's macro-control on finance and the biased development strategy of enterprises themselves, my country's listed companies are frequently warned and threatened by financial crises, and the real estate industry has financial industry. Under the operation of capital, the real estate industry is prone to speculative behavior; and with the inherent characteristics of high inventory, high debt, and high leverage, debt risks are common in this industry. As a representative enterprise with high leverage, Evergrande Group has recently fallen into a great debt crisis. This article will analyze its debt status and the company's financial status by analyzing the debt components and financial indicators of Evergrande Group. The current situation of the crisis provides solutions, which can serve as a warning and reference for my country's high-leverage and high-debt enterprises.*

KEYWORDS-*Liquidity risk, Debt crisis, Debt default.*

I. INTRODUCTION

The introduction of the paper should explain the nature of the problem, previous work, purpose, and the contribution of the paper. The contents of each section may be provided to understand easily about the paper. As one of the largest real estate companies in China, Evergrande Group officially announced that it would default on its debts on December 3, 2021. On December 7, it received a request from creditors (mainly overseas funders) to fulfill a guarantee of US\$260 million. The notice of obligation, on December 9, was rated by Fitch Ratings [Fitch International has been rated as the world's best rating agency in the survey report of the internationally renowned research agency Cantwell & Co for two consecutive years, and its financial institution rating business volume is the highest in the world. Second to none.] declared as a "limited default", the debt default event is large in amount and has a wide range of influence, which has attracted the attention of the entire industry and the country. According to the statistics of Evergrande Group's semi-annual report in 2021, the total liabilities of Evergrande Group have reached 1.97 trillion yuan, and its liabilities are mainly current liabilities. Because Evergrande Group is a capital-intensive enterprise, it has high capital requirements and low cash flow. There are a lot of current liabilities. When there are obstacles in the capital chain, it is difficult to realize the liquidity in time, and the liquidity problem is obvious. Once the company declares bankruptcy, the debt of 2 trillion yuan will become bad debts, and the lack of a large amount of cash flow will lead to the separation and collapse of the entire industry and even the financial industry. Therefore, it is urgent to solve the debt problem of Evergrande Group. At present, the Evergrande Group is gradually resuming the work process, but there are still many places that have not resumed work and production, and the wealth management products have not been paid in time, and the risk of bankruptcy and reorganization of the group still exists.

With the deployment of five ministries and commissions to reduce leverage in 2018: Accelerate the strategy of promoting the debt disposal of "zombie companies", and with the "three red lines" [the three red lines in real estate refer to the three clearer regulatory authorities tightening financing for housing enterprises Standard, which calls for controlling the growth of interest-bearing debt in the real estate industry, and sets three red lines. Among them, the "three red lines" policies for housing enterprise financing are: first: the asset-liability ratio after excluding advance receipts is greater than 70%; second, the net debt ratio is greater than 100%; second, the cash short-term debt ratio is less than 1.0 times. As a result, companies can no longer hold interest-bearing bonds. Real estate companies can no longer meet their own business development through high debt, and can only carry out business refinement operations through their own reasonable cash flow and good corporate internal control.

This article starts with the analysis of the business composition of Evergrande Group and the company's management philosophy, and analyzes its debt components; and the reasons for the formation of high debt; through the analysis of financial data, it explores why it is insolvent, and proposes solutions for the current debt status. measure.

II. Concept Definition and the Default Process of Evergrande Group

2.1 Concept Definition

2.2.1 Debt crisis

The debt crisis discussed in this paper mainly refers to a form of financial crisis that occurs in the process of production and operation of an enterprise. The debt crisis of an enterprise generally refers to the failure of an enterprise due to some unreasonable financing strategy choices in the process of daily operation and development. The scale of the debt is too large and exceeds its own solvency. The most common reason is mainly due to the excessive use of leverage by the company, which increases the company's debt, resulting in insolvency, resulting in broken capital chains, debt defaults, and operational difficulties. The debt default problem of Evergrande Group is mainly due to its own liquidity. Poor performance, too little cash flow, too large current liabilities, and debts that cannot be repaid in time.

2.2.2 Debt default

Debt breach of contract means that the debtor fails to repay the debt in accordance with the express provisions of the contract and fails to repay the amount stipulated in the contract on time. According to the standards of the three major international rating agencies, as long as one of the following three situations occurs, it will be determined as a default of debt: first, the debtor fails to repay the principal and interest in a timely manner in accordance with the express terms of the contract; second, the debtor declares bankruptcy Liquidation or taking over, the third is when the company announces asset reorganization and other forms, which damage the interests of creditors. Evergrande Group announced that it could not repay its creditors' debts in time, which constituted a default of debt, and the commercial paper that belonged to it defaulted.

2.2.3 Liquidity risk

Liquidity risk refers to the risk that a company cannot realize assets at a reasonable price or obtain sufficient funds in a timely manner at a reasonable cost to cope with the growth of assets or pay due debts, which may impair its solvency. It has the characteristics of strong sex and fast dissemination.

2.2 The Default Process of Evergrande Group

In July 2020, Evergrande Group's stock price continued to fall, and industries such as football, automobiles, and purified water also suffered losses in successive years. The progressive liabilities and the inability to repay short-term liabilities caused the company's overall financial risks to surge, coupled with stricter real estate control policies, the operating performance of Evergrande Group has continued to decline. Evergrande's total liabilities are as high as 1.97 trillion yuan, of which current liabilities are 1.57 trillion yuan, accounting for the majority. Overdue accounts payable is 95 million, overdue borrowings and interest are about 20 million, in addition to a large number of overdue contract liabilities and derivative financial liabilities. China Guangfa Bank applied to freeze Evergrande's assets. Fitch, China Chengxin, Standard & Poor's and other credit rating agencies downgraded Evergrande's credit with a negative outlook. Due to the downgrade of Evergrande's credit by many credit rating agencies, a large amount of subsequent liabilities will be incurred. Due to corporate reputation issues, it expires ahead of schedule. Relying on the profit of its own business alone cannot meet the purpose of corporate profitability. Debt default not only requires high liquidated damages, but also seriously affects subsequent normal business operations.

III. Analysis of the Causes of Debt Crisis

The debt of Evergrande Group mainly comes from the high current liabilities and the extremely high short-term cash debt ratio caused by the lack of cash flow of its own enterprises, thus stepping on the three red lines stipulated by the government, resulting in the lack of capital-intensive enterprises. With the support of interest liabilities, the capital chain is broken, and subsequent sales collection cannot be carried out, and it falls into a vicious circle.

3.1 Deterioration of cash flow

From the 2021 semi-annual report, it can be seen that the three continuous cash flows of Evergrande Group are all negative and Evergrande Group also holds a high amount of current liabilities, which needs to be approved in a short period of time. Repayment of debts in the form of realised assets or cash and cash equivalents. The negative net cash flow will increase the liquidity risk of Evergrande Group, making it difficult to repay current liabilities in a timely manner. Debt defaults will occur frequently, which will cause damage to its own daily operation and investment. impact and increase the severity of the debt crisis.

3.2 The real estate industry is determined by its own characteristics

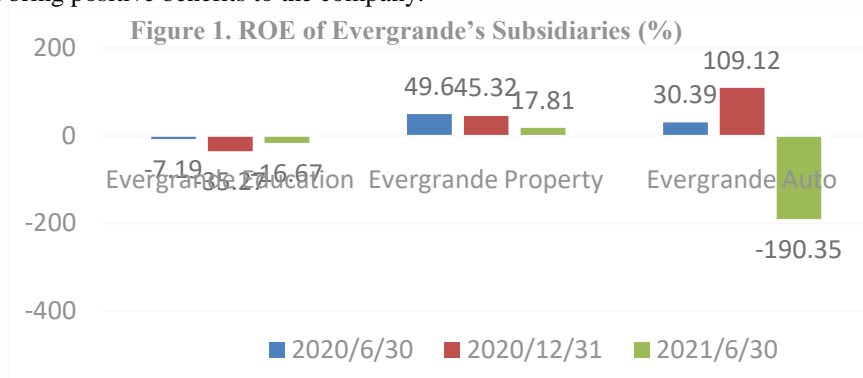
The real estate industry is a capital-intensive enterprise with a large demand for capital and a long occupation period. To develop, it is necessary to adopt a high-leverage model to leverage more income. Moreover, the real estate industry, the main business of Evergrande, is greatly affected by the policy. When the industry rules change, it will have a great impact on the enterprise. Through the previously relaxed financial

policies and the aggressive high-leverage model, Evergrande has expanded corporate debt and raised the scale of the enterprise has become one of the top real estate companies in China. Nowadays, the policy is gradually tightened, the debt threshold is raised, the high-leverage model cannot be applied, and Evergrande has stepped on the three red lines. Also, due to the long repayment cycle of selling houses, the method of repaying old debts by borrowing new money cannot take effect. The operating model has become a hindrance to development.

3.3 Diversified industry investment is too aggressive

3.3.1 Diversified industrial layout is not suitable

In addition to its own main business of real estate, Evergrande Group has also opened up many peripheral industries since 2007, all of which belong to centrifugal diversified industries, also known as non-related industries. The layout is reasonable, and new profit growth points can be obtained to reduce The impact of changes in the main business, and Evergrande's diversified industries did not bring more benefits to the company, but aggravated the burden of corporate debt. For example, Evergrande Bingquan, which has been reducing prices a few years ago, lost more than one billion yuan. In recent years, the automobile industry involved in the whole year has lost more than 7 billion yuan in 2020. Most of the various industries that Evergrande invests in are poorly correlated and cannot form a scale. It is a new field that has not been explored by the company, and the investment scale is large and the cycle is long, so it is impossible to quickly gather funds. Evergrande's diversified industrial layout is not clear, and the selected fields are mostly those that it is not good at, and cannot bring positive benefits to the company.

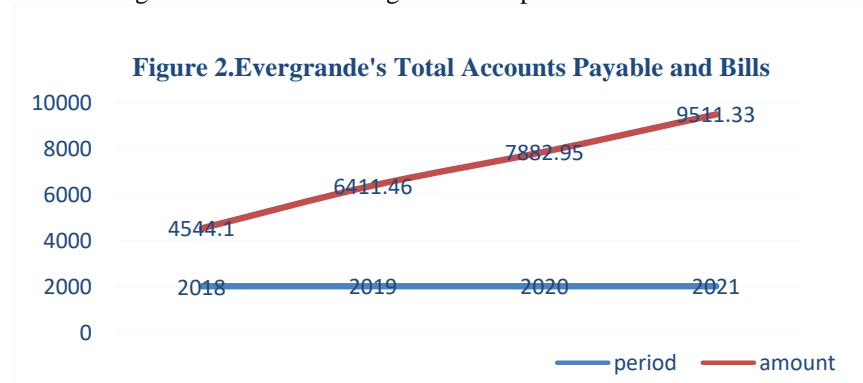


3.3.2 The scale of diversified investment is too large and the incubation process is too fast.

Evergrande Real Estate has borrowed a lot to develop diversified industries. For example, the cumulative investment in new energy vehicles exceeds 100 billion yuan, but it has been losing money year after year. It has not yet formed mass production, and because it enters an unfamiliar field, there are often mistakes in the investment process, in order to quickly achieve profitability. The purpose is to swallow the dates. For example, Evergrande Bingquan's new product was launched after only three months from research and development to its launch, but the results were not satisfactory. In 2016, it announced the sale of the mineral water business. It can be seen from the figure 1 that the return on equity of most diversified industries has been declining year by year, and some industries have even turned positive to negative.

3.4 Large increase in non-interest-bearing liabilities

Although Evergrande Group has stepped on the three red lines in the middle, it has made it more difficult to borrow interest-bearing debt, but the proportion of interest-free debt has increased year by year, so the debt is still high. The funds occupied upstream and downstream, including employee salaries payable, taxes payable, bills payable, accounts payable, etc., among which Evergrande Group's commercial bill liabilities are extremely large, which has brought a fatal blow to Evergrande Group.



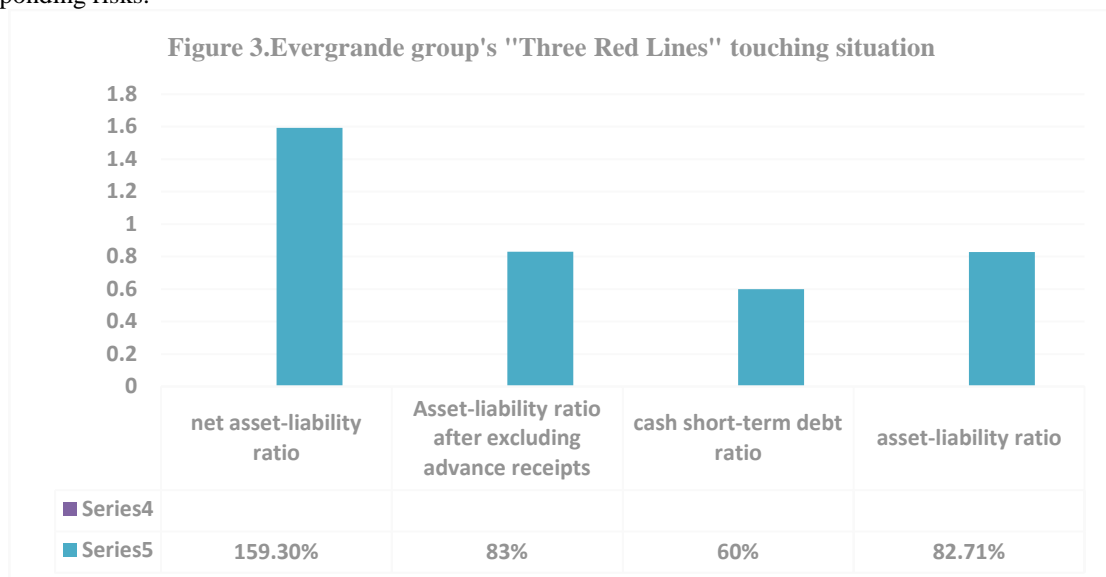
Commercial bills generally refer to commercial acceptance bills, which are unsecured short-term bills issued by commercial entities and based on commercial credit. Since commercial paper is included in notes payable in the balance sheet, it is reflected as a non-interest bearing liability.

Due to the restrictions of national policies, Evergrande Group has greatly reduced its own interest-bearing liabilities. However, due to the strong strength of Evergrande Group, cooperation with many upstream suppliers, and high bargaining power, it has increased the proportion of bills payable to meet the needs of the enterprise capital chain. Therefore, although interest-bearing liabilities have declined, the overall debt has not decreased but increased. The change in the debt structure has not reduced the company's debt default risk and asset-liability ratio, which has increased the pressure on suppliers and builders.

It can be seen from the figure 2 that the amount of bills payable by Evergrande Group has increased year by year, reaching 951.133 billion yuan on June 1, 2021, accounting for half of the current liabilities of the year. The "Interim Measures for the Administration of Acceptance, Discounting and Rediscounting of Commercial Bills" has been revised, and it is proposed that the payment period of commercial bills shall not exceed 6 months from the date of issue to the due date, so it is imminent to solve the crisis of bill exchange. Become the top priority of Evergrande Group.

3.5 Unreasonable capital structure

Capital structure is the proportional relationship between assets and liabilities in the total capital of an enterprise, which determines the future growth ability of an enterprise. Although the real estate industry is a capital-intensive enterprise, operating under a high-leverage business model can bring higher benefits, while Evergrande's own product circulation cycle is slow, the initial investment cost is high, and a large amount of debt is a necessary choice for the real estate industry, but it is too high. The debt ratio will obviously create corresponding risks.



In 2017, Evergrande also experienced a strategic transformation. In accordance with national requirements, it changed from the previous strategy of high leverage, high debt, high turnover and low risk to three high and one low strategy with low debt, low cost, low leverage and high turnover. The strategy of three lows and one high has indeed caused a slight decrease in the asset-liability ratio for a period of time, but due to the characteristics of the real estate industry, it can only choose to increase leverage to maintain the normal operation of the enterprise, and due to the management's aggressive target strategy, Implementing the goal of diversifying industries makes the asset-liability ratio of the company far higher than the industry standard value.

It can be seen from the table that the 21-year asset-liability ratio of Evergrande Group is as high as 83%, and the net debt ratio is as high as 159.3%. The net debt ratio is also called the net borrowing ratio. The high net debt ratio of Evergrande Group is mainly due to its high interest-bearing liabilities aggravate the liquidity problems of enterprises and increase the debt risks of enterprises.

IV. Countermeasures to the Debt Crisis

The debt of Evergrande Group is as high as 2 trillion yuan. If it is not dealt with in time, it will not only affect the relevant investors of the enterprise, but also cause a serious blow to the whole society and even the country. This article mainly proposes countermeasures for the current situation of Evergrande Group's debt.

Advice on flawed strategies such as lack of cash flow biased positioning of diversified industries, and unreasonably high leverage to reduce the impact of the crisis.

4.1 Maintain stable cash flow to deal with liquidity risks

As an enterprise whose main business is real estate, Evergrande Group has a long cycle from development to sales, and it is difficult to realize it in time. Under the circumstance of unstable cash flow, if the company's inventory cash flow is too small, when dealing with short-term debt problems, it will have liquidity problems, and Evergrande Group has narrowed its financing channels and raised the threshold due to the debt default problem. It cannot make timely loans or obtain income to solve the liquidity problem. Therefore, the control of cash flow becomes more important. Therefore, it is necessary to strengthen the review and supervision system of cash flow, and reasonably plan the inflow and outflow of each cash flow, so that cash flow activities and operating activities can be balanced.

As one of the main debt repayment methods of Evergrande Group, due to the impact of negative news, there has been a crisis of confidence among consumers. Evergrande's home buyers continued to decline, cash flow also decreased, and debt solvency decreased accordingly.

4.2 Accurately locate diversified industries and focus on main business

Throughout the development history of the company, it can be seen that the investment process of Evergrande Group's diversified industries has been bumpy and arduous, and many industries have ended in failure and sell-off. It is true that diversified industries can increase the company's new profit growth opportunities and avoid the company's core business. There is a risk of loss, but due to the unclear market positioning of the product and the inappropriate management methods of the company, it will also hit the core industry of the company and cause serious economic losses. Evergrande Group has done a good job in the real estate industry. At the same time, when considering diversified industries, attention should be paid to selecting industries that are closely related to the industry, which can form scale effects, and because of the low entry threshold, it can greatly reduce costs, obtain new profits, and avoid centrifugal diversified industrial layout. While developing diversified industries, it can better take into account the development of core industries, and form a situation in which the wealth is driven by the wealth first. The reduction of investment in unfamiliar industries can greatly improve the efficiency of investment, reduce the range of debt volatility, and reduce the risk of debt default.

4.3 Alleviating financial crisis by selling assets

Evergrande Group is currently in a serious debt crisis, with poor liquidity and slow sales receipts. It needs to obtain cash flow through unconventional forms such as selling its own fixed assets to deal with the risk of short-term debt maturity. For example, on November 25, 2021, Xu Jiayin He and his wife Ding Yumei sold a total of 2.4 billion shares of China Evergrande to deal with the upcoming debt maturity situation. Due to the extraordinary period, the sale of their own stocks and land is imminent. Only by reducing the value of the company itself can it be exchanged for the survival of the company.

4.4 Recognize the industry situation and improve the ability to dynamically respond to risks

The adjustment of the national macro policy will greatly change the business mode of the company. For real estate companies, the state has formulated many rules and measures. Evergrande Group should always pay attention to the changes in the political and economic environment, and adjust the management strategy with the idea of contingency. For example, Evergrande Group has touched the "three red lines" policy set up by the Ministry of Housing and Urban-Rural Development and the People's Bank of China, which has aggravated the deterioration of the debt crisis. Therefore, enterprises should pay attention to collecting external information, adjust internal control simultaneously, and reduce the risk of debt default.

4.5 Negotiate with creditors to reach a debt restructuring plan

Debt restructuring is a matter in which the creditor makes concessions in accordance with the agreement reached with the debtor or the court's ruling when the debtor is in financial difficulty. Evergrande Group's debt has reached 1.95 trillion yuan, and it cannot repay the debt through normal operations. Although Evergrande Group is gradually resuming work on many projects, there are still many lands in the state of development, which can be repaid with non-cash assets, transfer excess land to reduce corporate debt stress and the risk of bankruptcy, or reduce default risk by negotiating with creditors to convert debt into corporate capital.

4.6 Improve capital chain management, promote the progress of sales and payment collection

The capital chain refers to the basic circulating capital chain required to maintain the normal production and operation of the enterprise. The cycle of cash-assets-cash (value-added) is the process of enterprise operation. To maintain the operation of the enterprise, it must maintain the benign and continuous operation of this cycle. However, since Evergrande is a real estate company, buyers usually choose to take out loans to buy houses in instalments, so there will be a large amount of accounts receivable on the company's

books, and Evergrande, as a real estate company, usually chooses a high-leverage management method, so it will pass High debt is used to obtain more investment funds. When accounts receivable and accounts payable increase, inventory cash flow will decrease, liquidity risk will increase, and it will easily lead to the rupture of the capital chain. Nowadays, many industries of Evergrande Group have stopped working. If production is suspended, it is necessary to resume work and production as soon as possible, and maintain stable cash flow through sales receipts to deal with the risk of debt crisis brought about by liquidity problems. According to statistics, after 2021, Evergrande's promotion efforts will be intensified again, and a few local real estate projects will use 30% off sales to solve the debt crisis. As the severity of the debt crisis continues to increase, price reduction sales have become the only way.

V. CONCLUSION

Evergrande currently has a total debt of about 2 trillion yuan, and its cash flow is on the verge of breaking. If the company does not solve the debt problem in time, it may declare bankruptcy due to further deterioration of its operating conditions. The lack of two trillion cash flow is very likely to cause systemic financial and social risks, which will lead to a Great Depression in the real estate industry and earth-shaking changes in the entire financial industry. The internal management of Evergrande Group needs to make a reasonable plan to get through this crisis. The government should also increase policy support, properly handle the debt risks of Evergrande Group and other real estate companies, and prevent this incident from affecting the entire social ecology.

In the follow-up development strategy of Evergrande Group, the economic development should mainly focus on reducing debt and deleveraging, and greatly reducing the amount of current liabilities, keeping the ratio of cash to short-term debt at a high position, and in business development. On the one hand, resume work and production as soon as possible, restore corporate reputation, and try to establish good communication with upstream and downstream companies, maintain stickiness with customers, properly handle a large number of bills payable, and avoid aggravating the harm of debt default. In line with the policies stipulated by the state, establish a dynamic management concept with the outside world, rectify the internal corruption of the enterprise, transform the development structure of the enterprise, and move towards a refined operation and development model.

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