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Ever higher

On Monday, shares of the world's most encumbered and possibly most astounding property developer leapt by 23% in Hong Kong trading, bringing the year's gain to 215% and leaving envious bitcoin bulls to wonder why they chose to back such a losing laggard as the invisible digital currency.

China Evergrande Group is just about the most of everything, including the world's most painful short within the universe of companies commanding a market value of $1 billion or more and boasting a short interest of at least 10% (so relates Bloomberg, citing Markit). Some 20.7% of the Evergrande free float is sold short.

For the sellers, it's been a nightmare. The stock costs an arm and a leg to borrow, and then you wish you hadn't borrowed it—had never even heard the name—because the price only goes up. Then, again, many a lucrative bearish journey begins in exasperation.

We call the attention of the readers of *Grant's* to this situation because, in the first place, everything about Evergrande is incredible (the board of directors in 2016 earned $46.5 million, J.P. Morgan reports), and, secondly, because we suspect that the company name will one day become proverbial, like "Bank of United States" or "Hindenburg."

Corporate performance, as conventionally measured, can't easily explain the levitation: In fiscal 2017, Evergrande is expected to earn 11.2 billion renminbi on revenue of RMB 268 billion. Nor does valuation seem the obvious catalyst: At 36 times trailing net income, the shares are twice as expensive as those of a pair of comps, which themselves are fast-rising, Country Garden Holdings Co. and Sunac China Holdings Ltd.

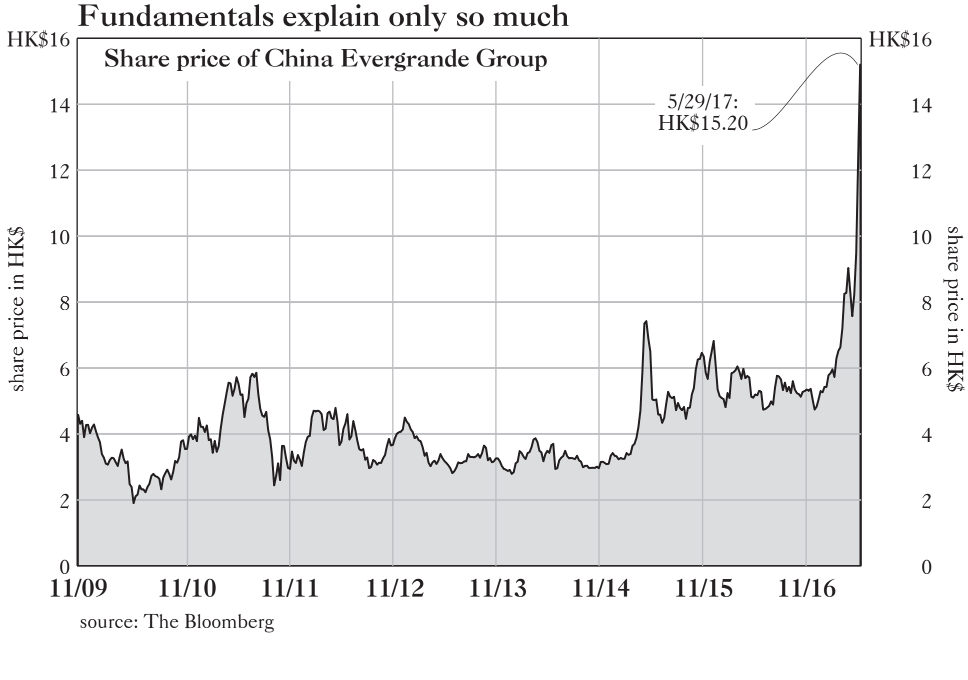
The most persuasive explanations for the ferocious updraft in Hong Kong ticker No. 3333 have little to do with securities analysis. They include aggressive, debt-financed share repurchases, a timely "overweight" recommendation from Morgan Stanley and the hope of a relisting of the Evergrande property subsidiary in Shenzhen. The switch in trading venue will catalyze a one-time price surge to close the prevailing gap between the (relatively low) Hong Kong price and the (prospectively high) Shenzhen one, or so the thinking goes. A titanic short squeeze has likewise powered the surge, though that commonplace observation leaves unanswered the question: What possessed the bears to sell the shares in the first place? And a more fundamental question: What does this company do for a living?

Evergrande buys land and builds apartments—800,000 units are under development. Its specialty is sprawling, elaborate residential communities on the outskirts of Chinese cities, though if "communities" connotes inhabitants, it is not quite the right word.

Evergrande does more than build mini-cities. It owns a soccer club and a plastic-surgery hospital. It holds interests in bottled water, vegetable oil, life insurance, grain, health, financial services, entertainment, media, milk and such.

Evergrande wheels and deals. It pays its suppliers (some of them, some of the time) in its own stock. It creates and distributes "wealth-management products," by which the yield-starved Chinese saver speculates. "A typical

Fundamentals explain only so much



source: The Bloomberg

[WMP]," says Anne Stevenson-Yang, co-founder of J Capital Research and the guest on the current *Grant's* podcast (just visit our website —*advt.*), "would be Evergrande Real Estate Superior Debt No. 1 Dedicated Trust Plan Phase 8, issued by Industrial Bank, issued to Inner Mongolia Luqiao Real Estate (an Evergrande affiliate) and secured by land holdings of that company. The 'private equity funds' are even more liberal and exciting names like Shandong Highway Xinye City Development Share Investment Management Co. Ltd. Jinan Evergrande Dedicated Fund. There is a whole lot of debt in China that calls itself equity."

For a harrowing look inside Evergrande, please treat yourself to the new J Capital report (visit www.GrantsPub.com/EvergrandeReport; still another *advt.*). Stevenson-Yang, by whose courtesy we post the analysis, gets right down to business. "Evergrande," she writes, "is . . . arguably the biggest pyramid scheme the world has yet seen. Servicing the company's mountainous debt requires constant new borrowings, and those loans in turn require that the growth continue."

Evergrande, Stevenson-Yang contends, is built on a simple misconception: the idea that apartments build and preserve wealth, no matter what (if anything) they may yield. It is not a uniquely Chinese fallacy. On a flying inspection of the Texas real estate bubble in the late 1980s in the company of Frederick E. "Shad" Rowe, your editor heard it from the developers themselves. "Real estate," they would say, "isn't a cash-flow business, it's an asset-appreciation business." It's an asset-appreciation business until you can't service the debt.

"Evergrande's debt," Stevenson-Yang proceeds, "ultimately relies upon the belief that its physical plant has value. No company has more masterfully maintained the illusion that these properties are reliable stores for the people's savings. Few of the properties fill up, and many have already visibly deteriorated, but nominally rising prices even where there is no secondary market uphold the scaffolding of the dream."

In Stevenson-Yang's telling, the chairman of Evergrande, Hui Ka Yan, resembles Jeff Bezos and a pair of Elon Musks. He doesn't just build half-empty apartment towers, but rather half-empty "grand constellations of towers, villas, exhibition centers, stores, hotels and restaurants that can accommodate 65,000 at a single site."

As for the finances: "The company has had negative free cash flow since 2006. In addition to massive on-balance-sheet debt, the company has partnerships, third-party guarantees, ballooning presales, forced loans from construction companies to which it owes money and myriad other hidden means of obtaining the ever-widening flows of cash needed to meet maturities of current debt. It is a company that would send most financial managers running for their blood pressure pills."

The on-balance-sheet liabilities of RMB 1.16 trillion may or may not be the least of it, but it is the least interesting part of it: "Off balance sheet, there are hundreds of billions more. Dozens of banks, trusts and private equities aggregate funds for Evergrande at rates as high as 15% and terms as short as three months."

Not just anything puts bitcoin in the shade.

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