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XIN - Q1 2008 Xinyuan Real Estate Co., Ltd. Earnings Conference Call

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## CORPORATE PARTICIPANTS

**Lisa Wang** *Xinyuan Real Estate Co., Ltd. - IR Director*

**Yong Zhang** *Xinyuan Real Estate Co., Ltd. - Chairman, CEO*

**Longgen Zhang** *Xinyuan Real Estate Co., Ltd. - CFO*

## CONFERENCE CALL PARTICIPANTS

**Michael Rosenthal** *QVT Financial - Analyst*

## PRESENTATION

**Lisa Wang** - *Xinyuan Real Estate Co., Ltd. - IR Director*

Hello, everyone, and welcome to Xinyuan's First Quarter 2008 Earnings Conference Call. The Company's first quarter earnings results were released earlier today and are available on the Company's investor relations website at [ir.xyre.com](http://ir.xyre.com) as well as on newswire services. You can also download a short presentation regarding today's earnings results on our website.

Today you will hear from Mr. Yong Zhang, our Chairman and Chief Executive Officer, who will discuss the business highlights for the first quarter of 2008 and the overall market conditions in the real estate industry in association with our guidance for 2008. In addition, Mr. Zhang will provide an update to the situation in Chengdu following the earthquake on May 12.

He will be followed by Mr. Longgen Zhang, our Chief Financial Officer, who will go over the Company's financial results. Following management's prepared remarks, we will open the call to questions. Before we continue, please note that the discussion today will contain forward-looking statements made under the Safe Harbor provision of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements involve inherent risk and uncertainties. As such, our results will be materially different from the views expressed today. Further information regarding this and other risks and uncertainties is included in our registration statement on Form F-1 and other documents filed with the U.S. Securities and Exchange Commission.

Xinyuan does not assume any obligations to update any forward-looking statements except as required under applicable law. I will now turn the call over to Xinyuan's Chairman and CEO, Mr. Yong Zhang. Mr. Zhang will be speaking in Mandarin and his comments will then be translated into English. Please take note that unless otherwise stated, all figures mentioned during this conference call are in U.S. dollars. Please go ahead, Mr. Zhang.

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**Yong Zhang** - *Xinyuan Real Estate Co., Ltd. - Chairman, CEO*

(interpreted) Hello everyone, and thank you for joining Xinyuan's first quarter 2008 earnings conference call. In our earnings release issued earlier today, we announced very good results for the first quarter of 2008. Total revenue for the quarter was \$125 million, an increase of 447% from the same quarter of 2007. Net income for the quarter was \$33 million, representing a 380% increase from the same quarter of the prior year.

We are pleased with the successful execution of our expansion plan into other Tier-II cities and the main contributors to our strong growth in revenue and net income during the quarter were sales from new developments outside of Zhengzhou. Total sales from Suzhou, Jinan and Hefei accounted for over 90% of total sales during the first quarter, representing 43%, 34%, and 15% of total sales, respectively.

In the first quarter, we launched the Suzhou International City Garden Project, which consists of 1,678 units with a total developable GFA of over 200,000 square meters. And we completed the construction on a combined total, of approximately, 115,000 square meters of GFA in our Jinan Elegant Scenery and the Suzhou Lake Splendid Project.



As of March 31st 2008, we had 14 completed projects, 8 projects under construction, with a total developable GFA of around 1.2 million square meters, and an additional 5 projects under planning with a total developable GFA of around 1.2 million square meters.

During the first quarter, we continued to rely on our standardized and scalable business model and emphasize the rapid asset turnover and the strict cost control to deliver results. We also concentrated our effort on strengthening our local subsidiaries and increasing our understanding of local markets. And our first quarter achievements are a reflection of this success.

In today's earnings release, we also provided full year guidance for 2008. Our CFO will explain our guidance to you in greater detail in a moment. However, I would first like to take a few minutes to discuss the overall market conditions within the real estate industry and the effects that governmental policy changes will have on our business and outlook for the remainder of the year.

As many of you are probably familiar by now, the real estate sector in China has enjoyed very rapid growth over the past couple of years and is considered at a risk of overheating by the Chinese government, especially in first tier cities. Aimed at cooling down the market, the government has recently introduced several new policy tightening measures, such as tightening the supply of credit and increasing the down payment for second-home buyers.

It also strengthened the enforcement of previously enacted measures such as reclaiming idle land not developed within two years and levying land appreciating taxes. The policy changes have created a degree of uncertainty within the market, affecting both buyer demand and the amount of credit available to developers. To date, the effects of these changes have been more pronounced in Tier I cities.

While Xinyuan's focus on Tier II cities and unique business model dedicated to quick asset turnover and no idle land bank has been an advantage compared to many of our peers. The decrease in the sales velocity and tightened credit supply, along with higher raw material costs, may affect our business results this year. However, we firmly believe that the effects of the regulatory controls on the industry will not change the strong long-term housing demand in Tier-Two cities in China.

Because the strong housing demand is fundamentally supported by China's continued economic growth and urbanization process, along with an increasing population of middle income households who are our targeted consumers. We are confident that the foundation for long-term growth remains secure and that Xinyuan will continue to benefit from strong demand and maintain fast growth in the next five to ten years.

In terms of land acquisition, although we did not purchase any new land in the first quarter of 2008, we continued to research potential cities and the land acquisition targets that match our business expansion plans. We remain cautious with our land acquisition strategy given the uncertainties of the market. We plan to review our land acquisition strategy by the end of June based on the progress of sales, available credit, and the overall market conditions.

In line with our overall business strategy, our current land bank can sustain 1.5 to 2 years of future development, giving us the flexibility to remain disciplined in our land acquisition strategy and allowing us to only purchase land that meets specified investment criteria. Going forward, we will continue to execute our proven business strategy and our extensive experience and successful track record provide a good foundation for future expansion.

Lastly, on behalf of everyone at Xinyuan, I would like to express our sincere condolences to all of the Sichuan earthquake victims and their relatives. As we announced recently, Xinyuan and its employees have made cash donations totaling over 2.3 million renminbi. With the donations, a Xinyuan Hope School will be built in the earthquake area. In addition to the cash donations, many of our employees in Chengdu have volunteered to help transport food items and shelter materials to the victims.

As previously mentioned, there was no damage to Xinyuan's two development projects in Chengdu. While certain delays are expected as a result of the earthquake, we are very happy to report that construction of Chengdu Xinyuan Splendid One has resumed after the development passed the government's earthquake safety inspections. The earthquake will have an effect on buyer demand in the short term, but it is too early to predict the extent to which it will be felt. Because Chengdu is the provincial capital and is away from the epicenter of the earthquake, there is a possibility that the sales could recover faster than expected.



We would also like to mention that the construction and design of our two Chengdu projects are in full compliance with the government's safety and quality standards. Our phase one project was designed and is being reinforced during construction with anti-seismic steel reinforced concrete walls built to withstand earthquakes of up to magnitude 8.0. This design structure will also be used in the Chengdu Xinyuan Splendid Phase II project.

With that, I will now turn the call over to Xinyuan's CFO, Mr. Longgen Zhang, who will give us an overview of the financial highlights for the first quarter of 2008. Longgen, please go ahead.

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**Longgen Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

Thank you, Mr. Zhang. Hello, everyone, and thank you for listening in on our call today. As a reminder, all of the following numbers are stated in U.S. dollars. Please note that certain figures we will talk about are non-U.S. GAAP, including all measures that are given excluding share-based compensation expenses. You can find a reconciliation of these figures in the financial tables at the end of our press release.

Though typically first quarter and the fourth quarter are the slowest seasons in the real estate industry, I am pleased to report that Xinyuan posted strong growth in the first quarter 2008 with significant increases in total revenues and net income.

Total revenues for the first quarter of 2008 were \$125.1 million, an increase of 36.9% from \$91.4 million for the fourth quarter of 2007, and 447% from \$22.9 million for the same period in 2007. The quarter over quarter increase in revenue was primarily due to increased revenue of \$54.8 million from Jinan International City Garden, Suzhou Lake Splendid and Suzhou Colorful Garden compared to the fourth quarter of 2007. The year-over-year increase in revenue was mainly attributable to additional revenue from seven new property developments with sales in the first quarter of 2008, including Suzhou Lake Splendid, Suzhou International City Garden, Anhui Wangjiang Garden, Suzhou Colorful Garden, Jinan Elegant Scenery, Zhengzhou Commercial Plaza and Jinan City Family.

Gross profit for the first quarter of 2008 was \$36.6 million compared to \$12.7 million and \$30.3 million for the first and the fourth quarters of 2007, respectively. The gross margin percentage for the first quarter of 2008 was 29.2%, compared to 55.3% and 33.1% for the first and fourth quarters of 2007 respectively. The quarter-over-quarter decrease in gross margin percentage was mainly because the fourth quarter of 2007 included a favorable adjustment of approximately \$3 million to the cost of revenue, resulting from a change in management's estimate of future revenue after reviewing actual marketing conditions. The year-over-year decrease in gross margin percentage was attributed to the first quarter 2007 sales of Zhengzhou Central Garden West and Zhengzhou Central Garden East, which generated higher gross margins due to lower land acquisition costs and construction costs.

Selling, general, and administrative expenses amounted to \$10.9 million for the first quarter of 2008, a decrease from \$13.9 million for the fourth quarter of 2007 and a substantial increase from \$2.9 million for the same period in 2007. The quarter-over-quarter decrease was primarily attributable to decreased selling and marketing activities in the first quarter of 2008, due to cold weather and the public holidays during the period as compared to the fourth quarter of 2007. The year-over-year increase in total selling, general, and administrative expenses was due to increased selling and marketing expenses to promote new projects, salaries, and other expenses associated with the addition of new employees, stock-based compensation amortization and professional fees.

Operating margin for the quarter was 20.5% compared to 42.6% in the corresponding period of 2007 and 17.9% for the fourth quarter of 2007. Excluding share-based compensation expenses, non-U.S. GAAP operating margin for the quarter was 23.1% compared to 42.6% in the corresponding period of prior year and 22.9% of the fourth quarter in 2007.

Change in fair value of derivative liabilities.

In the first quarter of 2008, the Company recognized a gain of \$11.3 million, arising from decrease in fair value of the warrants issued with floating rate notes, compared to expenses of \$2.4 million arising from increase in fair value of the warrants in the fourth quarter of 2007.

Net income for the first quarter of 2008 was \$33 million, an increase of 379.9% from \$6.9 million for the same period in 2007 and of 302.4% from \$8.2 million for the fourth quarter 2007.

Basic and diluted earnings per share amounted to \$0.22 and \$0.13 respectively, and basic and diluted earnings per ADS amounted to \$0.44 and \$0.26 respectively. Each ADS represents two ordinary shares.

Now I would like to move to guidance. As Mr. Zhang mentioned earlier, the biggest factors affecting our outlook for 2008 are lower demand and tightened credit. As you may recall, last quarter, we discussed the overall business environment and the way in which credit tightening measures may impact our future results. At the time, it was difficult to predict the effect these measures would have on the industry, and as a result, on our business operations. While there is still a degree of uncertainty and while the government maintains its control on credit lending, we feel that prices will remain relatively stable in Tier II cities and we believe that our healthy balance sheet and current cash flow position will provide us with future opportunities for growth going forward.

Because of this, we expect our total revenues for 2008 to be in the range of \$550 million to \$630 million, representing a year-over-year growth in the range of approximately 77% to 103% respectively. In addition, 2008 net income is anticipated to be between \$60 million and \$70 million, representing year-over-year growth of approximately 31% to 53%, respectively. At this time, we are happy to take your questions. Operator, please proceed.

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## QUESTIONS AND ANSWERS

### Operator

(OPERATOR INSTRUCTIONS). Your first question comes from the line of Michael Rosenthal with QVT. Please proceed.

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**Michael Rosenthal** - *QVT Financial - Analyst*

Good evening. Hello.

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**Longgen Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

Good evening.

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**Michael Rosenthal** - *QVT Financial - Analyst*

I wonder if you could describe the, I guess, the pace of sales and some of the pricing you're seeing in the various projects.

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**Longgen Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

Good evening, Michael. This time may be in the morning. Okay. We have the figures for the first quarter. Our average selling price is \$5,643 and to compare the renminbi per square meter and to compare the fourth quarter of 2007, that is \$5,365 renminbi per square meter. So we feel that the first quarter still we achieve a very good quarter. And also the sales price and to compare each city, we see a still slightly increase for each city.

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**Michael Rosenthal** - *QVT Financial - Analyst*

And would you say the pace of take up is consistent with the fourth quarter or has it improved a little bit?

**Longgen Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

We think the first quarter, I think, compared to last year, the fourth quarter, the velocity of sales in some city is slow down. It varies from city to city, but we still see some cities good like Anhui and also in Shandong, Jinan City. But other cities, for example, we see that in Suzhou and also in Chengdu, the velocity of sales is slow down.

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**Michael Rosenthal** - *QVT Financial - Analyst*

That's helpful. My other question relates to your decision to not acquire any land at auction. I guess I've seen a couple of articles saying that a lot of auctions have been cancelled because there's not enough -- there aren't three bidders in attendance. Was that a factor in the auction or not participating in auctions or you just are cautious about the pricing of land and you'd rather wait?

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**Yong Zhang** - *Xinyuan Real Estate Co., Ltd. - Chairman, CEO*

(interpreted) As you know, the credit has been tightened this year and there are uncertainties in the market. So we believe it's more cautious for us to review our land acquisition strategy after the June of this year. The main purpose, and our focus, is to prepare for our growth in the year of 2009 and 2010.

Under Xinyuan's business model, once we have the land, we can start construction within four to six months and within the year, we can get the cash back. So that allows us to be more flexible to cope with uncertainties in the market. So we can, sort of take advantage of a lower land market, which is currently available in China. Like other companies, which has large land banks, they are under pressure to get funding to develop their land. Xinyuan would benefit of our business model. We are having an advantage position and a very flexible position.

But actually, as you may know, the Jian-Xin in which we own 45% of shares has acquired two parcels of land in April. We didn't -- so we did acquire some land, but not as much as everybody expected, I guess.

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**Michael Rosenthal** - *QVT Financial - Analyst*

Okay. Thank you very much.

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**Operator**

(OPERATOR INSTRUCTIONS). Your next question is a follow-up from the line of Michael Rosenthal. Please proceed.

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**Michael Rosenthal** - *QVT Financial - Analyst*

Hi. Sorry. Could I just ask you, I guess, construction costs have gone up, somewhat dramatically, in the last few months. How have you built that into your expectations and do you feel you will be able to pass along those costs?

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**Longgen Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

For the first quarter of this year, our average cost of revenue is 3,900 renminbi per square meters and accounts for the other revenue percentage increase almost 2.6% compared to last quarter. That's due to because material and also the labor costs increase. We believe the increase can be transferred to the selling price and to keep our -- the target gross margin.

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**Michael Rosenthal** - *QVT Financial - Analyst*

Do you feel you're now fully accrued for projects under development for, I guess, the increase in expected costs or some of the products under development, there's going to have to be true ups at the end of the project?

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**Longgen Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

Michael, for the projects under construction, because we outsource our construction to third party, so most of them is already fixed -- total fixed cost, excluding the steel price. We maybe share the steel price increase, but that accounts for the total construction cost is small percentage. So we still think, for example, right now the first quarter and the land, average land cost is around 1,789 renminbi per square meter. The construction cost is around 2,112 yuan per square meters.

For the projects under construction, yes, because we thru the -- outsource, the third party construction, we thru the bidding system. So which one is bid, I think, is the lowest, then also more efficiency. We are going to select the winner. And most of our third party construction company is our long term strategic partnership. So we still think that we can control the construction costs through the outsource our strategic partnership and also concentration purchase. And control our costs. And we believe we still can control that.

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**Michael Rosenthal** - *QVT Financial - Analyst*

Okay. Great. Thank you.

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**Operator**

(OPERATOR INSTRUCTIONS). As there are no further questions in queue at this time, I'd like to turn the presentation over to Longgen Zhang for closing remarks.

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**Longgen Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

Thank you, everyone, for joining us on today's call. Even with the difficulties of the current market, we delivered good results for the first quarter with high year-over-year and quarter-over-quarter increases in revenues and net income. Looking forward, we'll remain optimistic for 2008 as our current land bank can stand 1.5 to two years of development and our financial position is healthy.

Throughout the remainder of 2008, we will continue to focus on strengthening our execution ability and streamlining our cost structure to capitalize on growth opportunities that will be available once the market begins to stabilize. If any of you have any questions, please feel free to contact us at any time. Thank you.

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**Operator**

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Have a great day.

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**Editor**

Portions of this transcript that are noted "interpreted" were interpreted on the conference call by an interpreter present of the live call. The interpreter, Ms. Lisa Wang, was provided by the Company sponsoring this Event.



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