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XIN - Q3 2018 Xinyuan Real Estate Co Ltd Earnings Call

EVENT DATE/TIME: NOVEMBER 13, 2018 / 1:00PM GMT



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CONFERENCE CALL PARTICIPANTS

William Zima *ICR, LLC - Head of Asia Practice*

Matthew Larson

John Sheehy

F. Michael Prouting

George Guo

Herman Tai

PRESENTATION

Operator

Good day, everyone, and welcome to the Xinyuan Real Estate Company Third Quarter 2018 Earnings Conference Call. Please note that today's call is being recorded.

I would now like to turn the conference over to Mr. Bill Zima of ICR. Please go ahead, sir.

William Zima - *ICR, LLC - Head of Asia Practice*

Hello, everyone, and welcome to Xinyuan's Third Quarter 2018 Earnings Conference Call. The company's third quarter earnings results were released earlier today and are available on the company's IR website as well as on Newswire services.

Before we continue, please note that the discussion today will contain forward-looking statements made under the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements involve inherent risks and uncertainties. As such, our results can be materially different from the views expressed today.

Further information regarding these and other risks and uncertainties is included in our registration statement and our Form 20-F and other documents filed with the U.S. Securities and Exchange Commission. Xinyuan does not assume any obligation to update any forward-looking statements, except as required under applicable law.

Today, you will hear from Mr. Lizhou Zhang, the company's Chief Executive Officer, who will comment on our operating results; he will be followed by Mr. Xuefeng Li, the company's Interim Chief Financial Officer, who will provide some additional color on Xinyuan's performance, review the company's financial results and discuss the financial outlook. Following management's prepared remarks, we will open up the call to questions.

Now with that said, I would like to turn the call over to Xinyuan's CEO, Mr. Zhang. Please go ahead.

Lizhou Zhang - *Xinyuan Real Estate Co., Ltd. - CEO & Executive Director*

Thank you, Bill. Good morning, and thank you all for joining our third quarter 2018 earnings conference call. We'll continue to advance the companies on multiple projects while driving positive results for our customers and shareholders even in a challenging environment.



As we reported our earnings release earlier today, we delivered significant increase to boost our top and bottom lines compared to the same period last year. We also made notable improvements to our margins, increasing gross margin to 25.1% and operating margin to 17%.

As we enter into the second half of 2018, global economy has shown sign of softening. Multiple sectors were affected by lower consumer confidence and decreased spending, especially those companies that rely on sales of discretionary items.

As a primary property developer in China, we felt the impact of the slowing economy on our contract sales and the sales prices. However, we were able to ensure our leading position in existing cities to achieve continued growth momentum through, one, our unique project portfolio geared towards non-luxury residential housing for China's growing in middle class; two, our growing in portfolio of active projects that create a meaningful sales pipeline for years to come; and three, our prudent capital supply and allocation plan. We remain focused on our primary strategy of developing domestic real estate projects as overall housing demand trends by Chinese citizens remain relatively consistent.

During the third quarter, we commenced presales of 4 projects, including Changsha Furong Thriving Family, Chengdu Xinyuan City I, Kunshan Xinyu Jiayuan, and Xingyang Splendid IV. We also added to our land bank with the new acquisition of Dalian International Health Technology Town, tapping into the northeast real estate market of China.

Overseas, our projects are progressing as planned and continue to meet their respective development goals. Overall, our ongoing focus of -- enhancing the strength of our core real estate business ensures our ability to achieve positive operating performance.

As we generate profits, we are pleased to deliver value to our shareholders by continuing our quarterly dividends payment program, as announced earlier today.

Now please allow me to turn the call over to our interim CFO, Mr. Xuefeng Li. Xuefeng, please go ahead.

Xuefeng Li - *Xinyuan Real Estate Co., Ltd. - Interim CFO*

Thank you, Mr. Zhang. Hello, everyone, and welcome to Xinyuan's third quarter 2018 earnings conference call. Allow me to take you through the financial results for this quarter, further discuss our latest operations and initiatives, and conclude by updating you on our financial outlook for the remainder of the year.

To comply with SEC's and the Financial Accounting Standards Board's requirements, we adopted ASC 606: Revenue from Contracts with Customers on January 1, 2018. We adopted ASC 606 on an "over time" basis via the cost input method and applied the standard only to contracts not completed as of the date of adoption. That means part of our profits will be recognized later than previously estimated under the percentage of completion method.

Our third quarter results reflect the adoption of ASC 606, especially with regard to revenues and net income and may not be directly comparable to the same period last year. All references below are in U.S. dollar terms unless otherwise stated.

Third quarter contract sales were \$571.3 million in the third quarter of 2018 compared to \$604.5 million in the third quarter of 2017 and \$633.9 million in the second quarter of 2018.

Total GFA sales in China were about 277,500 square meters in the second quarter (sic) [third quarter] compared to 369,500 square meters in the same quarter last year and 282,900 square meters in the last quarter.

Total revenue increased 23.4% to \$595.5 million from \$482.4 million in the third quarter of 2017 and increased 67.4% from \$355.8 million in the second quarter of 2018. The increase was mainly due to the successful delivery of Jinan Royal Palace and Zhengzhou Fancy City II (South) and presales of 4 projects in third quarter of 2018.

The average selling price per square meter sold in China was around RMB 13,000 in third quarter of 2018 compared to about RMB 14,000 in the last quarter and about RMB 11,000 in the third quarter of 2017.

SG&A expenses as a percentage of total revenue decreased to 8% from 10.6% in third quarter of 2017 and decreased from 13.2% in the last quarter. This was due to the increased revenue and the reduced marketing expenses.

Interest expense this quarter was about \$21.8 million compared to about \$24.7 million last quarter and \$11.4 million in the same quarter last year. The year-over-year increase was caused by a higher debt balance at the end of third quarter of 2018. Due to foreign exchange fluctuations, the exchange loss in this quarter was about \$15.5 million compared to about \$22.5 million of exchange loss last quarter.

Net income for the third quarter increased to \$23.9 million of 2018 compared to USD 16.5 million net earnings for the third quarter of 2017.

Diluted net earnings per ADS attributable to shareholders were USD 0.31 compared to USD 0.22 net earnings per ADS in the third quarter of 2017. The company repurchased 1.7 million U.S. ADS in third quarter of 2018.

Balance sheet, as of September 30, 2018, the company's cash and cash equivalents, including restricted cash, was USD 1.4 billion compared to USD 1.5 billion as of June 30, 2018.

Total debt outstanding was USD 4.1 billion, increasing from USD 3.6 billion at the end of second quarter of 2018.

The balance of company's real estate properties under development at the end of the third quarter of 2018 increased to about USD 4.5 billion compared to USD 3.7 billion at the end of the second quarter of 2018.

Shareholders' equity at the end of third quarter of 2018 was about USD 658 million compared to about USD 689 million at the end of the second quarter of 2018, reflecting the effect of exchange rate fluctuations.

Project updates. As of September 30, 2018, our total unsold land bank was 5.9 million square meters, including 1 project acquired in third quarter, which provides a strong foundation for our development in the future years.

U.S. project updates. As of September 30, 2018, our Oosten project in Brooklyn, New York, has recognized a total revenue of about USD 259.3 million from sales of 176 units out of 216 total units, representing approximately 81.5% of the total units sold.

Our Hudson Garden project in Manhattan, New York, completed excavation and the foundation work, a total of 29,000 square foot out of the 38,000 square foot of retail or commercial space has been leased to the U.S. department store retailer, Target, with a 20-year lease. A soft launch of the sales is scheduled to begin in the fourth quarter of 2018.

We continue to execute on planning, governmental approvals and pre-development of our ground-up development project in Flushing, New York. After the Landmark Protection Committee's approval on our landmark protection plan, we were awarded with a Certificate of Appropriateness. We began protecting, mastering molds and removing artifacts in the first half of 2018. Transfer work is near to be completed by the end of 2018. Offsite restoration work will follow at a later date.

U.K. project update. In the third quarter of 2018, we added another 11 floors to the structural core of the building with only 19 floors left to finish for a 53-story building for our completion target in 2020.

By the end of the third quarter of 2018, all of the 104 Affordable Housing apartments of the 423-unit Madison project have been presold. Of the remaining 319 apartments, 131 apartments have been sold, representing 41.1% of number of units.

Dividend. We announced a cash dividend for the third quarter of 2018 of \$0.10 per ADS, which will be paid before December 12, 2018 to shareholders of record as of November 26, 2018.

And finally, on to our full year 2018 financial forecast. For the fourth quarter of 2018, we expect the contract sales to be approximately USD 1,158 million. For 2018, company expects an increase in contract sales of about 10% and an increase in consolidated net income of 15% to 20% over 2017. This guidance excludes any potential foreign currency translation impact.

This concludes my prepared remarks for today's call. Operator, we are now ready to take some questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now take our first question from Matthew Larson from National Securities.

Matthew Larson

I've been a long-term investor in your company's stock and I have appreciated operationally you all continue to build out the business. I live in New York, so I'm familiar with the projects that you have going on here. And I like the fact that you've continued to pay the dividend, which validates your business, first of all, the U.S. investors that it's while we wait for the stock to appreciate, which has been a long way, unfortunately, we're getting paid while we wait. So thank you. Just a couple of quick questions. During the quarter or since if you can discuss that, have you been able to repurchase any of your debt securities, they're trading at a discount? You had made an announcement that you were looking to buy back \$50 million, roughly? And number 2, did you buy back any stock in the quarter?

Unidentified Company Representative

(foreign language) And that we -- actually, we see -- we keep on the implementation according to the board decisions. And for the third and fourth [quarters, we'll keep following] (corrected by company after the call) the decision from the board for the repurchasing of our debt.

Matthew Larson

Okay. So you haven't bought any yet, even though they're trading at a discount. Is this what you're saying, at this point, the board is considering it but it hasn't been completed?

Unidentified Company Representative

(foreign language) Well, up to latest statistics, for Xinyuan, up to now, in sum, in 2018, the repurchasing volume reached about USD 17.2 million.

Matthew Larson

Okay. So you bought back \$17 million so far. You can answer that after. Also another question. I mentioned that I live in the New York area and the Oosten project, which you completed a number of years ago, is a wonderful project. But I see that only \$8.8 million of properties were sold and there's still a number of the units are still on the market. Brooklyn has been a very strong market over the last few years, where the project is located. Is there any sort of reason why the sales seems slower than, I guess, they should be considering properties in New York and Brooklyn, in particular, have been moving pretty fast in general over the last few years. Can you give us an update on when you expect to finish selling all those units? And have they gone up in value while you've held them in inventory?



Unidentified Company Representative

(foreign language) Actually in the question you mentioned about Oosten project in Brooklyn. Actually, up to now, we have about 30 units of the project. All of them -- most of them now belong to this kind of large area types of the department. As -- which is the main reasons to -- for this selling to be so slow. And it is planned now in the first half of 2019, where we sell most of the existing units and also we are considering about plan for renting -- to rent this kind of departments.

Matthew Larson

I'm sorry, your -- I didn't catch the last part. You expect to sell them in the first half of 2019 and then you had a plan. I didn't catch the rest of the answer.

Unidentified Company Representative

I think that we will finish the selling in the plan -- in the first half of 2019. And also -- we are also in plan about parts of this project to be rented.

Matthew Larson

Oh, to be rented, I see. Okay. All right. And is that going to be a profitable project at the end of the day?

Unidentified Company Representative

(foreign language) Yes, sure for that. From our estimation, it will be profitable.

Matthew Larson

Okay, great. And I'm trying to think if there's anything else. You know what, listen, keep up the good work. I don't know how difficult it is in the PRC -- in China to get projects completed and sold because of the government's attempt to reign in speculation and their overall interest in reducing leverage. I know that getting financing is difficult and that there are certain restrictions on selling residential properties. You've been working in a difficult environment. And even though I haven't really made any money holding your stock over the years, it seems like you're working very hard. I have one last question, I'm sorry, then I'll let somebody else ask. You have a land management subsidiary as well as a reasonably large investment in blockchain to, I guess, facilitate property sales and things like that. Can you discuss your blockchain initiative and whether or not you will float your property management subsidiary to realize value?

Lizhou Zhang - Xinyuan Real Estate Co., Ltd. - CEO & Executive Director

(foreign language) Well, thanks for your question. And actually for blockchain technology Xinyuan, the very early -- actually Xinyuan launched this kind of exploration many years ago. But now it's still in early phases for this kind of technology in Xinyuan, and we estimated that after our [execution] (corrected by company after the call) for certain years to make this more effective, it will be more effective in future days.

Matthew Larson

All right. I mean, you might find out that your early investments in blockchain, as it relates to your real estate business, could be worth more than the value of the equity in your whole company, so don't take your eye off the ball there. And then, again, the second part of my question was, in the past, I've either read or you have said on conference calls that you might float your property management subsidiary on an exchange there in the PRC, which would unlock the value of it. Is there any plans to do so?

Unidentified Company Representative

(foreign language) Well, thanks for your question. Actually, for Xinyuan property of business, now, it is still in phase of the feasibility research before the formal disclosure and we're still investigating and making a lot of surveys on this plan. And when it is finished, we'll give our formal disclosure.

Unidentified Company Representative

(foreign language) Indeed, we did have the plan for our property to list it in Hong Kong.

Matthew Larson

Okay. List it. I would recommend that you put out a news release highlighting that fact and maybe putting out some estimated value of it, number one, as well as what you feel the blockchain initiative is worth.

Operator

I'm sorry for the interruption. We will now take our next question from [John Sheehy], private investor.

Unidentified Company Representative

Well, I want to add information about your question. As per your question about our property business, we continuously evaluating ways to maximize the value of our business. At this time, there have been no decisions made on any potential spin off. Should there be any development in the future, we will certainly make our shareholders aware, okay?

Operator

We will now take our next question from [John Sheehy], private investor.

John Sheehy

First, I would like to ask about housing market conditions. Have you seen any evidence of price declines or discounting or also easing off government regulations in your markets?

Unidentified Company Representative

(foreign language) Well, honestly speaking, this kind of limitations or regulations began to have some impact in the early phase of 2017. There is no big change in these kind of policies and no big impact seen as well. And we will try every -- our every effort to guarantee and ensure to sell in the whole year. It's been of some challenge to us, but we have the confidence that we will finish our sales target in this year.

John Sheehy

And have you seen any evidence of price declines in your markets?

Unidentified Company Representative

(foreign language) For Zhengzhou, there is no -- any signal for us or impact to getting this kind of discount in price, no discounting that we're seeing on this.

John Sheehy

That's great. And can you comment on the status of your Technology Town developments?

Unidentified Company Representative

(foreign language) Actually for this plan of Xinyuan it's one of our 5 auxiliary businesses. And from this year, we have acquired 2 projects, one in Dalian, northeast of China, very important in China and another is in the center of -- of Central China, Zhengzhou, where is also Xinyuan was originated. And in total, we have acquired about over -- we have over -- we have got this kind of effective cooperation with the government, and we have a total land area of 440 mous in Chinese units.

Unidentified Company Representative

(foreign language) As for Zhengzhou project, we already began our sales. And for Dalian project, at the end of 2018, we will also plan to begin our sales.

John Sheehy

Okay. And my last question, have senior management and directors purchased any shares? Or do they have any plan to purchase shares?

Unidentified Company Representative

(foreign language) Well, thank you for your question, the decision of purchasing plan, to repurchase the shares are always following the board meeting decision, and it will be implemented in certain range according to the board meeting decision.

Operator

We will now take our next question from Michael Prouting from 10K Capital.

F. Michael Prouting

So most of my questions have been asked and answered, but just quickly on blockchain initiative. I saw a news recently where a unit of Overstock.com announced a blockchain real estate initiative in Rwanda. And I'm just wondering if the company has any plans to take its blockchain initiative to Africa, particularly given the commercial relationships that Chinese companies generally have in Africa? Or for that matter any other overseas markets?

Unidentified Company Representative

(foreign language) There is no plan to cooperate with Africa in the area of blockchain technology.

Operator

We will now take our next question from [George Guo], private investor.

George Guo

I have a question about the -- your tax rate calculation. So it looks like the tax rate varies from quarter to quarter. Is that correct that you calculate about a 55% of tax rate value minus the currency fluctuation and then the interest rate?

Unidentified Company Representative

(foreign language) Well, thank you for your question. All the calculation for Xinyuan was under the tax policies and there is no problem for that. The reason why the -- the reason for the question is mainly because of loss of the foreign exchange. And all the taxes we have, we have -- losses will be removed from the foreign exchange losses.

George Guo

Thanks, also that your prediction for Q4 sales is very accurate and it's very big over a beating U.S. dollars, how are you so sure?

Unidentified Company Representative

(foreign language) Well, thank you for your question. Actually, well, we get -- we got our plan in very scientific ways in the very early year, early phase of the year. So this is not a temporary forecasting we overlook. And also for 2 reasons, we have confidence for ourselves to be accomplishing this year. On the one hand is our existing project in 2018, most of them will contribute to the fourth quarter. And the second reason, on the other hand, for the newly or pending project in the end of 2017, it will also give the project based on sales at the end of 2018. Based on the analysis, we have the confidence that we'd accomplish the whole year estimation in 2018.

Operator

We will now take our next question from [Herman Tai], private investor.

Herman Tai

It was indeed a -- government has a policy to -- they have start to rule out a policy ban pre-sales on 7 cities. They haven't started in your cities, yet, I think it's likely to get there. Are you going to lower your land expansion plan, lower your growth and lower your debt ratio?

Unidentified Company Representative

(foreign language) Up to now, there is no such kind of impact of these policies for the cities where we have projects, not this kind of impact, not to Xinyuan nowadays.

Herman Tai

So you are not going to lower your debt ratio in the near term? Is there no plan for it?



Unidentified Company Representative

(foreign language) Well, we get our control in the second quarter of the 2018. And now it is of the plan that whole years of debt ratio, you will -- we'll make it controllable less than the same level what we have in the middle of the year, of the whole year. This is our target to control it in a certain point.

Operator

It appears there are no further questions at this time. I'd now like to turn the conference back over to management for any additional or closing remarks.

Lizhou Zhang - *Xinyuan Real Estate Co., Ltd. - CEO & Executive Director*

Okay. We thank you for joining us on today's call, and we appreciate your ongoing support. We look forward to updating you on our progress in the weeks and the months ahead. Thank you, again.

Operator

This concludes today's call. Thank you for your participation. You may now disconnect.

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