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XIN - Q3 2017 Xinyuan Real Estate Co Ltd Earnings Call

EVENT DATE/TIME: NOVEMBER 10, 2017 / 1:00PM GMT



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## CORPORATE PARTICIPANTS

**John Liang**

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

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

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

## CONFERENCE CALL PARTICIPANTS

**Richard DiGeronimo**

**Richard Xu** - *Private Investor*

**Craig Merry** - *Private Investor*

## PRESENTATION

**Operator**

Good day, everyone, and welcome to the Xinyuan Real Estate Co., Ltd. Third Quarter 2017 Earnings Conference. Please note that today's conference is being recorded. I would now like to turn the conference over to Bill Zima of ICR. Please go ahead, sir.

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

Thank you, operator. Hello, everyone, and welcome to Xinyuan's Third Quarter 2017 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 will 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, company's Chief Executive Officer, who will comment on our operating results. He will be followed by Ms. Helen Zhang, the company's 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.

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

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

Thank you, Bill. Good morning, and thank you all for joining our third quarter 2017 earnings conference call. We are pleased to report that the third quarter 2017 financial results were in line with our expectations despite ongoing government restriction policies.

This quarter, we achieved 15% contract sales growth and 9% revenue growth from the same period last year. Our performance for the first 9 months of this year also meet our guidance for a 30% increase in contract sales growth, which we provided on our second quarter conference call. We have also been responsible increasing our landmark year-over-year, which provides us with a good foundation for the development and growth in incoming quarters. We remain confident with our full year sales performance. And Helen will provide more details during her remarks. We are also



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pleased to pay a dividend for the 23rd straight quarter. And our share repurchases efforts in the third quarter demonstrates our commitment to deliver value to our shareholders.

Now please allow me to turn the call over to our CFO, Ms. Helen Zhang. Helen, please go ahead.

### **Yuan Zhang** - *Xinyuan Real Estate Co., Ltd. - CFO*

Thank you, Mr. Zhang. Hello, everyone, and welcome to Xinyuan's Third Quarter 2017 Earnings Conference Call. Allow me to take you through the financial results for this quarter and then further discuss our latest operations in each areas, then conclude by updating you on our financial outlook for the rest of the year.

Third quarter contract sales increased 15% to \$605 million from \$525 million in the third quarter of 2016. Contract sales for the first 9 months of this year increased 28% to \$1.7 billion, an increase from \$1.3 billion in the same period last year. In renminbi terms, contract sales was were CNY 11.2 billion in the first 9 months of 2017 versus CNY 8.6 billion for the same period last year, which successfully meets the guidance that we provided last quarter. Total third quarter revenue increased 8% to \$480 million from \$444 million in the third quarter last year.

GFA sales in China was 370,000 square meters in the third quarter of 2017, up 9% year-over-year. The ASP per square meter sold in China was around CNY 11,000 in the third quarter compared to about CNY 10,000 the same period last year. The ASP saw a slight decrease from about CNY 12,000 in the second quarter this year. It is mainly due to sales of affordable units to lower-income residents as requested by local governments this quarter. We believe the overall housing price trends for our projects in China remain stable. For example, our newly launched projects in Zhengzhou and Changsha enjoy an ASP of about CNY 13,800 and CNY 11,300, respectively, in this quarter, which was above our overall average selling price.

SG&A expenses as a percentage of total revenue decreased to 10.6% from 12.1% in the third quarter last year, an increase from 9.8% in the second quarter of 2017. The increase was mainly due to advertising expenses related to the launch of the 2 new projects that I previously mentioned. Operating income margin increased to 12% from 11% in third quarter last year and is largely in line with our second quarter in 2017 performance.

Net income was negatively impacted by a onetime expense of \$16 million related to a loss on extinguishment of debt occurred upon the company's debt reduction in July this year. Net income for the third quarter of 2017 was \$16.5 million compared to \$28 million for the third period last year and \$20.8 million for the second quarter of 2017.

This quarter, there's still some minority interest attributable to a partner on a project at Zhengzhou International New City Phase I. At the end of third quarter, about 80% of the inventory of this project has been sold out. And what remains are mainly commercial projects, which will be sold gradually in the coming quarters. Minority interest will become minimal going forward.

Diluted net earnings per ADS attributable to shareholders were \$0.22 compared to \$0.41 in the third quarter last year and \$0.14 per ADS in the second quarter of 2017. The company repurchased about 420,000 ADSs at a total cost of about \$2.2 million in the third quarter of 2017.

Now come to our balance sheet. As of the end of Q3, the company's cash and cash equivalents, including restricted cash, decreased to about \$1.2 billion from about \$1.3 billion as of the end of Q2 this year. Total debt outstanding was about \$2.5 billion, which reflected a decrease of \$150 million compared to \$2.65 billion at the end of the second quarter of 2017. Leverage indicators, including our net gearing ratio, have improved accordingly. The balance of the company's real estate properties under development at the end of third quarter remain stable from last quarter at around \$2.1 billion.

As of the end of this quarter, the items, long-term bank loans became 0 because the loans have fallen into the category of current portion of long-term bank loans and other debt. In this category, about 30% are onshore corporate bonds that we can negotiate and extend each year. Another 30% are project construction loans that shall be repaid when sales reach a certain percentage, subject to renegotiation between the company and the banks. About 20% of loans that shall be repaid if we fail to obtain certain project certificates before certain dates. These loans or



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debt are categorized as current liabilities on a conservative basis. We believe that at least the half of this are likely to be negotiated and extended during the following 12 months.

Now let me give you some update of our projects. During the third quarter, we began presales of 2 new projects, Zhengzhou International New City Phase II and Changsha Mulian Royal Palace. These 2 projects have performed well both in terms of ASP and sales contribution. I would also like to point out that Xinyuan's inventory level has improved. Generally speaking, our total land bank now can support about 2 to 3 years of development compared to 1 to 2 years of development, which was the trend over the past few years.

And now a few words about our U.S. projects. In the third quarter, our Oosten project in Brooklyn, New York recognized a revenue of about USD 7 million. As of the end of Q3, 167 units has been sold out, out of 216 total units and total revenue from this project has reached \$244 million. Our 2 other U.S.-based projects, one in Manhattan and the other in Queens, are in the middle of foundational work and predevelopment process, respectively. And we'll continue to update you on their status in the following quarters.

Debt refinancing. In July, we announced the completion of the early redemption of the 13% senior notes due 2019. The refinancing improves our debt structure and allows us greater flexibility to continue executing our real estate development projects. We'll continue to evaluate additional opportunities to further optimize our financial structure.

Dividend. We announced a cash dividend for the third quarter of 2017 of \$0.10 per ADS, which will be paid to investors on December 15, 2017, to shareholders of record as of November 30 this year. We see our dividend policy as a long-term commitment to our shareholders.

And now I would like to introduce our new business segment, the construction management service, (foreign language). During the past year, Xinyuan has been trying to leverage its experience and resources in the industry to provide value to companies who would like to own buildings but have no property development expertise. During this quarter, Xinyuan entered into a construction management agreement for Guangzhou Huanqiu, an office building project owned by a high-tech company located in Guangdong province.

Under this agreement, we will charge a service fee for providing the construction management service and at the same time, provide some financial support by holding minority interest in this project through a limited partnership with the financial institution. The interest spread yield will be part of a profit on this project. We believe this asset-light business model will be a good supplementary business segment to our core traditional project development business for our future growth.

And finally, I'd like to provide a update on our financial outlook. For the fourth quarter this year, we estimate our contract sales to be in the range of CNY 4.6 billion to CNY 4.8 billion. And this implies our full year contract sales will grow between 35% to 37% over the prior year.

And this concludes my prepared remarks for today's call. And operator, we are now open to questions.

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) And we will take our first question from Richard DiGeronimo from -- he's a private investor.

### Richard DiGeronimo

Helen, a couple of questions. Have you decided what you're going to do with the Melaka property?



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

The Melaka property actually is still in the process of appraisal with the local government. We're applying for certain certificate before the reclamation. And it's very likely that the reclamation is going to start by March next year.

**Richard DiGeronimo**

Okay. So you're planning to develop it then?

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

Yes.

**Richard DiGeronimo**

Okay, great. Now it seems to me that there's consolidation going on in the Chinese real estate market. Are you guys going to be acquirers? Or are you going to consolidate with somebody else?

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

We are not consolidating with certain real estate company. But with regard to the model for the property development, we think acquiring land or, let's say, we're having opportunities to acquire land from a smaller-sized real estate developer with a single property or without much expertise in the real estate sector.

**Richard DiGeronimo**

Okay. So I mean, you're still relatively small compared to the larger real estate development companies. How are you going to get your scale up?

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

The company would like to grow. And we talked about the guidance. So this year, we're going to reach CNY 15 billion contract sales, between CNY 15 billion to CNY 16 billion contract sales this year. And we believe we have more land bank. We just talked about it. We would like to grow in the coming 2 and 3 years. We believe that if we reach CNY 30 billion, that size, and that will help us to be in the main list of the top 100 developers in China. Probably, we're going into the middle level of the top 100.

**Richard DiGeronimo**

Okay. And now with the shelf -- with the 50 million ADRs with JPMorgan, what are you planning on doing with that? And will that impact the dividend if it's used?

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

You are talking about the ADR of JPMorgan partner fees? Could you please repeat your question?



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**Richard DiGeronimo**

Yes, you just did a shelf with 50 million ADRs with JPMorgan Chase. And I was wondering what you had in mind with that shelf filing. And also with that, as you use that, will that impact the dividend?

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

I don't think so because we renewed the contract with JPMorgan. It's in the normal terms. I don't think there is any impact from that additional 50 million ADSs, which is...

**Richard DiGeronimo**

Okay. And what was the reasoning for that?

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

We would like to have a larger pool in case that in the future if we would like to issue more shares, we don't need to talk about a contract with the other party.

**Richard DiGeronimo**

Okay, yes. I actually like the idea in some ways because it will allow greater liquidity in the trading of Xinyuan. So I'm sure you'll put it to good use.

**Operator**

(Operator Instructions) And we'll take our next question from Richard Xu, a private investor.

**Richard Xu** - *Private Investor*

I have just a good question about the tax rate. I was under the impression that the tax rate was high because of the -- many of the sales come from the commercial properties. So when do you think that the tax rate will start to go down as I see that more of the sales are coming from the residential side? Can you comment on that?

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

If you take a look at our P&L, you will see that the loss of the extinguishment of the bond occurs USD 15 million. And this item actually is not tax-deductible. If we add it back, actually the effective tax rate for Q3 would be around 43%. And that's more or less the same compared to the same period of last year.

**Operator**

(Operator Instructions) And we'll take a follow-up question from Richard Xu, a private investor.

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**Richard Xu** -- *Private Investor*

Yes, sorry, I forgot to ask the available Zhengzhou International New City Project. I heard from the news that the company is acquiring additional land for this project. And it's a pretty sizable project. So based on this, can you tell what is your outlook on this specific project? And do you think that this can turn into -- do you have rough estimate of how much profit could be generated from this project alone?

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

The Zhengzhou International New City is a very big project with several phases. We talked about in our prepared remarks that the Phase I is going to be completed and that it has been sold out for 80%. And in Q2, the Phase II has contributed to sales for our overall sale scale. And in Q4, we're expecting the presales for the Phase III. So the one that -- the new piece of land acquired actually is Phase IV and V. We're going to continue to develop the land. And Phase IV and V, we're going to start presales second half next year.

**Operator**

(Operator Instructions) It appears we have no further questions. My apologies, we do have another question. We'll take our next question from Craig Merry, a private investor.

**Craig Merry** -- *Private Investor*

Yes. I was looking over the quarter, and you mentioned that the loss in the extinguishment of debt was not deductible. But if that's added back in the net income, you're still ending at a 50 -- I guess, I'm looking at the 9 months. You're still ending up with an over 40% tax rate, not the 23% you just mentioned.

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

If we added back, the effective tax rate is about -- it's about 43%. Yes, 43% as I just mentioned. Yes, actually the effective tax rate is a combination of land value-added tax and corporate income tax. It's 2 items.

**Craig Merry** -- *Private Investor*

All right. And then the transfer taxes on the Oosten property, are those counted as cost of sales? Or are they down in taxes as well?

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

Can you please repeat your second question?

**Craig Merry** -- *Private Investor*

There's a fairly substantial transfer tax in New York City and state of New York for very expensive housing projects. I was wondering where that's accounted for. Is that accounted for in cost of sales? Or is it accounted for in taxes?

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

For U.S. project, the overall tax rate is approximately 45%. And we didn't bear much tax expenses in 2016 and 2017 for the New York project.



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**Craig Merry** - - *Private Investor*

Okay. I was just talking about the transfer tax that show up when you sell a property. I think they can amount to about 4% combined for a very expensive unit.

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

And John, would you please give a further comment? John is our Head of U.S. business.

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**John Liang**

Sure. This is John Liang. The transfer tax in our transactions are borne by the purchasers.

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**Operator**

(Operator Instructions) And we'll take a follow-up question from Richard DiGeronimo, a private investor.

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**Richard DiGeronimo**

Just a question, I know you talked about the contract sales for the fourth quarter. Since you had that one-off \$13 million write-off because of the extinguishing of the bonds, the net income should rise, is that correct, for the fourth quarter?

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

Should rise compared to what?

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**Richard DiGeronimo**

Well, compared to the third quarter and then also for the fourth quarter of last year.

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

Yes, that's true. That's our expectation.

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**Operator**

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

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

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



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**Operator**

This concludes today's presentation. We thank you for your participation. You may now disconnect.

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