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XIN - Q2 2013 Xinyuan Real Estate Co., Ltd. Earnings Conference Call

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Yvonne Cheng *Brean Capital - Analyst*

George Fong *Goldman Sachs - Analyst*

Ibrahim Toure *Black Pearl Finance - Analyst*

PRESENTATION

Operator

Please standby, we are about to begin. Good day, and welcome to the Xinyuan Real Estate Company Limited Second Quarter 2013 Earnings Conference Call. As a reminder, this call is being recorded.

At this time, for opening remarks and introductions, I would like to turn the call over to Ms. Helen Zhang, Xinyuan Financial Controller. Please go ahead ma'am.

Helen Zhang - *Xinyuan Real Estate Co. - Financial Controller*

Hello everyone, and welcome to Xinyuan's second quarter 2013 earnings conference call. The company's second quarter earnings results was 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 US Private Securities Litigation Reform Act of 1995. Forward-looking statements involve inherent risks and uncertainties. As such, our result may be materially different from the views expressed today.

Further information regarding these and other risks and uncertainties is recorded in our registration statement and our Form 20-F and other documents filed with the US 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. Yong Zhang, our Chairman and Chief Executive Officer, who will comment on current operations and provide some perspectives on the market environment. He will be followed by Mr. Tom Gurnee, our Chief Financial Officer, who will provide some additional color on our performance, review the company's financial results in the second quarter and discuss the outlook for the third quarter and full-year of 2013.

Following management's prepared remarks, we'll open the call to questions. During the Q&A session, Mr. Zhang will speak in Mandarin, and I'll translate his comments into English. Please note that unless otherwise stated, all figures mentioned in this conference call are in US dollars.

I'll now turn the call over to Xinyuan's Chairman and CEO, Mr. Yong Zhang. Please go ahead sir.



Yong Zhang - *Xinyuan Real Estate Co. - Chairman and CEO*

Hello, everyone, and thank you for joining us today. We're pleased to report another stronger than expected quarter. In the second quarter of 2013, our revenue contract sales and net income once again exceed our previous guidance. The current fundamentals of the housing market in China remained healthy and the buying demand at our development projects were stable in the second quarter. So far homebuyer sentiment demand has remained stronger in the cities, where Xinyuan operate.

Looking at second half of this year, we expect to continue developing projects at a measured pace. We have four new projects scheduled to commence pre-sales and contribute to our result in the second half of this year. As a result, we are once again raising our full year 2013 financial forecast. At the same time, the company is actively seeking opportunity to acquire land in the second half of the year.

As announced earlier, our Board of Directors has recently approved second quarter cash dividend payment for 2013 of \$0.05 per ADS. Our regular dividend compared with our new \$30 million in extended share repurchases program demonstrates our confidence in Xinyuan's long-term growth prospects. We thank you for your loyal investor support.

Now I would turn the call over to Tom Gurnee, our Chief Financial Officer.

Tom Gurnee - *Xinyuan Real Estate Co. - CFO*

Thank you, Chairman. And as the Chairman has already said once again our second quarter numbers for contract sales, revenue and net income, were much better than we had expected going into the quarter. We were especially encouraged by our sales activity and by the progress made on bringing inventory from four new projects on line in the third and fourth quarter that we are raising our full year guidance forecast once again. More on that later. So, let's get started with contract sales in the quarter.

Contract sales in the second quarter reached \$196 million versus \$178 million recorded in the first quarter for a sequential increase of 10%. We were fully 31% ahead of previous guidance as our project sales department performed very well in the second quarter.

Included in the second quarter contract sales was the sale of 47,000 square meters of low cost space at our Shandong Splendid project to the local government authorities in Jinan for over \$43 million but at a price of less than RMB5,800 per square meter.

This below market price sale was specified in the land acquisition bid document back in 2010 and thus had been contemplated in our projects estimates for the last few years. Our selling prices continue to firm up as several projects near completion.

Our reported aggregate ASP however dropped from RMB8,985 per square meter to RMB8,312 per square meter in the second quarter and this was due to the below market price sale I just mentioned. If we exclude this one-off market sale, prices per square meter for our residential apartments and our four most active projects were buoyant.

Zhengzhou Royal House ASP was RMB 8,991 per square meter up 1.7% over the previous quarter. Zhengzhou Century East A ASP was up 5.9% over the previous quarter. Zhengzhou Century East B's prices were up 13.5% over the previous quarter and Shandong Splendid's ASP came in 3.5% up. So, all of our legacy projects showed higher ASPs than the previous quarter.

Holding us back somewhat in the second quarter was our diminishing inventory of sellable apartments. As you can see from the first table of our earnings press release, the sellable GFA at our active projects has fallen from 425,000 square meters at the end of the first quarter to 278,000 at the end of second quarter. Fortunately we have four new projects expected to come online in the back half of the year.

In the third quarter of 2013, we expect to commence pre-sales of two projects -- Zhengzhou XIN City with a total project GFA of 207,000 square meters and Suzhou XIN City with a total project GFA of 126,000 square meters. Together we expect these two projects to record contract sales of about \$40 million for the third quarter.



Additionally in the fourth quarter of 2013, we expect to commence pre-sales of two additional projects; Xuzhou Colorful City with a total project GFA of 118,000 square meters and Beijing Xindo Park with a total project GFA of 118,000 square meters.

Revenue under the US GAAP percentage of completion method totaled \$198.5 million up 17.5% over the first quarter of 2013 and nearly 42% ahead of previous guidance. The contract sales improvement of 31% mentioned earlier over guidance was certainly a factor in the upside. However another key factor to this quarter was the favorable outcome of project completion settlements with contractors, utilities and municipal authorities on three projects -- Chengdu Xinyuan Splendid, Zhengzhou Modern City and Kunshan International City Garden.

Under the percentage of completion method of accounting the result in cost savings on these three projects of approximately \$15 million resulted in higher than expected completion percentages, which in turn increased cumulative revenue recognition for these projects. Some of this was factored into our guidance but not all.

In the second quarter, we also recorded \$4 million of revenue in the USA, mainly from the sale of five apartments at our Lennox project in Irvine, California.

In short, in Q2, we find ourselves in the midst of a virtuous cycle with higher than expected prices and sales volumes, along with lower than expected project costs.

So, let me comment on gross profit. Second quarter gross profit totaled \$70 million or 35.2% of revenue compared to last quarter's profit \$57 million or 32.9% of revenue. Each quarter, we review in detail our project cost estimates. As a given project nears completion and delivery permits are issued, settlement conferences are held with contractors, utilities and government bodies, which serve to confirm and clarify the net impact of the gives and takes with suppliers and customers over a multi-year project.

In the fourth quarter of 2012, two quarters ago, Chengdu Splendid 1 and Kunshan International City Garden cost estimates were revised downward in light of such settlement conferences. Then in the first quarter of 2013, two quarters ago, Yipinxiangshan 2 and Chengdu Splendid 2 cost estimates were similarly revised downward. In this second quarter, Chengdu Splendid 2 cost estimates were once again revised downwards as were Zhengzhou Modern City and Kunshan International City Garden.

In short, we have a lot of projects being completed and as they completed their settlement conferences with vendors and these are resulting in favorable adjustments to our cost estimate.

In addition, each quarter we review in detail our total project sales estimates. In the second quarter, we revised total project sales estimates upwards by over \$10 million to recognize continued ASP firmness on the Shandong Splendid and Zhengzhou Century East A and B projects. Again under the percentage of completion method of accounting these increases in sales estimates resulted in lower than expected percentage sold ratios, which in return lowered cumulative cost recognition.

Okay, operating expenses. Operating expense for the second quarter edged higher as a percentage of revenues to 7.7% compared to 7.3% in the first quarter of 2013 and 6.2% in the second quarter of 2012. The sequential spending increase of over \$2 million from the first quarter is mainly attributable to approximately \$700,000 of consultant spending on HR practices overall and IT security service as well as the catch up for employee retention bonus of almost \$900,000.

Net income for the second quarter was \$39.1 million compared to \$26.6 million for the first quarter, up 47% sequentially. Net income was up 56% from the midpoint of guidance but down 43% from the \$69 million in last year's exceptional second quarter.

As expected, net income was favorably impacted by \$9 million one-off income tax benefit realized on the expiration of a five year statute of limitations period.



Second quarter fully diluted earnings per ADS were \$0.54 compared to \$0.37 in the first quarter but compared to US \$0.94 from a year ago second quarter. The balance sheet as of June 30, 2013 we reported \$875 million in cash an increase of \$248 million from March 31, 2013 mainly driven by the proceeds of a new \$200 million bond issue in May of this year.

Total debt rose from \$316 million at the end of last quarter to \$511 million as of June 30th. Net cash that is total cash minus total debt rose by \$54 million in the quarter to fully \$364 million at the end of June 2013. Book value per share marched along and reached \$847 million as of June 30th versus \$808 million last quarter and \$719 million a year ago.

In short, we continue to generate cash and add to our book value. But I must note we did not purchase any land in the second quarter so let me talk about land acquisition plan.

The entire management team has been very busy with land acquisition plans in China. As mentioned last quarter, we are hopeful of acquiring several Zhengzhou area projects this year under our managed auction program. But also we've expanded our sites for this program in several other jurisdictions including Shandong, Kunshan and others, where negotiations are underway.

This managed auction program was initiated over a year ago whereby we entered into agreements with local land bureaus to make refundable deposits to facilitate site preparation work to bring projects to auctions.

Through the second quarter of 2013, we have invested cumulatively \$143 million in such deposits while one auction was expected last quarter, the land bureau simply did not progress fast enough. Now we expect to see two managed auctions in Zhengzhou area in the third quarter. There is no assurance however that we'll be a successful bidder in any of these managed auctions. If we are not the successful bidder we'll receive back our deposit plus interest but we will not have additional lands developed.

Meanwhile we are preparing to step up our participation in the traditional on-site land auctions for the rest of the year. At this point, we expect to bid at auctions in Suzhou, Xuzhou, Kunshan, Chengdu, Jinan, Zhengzhou, Hainan and Yantai, so it's quite an expanded list from the previous period.

Let me remark on the status of US operation. Our Williamsburg New York project remains on schedule. We filed with the City of New York for building permits on July 15th. This was officially recorded on July 22nd. Detailed cost estimates are being generated by our provisional general contractor in preparation for engaging with construction lenders. We expect to make final general contractor selection later this quarter or early in the fourth quarter.

In the same timeframe, we expect to select the sales brokers and submit an operating plan to the City of New York shortly thereafter. Ground breaking remains projected for the fourth quarter of 2013 and we continue to target delivery in the first half of 2015. In short, the project is on plan and on budget.

So, now some words about the outlook for our company. First I'll talk about the third quarter. We are projecting third quarter contract sales of \$200 million to \$220 million. It will be an exciting transition quarter for Xinyuan as we launch two new projects, Zhengzhou XIN City and Suzhou XIN City.

The contract sales contribution on these two projects in the third quarter will more than offset the reductions at Century East A & B and Zhengzhou Royal Palace, which we expect to virtually be sold out during the third quarter.

Revenue under the percentage of completion method for the third quarter is projected at \$210 million to \$220 million and third quarter net income is expected to reach \$25 million to \$30 million. No unusual tax related events are expected.

Total year 2013, we are raising our full year guidance in light of continuing ASP firmness and higher confidence in our ability to launch four new projects on time in the second half of the year.



Contract sales are expected to exceed \$880 million up from previous guidance of about \$850 million. Revenue is expected to exceed \$820 million. This would be higher not for the fact that a shift in contract sales from mature projects to new projects will result in a lower overall percent complete ratio under the percentage of completion accounting.

Net income is expected to top \$110 million up from the \$105 million we guided previously and it should be noted that these full year projections do not fully contemplate our internally targeted project launch dates and GFA demand. So, there is potential upside in these numbers. I should also note that an expected strong fourth quarter will provide an excellent platform for sales and revenue growth in 2014.

Just a few notes on shareholder value. We are pleased to announce, as the Chairman mentioned on August 5th, we announced a dividend of \$0.05 per ADS will be paid at the end of August. The payout ratio is just 12% based on 2013 earnings guidance. During the second quarter 2013, the company also acquired 1.3 million ADSs on the open market for a total consideration of \$5.8 million at an average price of \$4.39 per ADS.

Finally my retirement, this will be my final Xinyuan Real Estate quarterly conference call. As a couple of months ago, I'm sure you noticed that the company announced my upcoming retirement from Xinyuan in August 2013. My successor has been identified and is expected to be on board in the first half of September. We will announce his/her identity and background at a later date when the details firmed up. I'll continue as CFO until the day of his/her arrival.

I want to thank the Chairman, the Board and my fellow employees for their wisdom, support and hard work over the last five years and I want to thank our investors for their continuing interest in Xinyuan.

Operator, can we go to Q&A please.

QUESTIONS AND ANSWERS

Operator

Absolutely. (Operator: Instructions). And we'll take our first question from Yvonne Cheng from Brean Capital.

Yvonne Cheng - Brean Capital - Analyst

Hello. Hi, thanks for taking my question. I have questions about the new project in Shandong and Jinan and could you give more detail about the Qihuzhimen project. And also I want to know, what is the current condition of this project?

Tom Gurnee - Xinyuan Real Estate Co. - CFO

It's probably most appropriate to have the chairman answer that. Helen, do you want to translate for the Chairman?

Yong Zhang - Xinyuan Real Estate Co. - Chairman and CEO

We've signed a letter of intent with the local government however the specific schedule of the land auction hasn't been decided yet. So, the company is having an active dialogue with the local government. And up to now there is no material information to report but the company hopes that once we have the material information we'll let the investors know.

Yvonne Cheng - Brean Capital - Analyst

Got it. Okay. Got it. Thank you.



Operator

(Operator Instructions). And we have a question from George Fong from Goldman Sachs.

George Fong - Goldman Sachs - Analyst

Hi. I have a question about net gearing. Do you have a net gearing target towards the end of the year and also the financing mix. Do you have an idea of how much loan versus bond going forward like when you issue your higher bond, the bond market was better than it is now. So, going forward do you have an idea as about like how much bond versus loan you have on your balance sheet? Thanks.

Tom Gurnee - Xinyuan Real Estate Co. - CFO

Well, I think it's a good question but this is so highly dependent on land acquisitions that it's really hard to call. So, right now we have a negative gearing ratio. In other words, we have more cash than we have debt but -- and we don't expect that to continue of course, we accumulate that cash in contemplation of buying property.

But so no, we don't have -- we have very many properties we're going to be looking at and we do have covenant established gearing ratios and such that we'll follow but we're not even close to those. We're not even within the ballpark. And so, I think the best time to ask that question is probably next quarter when we see how we've done on the land acquisition front. I'm sorry to bugger off on your question but I think the question gets much more relevant next quarter.

George Fong - Goldman Sachs - Analyst

Sure. And your capacity for loan versus bonds like you have like any complete guidance on that?

Tom Gurnee - Xinyuan Real Estate Co. - CFO

Well Helen is our expert on construction loans here in China. Helen do you have any comment on loan capacity. I guess we have four new projects so there is capacity there.

Helen Zhang - Xinyuan Real Estate Co. - Financial Controller

This year we're going to launch four new projects and for the first two we've already got the approval from the local banks and also we've already got the loan from the banks. There is another two on the way. The third one we have already got the approval from one of the local banks with very attractive interest rate. And the third one we're expecting the approval from the local banks sometime two weeks later. So, in conclusion we don't have any problem in getting the bank loans for this year.

George Fong - Goldman Sachs - Analyst

Sure. Thanks.

Tom Gurnee - Xinyuan Real Estate Co. - CFO

Thank you.

Operator

(Operator Instructions). We'll take a question from Ibrahim Toure from Black Pearl Finance.

Ibrahim Toure - *Black Pearl Finance - Analyst*

Hello. Thank you for taking my question. And I might have missed this but did you get the permits for the building in Brooklyn, New York?

Tom Gurnee - *Xinyuan Real Estate Co. - CFO*

No, we applied for the permit. We applied for the permits on July 15th.

Ibrahim Toure - *Black Pearl Finance - Analyst*

Okay. All right. Thank you. And a follow-up question is there anything that you believe you can do to increase shareholder confidence? Have you considered the option of a cash audit given that many investors fear the Chinese market because of cash fraud?

Tom Gurnee - *Xinyuan Real Estate Co. - CFO*

Yeah, good question, that's a good question. This question has been lingering for two years now and from time to time I'm asked on this conference call about it.

We do, do cash audits. We do spot surprise cash audits here on a monthly basis but also Ernst & Young our auditors for many years now has really stepped up -- well as all the auditors have they have stepped up their cash verification procedures and they went through an in-depth cash audit taking a lot of precautions for example going -- various levels in the banks, etcetera.

And so, we believe we've taken all the measures that we can to establish that our cash is real and we don't have VIEs, you can go kick our assets, they are not going anywhere. You can find them. You can see them. You can kick them. And I've had people recommend a forensic audit but that's a bit of a negative thing. There is, we are conducting regular audits, which I instituted about a year ago, where we're doing surprise audits on our largest bank balances done by our internal audit department on surprise visits.

So, I think between that and E&Y, I think, I think, we're pretty covered. And investors, it takes a lot to convince investors to have confidence and we're doing the best we can.

Ibrahim Toure - *Black Pearl Finance - Analyst*

Yeah. Thank you very much.

Tom Gurnee - *Xinyuan Real Estate Co. - CFO*

Thank you.

Operator

(Operator Instructions). And it appears we have no further questions.

Tom Gurnee - *Xinyuan Real Estate Co. - CFO*

Okay. Well, thank you, Nicole, and thank you investors for dialing in we appreciate it. And I think the management team, minus me because I'm retiring are looking forward to the next conference call, next quarter. Thank you very much.

Operator

And once again, ladies and gentlemen, that conclude today's conference. We appreciate your participation today.

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