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Q2 2019 Xinyuan Real Estate Co Ltd Earnings Call

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CONFERENCE CALL PARTICIPANTS

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

PRESENTATION

Operator

Good day, everyone, and welcome to the Xinyuan Real Estate Company Limited Second Quarter 2019 Earnings Conference Call. Please note that today's call is being recorded.

I would now like to turn the conference call 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 Second Quarter 2019 Earnings Conference Call. The company's second 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 may be materially different from the views expressed today.

Further information regarding these and other risks and uncertainties is included in 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. Yong Zhang, the company's Chairman and Chief Executive Officer, who will comment on the company's operating results. He will be followed by Mr. Brian Chen, 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.

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

Thank you, Bill. Good morning, and thank you all for joining our second quarter 2019 earnings conference call. We are pleased to announce that in the first half of 2019, Xinyuan maintained stable growth and commenced presales of 3 new projects in China. The total value of contracts signed in the first half was [RMB7,323.2 million] (corrected by company after the call), representing a [12.0%] (corrected by company after the call)increase compared to [RMB6,537.4 million] (corrected by company after the call) in the first half of 2018.

In addition, we achieved top and bottom line growth despite downward pressure of sales across the industry.

In the first half of 2019, total revenue increased 103.5% year-over-year. Moreover, we are able to reduce SG&A expenses as a percentage of total revenue to 11% in the first half from 16.4% in the first half of 2018. As a result, gross profit increased by 96% year-over-year, and net income was USD 38 million compared to net loss of USD 22 million in the half -- in the first half of 2018.

Furthermore, our overseas projects continued to proceed as planned, and presales of our Manhattan project are expected to launch at the end of the fourth quarter of 2019.

Lastly, we are also pleased to able to continue to deliver value to our shareholders with another dividend payment in this quarter. Despite market and policy uncertainties, we remain optimistic about our ability to achieve positive operating performance. We will remain focused on our core business, maintaining our competitive advantage and strengthening our market-leading position.

Now please allow me to turn the call over to our CFO, Mr. Brian Chen.

Yu Chen *Xinyuan Real Estate Co., Ltd. - CFO*

Thank you, Mr. Zhang. Hello, everyone. Welcome to Xinyuan's Second Quarter 2019 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. Please note that all figures are in U.S. dollar terms, unless otherwise stated.

As mentioned by Mr. Zhang earlier, we had a pretty good sales first half of this year. The total contract sales in RMB term for the first half of the year was RMB 7.3 billion, representing a 12% increase comparing to the RMB 6.5 billion in the first half of last year.

In terms of the contract sales, which only accounting those contract sales has over 30% of the down payment, the amount increased by 3.4% to RMB 6.8 billion from the RMB 6.45 billion in the first half of 2018.

Contract sales were $507.4 million in the second quarter of 2019 compared to $633.9 million in the second quarter of 2018 and $479.7 million in the first quarter of the year.

Total GFA sales in China were about 233.2 thousand square meter in the second quarter comparing to 282.9 thousand square meter in the same quarter last year and 211.4 thousand square meter last quarter.

Total revenue increased by 71.3% to $609.4 million from $355.8 million in the second quarter of 2018 and increased by 30% from about $468.9 million in the first quarter of the year.

The average selling price per square meter sold in China was about RMB 14.8 thousand in the second quarter of 2019 comparing to about RMB 15.3 thousand in last quarter and about RMB 14.2 thousand in the second quarter of 2018.

SG&A expense as a percentage of the total revenue decreased to only 10.3% from the 13.2% in the second quarter of 2018 and 12% in the first quarter of 2019.

Interest expense this quarter was about $28.4 million comparing to about $24.3 million last quarter and $24.7 million in the same quarter last year.

Due to FX exchange fluctuation, exchange loss in this quarter was about $4.4 million comparing to about $3.5 million exchange gain last year. On -- added together for the first half of this year, the net FX loss is about $0.9 million, which is offset by the hedge we put down this year. So the net FX impact is close to 0 for this year-to-date.

Net income for the second quarter increased to $19.8 million compared to a net loss of $9.3 million for the second quarter of 2018.

Diluted net earnings per ADS contributable to shareholder was $0.19 compared to a net loss of $0.10 per ADS in the second quarter of 2018. The company repurchased about 1.4 million ADS in the second quarter of 2019.

On the balance sheet side, as of June 30, 2019, the company maintained a really strong cash and cash equivalent position. Including the restricted cash, the position is about USD 1 billion comparing to $1.1 billion as at -- as of March 31, 2019.

Total debt outstanding was about $3.6 billion, increasing from about $3.5 billion at the end of the first quarter of 2019. The balance of the company's real estate properties under development at the end of the quarter of 2019 was about $3.8 billion comparing to $4 billion at the end of the first quarter of 2019.

Shareholder equity at the end of the second quarter of 2019 was about $753 million comparing to about $769 million at the end of the first quarter of 2019. The slightly decrease of $16 million in the shareholder equity is mainly impacted by the FX impact, which is about $24 million.

Project update size. As of June 30, 2019, our total unsold land bank was about 5.2 million square meters. On U.S. project update, as at the June 30, 2019, our Oosten project in Brooklyn, New York, has recognized total revenue of about $250.1 million from the sales of 173 units out of the total of 216 total units.

The BLOOM ON FORTY FIFTH project, which is our Hudson Garden project in Manhattan Hell's Kitchen, completed the superstructural construction and closed out 90% of its external wall and windows. During the past year, the project's design drawings were optimized, and the total number of units subsequently increased from 82 to 92. 29,000 square foot of the projects, 38,000 square foot of total retail space has been leased to the U.S. department store retailer, Target, for a 20 years term. Presales are expected to begin at the end of the fourth quarter this year. We continue to execute on the planning, governmental approval and predevelopment activities of the RKO project, which is 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. Chancellor work for the size landmark artifacts was completed at the end of the February 2019. The artifacts are now stored in the warehouse for restoration work.

U.K. project update. In the second quarter of 2019, the structural frame of the Madison in London was completed, and construction remains on track for completion in 2020. By the end of the second quarter of 2019, all of the 104 Affordable Housing apartments of the projects have been presold. Of the remaining 319 apartments, 134 apartments have been sold.

In terms of the listing of our Xinyuan Property Management subsidiary, our Xinyuan Property Management Company subsidiary has achieved rapid growth in recent year to further drive its development. We have applied to list the subsidiary in Hong Kong. The listing is expected to be completed around the end of September this year. After the listing, we will continue to be the controlling shareholder, and we will fully consolidate this subsidiary or company. We believe that listing on a high-quality platform, where many of its peers are listed, will benefit all our shareholders.

On the dividend side, we announced a cash dividend for the second quarter of 2019 of $0.10 per ADS, which will be paid before September 17, 2019 to shareholders of record as of September 3, 2019.

And finally, on to our full year 2019 financial forecast. For the full year of 2019, we expect an increase in the contract sales of about 10% and an increase in consolidated net income of 15% to 20% over 2018.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we will take our first question from [Alexandra Wan] with Citibank.

Alexandra Wan

I have 3 questions. So first one would be what is the actual cash flow in first half 2019 and the cash flow guidance for 2019 full year? My second question would be that what is the breakdown of total debt as of the first half of 2019? And how much is the onshore nonbank borrowings? And how much did we finance during the second half? And then my last question would be what is the on-book revenue and the estimated GPM?

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

I would like to answer the second question first. I may need you to repeat the first and third one. Your voice is a little bit low.

In terms of outstanding loan as at the end of the Q2, we had overall USD 3.6 billion debt. Out of the $3.6 billion, 61% coming from onshore and 39% coming from offshore.

For the 61% onshore, 30% of them coming from the construction loan extended by the mainstream bank and 24% also construction and land loan related loan from the trust. And 7% of the onshore is coming from onshore corporate bonds.

In terms of the offshore debt, 31% of them coming from the senior notes and 3% coming from back-to-back loans. And this remaining 5% coming from EB5 loans and some local construction loans from local financial institute in New York. In terms of the first one, I cannot catch the question. Anyone will pick that? Do you mind repeat your first question?

Alexandra Wan

Yes, yes. Sure. Yes, sure. Yes, sorry, if it was a little bit unclear. So what was the actual cash flow in first half 2019? And what is the cash flow guidance for the full year 2019?

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

So in terms of the cash movement for the first half of the year, we are starting by -- we had collect the cash payment from the client of about RMB 6.3 billion and had a return for the land acquisition fund of about RMB 1 million. And the expenditure of the -- on the land is about RMB 19 million and construction expenditure is RMB 30.4 million. And the tax payout is RMB 10.4 million and the other operating expenditure is about RMB 10.4 million. RMB 7.4 million outflow is used on the repurchase of the share and bonds and dividend payout. At the same time, we draw down another RMB 6.9 billion loan. And we are paying back RMB 5.8 billion. And we pay interest of the RMB 1 billion. So at the beginning, we have about RMB 8.2 billion cash, at the end is RMB 7 billion. This is RMB. What's your third question?

Alexandra Wan

I repeat my last question. What is the on-book revenue in the estimated GPM?

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

Thank you. Would you please repeat that question? We don't actually catch it.

Alexandra Wan

Yes, sure. What is the on-book revenue and estimated GPM?

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

GPM, do you mean gross profit margin? Sorry, where you mean the on-book revenue, do you mean the deposit we collect for the customer or do you mean the deferred revenue?

Alexandra Wan

If you have information on both, it'll be great if you could provide both, please.

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

You need a number as at the -- for the first half of the year or do you mean a forecast for the end of the year, in terms of the gross profit margin?

Alexandra Wan

Again, if you could provide both, it'll be great.

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

Gross profit margin for the first half of the year is 27%. We estimate a whole year is about 26%.

Operator

We'll take our next question from Edward Choi with TT International HK.

Edward Choi

So the first question I have is about your capital structure. If I look to stat, we are glad to see that at least you net gearing and also your cash to short-term debt has been at least stabilized in the second quarter. So but at the end of the day, with your bonds are trading at 14%, 15% yield is still showing a lot of liquidity question mark regarding your capital structure. So can you share us with your thoughts about how do you want to tackle your true debt pile? Are you thinking about how do you going to reduce your leverage going forward? Are you going to slow down some acquisitions going forward like other like some of your peers or what do you think about it. And also even from a equity standpoint, so a substantial portion of your operating profit actually went to interest payment. So with -- and once again, with your bonds are trading at 14% and 15%. So how do you balance the interest between your equity shareholder and your debt bondholders? Are you considering -- how do you balance the dividend because your dividend payment is definitely high that we are very glad on it. But if you're not pulling down the debt here, we will never get the net profit for our equity side of the valuation, right? So how do you balance the interest between the equity side and the debt side between the bond buyback, stock buyback and also your dividend payout and also interest -- your cost of financing?

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

Thanks for the question. Good question. We did acknowledge that, although the situation is stabilized. But our overall debt is pretty high. But let me specify that. Although the overall debt amount is increased, but structurally, the current portion of this long-term debt is actually improved significantly. If you look at the current portion of all this long-term debt, you recall by the end of the Q1, 51.9% of the overall debt, they are current. Now through the whole quarters, optimization in operation, the current component already go down to 33.6%, which means that current portion of this overall debt reduced by 33.8%. It's still high. So from the overall debt point of view, our intention is here to overall balance bring under control and reduce it, like in the next 3 to 6 months. We would achieve this through fair means. First of all, we will improve our performance by increase the profitability, improve the turnover, more cash generate coming from the operating activity. We will use this fund to pay down certain outstanding debt. As at this point, facing the current portion of debt, which mature in the next 12 months, we have either laying down funding prepared for those debt payment or some of them as at this point, we already paid down. So overall, you will see a decrease of the overall debt as well as the improved debt-related ratio in a quarter or 2.

We do need to strike a good balance between our equity shareholder and debtholder. We want to maintain a track record and pay out consistent dividend to our equity shareholder. But we only do so by doing a careful cash planning and make sure that we have sufficient fund to not only keep the liquidity on our operation, but have all the fund prepared to deal with the maturity of our debt out there.

Overall, we will need to strike this balance. As time passing by, when we improve our profitability, and then we tap into further equity issuance opportunity, we believe that in a few quarter, we'll have a good balance between -- a better balance between the equity investor and debt investor. The overall cost of the borrowing or the overall cost of the capital will reduce in 2 to 3 quarter. I hope I answered your question.

Edward Choi

I also have a second question. In terms of your FX exposure because majority of your cash flow is inside China. So do you hedge your U.S. dollar bond? if -- so what is your currency FX policy going forward? Are you planning to hedge or are you planning to reduce your U.S. dollar exposure?

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

Yes. Majority of our FX exposure which is those -- when you talk about those U.S. dollar-denominated senior notes, it was leased in our U.S. dollar functional currency entity. So they are not subject to the FX fluctuation. The only exposure is coming from some intercompany loan, that the overseas subsidiary expand to the Chinese domestic entity. At -- on weighted averages on last year, we had about USD 400 million -- actually Chinese yen denominate alone sitting in the U.S. functional currency. Right now, the exposure go down to equal to USD 170 million. Facing those exposure, we actually set up FX strategy that's the reason you see that. Comparing to last quarter, we achieved a pretty good FX hedge effect. The net FX movement after the hedge is only USD 29,000 for that USD 170 million exposure.

Edward Choi

Okay. So can you share with us actually what proportion of your debt or your cash flow revenue stream is actually hedged?

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

The hedge exposure is on the intercompany loan, that extend from our U.S. functional currency to the Chinese domestic, which is Chinese yen functional entity. The intercompany loan was denominated in RMB. So on the domestic side, there is no FX fluctuation. But on the U.S. dollar functional currency side, we have debt exposure equal to about USD 170 million.

Edward Choi

Yes. So if I -- we have to understand...

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

And we expect that balance will be reduced when we pay down 2/3 of those balance from Chinese entity to the U.S. functional entity in prepare for the settlement of these senior notes that's going to be expired on August 31, 2019.

Edward Choi

Yes. Sorry -- we understand that the company has U.S. dollar as a functional currency in the balance sheet. But at the end of the day, it's majority of your revenue and your cash flow as -- in terms of Chinese yen. So just -- so at the end of day, I just try to get a sense, how do you resolve this currency mismatch between your RMB, CNY cash flow and U.S. dollar debt?

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

Yes. As you mentioned our business model, overall, we are reporting in U.S. dollar. But this majority net asset and revenue and cost resides in China, which is RMB functional currency. In essence, we are facing with a kind of FX impact. For this, results are closely monitoring it. We analyze it, but our FX hedge is only focused on the foreign currency monetary balance. We don't really hedge the revenue and cost, neither hedge on our net asset.

Operator

(Operator Instructions) We'll take our next question from [Herman Tai], private investor.

Herman Tai

So my first question is that about 6 years ago in 2012 and 2013, when Mr. Zhang was the CEO, the company had a much lower leverage, a smaller land bank and a higher equity turnover. But then for the past few years, the company increased its leverage dramatically, and also have a much larger land bank and a high revenue growth. Now Mr. Zhang is back, I wonder if we are going to the way of running Xinyuan conservatively? Or are you going to continue the high-leverage, high-growth strategy?

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

Okay. To some extent, you are right that Mr. Zhang is considering that approach, like increase the debt lever and increase those kind of inventory is not sustainable. We do believe that relying on our operating efficiency, increase the turnover, increase the profitability is -- might be a better way to address the uncertainty and the challenging external environment. We are looking at that kind of possibility. So overall, deleverage it, yes, to bring the debt level down, more relying on our own cash inflow from operating to be more healthy and more sustainable growth could be the direction. Thank you.

Herman Tai

Okay. So my other question is that there was an article published by the author called Li (inaudible) in June. So the article talked about Xinyuan, and she said that Xinyuan hired some external CEOs and other high-ranking executives from Wanda for the past few years. So -- and Wanda is another like real estate company from China. And the -- she said that overall strategy was a failure because comparing Xinyuan to other competitors, from Henan, like Henan Jianye, Xinyuan was -- the growth was much slower, even though it tried to internationalize, took a lot of external capital. I wonder have the Chairman and CEO read that article and what you feel about it? And what kind of mistakes you think Xinyuan have made for the past few years?

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

So first of all, XIN is the first and only Chinese domestic real estate developer listed in the New York Stock Exchange. We really care about the -- in compliance and stable and had a growth -- healthy growth.

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

(foreign language)

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

[Interpreted]

Comparing to a lot of peer company, including the listed one and private one, XIN is famous for our compliance and healthy growth, which means that all of our entity are consolidated or fell under the listed company umbrella. We don't have any off balance sheet financing. We don't have any not so incompliance and tricky operation like a lot of our peer company in China.

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

(foreign language)

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

[Interpreted]

In the last few year, we are not as focused on the short-term growth. We are also looking at the strategies, how to upgrade our business model, which including that on top of the mainstream real estate development business, we invest and trying to build up another side subsidiary that are related to the real estate business to -- as an overall strategy.

So with all these things coming in, you might see that our growth might not be as fast as our peer company, but when we strike the balance between healthy growth and the speed and the scale, we prefer to go by our healthy and steady growth path. We do have lesson in the past, but we pick up lesson from there. We will focus on Xinyuan's way. And we are also open for different kind of alternative opportunities.

Operator

We will take our next question from Suvas Patel, a private investor.

Suvas Patel

I had 3 questions. The first one is in the second quarter earnings, there was a net loss attributable to noncontrolling interest of $9.171 million. My question is who is this noncontrolling interest, and why is this figure so large?

And then the second question I had is on the earnings forecast for 2019, is a -- it'll be 15% to 20% more than 2018. Is that based on ASC 606 or the percentage of completion method that 2018 had used compared to 2017. And the last question is, there is some talk about Xinyuan delisting from the U.S. Is that really true or is there any chance for that?

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

Okay. We will answer the first question first, and I will leave the third one to the Chairman and CEO. The first one is about the -- in Q2 about the net income contributed to the minority interest. They are related to 2 projects in Suzhou and Kunshan which are 2 cities close by Shanghai, in Shanghai suburban. For those 2 project, we own -- our equity is about 17% and 20%, respectively. And for those 2 projects, they are pretty profitable. So -- which contribute about USD 5 million and $4 million, respectively, to these 2 minority shareholder. And the second question is about?

Suvas Patel

Earnings forecast?

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

Yes. Sure, the earning forecast. I got you. The earning forecast is based on our U.S. GAAP reporting standard. So those kind of the revenue and net profit is actually contributed by a combination of the full accrual method as well as the POC method.

In terms of the third question, let me -- give me a sec to revert to our Chairman and CEO.

As at this point, in terms of the privatization, we all hear that from time to time. At this point, the Chair of the Board haven't decide or haven't made the -- any decision on that one. We are open to all kinds of alternative to optimize our capital structure.

Operator

And it does appear that there are no further questions at this time. I'd like to turn the call back over to management for any additional or closing remarks.

Yu Chen ***Xinyuan Real Estate Co., Ltd. - CFO***

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

Operator

And this concludes today's conference call. Thank you for your participation. You may now disconnect.

[Portions of this transcript that are marked [Interpreted] were spoken by an interpreter present on the live call.]