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XIN - Q2 2009 Xinyuan Real Estate Co., Ltd. Earnings Conference Call

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CONFERENCE CALL PARTICIPANTS

Liang Hsu *Brean Murray, Carret & Co. - Analyst*

PRESENTATION

Operator

Good day, everyone, and welcome to the Xinyuan Real Estate Second Quarter 2009 Earnings Conference Call. Today's conference is being recorded.

At this time, I would like to turn the call over to the IR Director Ms. Helen Zhang, for opening remarks and introductions. Please go ahead.

Helen Zhang *- Xinyuan Real Estate Company - Director of Investor Relations*

Hello, everyone, and welcome to Xinyuan's Second Quarter 2009 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 US 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 those and other risks and uncertainties is included in our registration statement and our Form 25 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 discuss the general business climate, comment on current operations, and provide some perspectives on the Company's long-term strategy and its plans in 2009. He will be followed by Mr. Tom Gurnee, our Chief Financial Officer, who will go over the Company's financial results and provide some color on our results and our 2009 outlook.

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

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

Yong Zhang *- Xinyuan Real Estate Company - Chairman and Chief Executive Officer*

Hello, everyone, and thank you for joining us today. We are happy to report fully the quarter. Revenues were $91.8 million, exceeding the high end of company's guidance by $6.8 million. GFA sales were 128,000 square meters, exceeding the high end of company guidance by 18,000 square meters. These achievements were due to improvement in demand and a positive response for our properties. We were pleased to see that overall trend grew stronger each month throughout the quarter.

We also kept the tight focus on controlling our costs. The actions we have taken over the past year to reduce our expenses allowed us to achieve significant leverage on our SG&A expenses, compared to previous quarters and the last year. Given this improvement in revenues and the profitability, our cash increased from the first quarter as we continue to improve our balance sheet and financial position.

As we move into the second half, we are cautiously opportunistic. We expect the demand to remain solid. Though there are still some uncertainties as to whether the sales [gain] momentum, we will continue at the same rate. Our priorities for the remainder of this year remain; number one, to continue to drive stronger sales, while managing our expenses. Number two, further strengthening our management team. And number three, looking at growth opportunities, as well as speeding up our development.

The opportunities for Xinyuan to expand are growing given the improvement in demand and the government initiatives. Our unique business model, which focuses on high quality, affordable development, with quick asset turnover, should allow us to take advantage of these opportunities. We are well positioned as we move forward, and hope to maintain the progress we have made in the first half. We have a leaner cost structure, a solid cash position, many growth opportunities and strong management team.

With that, let me turn the call over to Mr. Tom Gurnee, our Chief Financial Officer to go over some details for the quarter and outlook for the rest of this year.

Tom Gurnee - *Xinyuan Real Estate Company - Chief Financial Officer*

Okay, thank you. As the Chairman stated, our revenue under the percentage completion method of accounting increased 130% over the first quarter, beating guidance as he said by about 15% by the midpoint. Meanwhile, gross floor area or GFA sales surged from 47,000 square meters to 128,000, up 170% and 25% over the midpoint of the guidance range.

Our aggregate ASP decreased slightly from RMB5405 per square meter, to RMB5343 per square meter. Given that we raised the prices of all apartment categories on all projects, this somewhat cries out for an explanation, so I will address that and I want you to please refer to the table in the press release.

Note that each project reported substantial GFA growth quarter-to-quarter from Q1 to Q2, the two biggest GFA sales gainers were Chengdu Splendid, and Kunshan International City Garden. Each of these projects reported price increases in the quarter, but each had an average selling price below the average for all projects. Thus, this uneven growth had a mix impact on aggregate ASPs for Xinyuan.

Even while a given project mix could be a factor, for example all ASPs increased in this table, except [Shandong] International City Garden, but a closer look at the Shandong International City Garden reveals that we nearly sold out all of our higher priced multi room residences, with a result that most of the current volume is of the lower priced studio apartment variety, whose prices did rise in the quarter -- it is just a mix within that project resulted in a lower aggregate ASP. In fact, pricing increased between 4% and 14% in the quarter depending on the project and the product type within the projects.

So back to sales volume. This has been a remarkably rapid turnaround in sales activity just in the first quarter. We saw our first uptick in March, and each month of the second quarter saw an increase of 25% or more over the previous month, such that in June we recorded GFA sales of 55,200 square meters. July and August GFA sales are each well ahead of June.

And, what do we attribute this too? Mr. Zhang commented on the quality of our projects and obviously there is a bit of a rising tide in the sector in China right now, but we should also recognize that our largest projects and our newest projects, Suzhou, Kunshan, Chengdu are still in their early sales cycles, and as the selling process matures, momentum builds.

Discounting in the early going of these projects to gain traction has largely paid off, and we now have the momentum to raise pricing. We are also seeing the effectiveness of the outsourcing of our sales efforts, which took effect towards the end of March of this year and was felt fully in the second quarter. Finally, there are some certain one-off factors. For example, the opening of the subway line near the Kunshan property, which greatly expanded the universe of potential buyers for that property.

Let's take a look at the rest of the P&L. Gross margin was recorded at 16.8% of revenue, slightly ahead of our expectations in the previous quarter. No material changes were made in the total project sales or cost estimates under the percentage completion method of accounting and thus, there was virtually no movement on margins. SG&A expenses rose in dollar terms in the quarter by $2.8 million from $2.7 million in the first quarter to $7.5 million in the second quarter, but they fell from 11.7% of revenue to $8.1 million in the second quarter.

Now, advertising and promotion expenses rose $1.4 million from a very low base of $0.3 million in Q1, and we basically shutdown all promotion in a cost saving mode, waiting for the market to show some signs of life. Payments to sales agents which was initiated for the first time in March, totaled $0.8 million in the quarter versus nil in Q1 as the outsource program was just getting underway. Also, compensation expense rose $0.6 million on higher variable compensation. I think this merits and explanation, so I will do that.

Most of our employees received a monthly salary of 60% of their maximum achievable compensation. Based on achievement of company sales goals, up to 20% of that maximum achievable compensation is payable in quarterly bonuses and another 20% of that maximum achievable compensation is payable in an annual bonus.

In the first quarter of 2009, we fell far short of our sales goals and, thus, we neither accrued nor paid quarterly or annual bonuses. In the second quarter, we accrued and paid 20% quarterly bonus and accrued 10% or half of the achievable annual bonus. Thus, there was nearly a 50% increase in compensation expense from Q1 to Q2 on this factor.

Going forward, compensation expense could rise a maximum, on this basis of another 10% or so, only on the accrual for annual bonus. So, there cannot be nearly as much movement in future on this phase. Looking back, this program was quite effective in keeping costs very low during difficult times, particularly in the first quarter.

At the end of the second quarter, a headcount reached 397, down from 645 at the year end of 2008. This obviously reflects the tight cost controls we put in place and a conscious program of headquarter cost control. But also, it reflects the outsourcing in the sales function, and the lower design activity because of no new projects. Moving forward, we expect headcount to creep up a bit, but in a tightly controlled manner and dependent on new projects and new activity.

The next line now in our P&L is our 45% owned joint venture, Zhengzhou Jiantou Xinyuan Real Estate, which contributed book profits to Xinyuan of $2.5 million in the second quarter, versus $1 million in the first quarter. Their sales and financial performance closely resembled Xinyuan's, in other words, higher GFA sales and expanding ASPs; that's what drove their performance.

Now, the increase in our ADS price in the second quarter is $6.48, as of June 30, that drove a non-cash warrant accretion charge in the quarter of $1.6 million, with a warrant liability valuation standing at only $2 million at the end of June 2009. At today's ADS price of $5.27 that liability would have been valued at $1.1 million, so you can see the volatility of this.

There are 5.4 million warrants outstanding, at a strike price of $5.60 per share, or $11.20 per ADS. These warrants expire April 2010, thus, if the ADS price does not exceed $11.20 between now and April 2010, the entire $2 million of warrant liability will find its way from the balance sheet to other income.

Now also, during the second quarter the Company incurred a $2.1 million tax charge, related to the Company's 2008 China tax returns filed in the second quarter of 2009, so I will try my best to explain it. The adjustment resulted primarily from a one-time tax charge based on central government interpretation clarified during the second quarter 2009.

According to the new interpretation, provisional deemed profit tax payments made prior to January 1, 2008, when tax rates were 33%, will be considered final and not subject to adjustment for the new tax rate of 25%, effective January 1, 2008.

Prior to release of the new interpretation, the Company accounted for income tax on presales as prepaid, or shall we say equivalent to withholding taxes, measured at the applicable current tax rate in the year sales occurred. Prepaid taxes were then credited against subsequent tax liabilities or obligations when sales were finalized.

As a result of the release of the new interpretation, the Company will no longer be entitled to credit prepaid taxes against subsequent tax obligations to the extent that those prepaid taxes were assessed based on a rate in excess of the tax rate applicable in the year the sales were finalized. That's a mouthful, but it should be noted that this charge was a onetime, nonrecurring item applicable to the sales made in 2007 and before.

That all resulted in the net income in Q2 of $3.9 million, versus $1.1 million in the first quarter, and we came in at the high end of guidance. We were a little bit disappointed with this. We considered this to be $7.6 million normalized net income, as we did not anticipate the one-off $2.1 million central government tax interpretation issue, nor did we forecast a change in the value of the warrants and its $1.6 million P&L impact.

So now, I will go on to comment on the balance sheet. At the end of June, we had cash of nearly $237 million, up $55 million for March, and up about $43 million from December. Cash flow from operations totaled $38.9 million, versus $14.1 million in Q1. Total debt reached $361.8 million versus $342 million in Q1, and $368 million in December 2008.

The balance of real estate property under development continues to fall; it fell to $584 million in the second quarter from $612 million in the first quarter, and $623 million in the fourth quarter of 2008. This reflects sales activities outstripping construction spending at this time.

The Company is resetting its balance sheet at December 31, 2008, and will be filing an amendment to its 2008 Annual Report on the Form 20-F to reclassify the carrying amount outstanding under its floating rate notes and convertible notes, totaling $95.6 million and we are reclassing that from non-current liabilities to current liabilities.

We became aware after the filing of our Annual Report on Form 20-F that we were not in compliance with certain financial covenants related to the notes, due to misinterpretations of definitions in the indentures governing the notes. We subsequently obtained waivers from the note holders of any defaults that may have occurred as a result of the non-compliance and we have amended the indentures.

But because we became aware of the issue and obtained the waivers after issuing the 2008 financial statements, a carrying amount of the outstanding amount under the notes as of December 31, 2008, should have been classified as current liabilities rather than non-current liabilities.

This restatement has no effect on the Company's consolidated statement of operations or cash flows or even changes in shareholder's equity for the year ended December 31, 2008. The June 30, 2009 balance sheet reports the carrying out of the convertible notes once again, back into non-current liabilities, since the waivers were obtained prior to the issuance of the second quarter financials.

The floating rate notes on the other hand continue to be reported as current liabilities as of June 30, 2009 in light of their April 2010 maturity date.

So in -- now to take a look at the outlook for the rest of the year. The GFA sales trend established in Q2 and continuing thus far into the third quarter and the ASP increases accelerated, we feel compelled to update our guidance for the quarter and the year. So, for the third quarter, GFA sales are expected to reach 175,000 to 190,000 square meters. Revenue under the percentage of completion accounting method is expected to fall between $130 million and $140 million, and net income should reach $9 million to $12 million in the quarter.

For the year 2009, we see GFA sales up about 50% for the previous guidance to 500,000 to 520,000 square meters. We see revenue up about 40% from the previous guidance to $380 million to $400 million. Full year net income is revised upwards by 100% to $20 million to $23 million. We expect continued leverage on operating expenses. They will grow less than revenue and should trend below 8% of revenue in the second half.

So finally, I should note what is next for us on the growth side. The Longhai Road, or we call it the Alcohol Project, is due to commence construction starting next month. In addition, the Company is now preparing and participating in land auctions including two auctions this week. So we are back looking at expansion possibilities and, of course, we are doing it in a cautious way.

So that concludes my statement, and I will turn it back to the moderator.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

We will take our first question from Liang Hsu with Brean Murray.

Liang Hsu - *Brean Murray, Carret & Co. - Analyst*

Hi, good morning. Congratulations on the great quarter.

Tom Gurnee - *Xinyuan Real Estate Company - Chief Financial Officer*

Thank you, Liang Hsu.

Liang Hsu - *Brean Murray, Carret & Co. - Analyst*

I was just looking at your average in selling price in Q2, I know that you sort of explained why the price came out lower sequentially, but if we just look at year-over-year, the overall market seems to have already accelerated. According to a survey condition by the Statistic Bureau, actually just now, recently, the average market price across 70 cities in China, actually increased year-over-year in June.

So does this mean that you have not been able to raise your selling price as much as the competitors? And, how would your selling price be relative to the market rate in their respective categories?

Tom Gurnee - *Xinyuan Real Estate Company - Chief Financial Officer*

Maybe I will try to answer the first, and then I will get you to repeat the second so the Chairman can answer. Okay. Our three biggest projects are Suzhou, Kunshan and Chengdu. They all had late starts in 2008, so year-to-year comparisons are difficult because they virtually got rolling in the fourth quarter. And yes, we did some discounting particularly in Chengdu to get those projects off the ground in Q4 and Q1, but since then they have accelerated quite nicely.

In fact, like I said in my prepared remarks, ASPs increased just in the second quarter 4% to 14% depending on the property and the type of unit. Since June, between June and the end of August, we have had an average ASP increase of 10.5% -- some as high as 20%, some as low as 5%.

So, we are seeing acceleration of ASP increases. We probably could be accused of keeping our prices a little lower than others in the early going to get traction on these projects, but I think it was justified given the lack of maturity of the projects, that they were quite new in their sales cycles.

Did that help?

Liang Hsu - *Brean Murray, Carret & Co. - Analyst*

Yes. But you did mention you still applied more discounts in order to attract a sell. That's your pricing strategy down the road, right?

Tom Gurnee - *Xinyuan Real Estate Company - Chief Financial Officer*

Let me understand that. We would employ more discounts --.

Yong Zhang - *Xinyuan Real Estate Company - Chairman and Chief Executive Officer*

(spoken in Mandarin)

Helen Zhang - *Xinyuan Real Estate Company - Director of Investor Relations*

The total revenue in Q1 actually comes from old projects which is of higher price. In Q2, especially in terms of projects like Kunshan, Chengdu, and Suzhou, average price is comparatively lower than those of the old projects.

Liang Hsu - *Brean Murray, Carret & Co. - Analyst*

So do you have like new projects coming up that would benefit from lower costs and higher margins -- their going to start in 2010?

Tom Gurnee - *Xinyuan Real Estate Company - Chief Financial Officer*

Yes, we have two pieces of land, one in Zhengzhou that I referred to in my remarks called the Alcohol Project or the Longhai Road Project. We also have another piece of property in Chengdu adjacent to that one. The Chengdu property will likely begin construction in about -- towards the end of 2010, 2011 maybe end of --. But the Longhai Project is slated to begin in October. That will start contributing presales in April/May of next year. So, you won't have a P&L impact until April/May of next year.

But I should note -- I should embellish what the Chairman said. He brought up a very good point that as you have new projects, the pricing is naturally lower for a couple reasons; number one is to get traction. Number two is, it's a longer discounted -- time value of money until we get the delivery of their apartment. The early sales have to wait a year, a year-and-a-half to get their apartment, the later sales maybe only a few months. So, there is a natural increase over time even in a flat market of the project.

Yong Zhang - *Xinyuan Real Estate Company - Chairman and Chief Executive Officer*

(spoken in Mandarin)

Helen Zhang - *Xinyuan Real Estate Company - Director of Investor Relations*

I would like to emphasize on one project, which is Kunshan, a project near Shanghai area. We acquired the land at comparatively lower cost. And in term of the ASP, in Shanghai the ASP was in the range of RMB50,000, but in Kunshan ASP was in RMB6,000 to 7,000, and we believe that product can be enjoy a better profitability in the future.

Yong Zhang - *Xinyuan Real Estate Company - Chairman and Chief Executive Officer*

(spoken in Mandarin)

Helen Zhang - *Xinyuan Real Estate Company - Director of Investor Relations*

Another project I would like to talk about is in Chengdu. We acquired the land about two years ago and at comparatively lower costs, and we believe that in the coming years we are going to enjoy good profitability.

Liang Hsu - *Brean Murray, Carret & Co. - Analyst*

Okay. Great, thank you very much.

Tom Gurnee - *Xinyuan Real Estate Company - Chief Financial Officer*

Thank you.

Operator

(Operator Instructions)

If there are not further questions, I would like to turn the call back over to management for any closing remarks.

Tom Gurnee - *Xinyuan Real Estate Company - Chief Financial Officer*

I want to thank you very much for tuning in, and we hope to confirm beating those guidance numbers we gave you tonight next quarter when you dial-in. Thank you.

Operator

That does conclude today's conference, we thank you for your participation.
