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XIN - Q2 2014 Xinyuan Real Estate Co., Ltd. Earnings Call

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PRESENTATION

Operator

Good day, everyone, and welcome to the Xinyuan Real Estate Company Limited Second Quarter 2014 Earnings Conference Call. Please note that today's call is being recorded.

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

William Zima - *ICR, Ltd. - Managing Director*

Thank you, operator. Hello everyone, and welcome to Xinyuan's second quarter 2014 earnings conference call. The Company's second quarter earnings results were released earlier today and are available on the Company's IR Web site, 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 Private Securities Litigation Reform Act of 1995. Forward-looking statements involve inherent risks and uncertainties. As such, the Company's results would 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. Yong Zhang, the company's Chairman who will comment on our operating results and provide some perspectives on the property market environment. He will be followed by Dr. Manbo He, 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. The Company's controller Ms. Helen Zhang will also be on the call.

Following management's prepared remarks, we'll open the call to questions. During the Q&A session, Mr. Zhang will speak in Mandarin, and his comments will be translated in English.

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

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

Hello, everyone. Thank you, Bill. Good morning and thank you all for joining our second quarter 2014 earnings conference call. During the past several quarter, China's real estate market began to slow due to credit tightening and market adjustment were ongoing market consolidation and

[sale] with the larger developer, our smaller peers. However, we outperformed here on [China] new conditions and still experienced a sequential and year-over-year key asset sales increase in the second quarter.

Our contract sales and revenue in the year lower than expected mainly due to slower sales and our projects in Suzhou and Beijing. Our CFO will describe the performance of this project in greater detail.

During the second quarter, we did not acquire any new land parcels, but we simply rent a land in Xi'an and initial public auction price. With the good traffic and greater value in that region and are excited to enter Xi'an City -- in the city -- in the Xi'an City, one of the largest city in Northwest China, where we will continue to cautiously expand our land bank in second half of 2014 for future development.

For the remainder of the year, we expect to remain active with our project activity. We have five new projects that are scheduled to commence presales in second half of this year. We expect this [program] to contribute with greater levels of year-over-year growth in the second half of the year. As we've said in the first quarter earnings call, 2014 will be back-end loaded.

Now please allow me to turn the call over to our new CFO, Dr. Manbo. He joined our management team a month ago with extensive experience in accounting, financial reporting, operations, and corporate governance. Okay, please.

Manbo He - *Xinyuan Real Estate Co., Ltd. - CFO*

Thank you, Mr. Chairman. Hello, everyone. This is Dr. Manbo He speaking. I'm the CFO of the Company. Now I'll take a little time to give a brief review about the Q2 result for Xinyuan for the second quarter of 2014.

Firstly, let me take a look at the overall market situation. For the first half of 2014, many of us have [feeled] the economic pressure, especially in this various state development industry whereby statistics most of the companies are facing -- actually have experienced a slowing down in both sales and revenue and also profitability.

To my knowledge, over half of the public companies, the public real estate developers have reported the result, which are far below their previous expectation. That being said, we just take a little time to go through whatever happened to Xinyuan for the second quarter. The overall situation is as the Chairman have just mentioned that the credit tightening situation have been going on since the very beginning of this year, which put some tremendous pressure over for the developer to get the loans for developing and also for the buyers to get the mortgage.

And also the -- because of all that the overall property market has been softened. The trend of the industry or business consolidation is showing a stronger sign overall and the -- there is a clear signal that the bigger company in this industry is getting stronger and bigger, while the rest of them which unfortunately including Xinyuan is trying to either get [us] into the upper level of scale or facing the challenge of either being acquired or being just left to whatever that the market has left for them.

And we see the trend of the policy change starting from actually the later part of June that the restrictions on either the development loan or on the mortgage has been [is not] and which is part of the effort from the government from different levels of stimulating the market and that is the trend has been going on since June up to now and we don't see any other obstacles for that to continue in the rest of this year.

Now back to Xinyuan's result, from the contract sales and also from the average selling price, over the first half of 2014, Xinyuan has actually outperformed peers, even though the overall market is quite challenged and difficult. Our first quarter contract sales increased by 24% year-over-year and also our average selling price has increased by 22% year-over-year.

And for the GFA figure, our GFA sales of 149,000 square meters actually has over performed the number in the first quarter, which is 127,000 square meters. And also even a little bit more than what we did on the same quarter last year, which was a very strong quarter back then.



And on the dollar figures, the contract sales totaled \$198 million, which is much lower than our first quarter results and but still a bit higher than our second quarter in last year. We did [miss] the target of our \$277 million target for this quarter and for some of the regions we performed much better than the rest and I will go through a little bit more details about the regional performance results.

For instance, our better performed projects including Zhengzhou Thriving Family and Zhengzhou Xin City and those two projects actually did very well for second quarter and actually continued from the first quarter. And also our Jinan projects which is the target, those are the two barriers, whereby Xinyuan had a very history of a strong performance ever since the establishment of the business and it remains their position and that also will be the key focus of the future development as well.

However, some of the other cities where we had our projects are not up to our expectation, for instance our Suzhou Lake Royal Palace project, the -- for the second quarter we budgeted for a sales of RMB120 million which did not happen at all due to the later position of sales permit and also the slow sales of villa product. By the way, that's the only saleable product by our market research due to the construction progress.

Although in the second quarter that project didn't contribute anything to our overall performance, we still remain confident that for the coming quarter, for the third quarter we will see a much better performance as we launch our high-rise product.

Another project in Suzhou, the Xin City is Suzhou Xin City and we have targeted for RMB160 million sales which we only were able to complete 108 million out of that target. That's also due to the sales slowdown, because the last -- there is only one last been left to maintain a higher profitability.

And the next one is our Beijing Xindo Park project. We targeted for over RMB400 million sales where we only been able to finish RMB149 million. Because for the second quarter, we only had commercial property available for sale, but that location the total price for each closure unit is much higher because we designed for a larger space unit and under the circumstance its very difficult for anyone to sell large scale commercial properties in cities like Beijing and elsewhere. However, we're doing our best trying to cut it smaller phase and also we will have more residential units available in the third quarter. So we're expecting much better performance in the second half of 2014 of our Beijing Xindo Park project.

So overall, our revenue for the second quarter amounted to \$166 million compared with our first quarter number of \$226 million, we're a bit shy and also we are not even meeting the historic results for the second quarter in last year, which was \$198 million. Because of all that our gross profit was also adversely affected, the gross profit for our Q2 was \$43 million or 25.8% of revenue. And that figure in the first quarter was \$59 million or 26.2% of revenue. And for the same quarter of 2013, that figure was \$69 million and 35% of revenue.

Moving forward to the expenses side, our SG&A expenses were \$35 million in second quarter which was much higher than our Q1 spending and also compared with second quarter of last year is also more than double that figure.

As a percentage of total revenue, SG&A were 21% for second quarter in comparison to 10.7% in the first quarter and also 7.4% in second quarter of last year, which is much higher. The reason for that are firstly we have a higher selling expenses related to four new projects, which was just launched in the second quarter and also we've spend on project bonuses which was accrued from the previous years result and we've also have accrued expenses for the new launch of the incentive program.

The total amount of the incentive program is \$8 million of which we recognized half of it in the second quarter and will recognize the rest of it in the second half of this year. Taking into that -- into consideration, excluding all those non-usual expenses, the actual SG&A expenses has remained the same level as first quarter of this year.

Next on -- moving on to the taxation portion of the second quarter, we were able to reverse around \$16 million LVAT which was accrued previously and our team has worked very, very intelligently and we had a settlement of our Zhengzhou Model City project on that tax and which resulted in an income tax savings of \$12 million in the second quarter.

And the bottom line for the net income for the second quarter was \$6.8 million compared to \$10.1 million for the first quarter and for \$39 million for the same period in 2013. The net margin was a little bit over 1% -- over 4% compared to 4.4% for the first quarter. So it's not so much of a difference, however, compared to last year the net margin is dramatically lowered. That figure for last year the same quarter was 19.8%.

Now let's look at the balance sheet items as of June 30, 2014, we reported a \$683 million in cash and cash equivalent which included the restricted cash compared to \$655 million as of March 31. Our total debt outstanding was \$1.3 billion, an increase of \$363 million compared to \$947 million at the end of the first quarter. The cash increase was largely due to the proceeds from bank loans and other debts in the aggregate of \$397 million, partially offset by the payment of \$290 million for land acquisition and deposits as well as the construction input.

The balance of the Company's real estate property under development at the end of the second quarter was \$1.5 billion compared to \$868 million at the end of the first quarter of 2014, which by the way means we will have more units available for sale for the coming quarters. The increase of property under development was primarily due to the land premium of newly acquired four land parcels. The first quarter recognized as property under development after paying off all the land premium in the second quarter we will have to move it to the property under development sector in accounting.

And next one is land acquisition. For the second quarter ending in June, we did not acquire any new land. We did acquire parts of land with GFA of 361,000 square meters in late July, which as our Chairman had mentioned is in the Daxing New District of Xi'an City. It offers a total side area of approximately 85,000 square meters and the price we paid for the land was RMB579 million, approximately \$93 million, which was actually the starting price for the auction.

As you may know, Xi'an City is largest city in the northwest China with a population over 8 million and is growing very fast at both economically and in terms of its population. And the Daxing New District is a new important international trade base which is also part of the China's National 11th Five-Year Plan in west regions.

As I mentioned earlier, we will continue to focus on existing cities, targeting higher margin projects for future development like the cities I mentioned previously including Zhengzhou and Jinan where we had a very strong history of good performance in the past years and also we're focused on the Tier 1 cities, especially in Beijing and Shanghai which we do see a very strong demand even for many years to come. We have the opportunities even greater while some others more to middle-sized company are under tremendous pressure.

Overall, we will continue to expand our land bank in 2014 for future development as we do see this is a very good opportunity for companies like Xinyuan to take advantage of the other distressed companies. And we plan to pay in the range of RMB7 billion to RMB8 billion or equivalent to \$1.1 billion to \$1.3 billion for land acquisitions this year.

As of June 30, we have paid RMB84.2 billion or roughly \$680 million for land costs and deposits. And the land acquisition plan for the rest of the year is more related to negotiated land parcels, whereby we will try our best to lower our costs in acquiring land.

And next one I'll move to our U.S. project. I will have a very brief update here and also later on I will ask John and Mike to add more details in terms of the U.S. project. As everybody might have already known that our New York Oosten development project is very much on track. We have completed all site preparation, demolition and foundation construction in the second quarter, which is a very good start for us to be able to get this project online and we can see some real hard result on our books very soon. And on top of that we also completed the construction of our sales gallery, which is comprised of a showroom and sales office now have a local New York sales force and I'm very happy to actually invite everyone that might have interest in seeing one of the project there with your own eyes.

This project commenced presale in late June and now as everything is [finished] that this project is off to a very good start. And in addition, we completed a loan of construction financing in June 2014 in the amount of \$165 million with Fortress Capital which is exclusively to support this project in New York City.



In addition to all that, we're continuing with our share buyback program and also our dividend payment program. For the share buyback portion as we remain confident about our future prospects, we repurchased approximately 910,000 ADS in the market at a total cost of around \$3.8 million in the second quarter.

And in the dividend payment side, Xinyuan's Board of Directors has approved the payment of a quarterly dividend of \$0.05 per ADS payable on September 12, 2014 to shareholders of record as of August 29, 2014. So that's pretty much the main points of our second quarter results.

We're also seeing challenges and opportunities through the first half of 2014 and like I mentioned before we're focused on acquiring more profitable projects from our historically strong performed cities like Zhengzhou and Jinan and in doing that we will raise the criteria of land acquisition and we will have a yardstick of the future acquisitions of land with the ROI of over 50%.

And also we will do our very best to expand our financing channels to lower the overall costs in financing of the projects we're talking about. Currently, our construction loan cost is anywhere between 6% and 8% of interest rate and our trust loans bears interest rate between 8.5% to 12.5%. So overall, the average financing costs for us is around 9.8% considering the tough and tightening credit situation in China, that number is not bad.

Now, for the forward looking guidance, the management have reviewed the situation carefully and we come to the conclusion that for the third quarter, we expect contract sales to reach approximately \$265 million to \$280 million and our revenue for the third quarter is expected to anywhere between \$220 million to \$230 million. And for the net income, the bottom line, we expect the third quarter result will reach anywhere between \$7 million to \$9 million and that's the outlook for our third quarter.

For the full-year of 2014, we expect our contract sales to reach RMB9 billion to RMB10 billion or roughly \$1.45 billion to \$1.61 billion and the net income for the full-year is expected to reach \$50 million to \$55 million. So that's the outlook for third quarter and also for the rest of 2014.

This concludes our prepared remarks for today. And now we're ready to take some questions. Operator? Thank you.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) And we will take our first question from Frank Thomas of Merrill Lynch.

Frank Thomas - Merrill Lynch - Analyst

On the stock buyback, is there any indication you might increase it given the vast amount of cash you have on hand and the fact that the share price is below book value? Thank you and I will listen to your answer.

Manbo He - Xinyuan Real Estate Co., Ltd. - CFO

Thanks, Frank. For the stock buyback procedures and which is a policy that the Company has always been carefully considering in terms of not just showing the Company's confidence in the future outlook of the business development and also to give investors the confidence of growth, which is not done at a daily basis and it is carefully strategically discussed by the Board to support any strategic decisions we are going to send some right signal to the market.

So I don't have any more details to share with you today on that specific area. However, if you're interested, I will for sure get somebody from the office of the Board of Directors to follow-up with you.



Operator

(Operator Instructions) And our next question will come from Matthew Larson of Morgan Stanley.

Matthew Larson - Morgan Stanley - Analyst

Good morning, guys. I want to touch on the share buyback also. It's nice that your buyback shares every quarter, but since the stock is trading at a multi-month low, if not, kind of within the lowest range its traded at for the last few years and you do have some cash and frankly by doing so, you save the dividend, you can decrease the float and it increases book value and earnings. Why not just buy several million just get it done, if you have the cash available, instead of piecemealing it out. That's number one.

And number two, I just like to just point out it, it looks like you're doing things in general right, if I read your numbers correctly, you expect to do \$55 million to \$60 million for calendar year 2014, so we're looking at five or six times earnings in a difficult environment there which frankly as a long-term investor that I'm it's fine with me, because the stock didn't do much when you were trading at three times earnings. And if you're growing for the future, I think that seems to be the right thing to do. You've got strategic investors through TPG involved and so it's really a longer term investment thesis at this juncture.

Let me ask you about Brooklyn, if I could, you touched on and said that you got it up and running and a sales office open, but if you started taking orders month, month and a half ago, you must have gotten some traction. I mean, I live in New York, Brooklyn is very strong. You read about these places selling out before they even put the foundation in. Can you give us any color on any sales trends thus far?

Manbo He - Xinyuan Real Estate Co., Ltd. - CFO

Okay. Thanks, Matthew. I will answer your first question with regarding to the share buyback again. As I mentioned before, which is strategic long-term policy, so for us like Frank asked before, we do have cash, however, we need to balance to see which is the best way for us to use our cash on, either to buy back a stock for short-term good looking on the stock price or we spend our money more on our real business development which will have the better and stronger and long lasting support to the stock price. So that's the answer to the first question.

The second question, I will handover to Mr. Liang from New York City and who is the General Manager in charge of North American operation. John still there?

John Liang - Xinyuan Real Estate Co., Ltd. - EVP - Investment Strategies & International Operations, Managing Director - US Operations

Yes, Dr. He. Matthew, in regard to the Brooklyn project, we're executing the sales in a relatively controlled manner, especially the rhythm and pace of sales. As you probably know, the Brooklyn Waterfront Condo market is extremely supply constrained and it's in a pretty consistent upswing in the last two years. So under that backdrop, it would be relatively foolish to try to dash to the finish line this early in the game. Typically as a U.S. developer, they would start a presale typically about 6 to 12 months ahead of the final delivery of the project.

As a strategic decision, the Company decided to start that presale process earlier. So we're probably 18 to 24 months before the final delivery of the product. So we're -- like I said, we're adopting a very prudent and controlled manner in executing our sales. But the trend is very encouraging.

Even before we completed the sales office, I will just give you an example, on our Web site, we had accumulated 300 names that registered -- registered potential customers and right now we had to slow down the sales, because the demand is too high and we wanted to gradually create this hype and we wanted to do it in a very limited and controlled manner, so that each customer is treated as a VIP on a exclusive basis. So they have this sense that prices will increase and we're getting them a privileged preview of our product. But right now, we have completed somewhere between 25 and 30 contract sales. And we're not in a rush to do more. We are doing it in a very controlled manner. Thank you.

Operator

(Operator Instructions) We will take our next question from [Chong Win] of [Ukror].

Chong Win - Ukror - Analyst

I just wanted to ask about the corporate aircraft. Now it was delivered to you, I think, last September and you have the aircraft for about almost a year now, and how has the aircraft help you do your business?

Manbo He - Xinyuan Real Estate Co., Ltd. - CFO

Excuse me, Chong, sorry for that, but I didn't quite catch the question. What's the question again?

Chong Win - Ukror - Analyst

The question is how has the corporate aircraft help you in the business?

Manbo He - Xinyuan Real Estate Co., Ltd. - CFO

Aircraft? Okay. We acquired the aircraft for the Company's business expansion in light of the business opportunity in this industry as I mentioned that we do see the trend of consolidation which means that there are many companies in this business that are under distress and also we see the opportunity of many projects under distress as well. And that's why it is required that our top management need to take a very detailed look into those opportunities on a timely manner.

So for that matter, actually, the use of aircraft has been helped a lot in speeding up the process for reviewing all those projects. Quite frankly, even though it seems like we are still not so fast in acquiring those projects, we do see the necessity of using any means possible to help us to look through all the possibilities as it comes around. And for that subject, I do believe we're doing all we can to use whatever means in the best way we can, and that's just one of it.

Operator

And as we have no further questions, I'd like to turn it back over to management for any additional or closing remarks.

Manbo He - Xinyuan Real Estate Co., Ltd. - CFO

All right. If there is no more questions, I just would like to take the opportunity to thank everyone for joining us today. And if you have any further questions, you can always checkout our Web site and also if you can always contact our IR Manager and also our IR firms to get further clarifications of whatever questions you may have. Thank you, operator.

Operator

And that does conclude today's conference. We thank you for your participation.

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