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Xinyuan Real Estate – NYSE: XIN

Xinyuan Real Estate develops residential real estate complexes, primarily for middle-income families in China and the United States. In China, Xinyuan has 31 projects in the planning stage or under construction in Tier I and Tier II cities, such as Beijing, Shanghai, Tianjin, Zhengzhou, Jinan, Suzhou, and Xi'an. In the U.S., the company has three residential projects. These projects are the Oosten in Brooklyn, the Hudson Garden in Manhattan, and the RKO in Queens.

COMPANY DATA

By Date: **07/28/2017**

Current Price	$5.39
52-Week Range	$4.26-$7.06
Shares Outstanding (mn)	70.65
Market Cap ($mn)	$346.88
3-Mo. Average Volume	150.16K
Total Cash ($mn)	$1,245.90
Total Debt ($mn)	$2,327.10
Dividend Yield	8.1%
Short % of Float	0.4%

KEY FINANCIALS

	Trailing Twelve Months
Revenue($mn)	$1,610
Net Income($mn)	$72.32
Enterprise Value/ Revenue	0.9
Price to Earnings	4.39
Return on Equity	8.61%
Return on Assets	2.84%

Source: Factset

SHARE PRICE PERFORMANCE

COMPANY OWNERSHIP

Shares Held By Insiders and 5% Owners	49.50%
% of Float Held By Institutions	18.13%
Number of Institutions Holding Shares	20

Source: Yahoo Finance, Ownership 2017 & Xinyuan Investor Presentation

RECENT INVESTMENT HIGHLIGHTS

- The company is strongly committed to its shareholders, with a dividend yield of 8.1% and a $40 million share repurchase program

- Xinyuan released strong first quarter 2017 earnings on May 18th. Revenue rose by 19.3% year over year, while gross margins increased from 20.8% in first quarter 2016 to 22.3% in first quarter of 2017

- We expect contract sales to increase by 25% quarter over quarter in second quarter of 2017 due to pre-sale permits for the Zhengzhou project that already achieved in June

- On June 9th, Xinyuan filed with the Singapore Exchange regarding its redemption of its outstanding 13% Senior Notes due 2019, which will be funded using a 7.75% Senior Notes due 2021. The corresponding bond holders, the outstanding principal amount of the 2019 Notes is US$200 million. The debt refinancing was completed by July 10th

- Xinyuan announced its plans to develop the Hudson Garden building in June 2016. There will be between 75 and 90 condo units, and the company has executed a lease with Target for the first floor's 18,977 square feet of space[1]

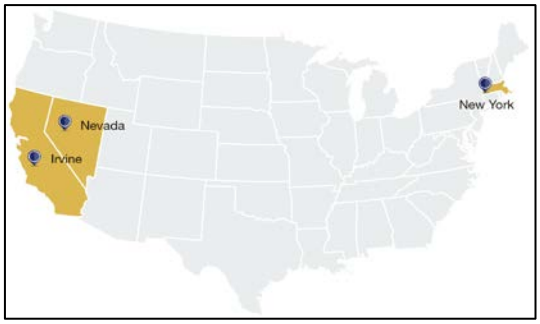
[1] The Real Deal, "Xinyuan moves forward with Hell's Kitchen condo project", July 13 2016

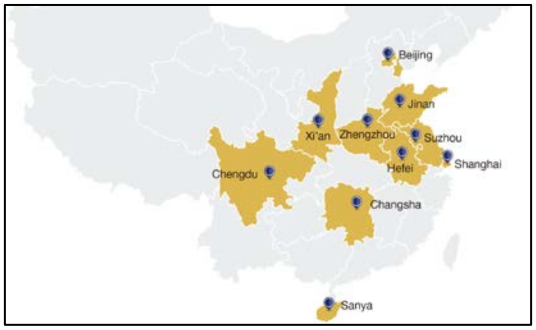
COMPANY DESCRIPTION

Xinyuan is a Chinese real estate developer that focuses on developing residential real estate in Chinese cities. Since its inception, the company has completed 41 projects and successfully sold 97% of its condos. This compares favorably to China's historical housing vacancy rate of 15%.[2] The company focuses on Tier I and Tier II cities, with 31 projects split between the two tiers. These projects represent approximately 5,918,000 square meters in gross floor area. Generally, there are four tiers of cities in China. Tier I cities are the most developed, have the largest populations, and tend to be directly run by the Chinese government.[3] Examples include Beijing, Shanghai, and Shenzhen. Tier II cities are the second most developed and are often provincial capitals. Examples include Zhengzhou, Jinan, Suzhou, and Xi'an.

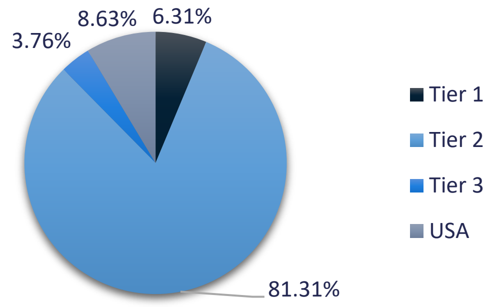
Xinyuan has also expanded into the U.S. market in recent years, with residential buildings throughout the boroughs of New York City. Specifically, in New York, the company has developments in Williamsburg, Brooklyn, Hell's Kitchen, Manhattan, and Flushing, Queens. The Williamsburg project, the Oosten, is entirely residential. The same holds true for the Queen's development, RKO. The Manhattan development is also primarily residential, with a grocery store on the first floor.

Besides the projects on the east coast, Xinyuan has acquired two pices of land available for resale in Irvine, CA and Reno, NV which were subsequently sold in 2015. Below is a map identifying the cities Xinyuan operates in and a pie chart identifying which regions the company derives the majority of its revenue from.





Source: XIN Investor Presentation



Source: JGR Capital Partners, Xinyuan 2016 20-K

[2] IPE Real Estate "Residential China: A tale of tier cities", April 2016

[3] South China Morning Post, China's tiered City System Explained, July 6 2016

INDUSTRY OVERVIEW

The Chinese real estate market is valued at over a trillion dollars and still growing fast
Currently, real estate is 15% of China's total GDP.[4] In 2015, there were a trillion dollars' worth of new home sales in China.[5] In 2016, this figure rose by 34%.[6] Industry-wide, real estate contract sales are projected to grow another 15% in 2017.[7] Xinyuan has a lot of potential to expand in this booming industry.

Increasing urbanization is the key trend that has lifted the Chinese real estate market higher in recent years
People are moving from rural communities to cities due to massive urbanization. This shift has occurred because economic growth is taking place in urban areas, not rural areas. The Chinese government encouraged this urbanization, making Tier I cities economic centers by setting up free trade zones within them.[8] They also encouraged banks to provide loans to developers who worked in these cities.[9] The rapid growth in urbanization can be seen in the chart below:

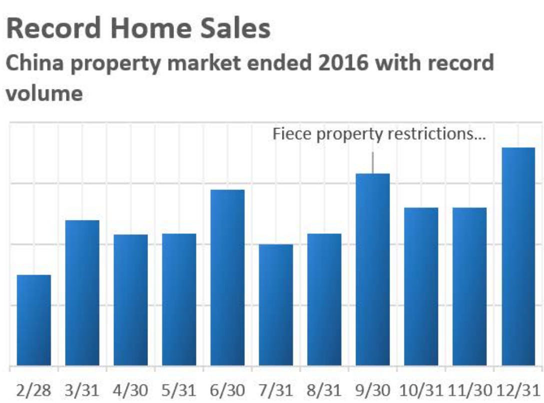
Source: Xinyuan Investor Presentation

Real estate is culturally significant and less price elastic in China
Property is culturally important in China. The imbalance between the number of men and women in China has heightened this significance, as men must be able to stand out to get married. One common way to do so is to buy property.[10] According to the Horizon Research & Consultancy Group, 75% of urban women in China believe being able to buy property is a key determinant when choosing partners for marriage. Partly because of this, parents often buy property as gifts for their children. Parents often see real estate as a stable investment. In recent years, local governments in various regions have raised inheritance taxes up to 50%. To circumvent this tax, parents often use their own money to buy property under their child's name.

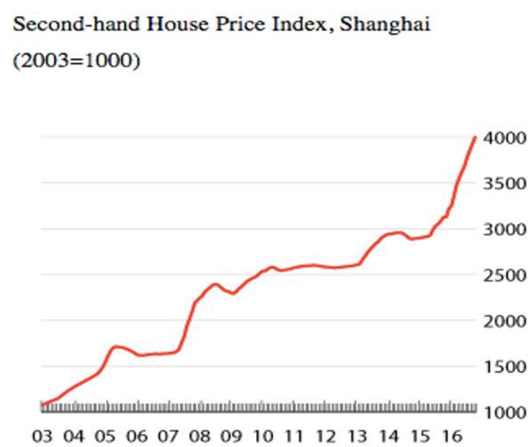
[4] Forbes, "China's Real Estate Sector is Overstocked", July 6 2016
[5] Forbes, "China's Trillion Dollar Housing Market: A Few Figures To Think About", July 12 2016
[6] China Daily, "China's real estate investment up 6.9% in 2016", January 20 2017
[7] Bloomberg, "China Property Stocks Priced for Disaster are Bargain to Goldman", February 7 2017
[8] Dezan Shira & Associates, "A Closer Look at China's Free Trade Zones" September 4 2015
[9] Reuters, "Loans to Chinese property developers surge again in Q1" April 24 2015
[10] The Economist, "The hypergamous Chinese", July 14 2013

Since 2008, Chinese local and national governments have released over 40 policies/regulations to clamp down on growth, but these efforts have shown minimal effectiveness

These regulatory actions have been designed to cool down the housing market, particularly in Tier I cities. Recently, in Nanjing and Qingdao, the government restricted people without permanent resident cards and people who already own a house from buying property.[11] They have also made it more difficult to qualify for mortgages in some cities. These actions lower demand by eliminating potential buyers and can even distort the market, making it difficult for real estate developers to sell condos. Despite this, housing prices have continued to rise, even in Tier I cities. Chinese regulatory policies have not hampered home sales growth or price growth, which can be seen in the two charts below. The bar chart shows how home sales reached an all-time high in December, despite stringent property restrictions being passed in September. The line chart shows how housing prices have skyrocketed in Shanghai since 2003, especially in recent years, despite government regulations.



Source: Bloomberg, 2017



Source: eHomeday, 2017

A few factors make China's potential real estate bubble less dangerous than some may make it out to be[12]

For one, Chinese buyers make larger down payments, usually greater than 30%, making them less burdened by debt. The Southwestern University of Finance & Economics found, even if housing prices across the nation fell by 30%, only 3% of Chinese buyers would become insolvent.[13] Also, although Chinese housing prices have been rising rapidly along with Chinese incomes, with nominal wages rising 13% year over year for the past decade.[14] There is a real demand for housing in Tier I, Tier II, and some Tier III cities, with a supply

[11] Xinhuanet, "More Chinese cities further restrict housing purchases to cool market", March 16, 2017
[12] Bloomberg, "Pinpointing the Bubble in China's Real-Estate Market", December 13 2016
[13] Forbes, "Why China's Housing Market Refuses to Crash", April 5 2016
[14] Forbes, "How People In China Afford Their Outrageously Expensive Homes", March 30 2016

shortage, due to the limited land available for development. These cities have been increasing overall Chinese real estate prices.

Recently, the Chinese government has been working to build a megacity in Xiongan, a county near Beijing[15]
The government hopes it will stimulate the economy of Xiongan, along with working to moderate housing prices in Beijing.[16] Some citizens also believe living in that city will give them access to Beijing's resources, including better jobs and education. Beijing is overcrowded, and real estate is unaffordable to many, so the Chinese government will likely encourage residents and companies to move to Xiongan, instead of Beijing.

REGULATIONS MAY HAVE LESS IMPACT ON XINYUAN THAN INVESTORS BELIEVE

The harshest regulations towards the real estate market have been for Tier I cities, which contributed only 6% of Xinyuan's revenue in 2016
These cities have seen the strongest growth in the past two decades, which is why the government has focused on lowering prices in these markets. However, the majority of Xinyuan's projects and revenue are from Tier II cities, unlike many of its competitors. Tier II cities have also seen strong price growth in recent years. Other major real estate developers, such as the $2.57 billion CIFI, are also expecting major growth from Tier II cities in the years to come.[17] This will be partly driven by the lack of land available for development in Tier I cities and Chinese regulatory actions that make it more difficult for investors to buy housing in Tier I cities. However, Xinyuan has roughly 50% of its projects under construction in Zhengzhou and Jinan, Tier II cities seeing real estate price growth of 20-25% year over year in 2017.[18] Xinyuan also has developments in Beijing, Tianjin, Chengdu, Changsha, and Suzhou, among others. All these markets are seeing around 20% growth, which should help boost Xinyuan's revenue.

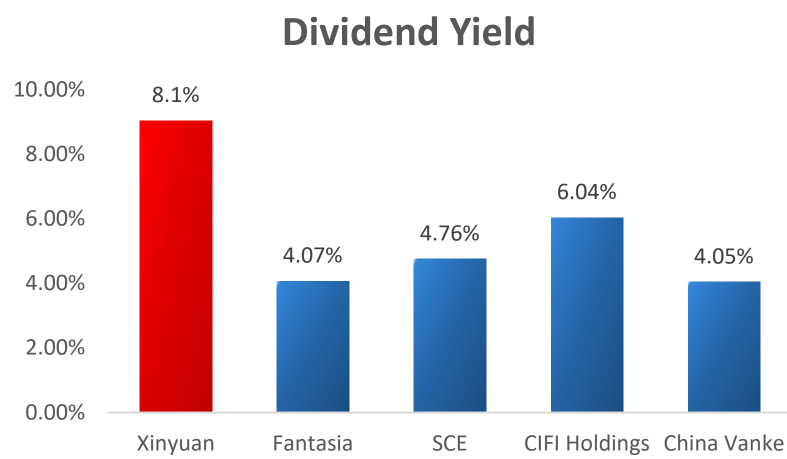
Even if Chinese regulatory actions should negatively affect Xinyuan's revenue, we would argue this scenario is already priced in
In September, the company traded at its 52-week high of $7.06. The announcement of property-buying restrictions caused it to drop to the $4-$5 range, where it trades. Despite this, in the first quarter of 2017 earnings, Xinyuan saw its revenue grow by 19.3% year over year, while gross margins increased from 20.8% in first quarter of 2016 to 22.3% in first quarter of 2017.

[15] Wall Street Journal, "China Looks to Build a Major City From Scratch", April 17 2017
[16] CNBC, "China to launch special economic zone in province hit by layoffs", April 3 2017
[17] South China Morning Post, "China's second-tier cities next in line for property boom, says Shanghai developer CIFI", March 8 2017
[18] Koneko Research, "March NBS Price Data in Chinese Cities With Home Price Restrictions", April 19 2017

ATTRACTIVE CAPITAL DEVELOPMENT

Over the past 12 months, Xinyuan has doubled the dividend and approved a new $40 million share repurchase program

The company now supports a 8.25% dividend yield, and the share repurchase program adds to the $9 million remaining (as of December 31, 2016) under previous buyback authorization. This dividend is very generous, even when compared to its competitors, as shown in the chart below. These returns are sustainable as well, as the payout ratio is only 28.3%.



Source: JGR Capital Partners

Xinyuan has been working to bring down expenses, particularly interest expenses, which will help improve net income and cash flow from operations

Paying historical debt with new debt at a lower interest rate would help Xinyuan effectively bring down its interest expense and increase cash flow from operations. On June 9th, Xinyuan filed with Singapore Exchange regarding its redemption of its outstanding 13% Senior Notes due 2019, which will be funded using a 7.75% Senior Notes due 2021. The outstanding principal amount of the 2019 Notes is $200 million.

HISTORY OF EXECUTING

Xinyuan has bought real estate developers in China to take advantage of the land these developers owned or projects already under construction

Buying land can be difficult and expensive in China, with land prices rising 5.3% in 2016.[19] Buying smaller developments is a good way to acquire land, as these developers bought the rights to land at lower prices. Since 2013, Xinyuan has acquired land in Kunshan, Sanya, Shanghai, Jinan, Beijing, and Changsha. The company is planning to acquire more land through acquisitions in 2017.

[19] China Daily, "China land prices increase in 2016", February 13 2017

These acquisitions have contributed significantly to Xinyuan's growth
Xinyuan's Sanya acquisition in 2014 and its recently completed development in fourth quarter of 2016 resulted in 23% increase in gross floor sales from fourth quarter of 2016 to first quarter of 2017. The average selling prices per square meter also increased 21% during the same period. Even assuming prices remains constant, the property would generate a total revenue approximately three times the cost of the land acquisition.

Since 2012, Xinyuan has expanded to the U.S. market by completing five land acquisitions
Two were acquired for resale in Irvine, CA and Reno, NV and were subsequently sold in 2015. The others, are residential projects in New York. One, the Oosten in Brooklyn, has been completed. Two other projects, the Hudson Garden in Manhattan and the RKO in Flushing, are still in their early stages. Xinyuan recently broke ground on the Hudson Garden property, while RKO is in the planning stage. It is also worth noting that Xinyuan has acquired 100% share of a Malaysian company that owns offshore landfill reclamation rights, demonstrating the company can pursue high growth opportunities globally.

ENTER U.S. MARKET OPPORTUNITY

By entering the U.S. market, Xinyuan differentiates itself from its competitors and lowers the overall risk by diversifying its real estate portfolio
The majority of Chinese real estate companies rely exclusively on performance of the Chinese market. Given the possibility of more restrictive regulations from the Chinese government, Xinyuan poses a significant advantage over its competitors as its expanding U.S. properties would be unaffected and contributing to sales.

So far, Xinyuan has been doing well in the U.S. market and looks poised for further success
The Oosten has 80% of their units pre-sold, despite only recently completing their construction. The Hudson Garden will be largely residential, with an anchor retail tenant on the first floor. Xinyuan has already successfully found this anchor tenant, the well-known Minneapolis-based retailer, Target.[20] The RKO building is relatively new, as the most recent of Xinyuan's U.S. developments. The company paid $175 per square feet for the land and plans to sell each condo for $1,150 to $1,300 per square foot, yielding attractive margins.[21]

Top 5 Best-Selling Buildings in NYC 2016		
1	The Greenwich Lane, Manhattan	Rudin Global Holdings
2	**Oosten, Brooklyn**	**XIN Development**
3	Navy Green, Brooklyn	Dunn Development
4	56 Leonard, Manhattan	Alexico Group, Hines
5	432 Park Avenue, Manhattan	CIM Group, Macklowe

Source: Property Shark

[20] NY POST, "Target to open a store in Hell's Kitchen", November 8 2016
[21] The Real Deal "With RKO Theater deal, Xinyuan makes big bet on Flushing", August 1 2016

Source: Xinyuan Investor Presentation

The success of Xinyuan's three initial projects is a great sign, as this success will allow it to continue tapping into the enormous potential of the New York City real estate market
Wealthy Chinese people are the top foreign buyers of real estate in America, particularly in New York City, with total investment into American real estate by Chinese buyers projected to grow to $50 billion by 2025.[22] Xinyuan's presence in China and the U.S. will allow them to tap into this growing market, *a critical advantage that few other real estate developers have*.

Xinyuan working with the Bank of Ozarks, improved the company's legitimacy in the U.S.[23]
Xinyuan received a $108 million loan from the Bank of Ozarks to help develop the company's midtown Manhattan development. This is critical for improving Xinyuan's legitimacy among American investors and lenders. Many American individuals and banks view Chinese companies suspiciously, due to previous Chinese companies having been accused of various fraud. This stigma has unfairly tarnished Xinyuan and hurt its valuation. We believe Xinyuan's increasing legitimacy will eventually result in investors having greater interest in Xinyan's shares. Increased trust in Xinyuan will also be a positive in other regards, as Xinyuan will be able to access more U.S. based funding and work with other real estate developers on bigger projects.

COMPETITIVE ENVIRONMENT

The real estate market in China is massive and competitive
There is fierce competition in the Chinese real estate market, particularly in Tier I cities. Xinyuan is also entering other competitive markets, like New York City and other major cities in the U.S.

[22] The Washington Post, Wealthy Chinese buyers are a growing force in U.S. real estate markets, October 14 2016
[23] The Real Deal, "Xinyuan scores $108M construction loan from Ozarks for Hell's Kitchen condo project", March 27 2017

Toll Brothers (NYSE: TOL) is a U.S. based real estate developer that develops buildings across the nation

It is large, with an $6.4 billion market capitalization. The company focuses on buildings in affluent suburbs, with properties in 19 states; it also has five projects in Manhattan and one development in Brooklyn, making it a competitor to Xinyuan. It focuses on condominiums, similarly to Xinyuan. Toll Brothers is working aggressively to attract buyers to its developments, offering to pay property taxes for Manhattan buyers.[24] This incentivizes buyers to purchase a Toll Brothers condo, instead of a condo in Xinyuan's Hudson Garden property. This may force Xinyuan to cut prices on its condos or offer to pay property taxes similar to Toll Brothers. Xinyuan's main advantage is it is targeting the lower end of the market, instead of luxury homebuyers. It is increasingly difficult to sell or rent luxury properties in New York City, as prices fall and the average sale time goes up.[25] The Hudson Garden project is priced at $2,000 per square foot, slightly above the 2016 Manhattan average of $1,760 per square foot.[26] This is an excellent position to be in; while luxury condos may struggle, the overall Manhattan real estate market is still healthy, with the average sales price of a condo rising 7.7% in 2016 (Samuel Miller).

Related Companies is one of the most active Manhattan real estate developers, having built 14 buildings between 2011 and 2015[27]

Related Companies is a private company that develops residential and commercial real estate. The company has properties in other major cities, but its focus is on New York City. It is working on the Hudson Yards development, an attempt by New York to expand the Midtown business district. While it competes in the same markets as Xinyuan, the projects Related Companies undertakes are larger in scale than, because related companies focus on the luxury side of the market, similarly to Toll Brothers.

China Vanke (SZSE: 000002) is the only major competitor that operates in both the U.S. and China

The company operates in the majority of China's main cities, with MarketWatch crowning it the second largest homebuilder in China.[28] Just like Xinyuan, it has not operated in the U.S. market for long, only entering the market in 2013. This puts the two companies on an even playing field. Recently, China Vanke has run into some legal trouble, having been accused of illegally selling property in the city of Xi'an.[29] The company is also struggling with its corporate governance. The largest shareholder of China Vanke Baoneng Group, and China Vanke's chairman publicly insulted the group, calling them "unwelcome."[30] Baoneng has been working to get rid of the current management. Evergrande, a rival developer, also bought a sizeable stake in China Vanke. The conflict between management and these shareholders escalated enough for the Chinese Securities regulator to criticize both groups publicly for not resolving the problem quickly enough. This conflict is still ongoing and will likely distract management, potentially hurting performance over the next few years.

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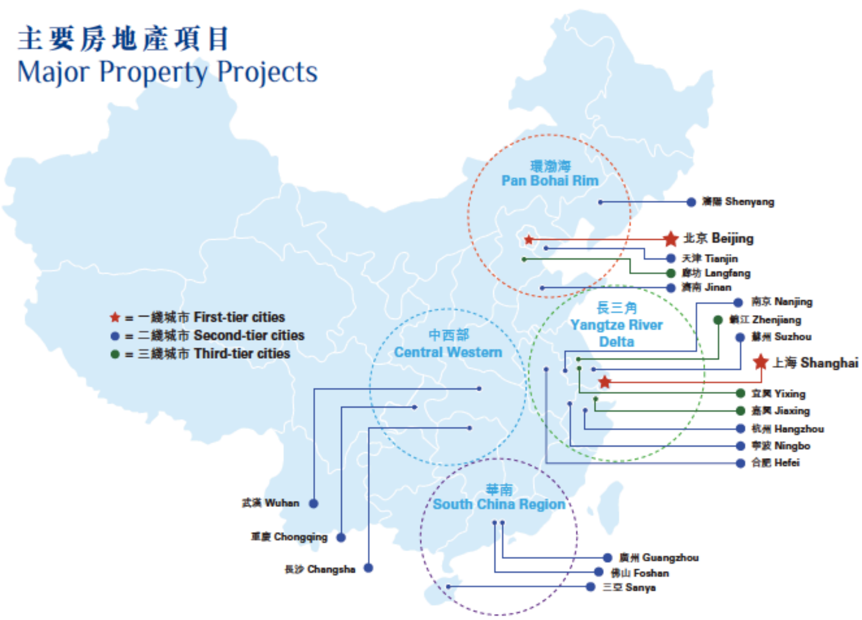
[24] Bloomberg, "Toll Brothers to Pay Manhattan-Condo Taxes to Attract Buyers", February 15 2017
[25] Business Insider, "The 'golden years' of New York City's luxury real-estate market are over", December 28 2016
[26] NY Curbed, "Despite a record-breaking year, Manhattan sales market frenzy is over", January 4 2017
[27] The Real Deal, "Manhattan's development machers", September 1 2015
[28] MarketWatch, "Homebuilder China Vanke net profit shoots up 16%", March 26 2017
[29] Financial Times, "City of Xi'an halts China Vanke property sales on suspicion of illegal activity", April 26 2017
[30] Bloomberg, "Battle for Control of China's Biggest Developer Spooks Fund Managers", August 11 2016

CIFI Holdings Group (SEHK: 0884) operates in numerous Tier I and Tier II cities, including Shanghai, Nanjing Suzhou, Hefei, Beijing, Jinan, and Tianjin

Xinyuan competes with CIFI in Shanghai, Beijing, Jinan, and Tianjin. CIFI has residential, commercial, and office space developments. It is a fierce competitor to Xinyuan, growing in sales by 75% in 2016. However, it has a larger presence in Tier I cities than Xinyuan, which leaves it exposed to Chinese regulatory actions negatively affecting its sales. By the end of 2016, CIFI had 30 major property projects, 12 of which were in the Tier I. Interestingly, the company sees strong growth in Tier II cities, projecting some cities will see prices double within a three to five-year time frame.[31]



Source: CIFI 2016 20-K

VALUATION

Comparable Company Analysis:

We compared Xinyuan to several other Chinese real estate developers that focus on Tier I and Tier II cities

Most of Xinyuan's competitors are not listed on the U.S. stock exchanges; rather, they are listed on the Hong Kong, Shanghai, or Shenzhen stock exchange. We used EV/EBITDA for our comparison, since many of these companies are larger than Xinyuan, and we wanted to make our analysis capital structure independent.

[31] South China Morning Post, "China's second-tier cities next in line for property boom, says Shanghai developer CIFI", March 8 2017

Bull Case:

Comparable Company Analysis ($ in millions) Company Name: Xinyuan Real Estate	Ticker	Market Cap	EV/EBITDA	P/E LTM	P/B	Dividend Yield
CIFI Holdings (Group) Co. Ltd.	SEHK:884	3,510.1	17.4x	8.7x	1.6x	4.2%
China Aoyuan Property Group Limited	SEHK:3883	1,159.7	9.3x	9.2x	0.9x	0.0%
Greentown China Holdings Limited	SEHK:3900	2,832.2	58.4x	10.3x	0.9x	1.3%
KWG Property Holding Limited	SEHK:1813	2,310.8	36.7x	4.7x	0.7x	10.2%
Yinyi Real Estate Co., Ltd	SZSE:000981	4,321.6	25.7x	141.2x	3.4x	0.2%
Kaisa Group Holdings Ltd.	SEHK:1638	1,993.2	NM	NM	1.1x	0.0%
Beijing Urban Construction Investment & Development Co., Ltd.	SHSE:600266	3,203.2	32.0x	52.4x	1.1x	2.0%
Jingrui Holdings Limited	SEHK:1862	464.7	-145	30.5x	1.0x	0.0%
Hangzhou Binjiang Real Estate Group Co.,Ltd	SZSE:002244	3,140.7	7.6x	12.3x	1.6x	1.0%
Sunac China Holdings Limited	SEHK:1918	10,145.4	93.8x	28.6x	3.1x	1.4%
Low		464.70	-145.0x	4.7x	0.5x	0.0%
High		10145.40	93.8x	141.2x	4.6x	10.2%
Mean		3308.16	15.1x	33.1x	1.4x	2.0%
Median		2986.45	25.7x	12.3x	1.1x	1.2%
Xinyuan Real Estate	XIN	380.79	9.85x	4.86x	0.38x	8.1%

Source: JGR Capital Partners

Bull Case
$8.26

Using the EV/EBITDA multiple, Xinyuan appears undervalued compared to its peers
Xinyuan has a 9.85 EV/EBITDA ratio, while the mean ratio is 15.1. Under a bull case scenario, we believe Xinyuan will approach this mean EV/EBITDA ratio, which would yield a price per share of $8.26. The average EBITDA margin among comparable companies was 12% in 2016, which is in line with Xinyuan's EBITDA margin. However, Xinyuan's EBITDA growth in 2016 was 64%, compared to the mean growth of its competitors of 46%, indicating Xinyuan should trade at a greater EV/EBITDA multiple than its peers.

Expansion into the major U.S. cities would benefit Xinyuan's financial and risk profile
Xinyuan would be more diversified than its competitors and less subject to regulations in China. This expansion would lower risk and increase their valuation their evaluation multiple.

Base Case:

Comparable Company Analysis ($ in millions) Company Name: Xinyuan Real Estate	Ticker	Market Cap	EV/EBITDA	P/E LTM	P/B	Dividend Yield
CIFI Holdings (Group) Co. Ltd.	SEHK:884	3,510.1	17.4x	8.7x	1.6x	4.2%
China Aoyuan Property Group Limited	SEHK:3883	1,159.7	9.3x	9.2x	0.9x	0.0%
Greentown China Holdings Limited	SEHK:3900	2,832.2	58.4x	10.3x	0.9x	1.3%
KWG Property Holding Limited	SEHK:1813	2,310.8	36.7x	4.7x	0.7x	10.2%
Kaisa Group Holdings Ltd.	SEHK:1638	1,993.2	NM	NM	NM	0.0%
Jingrui Holdings Limited	SEHK:1862	464.7	-145	30.5x	1.0x	0.0%
Hangzhou Binjiang Real Estate Group Co.,Ltd	SZSE:002244	3,237.7	7.6x	15.6x	1.8x	0.5%
Sunac China Holdings Limited	SEHK:1918	10,145.4	93.8x	28.6x	3.1x	1.4%
Low		464.70	-145.0x	4.7x	0.5x	0.0%
High		10145.40	93.8x	30.5x	4.6x	10.2%
Mean		3206.73	11.2x	15.4x	1.4x	2.2%
Median		2571.50	17.4x	10.3x	1.1x	0.9%
Xinyuan Real Estate	XIN	380.79	9.85x	4.86x	0.38x	8.1%

Source: JGR Capital Partners

Base Case
$6.11

We removed two companies from the comparable company analysis due to their market capitalization being too large relative to Xinyuan and having extremely high margins

Beijing Urban Construction Investment and Development and Yinyi has much longer operation time, higher profit margin and more diversified project, including highway construction and municipal project, making XIN difficult to compare with their business. And after removing these two companies, the average EV/EBITDA margin falls to 11.2, roughly 10% less than Xinyuan's EV/EBITDA margin. Under our base case scenario, Xinyuan cannot sufficiently improve its net income margin by refinancing its debt, causing it to trade at a 10% discount to these eight companies.

We are more conservative about the company's expansion in our base case model

One of the biggest benefits of expanding the company's U.S. presence is that it will lower Xinyuan's overall risk, because it will have more geographic diversification than its competitors, and Chinese regulations will have less of an impact on the company's financials. We consider both Yinyi and Beijing Urban Construction to be lower risk than the rest of Xinyuan's peers, as they are larger, have been operating for a longer period of time, and have achieved higher margins. The two companies are more diversified than Xinyuan, as they construct roads and public works, further lowering risk. If further U.S. expansion lowered Xinyuan's risk profile, it would allow us to include larger companies that receive higher multiples due to their lower risk, such as Yinyi and Beijing Urban Construction.

INCOME STATEMENT (IN THOUSANDS)	Historical 2014	2015	2016	Projected 2017E	2018E	2019E	2020E	2021E
Revenue	$ 919,744	$ 1,164,324	$ 1,561,625	$ 1,680,515	$ 1,840,164	$ 2,005,779	$ 2,166,241	$ 2,296,216
Percentage Increase	*N/A*	*27.1%*	*34.4%*	*16.0%*	*13.0%*	*9.0%*	*8.0%*	*7.0%*
Cost of Goods Sold	677582	$ 891,334	$ 1,203,636	$ 1,260,386	$ 1,361,721	$ 1,454,190	$ 1,548,862	$ 1,607,351
Gross Profit Margin	*26.3%*	*23.4%*	*22.9%*	*25.0%*	*26.0%*	*27.5%*	*28.5%*	*30.0%*
Gross Profit	$ 242,162	$ 272,990	$ 357,989	$ 420,129	$ 478,443	$ 551,589	$ 617,379	$ 688,865
Selling and Distribution	$ 39,494	$ 52,126	$ 58,213	$ 70,014	$ 76,665	$ 83,565	$ 90,250	$ 95,665
Percentage of Revenue	4.3%	4.5%	3.7%	4.2%	4.2%	4.2%	4.2%	4.2%
General and Administrative	$ 105,622	$ 115,329	$ 120,415	$ 117,636	$ 123,291	$ 130,376	$ 142,972	$ 151,550
Percentage of Revenue	11.5%	9.9%	7.7%	7.0%	6.7%	6.5%	6.6%	6.6%
Total Operating Expenses	$ 145,116	$ 167,455	$ 178,629	$ 187,650	$ 199,956	$ 213,941	$ 233,222	$ 247,216
Percentage of Revenue	*16.3%*	*14.8%*	*11.7%*	*11.2%*	*10.9%*	*10.7%*	*10.8%*	*10.8%*
Operating Income	$ 97,046	$ 105,535	$ 179,359	$ 232,479	$ 278,486	$ 337,648	$ 384,156	$ 441,649
Other Income/Expenses	$ 10,205	$ 33,739	$ 16,208	$ 28,262	$ 30,947	$ 33,732	$ 36,431	$ 38,617
Percentage of Revenue	*1.1%*	*2.9%*	*1.0%*	*1.7%*	*1.7%*	*1.7%*	*1.7%*	*1.7%*
EBITDA	$ 114,249	$ 148,026	$ 204,256	$ 270,605	$ 320,235	$ 383,154	$ 433,303	$ 493,744
Depreciation & Amortization	$ 6,998	$ 8,752	$ 8,688	$ 9,864	$ 10,802	$ 11,774	$ 12,716	$ 13,479
Percentage of Revenue	*0.78%*	*0.77%*	*0.21%*	*0.59%*	*0.52%*	*0.44%*	*0.52%*	*0.49%*
EBIT	$ 107,251	$ 139,274	$ 195,568	$ 260,741	$ 309,433	$ 371,381	$ 420,587	$ 480,266
Interest Expense	$ 28,201	$ 20,281	$ 29,857	$ 37,643	$ 41,219	$ 34,900	$ 33,360	$ 33,065
Percentage of Revenue	*3.1%*	*1.7%*	*1.9%*	*2.2%*	*2.2%*	*1.7%*	*1.5%*	*1.4%*
EBT	$ 79,050	$ 118,993	$ 165,711	$ 223,097	$ 268,214	$ 336,480	$ 387,227	$ 447,200
Income Taxes Paid	$ 30,558	$ 52,511	$ 86,248	$ 100,270	$ 120,547	$ 151,229	$ 174,037	$ 200,992
Tax Rate	38.7%	44.1%	52.0%	44.9%	44.9%	44.9%	44.9%	44.9%
Net Income	$ 48,492	$ 66,482	$ 79,463	$ 122,828	$ 147,667	$ 185,251	$ 213,190	$ 246,209
Minority Interest	$ 19	$ 1	-$ 6,485	-$ 2,314	-$ 2,534	-$ 2,762	-$ 2,983	-$ 3,162
Percentage of Revenue	*0.0%*	*0.0%*	*-0.4%*	*-0.1%*	*-0.1%*	*-0.1%*	*-0.1%*	*-0.1%*
Net Income for Shareholders	$ 48,511	$ 66,483	$ 72,978	$ 120,513	$ 145,133	$ 182,489	$ 210,207	$ 243,047

Source: JGR Capital Partners, Xinyuan 20-F

We calculated revenue projections based on property price growth data in 2017 provided by China's National Bureau of Statistics for Xinyuan's five biggest markets: Zhengzhou, Beijing, Jinan, Tianjin, and Chengdu

Growth in these markets has been around 20-25%, historically. We used half that growth, assuming Chinese regulatory actions would slow price appreciation in 2017. We then used the weighted average of the actual housing price growth and the halved growth to project revenue growth of 15.95% for 2017. This figure is in line with the industry-wide growth estimate for 2017 of 15%. We were conservative with future projections, decreasing the revenue growth rate from 2018 to 2021, assuming Chinese regulatory actions would affect Xinyuan negatively, with revenue growth falling to 7% by 2021. This compares to 27.7% and 34.4% in 2015 and 2016, respectively.

While Xinyuan saw its gross profit margin decrease in the previous years to 20-25%, many of Xinyuan's current projects have estimated gross margins of 30% or more

At the end of 2016, Xinyuan had 17 active projects in China. 15 of those projects have estimated gross profit margins of between 24% and 42.9%, while the other two projects have gross profit margins of 14.6% and 12.3%. Based on this, we projected a conservative increase in Xinyuan's gross profit margin, from 22.9% to 30% by 2021.

To project Xinyuan's operating expenses, we used historical averages for the selling and distribution and general and administrative line items as a percentage of revenue. These two items make up the majority of Xinyuan's operating expenses. For the past three years, the company underwent a significant expansion by acquiring new land and entering new markets. The company expects this downward trend to continue through 2017 as more projects approach completion, allowing the company to spread their costs. To capture this cost cutting, we assume the selling and distribution and general and administrative of 7%, 6.7%, and 6.5% of Revenue in 2017, 2018, and 2019, while remaining around 6.5% from 2020 onwards.

Similar to general and administrative expenses, depreciation and amortization expenses have declined trend over the past three years, when looking at the line item as a percentage of revenue. Therefore, we projected out depreciation and amortization using a three-year moving average.

HISTORICAL FINANCIALS

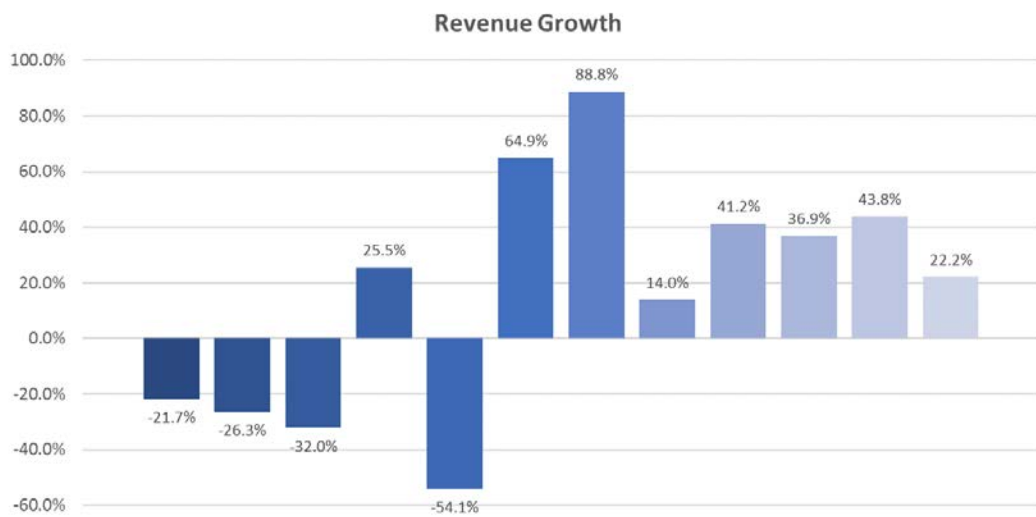
Income Statement ($)	FY 2014	FY 2015	FY 2016
Total Revenue	919,747,673	1,164,323,998	1,561,624,693
Real estate sales, net of sales taxes	$ 892,825,892	$ 1,134,466,776	$ 1,524,968,403
Real estate management services income	21,563,570	21,611,201	30,022,747
Real estate lease income	4,936,186	6,573,263	5,946,051
Other revenue	422,025	1,672,758	687,492
Revenue Growth Rate	N/A	26.6%	34.1%
Total Costs of Revenue	-677,582,117	-891,333,892	-1,203,636,380
Cost of real estate sales	-650,573,170	-866,242,863	-1,174,571,926
Cost of real estate management services	-20,439,545	-19,442,859	-24,281,442
Cost of real estate lease income	-3,173,215	-3,956,322	-3,682,645
Other costs	-3,396,187	-1,691,848	-1,100,367
Gross Profit	242,165,556	272,990,106	357,988,313
Total Operating Expenses	-145,116,061	-167,455,085	-178,629,347
Selling and distribution expenses	-39,493,575	-52,126,074	-58,213,716
General and administrative expenses	-105,622,486	-115,329,011	-120,415,631
Operating Income	97,049,495	105,535,021	179,358,966
Total Other Income/Expenses	10,205,255	33,739,298	16,208,421
Interest income	14,577,322	24,503,736	20,916,567
Loss on extinguishment of debt	-9,848,931	0	-12,123,750
Net realized gain on short-term investments	3,128,014	603,078	2,505,696
Unrealized gain on short-term investments	122,033	49,443	235,334
Exchange gains	706,108	403,286	458,959
Other income	3,212,606	5,945,120	4,540,227
Share of (loss)/gain of equity investees	-1,691,897	2,234,635	-324,612
Interest Expense	-28,200,767	-20,281,416	-29,856,832
Income from operations before income taxes	79,053,983	118,992,903	165,710,555
Income taxes	-30,557,618	-52,511,318	-86,247,875
Net income	48,496,365	66,481,585	79,462,680
Net loss/(income) attributable to non-controlling interest	19,365	522	-6,485,132
Net income attributable to Xinyuan Real Estate Co., Ltd.	$ 48,515,730	$ 66,482,107	$ 72,977,548
Earnings per share:			
Basic	$ 0.32	$ 0.47	$ 0.55
Diluted	$ 0.29	$ 0.45	$ 0.53
Shares used in computation:			
Basic	151,935,765	142,625,427	133,261,510
Diluted	177,118,235	146,487,949	137,653,029
Other comprehensive loss, net of tax of nil			
Foreign currency translation adjustments	$ (3,354,027)	$ (73,604,028)	$ (66,273,588)
Comprehensive income/(loss)	45,142,338	-7,122,443	13,189,092
Comprehensive loss/(income) attributable to non-controlling interest	19,440	-621	-5,846,269
Comprehensive income/(loss) attributable to Xinyuan Real Estate	$ 45,161,778	$ (7,123,064)	$ 7,342,823

Source: Xinyuan 20-K

Xinyuan has seen strong revenue and net income growth from 2014 to 2016

In 2015, revenue grew by 26.6%, while in 2016, it grew by 34.4%. This has been primarily driven by the real estate sales segment, which has benefitted from the strong housing market in China. Xinyuan has tightly controlled operating expenses, which only went up 15% in 2015 and 6.6% in 2016. This resulted in EPS growth of 55% and 20% in 2015 and 2016, respectively.

Interest expense increased roughly 47% in 2016 due to Xinyuan paying off debt early
This drove EPS growth lower in 2016**.** Much of Xinyuan's older and higher yielding debt has provisions that result in one-time interest expense when debt is paid off early. In 2016, Xinyuan recorded a $12 million loss on their early extinguishment of debt, while the company recorded no loss in 2015. EPS was also positively influenced by Xinyuan's strong share repurchase program, which resulted in shares outstanding decreasing steadily over this three-year period.



Source: JGR Capital Partners

Revenue growth can be inconsistant when looking at it on a quarter-over-quarter basis
Large condo sales may happen in third quarter of one year, while in fourth quarter of another year. This will be influenced by the macroeconomic growth in each specific quarter, which can vary year to year. The company may also finish constructing or selling a major property in the first quarter of one year, which will cause that quarter's revenue to seem unnaturally high. Over the course of a year, this lumpiness becomes more stable.

The company has roughly $1.2 billion in cash, with $300 million in restricted cash
Xinyuan has around $2.3 billion in debt, which is used to finance its projects. This may seem like a high amount of debt, but it is typical among real estate developers in China. Xinyuan also has $1.7 billion in real estate properties they expect to sell soon, spread throughout its major markets, such as Zhengzhou, Beijing, Suzhou etc.

Income Statement ($Thousands)	Q1 2016	Q4 2016	Q1 2017
Total revenue	235,384	505,340	280,714
Total costs of revenue	(186,490)	(378,507)	(218,147)
Gross profit	48,894	126,833	62,567
Selling and distribution expenses	(8,121)	(22,058)	(10,488)
General and administrative expenses	(23,408)	(30,226)	(25,017)
Operating income	17,365	74,549	27,062
Interest income	8,471	6,107	2,599
Interest expense	(5,000)	(13,236)	(9,325)
Net realized gain on short-term investments	109	198	588
Unrealized gain/(loss) on short-term investments	920	(623)	1,254
Other income	7	459	159
Loss on extinguishment of debt	0	(12,124)	0
Exchange (loss)/gains	54	261	(51)
Share of (loss)/gain of equity investees	42	(138)	(243)
Income from operations before income taxes	21,968	55,453	22,043
Income taxes	(15,073)	(38,735)	(14,625)
Net income	6,895	16,718	7,418
Net income attributable to non-controlling interest	(776)	(4,588)	42
Net income attributable to Xinyuan Real Estate Co., Ltd. Shareholders	6,119	12,130	7,460
Earnings per ADS:			
Basic	0.09	0.18	0.12
Diluted	0.09	0.18	0.11

First Quarter of 2017 Earnings, Source: JGR Capital Partners/Xinyuan 6-K

Xinyuan's first quarter earnings were strong

In the conference call for fourth quarter of 2016, management mentioned a project in Zhengzhou would likely negatively affect the first quarter of 2017 earnings due to a possible delay in receiving pre-sales permits. While the delay did occur, Xinyuan's revenue rose by 19.3%, compared to the same period in 2016. This strength comes despite the uptick in Chinese regulation. Two of the biggest factors contributing to this beat were average selling prices (ASP) increases and the success of the Oosten project. The latter represented 20% of revenue in 2016. Margins improved, with gross margins increasing from 20.8% in first quarter of 2016 to 22.3%. This margin improvement was primarily because units were sold in developments with higher margins in the first quarter of 2017, such as Zhengzhou and Kunshan. SG&A expenses decreased, as well, when expressed as a percentage of revenue, from 13.4% to 12.6%. The company also repurchased $7 million worth of shares, which contributed to EPS growing 22% year-over-year.

2017 outlook is strong

Foundational work has begun on the Hudson Garden development, and a general contractor has been found for RKO. The company has also allocated up to one billion yuan to fund land acquisitions for 2017. Land acquisitions are necessary to start future developments. Future quarters should also see a revenue boost from pre-sales for projects currently in planning/under construction. Efforts to decrease Xinyuan's interest expenses via refinancing have also seen further progress, with a $300 million 7.75% note offering completed in first quarter of 2017. In addition, the company expects the pre-sale permits for the Zhengzhou project to arrive in June. 2017 revenue will contribute to second quarter earnings growth, and management believes the company will see an increase of 25% contract sales, compared to the first quarter of 2017.

RISK FACTORS

The Chinese real estate market bubble is a major risk for Xinyuan's business

Xinyuan could see its sales decline significantly if the real estate market crashes. However, we believe it is unlikely for housing prices to decline sharply, due to the Chinese government's controls over the market.

The Chinese government may implement more regulations within Xinyuan's major markets, making it difficult for buyers to acquire property

The Chinese government could raise minimum down payments to 70% for first-time buyers, compared to the current 30-40% rate.[32] This would make it more difficult for real estate companies, including Xinyuan, to sell its properties, which would hurt revenue.

The company is exposed to foreign exchange rate risk

Xinyuan trades in USD and pays its dividend in dollars. However, it earns revenue and pays out expenses in yuan. If the yuan weakens sharply, it will cause USD revenue to decline. Xinyuan's US properties do partially offset this risk but the majority of its projects are still in China.

[32] Bloomberg, "China Property Stocks Priced for Disaster are Bargain to Goldman", February 7 2017

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