Management Discussion and Analysis

China Property Market

Looking back to 2009, China real estate market experienced a great change from "cold" to "hot" and went through a year of ups and downs. Under the domestic and international macro-economic environment, the Chinese government decisively adopted a series of economic stimulus measures and bailout policies, the domestic real estate market in 2009 got out of the shadow of the market downturn in 2008, leading the national economy the first to pick up with a performance continuously exceeding expectation. The turnover of property transaction in the second half of the year obviously increased and the property prices in certain core cities raised significantly. The Group seized the opportunity of the investment and M&A of quality projects and rapid return of funds during the best time of market conversion, which laid a solid foundation for the sustainable development of the Company.

Looking forward to 2010, this will also be a complex year for domestic and international economic situation. Under the background of economy stabilization and recovery, the national policy in this year will be mainly on stabilization and the prevention of inflation. With the further decline for the dependence on the real estate from the macro economy, showing solicitude for people's livelihood and differential regulation will become the main tone of the policy for property market in 2010. It is worth paying close attention to the following five development trends in the real estate industry in 2010: firstly, increasing competition in the industry; secondly, the second and third-tier cities in Mainland China will become a new hotspot; thirdly, numerous requirements for subsequent development are added to the government's land transfer conditions, and combating the practice of land hoarding will become a focus in real estate regulation; fourthly, the scale of transferring the land parcels for commercial and residential uses will gradually reduce, and SMEs will get more opportunities to obtain lands; fifthly, the government will promulgate more restrictive policies against market speculation and the behavior for investment purchases.

Business Review

The Group continued to deepen our national development strategy of "Regional Focus, Balanced Distribution" in 2009 and achieved a satisfactory sales performance: delivered area amounted to 522,800 square meters, and property sales revenue amounted to approximately RMB2,348.15 million, representing an increase of 285.6% compared with 2008.

Project	Delivered Area (thousand square meters)	Sales Revenue Amount (RMB million)
Chongqing Aoyuan • City of Health	304.5	1,130.28
Nansha Aoyuan	87.2	465.07
Panyu Aoyuan	43.8	261.62
Nanguo Aoyuan	38.5	259.16
Qingyuan Aoyuan	20.1	133.71
Others	28.7	98.31
Total	522.8	2,348.15

The performance in 2009 was significantly improved, which was among one of the indicators showing our successes in various fields of works. The Group decisively seized the opportunity and achieved a tremendous advancement and improvement in various aspects amidst the complex and volatile international and domestic economic situation in 2009:

Major breakthroughs achieved in investment and M&A

In respect of investment, the M&A strategy has achieved remarkable results. Through M&A, we successfully acquired Chang'an Ave, Aoyuan Zhongshan Plaza and Aoyuan Plaza, which laid a solid foundation for the future development of the Group. The deploy for national first-tier cities and resources-based cities has been revealed, and formed a deploy which is centered around regions such as Beijing, Guangdong Province and Shenyang; at the same time, we have successfully reserved quality land bank including Project of Shenyang Aoyuan • International New Town, which made our land bank reach approximately 9.0 million square meters in 2009, representing a significant increase compared with the land bank of 5.6 million square meters in 2008. The average cost of the land bank of only RMB544 per square meter has laid a good foundation for the future operation of the Group.

Continuous improvement in operating capacity of each project

The operating and management capacity of each project continues to improve, and their self-operation ability are enhanced. For instance, according to the official statistics published by Bureau of Land Resources and Housing Management of Chongqing Municipality, Chongqing Aoyuan • City of Health was nominated TOP 10 in a monthly ranking for Chongqing single site sales in 2009 for 10 times. In addition, Chongqing Aoyuan • City of Health also ranked No. 1 in terms of sales area and unit sales for a single site in Chongqing real estate market in 2009; Qingyuan Aoyuan, First Phase completed the works involving its demonstration area, launching and returning funds in sales within a relatively short time, and achieved a good performance of development and returning funds in the same year.

Significant broadening in financing channels

By continuous development and expansion of business channels between the Group and other banks and other non-bank financial institutions as well as the planning, design and implementation of the financing programs for the projects of the Group, we have obtained banking facilities amounting to RMB6.4 billion in aggregate and new loans for the year amounting to approximately RMB2.0 billion in 2009. We have applied to each bank to adjust the previous loans with higher interest rates, with the effective annual interest rate reduced from 6.9% in 2008 to 5.6% in 2009. Highly efficient financing capacity and foreign exchange business capacity have provided us a funding security for the project development, mergers and acquisitions of the Group, and made a great contribution for the investment and deploy of the Group.

More distinctive brand personality

In 2009, the Group's brand idea became clearer and its personality was more distinctive. The Group has established its theme involving the creation of a lifestyle of low carbon, health and regimen and a brand personality which is characterized with "building a low carbon and healthy living" in the future, and formed a unique development path with differentiation. The Group has established a standard design system of "low-carbon and healthy house" in respect of product research and development, and selected to apply the system to each project according to their characteristics, incorporating the brand concept of "low carbon and health" into the project development and construction. Among which, Beijing project "Chang'an Ave" reached a strategic advisory relationship with the initiator of China's low carbon property — "CIHAF China Home", using 15 world's leading low carbon technologies to build with all its strength a high-end "high comfort level" low carbon mansion. Nansha Aoyuan's five blocks were committed to building a luxurious mansion area with a theme of low carbon, health and regimen on the back of the natural ecological resources of "mountain, forest, lake, sea, spring" only distributed in Guangzhou; Aoyuan Zhongshan Plaza successfully declares "healthy house construction pilot site", and we are devoted to construct this project as the chief healthy life city in Zhongshan.

Improvement of the incentive and appraisal system as well as optimization of personnel structure

In 2009, we established and perfected the incentive and appraisal system, strengthening the concept of "Result is King", and together with the right positioning of our marketing management and cost control, the Group eventually completed its estimated annual sales targets ahead of schedule in October 2009. The lump costs of each project were controlled within the budget set at the beginning of the year. We invited a number of high-end talents to join the Group around 2009. In order to enable these high-end talents to adapt our management culture and improve themselves as quickly as possible, we strived to create a good communication environment for them.

Future Outlook

In 2010, the Group has established an operating guiding ideology summarized as "taking marketing as its orientation, taking economic benefits as its goal; taking the achieving of maximum benefits for projects and the Group as a whole as its purpose, giving consideration to improve the Group's brand value as well". We also insist on the implementation of the incentive and appraisal system summarized as "Result is King, Effectiveness comes First", and re-examine the project development strategies and pace in respective areas. We commence our major works specifically in several aspects below:

1. In respect of the operation of regional project company: taking the completion of 2010 operation plan and maximizing overall profit for projects as its goal, coordinating and arranging management to the projects during the whole development cycle, achieving the four-class resolution of target plan as well as putting the business indicator into the daily actual work of each division for implementation. In connection with the new changes in the market, by product positioning and planning, comprehensive development of cost planning during the whole process, product cost performance improvement planning, supporting the promotion of integrated and systematic work of marketing objective, etc, which greatly enhance the profitability of the projects, and while laying the foundation for rapid growth and future benefits of the projects and the Group, we strive to put the integrated management level of the Company to a higher grade through an effective operating management.

2. In respect of design management and product research and development: focus is put on conducting the technical research involving low carbon, health, energy-saving house, and we continue to improve the system documentation on design and guidance and product design standards of the Group, maintaining and updating product library series, upgrading design standardization especially the guide for fine decoration standard, and gathering all efforts to build a new generation of outstanding property series of the Group.

3. In respect of brand promotion and marketing management: adhering to the development notion of "creating a low carbon and healthy lifestyle", and combining of the Group's product strategy of "building different series of low carbon and healthy house", the Group will unite and integrate quality resources and customers of various project and closely align brand promotion with marketing campaigns to form a distinctive brand image of the Group and contribute to a remarkable enhancement in the Group's brand value by adopting effective measures.

4. In respect of team building and incentive-based management: the Group will continue to take an incentive and appraisal approach whereby "actual operating performance" in terms of sales, profit margin and profit amount of the respective projects will be the core indicators in appraising our staff members. High-calibre key personnel will be trained and developed to form a pool of talents serving different business lines of the companies under the Group.

5. In respect of land reserve, investment and financing: through the acquisition of equity interests, cooperation with funds, and via auction, tender and listing-for-sale, the Group will endeavour to hold the development opportunities in the second-tier hotspot cities while expanding in first-tier cities including Guangzhou, Beijing and Shenzhen, in order to accumulate quality land bank for the Group. In addition, efforts will be stepped up for getting more involved in old-city redevelopment schemes in the year 2010.

In 2010, the Group plans to commence the development of new construction area of approximately 867,000 square meters and completes approximately 600,000 square meters.

Land Bank

In 2009, the Group still adhered to a prudential and rational land bank strategy. With the principle of "Regional Focus, Balanced Distribution", the Group increased its land bank in its existing focus region (such as the Pearl River Delta and Pan Bohai Rim), while driving product recognition and raising brand reputation via its existing projects.

We believe that a low and reasonable land cost is in line with the strategic choice of the Group's solid and long-term development. In 2009, the Group newly acquired five parcels of land located in four cities, namely, Beijing, Guangzhou, Zhongshan and Shenyang, with the new total gross floor area amounting to approximately 4.03 million square meters. Such new land banks are strategically located in urban centers or areas with a high development potential, which laid a solid foundation for the development of future business and operation of the Group. The Group will insist and remain prudent to hold the golden opportunity to buy, merge and acquire premium lands, so as to increase the land bank of the Group.

In June 2009, the Group entered into an agreement to acquire 100% equity interest of Earning Ever Limited ("Earning Ever") for a consideration of approximately RMB640 million. Earning Ever owns the land use right of a site located in the urban area of Zhongshan City, Guangdong Province with a total site area of approximately 0.35 million square meters. Among which, the Group obtained an approximately RMB590 million bank loan with interest rate of 4.5% per annum (interest will be exempted if repaid on a timely basis) by way of entering into a 3-year loan agreement with a bank.

In July 2009, the Group completed the acquisition of 41.33% equity interest in Century Profit Zone Investments Limited ("Century Profit"), which owns a parcel of land located at southeast section, intersection of Xidawang Road and Jianguo Road, Chaoyang District, Beijing with a total gross floor area of approximately 0.25 million square meters. At the same time, the Group also entered a subscription agreement, under which, the Group can further acquire 11.36% of the entire issued share capital of Century Profit in September 2010 with a consideration of RMB296 million. Upon commencement of cooperation in respect of the project, the Group generated earnings of approximately RMB100 million in 2009. This project represents a highly profitable and high quality land bank and this successful acquisition is a milestone in the development history of the Group.

In October 2009, the Group completed the acquisition of certain equity interest in Head Win Limited with a total consideration of approximately RMB258 million, enabling the Group to own the entire equity interest in Head Win Limited. The project is located in the central area of Panyu District, Guangzhou City, with a total gross floor area of approximately 0.245 million square meters. The land bank carries a lower cost. Upon the completion of acquisition, the project became wholly-owned by the Group and the progress for development was enhanced.

In 2009, the Group acquired two parcels of land in Shenyang with a total gross floor area of approximately 2.84 million square meters through auction, tender and listing-for-sale. The acquisition cost was relatively low at only RMB392 per square meter, which further enriched the Group's land bank for future development.

As at 31 December 2009, the Group had a total land bank of approximately 9.0 million square meters, of which the completed properties, the properties under construction and the properties held for future development were 0.58 million square meters, 0.98 million square meters and 7.47 million square meters respectively.

Diversified Land bank Portfolio:
(As at 31 December 2009)

Land Bank by Location

- Guangdong 38%
- Shenyang 35%
- Yulin 16%
- Jiangxi 6%
- Beijing 3%
- Chongqing 2%

Development status and location

Location	Completed properties	Properties under development	Properties to be developed	Total
	Aggregate GFA (million sq.m.)			
Guangdong Province	0.36	0.58	2.46	3.40
Shenyang	—	—	3.16	3.16
Yulin	—	0.13	1.33	1.46
Jiangxi	0.01	0.01	0.52	0.54
Chongqing	0.21	0.01	—	0.22
Beijing	—	0.25	—	0.25
Total	0.58	0.98	7.47	9.03

Newly acquired projects for the year ended 31 December 2009:

Projects	Location of Project	Consideration for Acquisition	Aggregate GFA sq.m.	Group's interest	Strength
Chang'an Ave	No. 86 Jianguo Road, Zhaoyang District, Beijing, southeast corner of the intersection between Jianguo Road and Dawang Road West	Consideration for the acquisition is RMB 370 million, and the effective interest of the project acquired is 40% (ownership will be increased to 51% by September 2010[1])	250,000	40%	Located at the core area of Beijing's CBD, highly profitable project
Aoyuan Zhongshan Plaza	Within Guang Feng She Area, Western District of Zhongshan, Guangdong Province	Consideration for the acquisition is RMB 640 million (a bank provided a three-year interest-free bank loan of RMB590 million, and the Group invested RMB 50 million)	703,000	100%	High internal rate of return
Aoyuan Plaza	North to Fude Road, South downtown, Panyu District, Guangzhou	Consideration for the acquisition is RMB 258 million, and the equity interest acquired is 49%. Upon acquisition, the Group holds 100% interest of this project	245,000	100%	Located at the core residential and commercial area of Panyu, highly profitable project
Shenyang Aoyuan • International New Town	Southern side of Yinxing Road, Sujiatun District, Shenyang	Consideration for the acquisition is RMB 822 million	2,432,000	100%	Low land cost
Shenyang Aoyuan • International Animation City	South Coast of Hun River, Dongling District, Shenyang, on the western side of 107 Provincial Road	Consideration for the acquisition is RMB 289 million	404,000	100%	Low land cost
Total			4,034,000		

Note 1: The Group also entered into a convertible subscription agreement, under which, the Group can acquire 11% interest of Chang'an Ave at a consideration of RMB 296 million on September 2010. This amount has been settled in 2009.

Financial Review

Revenue

The revenue is primarily generated from two business segments: property development and property investment. For the year ended 31 December 2009, the Group's total revenue was approximately RMB2,364.5 million (2008: RMB619.9 million), representing an increase of 281.4% over 2008, which was mainly attributable to the increase in property sales.

In 2009, the Group's sales revenue generated from property development amounted to approximately RMB2,348.1 million (2008: RMB609.0 million), representing an increase of 285.6% over 2008. The increase of sales revenue was primarily due to an increase in the area of delivered properties. The sales revenue generated from property development attributable to Guangzhou, Chongqing and other cities represented 43%, 48% and 9% respectively. The average price of delivered properties for the year was basically in the line with 2008.

In 2009, the Group's revenue derived from property investment was approximately RMB15.1 million (2008: RMB9.5 million), representing an increase of 58.9% over 2008.

Gross profit and margin

In 2009, the gross profit of the Group was approximately RMB439.7 million, representing an increase of 1,828.5% over approximately RMB22.8 million in 2008; the gross margin increased to 18.6% from 3.7% in the corresponding period of 2008.

Other income

In 2009, the Group's other income was approximately RMB70 million, which mainly included an interest income of approximately RMB36.8 million and reversal of accruals of approximately RMB30.2 million.

Selling and Administrative expenses

In 2009, the Group's selling and distribution costs decreased by 32.4% to approximately RMB91.5 million from approximately RMB135.3 million in 2008. The sales costs ratio significantly decreased to 3.9% from 21.8% in 2008. The total administrative expenses decreased by 38.5% to approximately RMB121.9 million from approximately RMB198.3 million in 2008. It was benefited from more effective marketing approaches adopted by the Group to reduce costs while appointing more experienced management to improve the operating efficiency and implement more stringent budget control measures.

Financial Position

The Group's total assets amounted to approximately RMB11,725.3 million as at 31 December 2009 (as at 31 December 2008: RMB8,348.4 million) and total liabilities were approximately RMB5,972.4 million (as at 31 December 2008: RMB3,459.0 million). Current ratio was 2.3 as at 31 December 2009 (as at 31 December 2008: 3.5).

Financial Resources and Liquidity

In 2009, the Group derived its sources of fund primarily from income generated from business operations and cash from bank borrowings, which were used in our business operations and investment in development projects. In addition, in July 2009, the Company issued 360 million new shares and placed them to independent investors at HK$1.73 per share in order to enhance the Group's financial position and cash flow to further enlarge its land bank. The net proceeds from the placement were approximately HK$600 million and were used for satisfying the Group's general working capital requirement as well as the acquisition of 41.33% of the issued share capital of Century Profit.

The Group expects that income generated from business operations and bank borrowings will continue to be the main sources of funding in the coming year. Therefore, the Group will continue to strengthen cash flow management, improve the efficiency of capital returns of projects and strictly control the cost and various expenses. In addition, the Group will continue to explore opportunities of cooperation with foreign and domestic investors to provide another source of funding for the expansion of projects and business development.

Cash Position

As at 31 December 2009, the Group had bank balances and cash of approximately RMB1,283.9 million (as at 31 December 2008: RMB1,345.9 million).

As at 31 December 2009, the Group had restricted bank deposits of approximately RMB745.4 million (as at 31 December 2008: RMB135.7 million).

Borrowings and Net Gearing Ratio

Bank Borrowings

The Group had bank borrowings of approximately RMB2,586.4 million as at 31 December 2009 (as at 31 December 2008: RMB1,214.7 million).

Repayment Period

	31 December 2009 RMB Million	31 December 2008 RMB Million
Within one year	743.4	215.0
More than one year, but not exceeding two years	492.7	625.7
More than two years, but not exceeding five years	1,350.3	374.0
	2,586.4	1,214.7

The majority of bank borrowings of the Group are variable-rate borrowings. The effective interest rate on bank borrowings for 2009 was 5.6% (2008: 6.9%). The Group has implemented certain interest rate management policies which mainly include, among others, close monitoring of interest rate movements and replacing and entering into new banking facilities when good pricing opportunities arise.

As at 31 December 2009, the Group had banking facilities of approximately RMB6,373.0 million (as at 31 December 2008: RMB2,385.0 million) for short-term and long-term bank loans, of which approximately RMB5,081.9 million (as at 31 December 2008: RMB1,170.3 million) were unutilized.

Convertible Notes

Convertible notes with an aggregate principal amount of USD60.0 million were issued by a subsidiary of the Group in 2007. The convertible notes have an interest rate of London Inter Bank Offer Rate plus 3.0% payable semi-annually. The Group did not use any financial instruments for hedging purpose as at 31 December 2009.

Net Gearing Ratio

The gearing ratio is measured by the net borrowings (total borrowings net of cash and cash equivalents and restricted bank deposits) over the total capital and reserves attributable to equity holders. As at 31 December 2009, the net gearing ratio of the Group was 15.4% (as at 31 December 2008: 0.8%).

Contingent Liabilities

As at 31 December 2009, the Group had the following contingent liabilities relating to guarantees in respect of mortgage facilities provided by bank to purchasers amounting to approximately RMB1,859.3 million (as at 31 December 2008: RMB646.8 million).

The contingent liabilities represented the guarantees in respect of mortgage facilities granted by certain banks relating to the mortgage loans arranged for certain purchasers of the Group's properties. Pursuant to the terms of the guarantees, upon default in mortgage payments by these purchasers, the Group is liable to the repayment of outstanding mortgage principals together with accrued interest and penalty owed to the banks by defaulted purchasers, and the Group is entitled to take over the legal title and possession of the related properties. The amounts as at 31 December 2009 were to be discharged upon the earlier of (i) issuance of the real estate ownership certificate; and (ii) the satisfaction of mortgaged loan by the purchasers of properties.

In 2007, a subsidiary of the Group (the "Purchaser") entered into an agreement with two independent third parties (the "Vendor") for a potential acquisition of a company (the "Target"). However, this acquisition agreement was subsequently terminated by the Purchaser because of the uncertainty about the validity of the Vendor's shareholding in the Target. The Vendor then claimed against the Purchaser for compensation of approximately RMB61,096,000. The legal case is in legal proceeding. No provision has been provided for this case, however, because in the opinion of the executive directors of the Group and the Group's legal counsel, the likelihood that the subsidiary is required to pay the compensation is remote.

As at 31 December 2009, the Group had the contingent liabilities relating to guarantees in respect of bank borrowings of approximately RMB590 million of Century Profit.

Commitments

As at 31 December 2009, the Group has construction cost contracted but not provided for of approximately RMB2,367.0 million (as at 31 December 2008: RMB1,788.0 million). The Group expects to fund these commitments principally from sale proceeds of the properties and partly from bank borrowings.

Foreign Currency risks

Most of the Group's revenues and operating costs were denominated in Renminbi. Except for the bank deposits denominated in foreign currencies, the convertible notes denominated in U.S. dollar and the bank loans denominated in HK dollar, the Group's operating cash flow or liquidity is not subject to any other material direct exchange rate fluctuations. The Group did not enter into any foreign exchange hedging arrangements as at 31 December 2009.

Pledge of assets

As at 31 December 2009, the Group pledged its property held for development and properties under construction of approximately RMB1,937.8 million (as at 31 December 2008: RMB1,204.3 million) to various banks to secure project loans and general banking facilities granted to the Group.

Subsequent Events

According to our announcement dated 29 March 2010, on 29 March 2010, the Group entered into a framework agreement to acquire a commercial office building of 6,586.75 sq.m. and parts of the parking spaces at a consideration of approximately RMB176.5 million. As the recent property market in the PRC is on rebound, such acquisition represents a good investment opportunity and the Group will be benefited from the anticipated growth in property value.

According to our announcement dated 15 April 2010, on 15 April 2010, the Group entered into an agreement with Sunrise Partners Limited Partnership to agree upon the early redemption of convertible notes with a principal of USD 60.0 million by the Group.

Employees and Remuneration

As at 31 December 2009, the Group employed a total of 477 employees. The Group has adopted a performance based incentive system since September 2007 to motivate and retain its high-calibre staff and such system is subject to review on a regular basis. As at 31 December 2009, share options in respect of a total of 38,195,145 shares of the Company was granted to certain directors and employees. In addition to basic salary, year-end bonuses are also offered to staff with outstanding performance. At the same time, the Group is required to pay on behalf of the employees a social insurance premium and other insurance premium benefits according to relevant national and local government labor laws and regulations. The Group believes the salaries and benefits that the employees receive are competitive in comparison with market rates.