

CHINA HGS REAL ESTATE INC.

Form 10-Q

February 14, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2011

“ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 001-34864

CHINA HGS REAL ESTATE, INC.

(Exact Name of Registrant as Specified in Its Charter)

Florida

33-0961490

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(State or Other Jurisdiction of Incorporation) (I.R.S. Employer Identification Number)

6 Xinghan Road, 19th Floor, Hanzhong City

Shaanxi Province, PRC 723000

(Address of Principal Executive Offices, Zip Code)

+(86) 091 - 62622612

(Registrant's Telephone Number, including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The number of shares outstanding of each of the issuer's classes of common equity, as of February 14, 2012 is as follows:

Class of Securities	Shares Outstanding
Common Stock, \$0.001 par value	45,050,000

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PART I: FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****CHINA HGS REAL ESTATE, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)**

	December 31 2011	September 30 2011
ASSETS		
Current assets:		
Cash	\$365,606	\$8,837,795
Restricted cash	895,683	885,678
Advances to vendors	5,907,723	5,931,149
Loans to outside parties, net	2,003,351	2,571,651
Security deposits for land use rights	15,438,528	6,254,691
Real estate property development completed	18,093,372	18,886,485
Real estate property under development	18,111,365	16,707,423
Other current assets	101,230	85,423
Total current assets	60,916,858	60,160,295
Property, plant and equipment, net	1,096,242	1,113,032
Real estate property under development, net of current portion	47,814,179	47,010,098
Total Assets	\$109,827,279	\$108,283,425
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$4,266,819	\$7,440,593
Other payables	636,704	324,298
Construction deposits	471,332	469,084
Customer deposits	12,922,221	11,564,868
Shareholder loan	1,810,000	1,810,000
Accrued expenses	1,890,694	2,003,913
Taxes payable	4,010,745	4,023,698
Total current liabilities	26,008,515	27,636,454
Customer deposits, net of current portion	12,196,165	10,420,650
Construction deposits, net of current portion	586,475	577,423
Total liabilities	38,791,155	38,634,527
Commitments and Contingencies		
Stockholders' equity		
Common stock, \$0.001 par value, 100,000,000 shares authorized, 45,050,000 shares issued and outstanding as of December 31, 2011 and September 30, 2011	\$45,050	\$45,050
Additional paid-in capital	17,736,260	17,724,085

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Statutory surplus	5,945,384	5,945,384
Retained earnings	41,352,568	40,322,106
Accumulated other comprehensive income	5,956,862	5,612,273
Total stockholders' equity	71,036,124	69,648,898
 Total Liabilities and Stockholders' Equity	 \$ 109,827,279	 \$ 108,283,425

The accompany notes are an integral part of these unaudited condensed consolidated financial statements

CHINA HGS REAL ESTATE, INC.**CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME****(Unaudited)**

	Three months ended December 31,	
	2011	2010
Real estate sales	\$2,501,981	\$135,952
Less: Sales tax	(175,905)	(55,039)
Cost of real estate sales, exclusive of depreciation	(881,900)	(79,783)
Gross profit	1,444,176	1,130
Operating expenses		
Selling and distribution expenses	42,441	30,915
General and administrative expenses	318,772	71,146
Total operating expenses	361,213	102,061
Operating income (loss)	1,082,963	(100,931)
Interest income	13,937	6,335
Interest (expense)	(18,100)	-
Income (loss) before income taxes	1,078,800	(94,596)
Provision for income taxes	48,338	1,699
Net income (loss)	1,030,462	(96,295)
Other comprehensive income		
Foreign currency translation adjustment	344,589	\$627,807
Comprehensive income	\$1,375,051	\$531,512
Basic and diluted income per common share		
Basic	\$0.02	\$-
Diluted	\$0.02	\$-
Weighted average common shares outstanding		
Basic	45,050,000	45,050,000
Diluted	45,050,000	45,059,434

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

CHINA HGS REAL ESTATE, INC.**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	Three months ended December 31,	
	2011	2010
Cash flows from operating activities		
Net income (loss)	\$1,030,462	\$(96,295)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	22,081	17,750
Stock based compensation	12,175	7,716
Changes in assets and liabilities:		
Restricted cash	(5,750)	(48,064)
Advances to vendors	51,748	-
Loans to outside parties	579,495	4,198,710
Security deposits for land use rights	(9,136,065)	-
Real estate property development completed	881,900	79,783
Real estate property under development	(1,898,986)	(5,046,819)
Other current assets	(15,367)	(22,799)
Accounts payables	(3,203,189)	(75,966)
Other payables	310,247	(716,308)
Customer deposits	3,021,626	7,123,569
Construction deposits	6,272	(357)
Accrued expenses	(122,461)	(25,972)
Taxes payable	(32,172)	(757,482)
Net cash (used in) provided by operating activities	\$(8,497,984)	\$4,637,466
Cash flow from financing activities		
Proceeds from shareholder loan	3,142,332	-
Repayment of shareholder loan	(3,142,332)	-
Net cash provided by financing activities	\$-	\$-
Effect of changes of foreign exchange rate on cash	25,795	203,479
Net (decrease) increase in cash	(8,472,189)	4,840,945
Cash, beginning of period	8,837,795	12,621,845
Cash, end of period	\$365,606	\$17,462,790
Supplemental disclosures of cash flow information:		
Interest paid	\$-	\$-
Income taxes paid	\$18,817	\$32,900

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

CHINA HGS REAL ESTATE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION AND BASIS OF PRESENTATION

China HGS Real Estate Inc. (“China HGS” or the “Company” or “we”, “us”, “our”), through its subsidiaries and variable interest entity (“VIE”), engages in real estate development, and the construction and sales of residential apartments, parking lots and commercial properties in Tier 3 and Tier 4 cities and counties in China.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the U.S. generally accepted accounting principles (“GAAP”) for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended December 31, 2011 and 2010 are not necessarily indicative of the results that may be expected for the full year. The information included in this Form 10-Q should be read in conjunction with Management’s Discussion and Analysis of Financial Condition and Results of Operations and the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2011.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

The condensed consolidated financial statements include the financial statements of China HGS Real Estate Inc. (the “Company” or “China HGS”), China HGS Investment Inc. (“HGS Investment”), Shaanxi HGS Management and Consulting Co., Ltd. (“Shaanxi HGS”) and its variable interest entity (“VIE”), Shaanxi Guangsha Investment and Development Group Co., Ltd. (“Guangsha”). All inter-company transactions and balances between the Company and its subsidiaries have been eliminated upon consolidation.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes, and disclosure of

contingent liabilities at the date of the condensed consolidated financial statements. Estimates are used for, but not limited to, the selection of the useful lives of property and equipment, provision necessary for contingent liabilities, fair values, revenue recognition, taxes, budgeted costs and other similar charges. Management believes that the estimates utilized in preparing its condensed consolidated financial statements are reasonable and prudent. Actual results could differ from these estimates.

Fair value of financial instruments

The Company follows the provisions of Accounting Standards Codification (“ASC”) 820, Fair Value Measurements and Disclosures. It clarifies the definition of fair value, prescribes methods for measuring fair value, and establishes a fair value hierarchy to classify the inputs used in measuring fair value as follows:

Level 1-Inputs are unadjusted quoted prices in active markets for identical assets or liabilities available at the measurement date.

Level 2-Inputs are unadjusted quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, inputs other than quoted prices that are observable, and inputs derived from or corroborated by observable market data.

Level 3-Inputs are unobservable inputs which reflect the reporting entity’s own assumptions or what assumptions the market participants would use in pricing the asset or liability based on the best available information.

The carrying amounts reported in the accompanying condensed consolidated balance sheets for cash, restricted cash, advance to vendors, loans to outside parties, security deposits for land use rights, other current assets, accounts payable, customer deposits, other payables, accrued expenses, and taxes payable, approximate their fair value based on the short-term maturity of these instruments. The fair value of the long term customer and construction deposits approximate their carrying amounts because the deposits are received in cash.

CHINA HGS REAL ESTATE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition

Real estate sales are recognized in accordance with ASC 360-20 “Real Estate Sales”.

Revenue from the sales of development properties is recognized by the full accrual method at the time of the closing of an individual unit sale. This occurs when title to or possession of the property is transferred to the buyer. A sale is not considered consummated until (a) the parties are bound by the terms of a contract, (b) all consideration has been exchanged, (c) any permanent financing of which the seller is responsible has been arranged, (d) all conditions precedent to closing have been performed, (e) the seller does not have substantial continuing involvement with the property, and (f) the usual risks and rewards of ownership have been transferred to the buyer. Further, the buyer’s initial and continuing investment is adequate to demonstrate a commitment to pay for the property, and the buyer’s receivable, if any, is not subject to future subordination.

The Company provides “mortgage loan guarantees” only with respect to buyers who make down-payments of 30%-50% of the total purchase price of the property. The period of the mortgage loan guarantee begins on the date the bank approves the buyer’s mortgage and we receive the loan proceeds in our bank account and ends on the date the “Certificate of Ownership” evidencing that title to the property has been transferred to the buyer. The procedures to obtain the Certificate of Ownership take six to twelve months (the “Mortgage Loan Guarantee Period”). If, after investigation of the buyer’s income and other relevant factors, the bank decides not to grant the mortgage loan, the Company’s mortgage-loan based sales contract terminates and there is no guarantee obligation. If, during the Mortgage Loan Guarantee Period, the buyer defaults on his or her monthly mortgage payment for three consecutive months, we are required to refund the loan proceeds back to the bank, although we have the right to keep the customer’s deposit and resell the property to a third party. Once the Certificate of Ownership has been issued by the relevant government authority, the Company’s loan guarantee terminates. If the buyer then defaults on his or her mortgage loan, the bank has the right to take the property back and sell it and use the proceeds to pay off the loan. The Company is not liable for any shortfall that the bank may incur in this event.

To date, no buyer has defaulted on his or her mortgage payments during the Mortgage Loan Guarantee Period and the Company has not had to refund any loan proceeds pursuant to its mortgage loan guarantees.

Foreign currency translation

The Company's financial information is presented in U.S. dollars. The functional currency of the Company's operating subsidiaries is Renminbi ("RMB"), the currency of the PRC. The financial statements of the Company have been translated into U.S. dollars in accordance with ASC 830-30 "Translation of Financial Statements". The financial information is first prepared in RMB and then is translated into U.S. dollars at year-end exchange rates as to assets and liabilities and average exchange rates as to revenue and expenses. Capital accounts are translated at their historical exchange rates when the capital transactions occurred. The effects of foreign currency translation adjustments are included as a component of accumulated other comprehensive income in stockholders' equity.

	For three months ended December 31,		September 30,
	2011	2010	2011
Period end RMB : USD exchange rate	6.3647	6.6118	6.3952
Three months average RMB : USD exchange rate	6.3771	6.6670	

The RMB is not freely convertible into foreign currency and all foreign exchange transactions must take place through authorized institutions. No representation is made that the RMB amounts could have been, or could be, converted into U.S. dollars at the rates used in translation.

CHINA HGS REAL ESTATE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Advances to vendors

Advances to vendors consist of balances paid to contractors and vendors for services and materials that have not been provided or received and generally relate to the development and construction of residential units in the PRC. Advances to vendors are reviewed periodically to determine whether their carrying value has become impaired. Historically, the Company has not experienced any losses as a result of these advances.

Loans to outside parties

Loans to outside parties consist of various cash advances to unrelated companies and individuals with which the Company has business relationships. Loans to outside parties are reviewed periodically as to whether their carrying value has become impaired. The Company considers the assets to be impaired if the collectability of the balances becomes doubtful. For the three months ended December 31, 2011 and 2010, the provision for losses on loans to outside parties was \$7,526 and \$7,199, respectively.

Security deposits for land use rights

Security deposits for land use rights consist of the deposit held by the PRC government for the purchase of land use rights in Hanzhong City and the deposit held by an unrelated party to transfer its land use rights in Hanzhong City to the Company. The deposits will be reclassified to real estate property under development upon the transfers of legal title.

Real estate property development completed and under development

Real estate property consists of finished residential unit sites and commercial offices and residential unit sites under development. The Company leases the land for the residential and commercial units sites under land use right leases

with various terms from the PRC government. The cost of land use rights is included in the development cost and allocated to each project. Real estate property development completed and real estate property under development are stated at the lower of cost or fair value.

Expenditures for land development, including cost of land use rights, deed tax, pre-development costs, and engineering costs, exclusive of depreciation, are capitalized and allocated to development projects by the specific identification method. Costs are allocated to specific units within a project based on the ratio of the sales area of units to the estimated total sales area of the project (or phase of the project) multiplied by the total cost of the project (or phase of the project).

Cost of amenities transferred to buyers is allocated to specific units as a component of total construction cost. The amenity cost includes landscaping, road paving, etc. Once the projects are completed, the amenities are under control of the property management companies. In accordance with GAAP, real estate property development completed and under development is subject to impairment when the carrying amount exceeds fair value. An impairment loss is recognized only if the carrying amount of the assets is not recoverable and exceeds fair value. The carrying amount is not recoverable if it exceeds the sum of the undiscounted cash flows expected to be generated by the assets.

Management evaluates, on a yearly basis, the impairment of the Company's real estate developments based on a community level. Each community is assessed as an individual project. The evaluation takes into account several factors including, but not limited to, physical condition, inventory holding period, management's plans for future operations, prevailing market prices for similar properties and projected cash flows. There were no impairment losses for the three months ended December 31, 2011 and 2010, respectively.

CHINA HGS REAL ESTATE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Customer deposits

Customer deposits consist of amounts received from customers relating to the sale of residential units in the PRC. In the PRC, customers will generally obtain permanent financing for the purchase of their residential unit prior to the completion of the project. The lending institution will provide the funding to the Company upon the completion of the financing rather than the completion of the project. The Company receives these funds and recognizes them as a liability until the revenue can be recognized.

Stock-based compensation

The Company accounted for share-based compensation in accordance with ASC Topic 718, Compensation - Stock compensation, which requires that share-based payment transactions be measured based on the grant-date fair value of the equity instrument issued and recognized as compensation expense over the requisite service period, or vesting period.

ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in the subsequent period if actual forfeitures differ from initial estimates. Forfeiture rate is estimated based on historical and future expectation of employee turnover rate and are adjusted to reflect future change in circumstances and facts, if any. Share-based compensation expense is recorded net of estimated forfeitures such that expense was recorded only for those stock options and common stock awards that are expected to vest.

Income taxes

The Company utilizes ASC 740, "Income Taxes," which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect

taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized

ASC 740-10-25 prescribes a more-likely-than-not threshold for consolidated financial statement recognition and measurement of a tax position taken (or expected to be taken) in a tax return. It also provides guidance on the recognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, years open for tax examination, accounting for income taxes in interim periods and income tax disclosures. There are no material uncertain tax positions as of December 31, 2011 and September 30, 2011.

The Company is a corporation organized under the laws of the State of Florida. However, all of the Company's operations are conducted solely by its subsidiaries in the PRC. No income is earned in the United States and the management does not repatriate any earnings outside the PRC. As a result, the Company did not generate any U.S. taxable income for the three months ended December 31, 2011, and 2010

CHINA HGS REAL ESTATE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Land appreciation tax (“LAT”)

In accordance with the relevant taxation laws in the PRC, the Company is subject to LAT based on progressive rates ranging from 30% to 60% on the appreciation of land value, which is calculated as the proceeds of sales of properties less deductible expenditures including borrowing costs and all property development expenditures. LAT is exempted if the appreciation values do not exceed certain thresholds specified in the relevant tax laws.

The whole project must be completed before the LAT obligation can be assessed. Accordingly, the Company should record the liability and the total related expense at the completion of a project unless the tax authorities impose an assessment at an earlier date. The methods to implement this tax law vary among different geographic areas. Hanzhong, where the project Mingzhu Garden, NanDajie and Central Plaza are located, implements this tax rule by requiring real estate companies prepay the LAT based upon customer deposits received. The tax rate in Hanzhong is 1%. Yangxian, where the project Yangzhou Pearl Garden is located, requires a tax rate of 0.5%.

Recent accounting pronouncements

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, Intangibles — Goodwill and Other (Topic 350). This Accounting Standards Update amends FASB ASC 350. This amendment specifies the change in method for determining the potential impairment of goodwill. It includes examples of circumstances and events that the entity should consider in evaluating whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company does not expect the adoption of the provisions in ASU 2011-08 will have a significant impact on the Company’s consolidated financial statements.

In December 2011, the FASB issued Accounting Standards Update No. 2011-10, Property, Plant, and Equipment (Topic 360) — Derecognition of in Substance Real Estate — a Scope Clarification (ASU 2011-10). Under the amendments in this Update, when a parent (reporting entity) ceases to have a controlling financial interest (as described in Subtopic 810-10) in a subsidiary that is in substance real estate as a result of default on the subsidiary’s nonrecourse debt, the reporting entity should apply the guidance in Subtopic 360-20 to determine whether it should derecognize the in substance real estate. Generally, even if the reporting entity ceases to have a controlling financial interest, the

reporting entity would continue to include the real estate, debt, and the results of the subsidiary's operations in its consolidated financial statements until legal title to the real estate is transferred to legally satisfy the debt. ASU 2011-10 should be applied on a prospective basis to deconsolidation events occurring after the effective date. Prior periods should not be adjusted even if the reporting entity has continuing involvement with previously derecognized in substance real estate entities. ASU 2011-10 is effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2012. The Company does not expect the adoption of the provisions in ASU 2011-10 will have a significant impact on the Company's consolidated financial statements.

In December 2011, the FASB issued Accounting Standards Update No. 2011-11, Balance Sheet (Topic 210)—Disclosures about Offsetting Assets and Liabilities (ASU 2011-11). The update requires entities to disclose information about offsetting and related arrangements of financial instruments and derivative instruments. The ASU is effective for annual periods beginning on or after January 1, 2013 and interim periods therein. The Company is currently evaluating the impact this update will have on our consolidated financial statements.

In December 2011, FASB issued Accounting Standards Update No. 2011-12, Comprehensive Income ("ASU 2011-12"). Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. Among the new provisions in ASU 2011-05 was a requirement for entities to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented (for both interim and annual financial statements); however this reclassification requirement is indefinitely deferred by ASU 2011-12 and will be further deliberated by the FASB at a future date.

CHINA HGS REAL ESTATE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3. SECURITY DEPOSITS FOR LAND USE RIGHTS

In May 2011, the Company entered into a development agreement with the local government. Pursuant to the agreement, the Company will prepay the development cost of \$18,717,163 (RMB119,700,000) and the Company has the right to acquire the land use rights through public bidding. The prepaid development cost will be deducted from the final purchase price of the land use rights. As of December 31, 2011, a deposit of \$3,142,332 (RMB20,000,000) was paid by the Company.

In August 2011, the Company entered into a land transfer agreement with Hanzhong Shijin Real Estate Development Limited (“Shijin”). Pursuant to the agreement, Shijin agreed to transfer certain land use rights to the Company for a total price of \$7,114,711 (RMB45,500,000). As of December 31, 2011, a deposit of \$4,713,498 (RMB30,000,000) was paid by the Company.

On November 18, 2011, the Company won two bids for the land use rights by auction to obtain two parcel of land in Yangxian location for total consideration and the bidding commission of \$12,507,462 (RMB 79,606,242) . As of December 31, 2011, the Company has paid \$7,582,698 (RMB48,261,600) in accordance with the bid terms. The Company was required to make payment of the remaining 40% of the total consideration before January 20, 2012. The Company received a letter from the local Land Management Bureau to postpone the payment date to June 30, 2012.

NOTE 4. REAL ESTATE PROPERTY DEVELOPMENT COMPLETED AND UNDER DEVELOPMENT

The following summarizes the components of real estate property development completed and under development as of December 31, 2011 and September 30, 2011:

	December 31, 2011	September 30, 2011
Development completed:		
Mingzhu Garden (Mingzhu Nanyuan & Mingzhu Bei yuan)	\$ 2,702,074	\$ 2,950,520
Nan Dajie (Mingzhu Xinju)	3,955,287	4,048,911
Yangzhou Pearl Garden	\$ 10,836,488	\$ 11,290,390
Central Plaza	599,523	596,664
Real estate property development completed	\$ 18,093,372	\$ 18,886,485

Under development:

Mingzhu Garden (Mingzhu Nanyuan & Mingzhu Beiyuan)	\$ 25,944,503	\$ 25,403,633
Oriental Mingzhu Garden	29,212,680	28,717,247
Nan Dajie (Mingzhu Xinju)	75,259	-
Yangzhou Pearl Garden	10,693,102	9,596,641
Real estate property under development	\$ 65,925,544	\$ 63,717,521
Less: Short Term portion	\$ 18,111,365	\$ 16,707,423
Real estate property under development - Long Term	\$ 47,814,179	\$ 47,010,098

As of December 31, 2011 and September 30, 2011, land use rights included in real estate property under development totaled \$47,017,980 and \$46,793,742, respectively.

CHINA HGS REAL ESTATE, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****NOTE 5. CUSTOMER DEPOSITS**

Customer deposits consist of amounts received from customers for the pre-sale of residential units in the PRC. The detail of customer deposits is as follows:

	December 31, 2011	September 30, 2011
Customer deposits by real estate projects		
Mingzhu Garden (Mingzhu Nanyuan & Mingzhu Beiyuan)	\$ 14,671,124	\$ 12,860,399
Yangzhou Pearl Garden	10,447,262	9,125,119
Total	\$ 25,118,386	\$ 21,985,518
Less: Short Term portion	\$ 12,922,221	\$ 11,564,868
Customer deposits – Long Term	\$ 12,196,165	\$ 10,420,650

Customer deposits are typically 10%-20% of the unit price for those customers who purchase properties in cash and 30%-50% of the unit price for those customers who purchase properties with mortgages. Buyers with mortgage loans pay customer deposits then banks provide the balance of the funding to the Company upon consummation of the sales. The banks hold the properties as collateral for customers' mortgage loans. If the customers default, the bank will repossess the collateral properties. Except during the Mortgage Loan Guarantee Period of approximately six to twelve months, the banks have no recourse to the Company for customers' defaults.

CHINA HGS REAL ESTATE, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****NOTE 6. STOCK OPTIONS**

Under the fair value recognition provisions of ASC Topic 718, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized on a straight-line basis as expense over the vesting period. Additionally, the Company is required to use judgment in estimating the amount of stock-based awards that are expected to be forfeited. If actual forfeitures differ significantly from the original estimate, stock-based compensation expense and the results of operations could be impacted.

In January 2010, the Company's Board of Directors granted stock options to three newly appointed independent directors to purchase up to 34,000 shares of the Company's common stock ("2010 Stock Options). 20% of the shares underlying the options were exercisable on the grant date and the remaining 80% of the shares underlying the options become exercisable over the next eight quarters at the rate of 10% at the end of every quarter. The exercise price of the options is \$2.60 per share and the options expire on January 6, 2015. As of December 31, 2011 and September 30, 2011, 100% and 90% of the option awards have vested, respectively.

On March 16, 2011, the Company's Board of Directors granted stock options to three independent directors to purchase up to an aggregate of 34,000 shares of the Company's common stock ("2011 Stock Options). Twenty percent (20%) of the shares underlying the options were exercisable on the grant date and the remaining 80% of the shares underlying the options become vested over the next eight quarters at the rate of 10% at the end of every quarter. The exercise price of the options is \$2.37 per share and the options expire on March 16, 2016.

The assumptions used in calculating the fair value of options granted using the Black-Scholes option pricing model are as follows:

	Options granted on March 16, 2011		Options granted on January 6, 2010	
Risk-free interest rate	1.87	%	2.6	%
Expected life of the options	5 years		5 years	
Expected volatility	65	%	133	%
Expected dividend yield	0	%	0	%

The fair value of the 2011 Stock Options granted was \$44,590 utilizing the Black Sholes model (2010 Stock Options \$77,157). The Company uses the Black-Scholes option-pricing model, which incorporates various assumptions

including volatility, expected life and interest rates to determine fair value. The Company's expected volatility assumption is based on the historical volatility of Company's stock. The expected life assumption is primarily based on the simplified method due to the Company's limited option exercise behavior. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

The following table summarizes the stock option activities of the Company:

	Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Fair Value
Outstanding at September 30, 2011	68,000	\$ 2.49	3.87	\$ 121,747
Granted	-	-	-	-
Forfeited	-	-	-	-
Exercised	-	-	-	-
Outstanding at December 31, 2011	68,000	\$ 2.49	3.62	\$ 121,747
Exercisable at December 31, 2011	54,400	\$ 2.51	1.58	\$ 103,912

The stock-based compensation expense recognized in the three months ended December 31, 2011 and 2010 was \$12,175 and \$7,716, respectively. As of December 31, 2011, there was \$17,836 of unrecognized compensation cost related to stock option awards that is expected to be recognized as expense over approximately 2 years.

CHINA HGS REAL ESTATE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7. TAXES

(A) Business sales tax

The Company is subject to a 5% business sales tax on revenue. It is the Company's continuing practice to recognize 5% of the sales tax on estimated revenue, and file tax returns based on the actual result.

B) Corporate income taxes ("CIT")

The Company's PRC subsidiaries and VIE are governed by the Income Tax Law of the People's Republic of China concerning private-run enterprises, which are generally subject to income tax at a statutory rate of 25%, on income reported in the statutory financial statements after appropriate tax adjustments.

However, as approved by the local tax authority of Hanzhong City, the Company's CIT was assessed annually at a pre-determined fixed rate as an incentive to stimulate the local economy and encourage entrepreneurship. The local income tax rate in Hanzhong is 2.5% and in Yangxian is 1.25% on revenue..

Although the possibility exists for reinterpretation of the application of the tax regulations by higher tax authorities in the PRC, potentially overturning the decision made by the local tax authority, the Company has not experienced any reevaluation of the income taxes for prior years. The PRC tax rules are different from the local tax rules and the Company is required to comply with local tax rules. The difference between the two tax rules will not be a liability of the Company. There will be no further tax payments for the difference.

The following table reconciles the statutory rates to the Company's effective tax rate for the years ended September 30, 2011 and 2010:

For the three months ended
December 31,

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	2011		2010	
Chinese statutory tax rate	25.0	%	25.0	%
Exemption rendered by local tax authorities	(19.5)%	(23.2)%
Effective tax rate	4.5	%	1.8	%

The parent Company China HGS Real Estate Inc. is incorporated in the United States. Net operating loss carry forwards for United States income tax purposes amounted to \$101,603 and \$71,328 as of December 31, 2011 and September 30, 2011, respectively, which are available to reduce future years' taxable income. These carry forwards will expire in 2032. However, the change in control resulting from the reverse merger in 2009 limits the amount of loss to be utilized each year. Management doesn't expect to remit any of its net income back to the United States in the foreseeable future. Accordingly, the Company recorded a full valuation allowance as of December 31, 2011 and September 30, 2011. The components of deferred taxes as of December 31, 2011 and September 30, 2011 consist of the following:

	As of December 31, 2011	September 30, 2011
Net operating loss carry-forwards for parent company	\$34,546	\$ 24,252
Valuation allowance	(34,546)	(24,252)
Net deferred tax asset	\$-	\$ -

CHINA HGS REAL ESTATE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(C) LAT

Since January 1, 1994, LAT has been applicable at progressive tax rates ranging from 30% to 60% on the appreciation of land values, with an exemption provided for the sales of ordinary residential properties if the appreciation values do not exceed certain thresholds specified in the relevant tax laws. However, the Company's local tax authority in Hanzhong city has not imposed the regulation on real estate companies in its area of administration. Instead, the local tax authority has levied the LAT at the rate of 0.8% or 1.0% against total cash receipts from sales of real estate properties, rather than according to the progressive rates.

For the three months ended December 31, 2011 and 2010, the Company has made full payment for LAT with respect to properties sold in accordance with the requirements of the local tax authorities.

(D) Taxes payable consisted of the following:

	December 31, 2011	September 30, 2011
CIT	\$ 637,141	\$ 604,665
Business tax	3,287,528	3,333,941
Other tax and fees	86,076	85,092
Total taxes payable	\$ 4,010,745	\$ 4,023,698

NOTE 8. SHAREHOLDER LOAN and RELATED PARTY TRANSACTIONS

On June 28, 2011, the Company entered into a one-year loan agreement ("USD Loan Agreement") with Mr. Xiaojun Zhu, the major shareholder and Chairman of the Board of Directors, pursuant to which the Company borrowed \$1,810,000 from Mr. Xiaojun Zhu to make a capital injection into Shaanxi HGS, the Company's subsidiary. The interest rate for the loan is 4% per annum.

In connection with the land use rights auctions, the Company borrowed an additional \$3,142,332 (RMB 20, 000,000) from Mr. Xiaojun Zhu on November 14, 2011 to fund the deposits for the land use rights bids. The shareholder loan was interest-free for the first month and had an annual interest rate of 15% thereafter. The Company repaid the full

amount to Mr. Xiaojun Zhou on December 7, 2011.

The Company recorded interest expense of \$18,100 for the three months ended December 31, 2011

NOTE 9. CONTINGENCY AND COMMITMENTS

As an industry practice, the Company provides guarantees to PRC banks with respect to loans procured by the purchasers of the Company's real estate properties for the total mortgage loan amount until the completion of obtaining the "Certificate of Ownership" of the properties from the government, which generally takes six to twelve months. Because the banks provide loan proceeds without getting the "Certificate of Ownership" as loan collateral during this six to twelve months' period, the mortgage banks require the Company to maintain, as restricted cash, 5% to 10% of the mortgage proceeds as security for the Company's obligations under such guarantees. If a purchaser defaults on its payment obligations, the mortgage bank may deduct the delinquent mortgage payment from the security deposit and require the Company to pay the excess amount if the delinquent mortgage payments exceed the security deposit. The Company has made necessary reserves in its restricted cash account to cover any potential mortgage defaults as required by the mortgage lenders. The Company has not experienced any losses related to this guarantee and believes that such reserves are sufficient.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following discussion and analysis of financial condition and results of operations relates to the operations and financial condition reported in the financial statements of China HGS Real Estate, Inc. for the three months ended December 31, 2011 and 2010 and should be read in conjunction with such financial statements and related notes included in this report.

As used in this report, the terms "Company," "we," "our," "us" and "HGS" refer to China HGS Real Estate, Inc. and its subsidiaries.

Preliminary Note Regarding Forward-Looking Statements.

We make forward-looking statements in Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report based on the beliefs and assumptions of our management and on information currently available to us. Forward-looking statements include information about our possible or assumed future results of operations which follow under the headings "Our Business Overview," "Liquidity and Capital Resources," and other statements throughout this report preceded by, followed by or that include the words "believes," "expects," "anticipates," "intends," "plans," "estimates" or similar expressions.

Forward-looking statements are subject to a number of risks and uncertainties that could cause actual results to differ materially from those expressed in these forward-looking statements, including the risks and uncertainties described below and other factors we describe from time to time in our periodic filings with the U.S. Securities and Exchange Commission (the "SEC"). We therefore caution you not to rely unduly on any forward-looking statements. The forward-looking statements in this report speak only as of the date of this report, and we undertake no obligation to update or revise any forward-looking statement, whether as a result of new information, future developments or otherwise. These forward-looking statements include, among other things, statements relating to:

- our ability to expand in 2012;*
- our ability to obtain additional land use rights at favorable prices;*
- the market for real estate in Tier 3 and 4 cities and counties;*
- our ability to obtain additional capital in future years to fund our planned expansion; or*
- economic, political, regulatory, legal and foreign exchange risks associated with our operations.*

Business Overview

The real estate market plodded forward amid increasingly restrictive policies in the first half of 2011. In January 2011, Shanghai and Chongqing officially started to levy property tax. In February 2011, Beijing issued a purchase restriction order on the number of homes a person is allowed to purchase to curb speculation and control rising real estate price, and more than 40 cities nationwide soon followed suit. In March 2011, the National Development and Reform Commission announced that from May 2011, each residential house must be marked clearly with a specific price as the ceiling price. Apart from administrative measures, to further tighten liquidity, the People's Bank of China increased banks' required reserve ratios six consecutive times and raised the benchmark interest rate three times since the beginning of the year, leaving a profound impact on the residential housing transaction volume. In 2011, residential housing transaction volume in major cities nationwide recorded a decrease compared with that of the same period of 2010. The first-tier cities with stricter policies witnessed a more extensive decrease in transaction volume.

We conduct substantially all of our business through Shaanxi Guangsha Investment and Development Group Co., Ltd, in Hanzhong, Shaanxi Province. Since the initiation of our business, we have been focused on expanding our business in certain Tier 3 and Tier 4 cities and counties in China. The restrictive policies started to have significant impact on the real estate market in Tier 3 and Tier 4 cities in late 2011. These policies also negatively affected buyers' confidence and consumption psychology. Some buyers are taking a wait-and-see attitude and may delay their purchasing decision.

With uncertainties in the PRC government's credit tightening policies, the market for real estate sales in the three months ended December 31, 2011 was extremely challenging. As a result, our sales volume dropped significantly compared to the average quarterly sales during fiscal 2011. Our sales, gross margin and net income for the three months ended December 31, 2011 were \$ 2,501,981, \$1,444,176 and \$1,030,462 respectively, only representing approximately 4%, 7% and 6% of fiscal 2011 annual sales, gross margin and net income, respectively. We expect continuing deterioration in market conditions, which will put our business under increasing pressure. We expect the deterioration in market conditions to continue into the second quarter of 2012.

In addition, as compared to the last year, we are constructing more high-rise buildings with longer construction periods. None of our current construction projects were completed and delivered during the three months ended December 31, 2011. As a result, we were unable to recognize any contract sales as revenue. We expect some of our current real estate properties under construction to be completed and delivered to the consumer in the third and fourth quarter of fiscal 2012. This is a characteristic of our business. The uneven sales revenues from quarter to quarter are due in part to the rate at which units are completed and delivered to buyers.

Despite the declining transaction volume and cooling real estate market, housing prices in Tier 3 and Tier 4 cities and counties have not shown a substantial correction. For the three months ended December 31, 2011, our average selling price for real estate projects located in Yang County was approximately \$444 per square meters, an increase of 16% from the average selling price of \$383 per square meter in fiscal 2011. The average selling price of our Hanzhong real estate projects almost doubled from the average selling price in fiscal 2011, but this was mainly due to the fact we sold more commercial properties in Hanzhong for the three months ended December 31, 2011. We believe the fundamentals underpinning real estate demand remain strong. We intend to remain focused on our existing construction projects in Hanzhong city and Yang County, deepen our institutional sales network, enhance our cost and operational synergies and improve cash flows and strengthen our balance sheet. We expect these imperatives will help us cope with this difficult period and better position us to capitalize on opportunities from a future market upturn.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these condensed consolidated financial statements requires us to make estimates and judgments that affect our reported assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We evaluate our estimates on an on-going basis and use them on historical experience and various other assumptions that are believed to be reasonable under the circumstances as the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates because of different assumptions or conditions.

We believe the following critical accounting policies affect our significant estimates and judgments used in the preparation of our condensed consolidated financial statements. These policies should be read in conjunction with Note 2 of the notes to condensed consolidated financial statements.

Principles of Consolidation

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP"). The condensed consolidated financial statements include the financial statements of the Company and its subsidiaries China HGS Investment Inc., Shaanxi Hanguangsha Management and Consultation Limited Company and the variable interest entity Shaanxi Guangsha Investment and Development Group Co., Ltd. All significant inter-company balances and transactions are eliminated in consolidation.

We determined that we are the primary beneficiary of Guangsha based on ongoing reassessments, taking into consideration our economic control over Guangsha; the existing contractual relationship in which all of Guangsha's activities either involve or are conducted on our behalf, and we have the obligations to absorb Guangsha's expected returns and losses.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes, and disclosure of contingent liabilities at the date of the condensed consolidated financial statements. Estimates are used for, but not limited to, the selection of the useful lives and residual values of property and equipment and intangible assets, provision for doubtful accounts, provision necessary for contingent liabilities, fair values, revenue recognition, and other similar charges. Management believes that the estimates utilized in preparing its condensed consolidated financial statements are reasonable and prudent. Actual results could differ from these estimates.

Fair Value of Financial Instruments

The Company follows the provisions of Accounting Standards Codification ("ASC") 820, Fair Value Measurements and Disclosures. ASC 820 clarifies the definition of fair value, prescribes methods for measuring fair value, and establishes a fair value hierarchy to classify the inputs used in measuring fair value as follows:

Level 1 - Inputs are unadjusted quoted prices in active markets for identical assets or liabilities available at the measurement date.

Level 2 - Inputs are unadjusted quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, inputs other than quoted prices that are observable, and inputs derived from or corroborated by observable market data.

Level 3 - Inputs are unobservable inputs which reflect the reporting entity's own assumptions on what assumptions the market participants would use in pricing the asset or liability based on the best available information.

The Company's unaudited condensed consolidated financial instruments include cash and cash equivalents, loans to outside parties, other current assets, accounts payable, accrued expenses, customer deposits, construction deposits and taxes payable. Management has estimated that the fair value of these financial instruments approximate their carrying amounts due to the short-term nature. The fair value of the long term customer and construction deposits approximate their carrying amounts because the deposits received is cash.

Revenue Recognition

We recognize revenue from the sales of real property in accordance with the full accrual method at the time of the closing of an individual unit sale. This occurs when title to or possession of the property is transferred to the buyer. A sale is not considered consummated until (a) the parties are bound by the terms of a contract, (b) all consideration has been exchanged, (c) any permanent financing of which the seller is responsible has been arranged, (d) all conditions precedent to closing have been performed, (e) the seller does not have substantial continuing involvement with the property, and (f) the usual risks and rewards of ownership have been transferred to the buyer. Further, the buyer's initial and continuing investment is adequate to demonstrate a commitment to pay for the property, and the buyer's receivable, if any, is not subject to future subordination.

Customer Deposits

The classification of customer deposits as current liabilities or long term liabilities is subject to our estimation on whether we expect to be able to recognize these deposits as revenue within one year of the balance sheet date. We convert the customer deposits to revenue when the homebuyers or banks pay off the balance, and the certificates of the ownership are delivered to the homebuyers or the banks.

Loan to outside parties

We periodically evaluate the collectability of loans to outside parties and maintain an allowance for doubtful accounts for estimated losses resulting from the inability of outside parties to pay back the loans. Loans with aging over one year are booked as allowance for doubtful accounts. If the balance of the loans over a year is significant, our provision for doubtful accounts could be material to our net income.

Real Estate Under Development/Real Estate Completed

The real estate property development completed and under development are subject to valuation adjustments when the carrying amount exceeds fair value. An impairment loss shall be recognized only if the carrying amount of the assets is not recoverable and exceeds fair value. The carrying amount is not recoverable if it exceeds the sum of the undiscounted cash flows expected to be generated by the assets. Impairment analyses are based on our estimated sales and available market information at the time the analyses are prepared. If our estimates of the projected future cash flows or market conditions change, our evaluation of impairment losses may be different and such differences could be material to our consolidated financial statements. The evaluation of anticipated cash flows is subjective and is based, in part, on assumptions regarding estimated sales and capital requirements that could differ materially from actual results.

We classify “real estate completed” and “real estate under development” on our balance sheet into current and non-current portions based on the estimated date of completion. Real estate completed and real estate under development that we expect to be sold within one year from the balance sheet date are classified as current assets.

Income taxes

The Company was incorporated in the United States. It is governed by the Income Tax law of United States. However, the Company conducts all of its operations through its VIE Shaanxi Guangsha Investment and Development Group Co., Ltd (“Guangsha”) in PRC, therefore did not generate any taxable income outside of the PRC for the periods ended December 31, 2011 and 2010. The Management does not expect to repatriate Guangsha’s net income back to U.S. in the near future. Guangsha is governed by the Income Tax Law of the PRC concerning the private-run enterprises, which are generally subject to tax at a statutory rate of 25% on income reported in the statutory financial statements after appropriate tax adjustments. However, the local taxing authority of Hanzhong City, in which Guangsha operates, has the power to assess corporate taxes annually on local enterprises at a pre-determined fixed rate as an incentive to stimulate the local economy and encourage entrepreneurship. In 2010, the taxing authority assessed us for income taxes at 2.5% on revenue in Hanzhong and 1.25% on revenue in Yang County. Accordingly the Company records the appropriate income tax expenses based on the fixed rates as determined by the local tax authority. Although the possibility exists for reinterpretation of the application of the tax regulations by higher tax authorities in the PRC, potentially overturning the decision made by the local tax authority, the Company has not experienced any

reevaluation of the income taxes for prior years. Management believes that the possibility of any reevaluation of income taxes is remote based on the fact that the Company has obtained the written tax clearance from the local tax authority. Thus, no additional taxes payable has been recorded for the difference between the taxes due based on taxable income calculated according to statutory taxable income method and the taxes due based on the fixed rate method. It is the Company's policy that if such reevaluation of income taxes becomes probable and the amount of additional taxes due can be reasonably estimated, additional taxes shall be recorded in the period in which the amount can be reasonably estimated and shall not be charged retroactively to an earlier period.

RESULTS OF OPERATIONS**Three Months Ended December 31, 2011 compared to Three Months Ended December 31, 2010****Revenues**

The following table summarizes our revenue generated by different projects:

	For Three Months Ended December 31,					
	2011		2010		Variance	
	Revenue	%	Revenue	%	Amount	%
Mingzhu Garden (Mingzhu Nanyuan & Mingzhu Beiyuan)	\$1,021,241	40.8%	\$-		\$1,021,241	100%
Yangzhou Pearl Garden	1,136,913	45.4%	135,952	100%	1,000,961	736.3%
NanDajie (Mingzhu Xinjun)	343,827	13.8%	-		343,827	100%
Total Real Estate Sales before Sales Tax	\$2,501,981	100%	\$135,952	100%	\$2,366,028	1,740.3%
Sales Tax	(175,905)		(55,039)		120,866	219.6%
Revenue net of sales tax	\$2,326,076		\$80,913		\$2,245,163	2,774.8%

Our revenues are derived from the sale of residential buildings, commercial front-stores and parking lots in projects that we have developed. Revenues increased by 1,740.3% to approximately \$2.5 million for the three months ended December 31, 2011 from approximately \$0.1 million for the three months ended December 31, 2010. The total GFA sold during the three months ended December 31, 2011 was 3,877.4 square meters, an increase from 473.5 square meters sold in the same quarter of fiscal 2011. The decrease in revenue recognized for the three months ended December 31, 2010 was attributable to the delay of revenue recognition caused by the inability of the Company to obtain property sales invoices from the Hanzhong City Local Taxation Bureau during the first quarter of fiscal 2011. As a result, the Company couldn't transfer the property ownership to the buyers and the related sales were deferred.

Mingzhu Garden (Mingzhu Nanyuan & Mingzhu Beiyuan)

For the three months ended December 31, 2011, 3 units of residential and 8 units of commercial properties from Mingzhu Garden were sold with revenue of approximately \$1.02 million. The Company did not recognize any revenue from Mingzhu Garden projects for the three months ended December 31, 2010.

Yangzhou Pearl Garden

The Company sold total of 24 units of residential and commercial properties from Yangzhou Pearl Garden with revenue of approximately \$1.1 million, as compared to \$0.1 million in revenue recognized for the three months ended December 31, 2010. The revenue increased by approximately \$1million or 736.3%. The increase in sales was mainly caused by the continuous reconstruction in Yang County. The target of the reconstruction is to move the residential, commercial and government districts from the old downtown area to the newly built residential and municipal area. As the largest residential project of the reconstruction in Yang County, Yangzhou Pearl Garden is well known by the local residents for its high quality, high standard and acceptable price for local middle-class families.

NanDajie (Mingzhu Xinjun)

The Company sold 1unit of residential and 1 unit of commercial properties from NanDajie (Mingzhu Xinjun) with revenue of approximately \$0.3 million. The Company did not recognize any revenue from NanDajie project for the three months ended December 31, 2010. As of December 31, 2011, there were 14 units of residential and commercial properties remaining in the NanDajie project.

Sales taxes

Sales taxes for the three months ended December 31, 2011 and 2010 consisted of a business tax, 5% of the revenue, an urban construction tax, 7% of business tax, an education surcharge tax, 3% of business tax, and land appreciation tax. Land appreciation tax for the three months ended December 31, 2011 and 2010 was assessed at the rate of 0.5% of the customer deposits in Yangzhou and 1% of the customer deposits in Hanzhong. The sales taxes for the three months ended December 31, 2011 more than doubled to \$175,905 from the same quarter in the last year, primarily as a result of the increase in our revenue.

Cost of Sales

The following table sets forth a breakdown of our cost of sales:

	For Three Months Ended					
	December 31,				Variance	
	2011		2010		Amount	%
	Cost	%	Cost	%		
Land use right	\$112,316	13 %	\$8,260	10 %	\$104,056	1260 %
Construction cost	769,584	87 %	71,523	90 %	697,061	975 %
Total cost	\$881,900	100 %	\$79,783	100 %	\$802,117	1005.4 %

Our cost of sales consists primarily of costs associated with land use rights and construction costs. Cost of sales are capitalized and allocated to development projects using the specific identification method. Costs are allocated to specific units within a project based on the ratio of the sales area of units to the estimated total sales area of the project or phase of the project times the total cost of the project or phase of the project.

Cost of sales was approximately \$0.9 million for the three months ended December 31, 2011 compared to \$0.08 million for the three months ended December 31, 2010. The \$0.8 million increase in cost of sales was mainly attributable to increased revenue.

Land use rights cost: The cost of land use rights includes the land premium we pay to acquire land use rights for our property development sites, plus taxes. Our land use rights cost varies for different projects according to the size and location of the site and the minimum land premium set for the site, all of which are influenced by government policies, as well as prevailing market conditions. Costs for land use rights for the three months ended December 31, 2011 were \$112,316, as compared to \$8,260 for the three months ended December 31, 2010, representing an increase of \$104,056 from the same quarter last year. The increase was consistent with the fact that the total GFA sold during the three months ended December 31, 2011 was 3,877 square meters, a significant increase from 473 square meters sold in the same quarter of fiscal 2011.

Construction cost: We outsource the construction of all of our projects to third party contractors, whom we select through a competitive tender process. Our construction contracts provide a fixed payment which covers substantially all labor, materials and equipment costs, subject to adjustments for some types of excess, such as design changes during construction or changes in government-suggested steel prices. Our construction costs consist primarily of the payments to our third-party contractors, which are paid over the construction period based on specified milestones. In addition, we purchase and supply a limited range of fittings and equipment, including elevators, window frames and door frames. Our construction costs for the three months ending December 31, 2011 were approximately \$0.8 million as compared to approximately \$0.07 million for the three months ended December 31 2010, representing an increase

of \$0.7 million. The increase in construction cost is due to the increase in units sold reflected in the increased revenue recognized.

The total cost of sales as a percentage of real estate sales before sales tax for the three months ended December 31, 2011 decreased to 35.2% from 58.7% for the three months ended December 31, 2010, which was mainly attributable to more commercial property with higher selling price sold during the three months ended December 31, 2011. Most of the properties sold during three months ended December 31, 2010 were residential units with lower selling price.

Gross Profit

Gross profit was approximately \$1.4 million for the three months ended December 31, 2011 as compared to approximately \$0.001 million for the three months ended December 31, 2010, an increase of \$1.4 million, which was mainly attributable to the increase in revenue. The overall gross profit as a percentage of real estate sales before tax increased to 57.7% in the three months ended December 31, 2011 from the same quarter last year and average gross margin of 38% in fiscal 2011, mainly due to the increase in sales and more commercial properties with higher selling price sold in the first quarter of fiscal 2012. The gross margin percentage could decrease if we sell more residential units in the following period of 2012.

The following table sets forth the gross margin of each of our projects:

	For Three Months Ended December 31, 2011		2010		
	Gross Profit	Percentage of Revenue	Gross Profit	Percentage of Revenue	
Mingzhu Garden (Mingzhu Nanyuan & Mingzhu Beiyuan)	\$ 759,166	74.3	% \$ -	-	
Yangzhou Pearl Garden	629,895	55.4	% 56,169	41	%
NanDajie (Mingzhu Xinjun)	231,019	67.2	% -	-	
Sales Tax	(175,905)		(55,039)		
Total Gross Profit	\$ 1,444,175	57.7	% \$ 1,130	0.8	%
Total Real Estate Sales before Sales Tax	\$ 2,501,981		\$ 135,952		

Operating Expenses

Total operating expenses increased by 253.9% or \$259,152 to \$361,213 for the three months ended December 31 2011 from \$102,061 for the three months ended December 31, 2010 as a result of an increase in general and administration expenses of \$247,626.

The increase in general and administrative expenses for three months ended December 31, 2011 was primarily due to the fact that there was a significant recovery of general administrative expenses for the three months ended December 31, 2010 as the Company entered into a settlement agreement in December 2010 with respect to fees owed in connection with its reverse acquisition in 2009, pursuant to which approximately \$167,000 of general and administrative expenses were recovered. A portion of the increase in general administrative expense for the three months ended December 31, 2011 was also attributed to higher executive compensation, taxes and travel expense.

Additionally, selling expense increased by \$11,526 to \$42,441 for the three months ended December 31, 2011 from \$30,915 for the three months ended December 31, 2010, which was consistent with increased revenue.

	For Three Months Ended December 31,			
	2011	2010		
Selling expenses	\$42,441	\$30,915		
General and administrative expenses	318,772	71,146		
Total operating expenses	\$361,213	\$102,061		
Percentage of Real Estate Sales before Sales Tax	14.4	% 75.1	%	

Income Taxes

U.S. Taxes

China HGS is a Florida corporation. However, all of our operations are conducted solely by our subsidiaries in the PRC. No income is earned in the United States and we do not repatriate any earnings outside the PRC. As a result, we did not generate any U.S. taxable income for the three months ended December 31, 2011 and 2010.

PRC Taxes

Our Company is governed by the Income Tax Law of the People's Republic of China concerning private-run enterprises, which are generally subject to tax at a new statutory rate of 25% on income reported in the statutory financial statements after appropriate tax adjustments.

However, the local taxing authority of Hanzhong City has the power to assess corporate taxes annually on local enterprises at a pre-determined fixed rate as an incentive to stimulate the local economy and encourage entrepreneurship. The taxing authority assessed us for income taxes at the rate of 1.25% on revenue in Yang County and 2.5% on our revenue in Hanzhong, instead of statutory rate of 25%. As a result, income tax expenses for the three months ended December 31, 2011 were \$48,338 compared to \$1,699 for the three months ended December 31, 2010 as a result of our higher revenue.

Net Income

We reported net income of \$1,030,462 for the three months ended December 31, 2011, as compared to net loss of \$(96,295) for the three months ended December 31, 2010. The \$1,126,757 increase in our net income was primarily due to the increase of revenue and gross profit as further discussed above under Revenues and Gross Profit above.

Other Comprehensive Income

We operate primarily in the PRC and the functional currency of our operating subsidiary is the Chinese Renminbi ("RMB"). The RMB is not freely convertible into foreign currency and all foreign exchange transactions must take place through authorized institutions. No representation is made that the RMB amounts could have been, or could be, converted into USD at the rates used in translation.

Translation adjustments resulting from this process amounted to \$344,589 and \$627,807 for the three months ended December 31, 2011 and 2010, respectively. The balance sheet amounts with the exception of equity at December 31, 2011 were translated at 6.3647 RMB to 1.00 USD as compared to 6.3952 RMB to 1.00 USD at September 30, 2011. The equity accounts were stated at their historical rate. The average translation rates applied to the income statements accounts for the periods ended December 31, 2011 and 2010 were 6.3771 RMB and 6.5377 RMB, respectively.

Liquidity and Capital Resources

Current Assets and Liabilities

Our principal need for liquidity and capital resources is to maintain working capital sufficient to support our operations and to make capital expenditures to finance the growth of our business. To date, we have financed our operations primarily through cash flows from operations and borrowings from our principal shareholder. Due to the credit tightening policies in China, banks were very slow to approve mortgage lending during the three months ended December 31, 2011. As a result, we receive fewer customer deposits from our pre-sale units which caused our cash and restricted cash balances to decrease to approximately \$1.3 million at December 31, 2011. Such balances have slowly started to increase to over \$1.8 million as of January 31, 2012. The People's Bank of China ("PBOC") posted a statement on its website on February 7, 2012, indicating that PBOC would ensure that lending support to affordable housing projects and loan demand from first-home families is met. Since most of our customers are first-time home buyers and our affordable housing units are in the pre-sales stage, we expect our cash flow will continue to improve in the first half of 2012. In addition, the Company has reached an agreement with the local Land Management Bureau to extend the payment term on the two land use right bids we won on November 18, 2011. The original due date of the final 40% of the total bid consideration (approximately \$5 million or RMB 31 million) was due on January 20, 2012, which has been extended to June 30, 2012. We do not have any additional commitments on land use right purchase as of February 14, 2012.

As of December 31, 2011, the Company had \$34,908,343 in working capital, an increase of \$2,384,502 as compared to \$32,523,841 as of September 30, 2011. The increase in working capital was mainly related to the significant decrease of account payable by \$3,173,744, offsetting by an increase in customer deposits of \$1,357,353.

Current assets increased by \$0.8 million to approximately \$60.9 million as of December 31, 2011 from \$60.2 million as of September 30, 2011. The primary changes in our current assets during this period were decreases in cash, real estate property development completed and loans to outside parties; and increases in security deposits for land use right and real estate property under development.

The decrease of cash from \$8,837,795 as of September 30, 2011 to \$365,606 as of December 31, 2011 was mainly due to the payment of land use right deposit of \$9.1 million. The decrease in cash was partially offset by cash generated from operating income and increased customer deposits. The decrease of real estate property development completed from \$18.9 million as of September 30, 2011 to \$18.1 million as of December 31, 2011 was attributed to our sales. The decrease of loans to outside parties from \$2,571,651 at September 30, 2011 to \$2,003,351 at December 31, 2011 was attributed to collection of previous lending to our construction material suppliers. The balance of real estate property under development increased \$9.2 million from \$6,254,691 as of September 30, 2011 to \$15,438,528 as of December 31, 2011 as a result of our progress in construction.

Total current liabilities as of December 31, 2011 totaled approximately \$26.0 million, representing a 5.9% decrease compared to \$10.4 million as of September 30, 2011. The decrease in current liabilities was mainly due to the

decrease in accounts payable of \$3.2 million, offsetting by the increase in customer deposits of \$1.4 million.

In order to fully implement our business plan, however, we may need to raise capital. Our expectation, therefore, is that we will seek to access the capital markets in both the U.S. and China to obtain the funds we require. At the present time, however, we do not have commitments of funds from any source.

Cash Flow

Comparison of cash flows results is summarized as follows:

	Three months ended December 31,	
	2011	2010
Net cash (used in)/provided by operating activities	(8,497,984)	4,637,466
Net cash provided by/(used in) financing activities	-	-
Effect of change of foreign exchange rate on cash	25,795	203,479
Net cash (decrease)/increase in cash	(8,472,189)	4,840,945
Cash, beginning of period	8,837,795	12,621,845
Cash, end of period	\$ 365,606	\$ 17,462,790

Operating Activities

Net cash used in operating activities during the three months ended December 31, 2011 was \$8,497,984 million, consisting of net income of \$1,030,462 million, noncash adjustments of \$34,256 and net changes in our operating assets and liabilities, which mainly included a decrease in loan to outside parties of \$579,495 due to the repayment from these vendors, a decrease in real estate property development completed of \$881,900 resulted from our sales and a decrease in account payable of \$3,203,189 as we settled balances with our suppliers; an increase in security deposits for land use rights of \$9,136,065, an increase in real estate property completed of \$1,898,986 attribute to our construction progress and an increase in customer deposits of \$3,021,626 resulted from our pre-sale efforts. The negative cash provided by operating activities is mainly attributable to our significant payment on security deposits on the land use rights, settlements of account payable with our suppliers and spending in the real estate property under development.

Net cash provided by operating activities for the three months ended December 31, 2010 amounted to \$4,637,467, despite our net loss of \$96,295, primarily as a result of the increase in customer deposits and the decrease in loans to outside parties. Our loans to outside parties decreased by \$4,198,710 as a result of the funds received from Saibo, a major construction materials supplier. Our real estate property under development increased by \$5,046,819 due to the Youngzhou Pearl Garden and Mingzhu Beiyuan projects. Our customer deposits increased by \$7,123,569, which was attributable to the delay in consummation of sales due to the new government procedures discussed above. Accordingly, our taxes payable decreased by \$757,482 because we incurred a net loss for the three months ended December 31, 2010.

Financing Activities

Net cash flows provided by financing activities amounted to \$0 for the three months ended December 31, 2011, which represents \$3,142,332 proceeds of a short-term loans from a controlling shareholder to finance the land use right payment and the Company's full repayment of such loan during the quarter.

Net cash flows used in financing activities amounted to \$0 for the three months ended December 31, 2010.

Inflation

Inflation has not had a material impact on our business and we do not expect inflation to have a material impact on our business in the near future.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this Quarterly Report on Form 10-Q (the “Evaluation Date”). The evaluation of our disclosure controls and procedures included a review of our processes and the effect on the information generated for use in this Quarterly Report on Form 10-Q. In the course of this evaluation, we sought to identify any material weaknesses in our disclosure controls and procedures and to confirm that any necessary corrective action, including process improvements, was taken. The purpose of this evaluation is to determine if, as of the Evaluation Date, our disclosure controls and procedures were operating effectively such that the information, required to be disclosed in our Securities and Exchange Commission (“SEC”) reports (i) was recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) was accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

As of December 31, 2011, Mr. Xiaojun Zhu, the Company’s Chief Executive Officer and Chief Financial Officer, has concluded that, as of that date, the Company’s controls and procedures were not effective due to material weaknesses (as defined in Public Company Accounting Oversight Board Standard No. 5) in the Company’s internal controls over financial reporting described in the Company’s Form 10-K filed on December 23, 2011.. This is due to the fact that the Company lacked sufficient personnel with the appropriate level of knowledge, experience and training in the application of U.S. generally accepted accounting principles (“GAAP”) standards, especially related to complicated accounting issues. This could cause the Company to be unable to fully identify and resolve certain accounting and disclosure issues that could lead to a failure to maintain effective controls over preparation, review and approval of certain significant account reconciliation from PRC GAAP to U.S. GAAP and necessary journal entries.

The Company has employed a relatively small number of professionals in bookkeeping and accounting functions, which has prevented the Company from appropriately segregating duties within its internal control systems. The inadequate segregation of duties is a weakness because it could lead to the untimely identification and resolution of accounting and disclosure matters or could lead to a failure to perform timely and effective reviews.

Based on the control deficiency identified above, we have designed and plan to implement, or in some cases have already implemented, the specific remediation initiatives described below:

We have engaged a V.P. of Finance that has substantial U.S. GAAP financial reporting experience. This individual's primary responsibility is to assist the Company in converting the financial statements prepared under PRC GAAP into U.S. GAAP and help train Company accounting personnel in U.S. GAAP standards. The Company has already interviewed and reviewed several CFO candidates. All the candidates and comments of review were discussed by the Board of Directors. The Company is seeking the better ones to best match the Company's demands.

The Company engaged Aureacher Capital & Consulting Group as an independent professional consultant in internal control over financial reporting. Aureacher assisted the Company's Internal Control Evaluation Committee in evaluating the internal control effectiveness in 2011. Based on the COSO framework, Aureacher and the Internal Control Evaluation Committee have completed internal control readiness and performed implementation training to all the staff of the Company. The new internal control system and control activities will be rolled out to the Company in 2012.

The remedial measures being undertaken may not be fully effectuated or may be insufficient to address the significant deficiencies we identified, and there can be no assurance that significant deficiencies or material weaknesses in our internal control over financial reporting will not be identified or occur in the future. If additional significant deficiencies (or if material weaknesses) in our internal controls are discovered or occur in the future, among other similar or related effects: (i) the Company may fail to meet future reporting obligations on a timely basis, (ii) the Company's consolidated financial statements may contain material misstatements, and (iii) the Company's business and operating results may be harmed.

The Company is planning to start an internal audit function. With the assistance of Aureacher, the internal audit department will perform the management self-assessment of the internal controls over financial reporting in 2012, which would be attested by the external auditor if necessary.

The remedial measures being undertaken may not be fully effectuated or may be insufficient to address the significant deficiencies we identified, and there can be no assurance that significant deficiencies or material weaknesses in our internal control over financial reporting will not be identified or occur in the future. If additional significant deficiencies (or if material weaknesses) in our internal controls are discovered or occur in the future, among other similar or related effects: (i) the Company may fail to meet future reporting obligations on a timely basis, (ii) the Company's consolidated financial statements may contain material misstatements, and (iii) the Company's business and operating results may be harmed.

Changes in Internal Control over Financial Reporting

Except for the matters described above to improve our internal controls over financial reporting, there were no changes in our internal control over financial reporting for the three months ended December 31, 2011 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting, however the Company is in the process of designing and planning to change as described above.

PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We may be subject to, from time to time, various legal proceedings relating to claims arising out of our operations in the ordinary course of our business. We are not currently a party to any legal proceedings, the adverse outcome of which, individually or in the aggregate, would have a material adverse effect on the business, financial condition, or results of operations of the Company.

ITEM 1A. RISK FACTORS

As a “smaller reporting company” as defined by Item 10 of Regulation S-K, the Company is not required to provide information required by this item.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a) Exhibits

Exhibit Number Description of Exhibit

31.1	Rule 13a-14(a) Certification of Chief Executive Officer and Chief Financial Officer
32.1	Section 1350 Certification of Chief Executive Officer and Chief Financial Officer
101.INS*	XBRL Instance
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation
101.DEF*	XBRL Taxonomy Extension Definition
101.LAB*	XBRL Taxonomy Extension Labels
101.PRE*	XBRL Taxonomy Extension Presentation

* Furnished electronically herewith

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

China HGS Real Estate, Inc.

February 14, 2012 By: /s/ Xiaojun Zhu

Xiaojun Zhu

Chief Executive Officer and Chief Financial Officer

(Principal Executive Officer and Principal Accounting and Financial Officer)